

CONSOLIDATED FINANCIAL STATEMENTS

The Hospital of Central Connecticut  
Years Ended September 30, 2014 and 2013  
With Report of Independent Auditors

Ernst & Young LLP



The Hospital of Central Connecticut

Consolidated Financial Statements

Years Ended September 30, 2014 and 2013

**Contents**

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Balance Sheets .....	3
Consolidated Statements of Operations and Changes in Net Assets .....	4
Consolidated Statements of Cash Flows.....	6
Notes to the Consolidated Financial Statements.....	7



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## Report of Independent Auditors

The Board of Directors  
Hartford HealthCare Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of The Hospital of Central Connecticut (the Hospital), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Grand Indemnity Company, Ltd., a wholly-owned subsidiary, which statements reflect total assets of \$28,004,120 in 2013, and total revenues of \$795,380 in 2013. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Grand Indemnity Company, Ltd., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not



for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### **Opinion**

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hospital of Central Connecticut at September 30, 2014 and 2013, and the consolidated 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.

*Ernst & Young LLP*

January 28, 2015

The Hospital of Central Connecticut

Consolidated Balance Sheets

	<b>September 30</b>	
	<b>2014</b>	<b>2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 50,445,261	\$ 39,433,385
Accounts receivable, less allowance for doubtful accounts of approximately \$16,574,000 in 2014 and \$18,330,000 in 2013	40,490,596	45,274,226
Premiums receivable	-	75,002
Reinsurance recoverable	-	3,675,000
Other receivables	22,122,989	7,955,738
Due from affiliates, net	1,189,837	5,024,941
Inventories of supplies	5,624,397	5,420,384
Prepaid expenses and other assets	2,168,888	3,466,789
Total current assets	<u>122,041,968</u>	<u>110,325,465</u>
Assets whose use is limited:		
Investments related to GIC	-	8,549,662
Board-designated interest in investments held by Endowment LLC	118,173,085	109,829,752
Donor-restricted interest in investments held by Endowment LLC	28,911,994	28,172,961
Donor-restricted investments	1,230,252	1,383,135
Funds designated for debt service	16,303,490	2,532,172
	<u>164,618,821</u>	<u>150,467,682</u>
Funds held in trust by others	16,309,118	15,974,359
Other assets	24,115,241	13,023,091
Property, plant, and equipment, net	174,170,445	163,810,215
Total assets	<u>\$ 501,255,593</u>	<u>\$ 453,600,812</u>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 3,874,962	\$ 12,557,820
Salaries, wages, payroll taxes, and amounts withheld from employees	11,492,908	14,042,968
Accrued expenses	9,390,201	11,653,287
Estimated third-party payor settlements	19,389,673	11,976,659
Due to affiliates, net	5,524,919	1,174,351
Current portion of long-term debt and capital leases	872,430	2,329,243
Current portion of accrued pension liability	341,981	2,677,440
Current portion of other liabilities	2,715,558	1,505,835
Total current liabilities	<u>53,602,632</u>	<u>57,917,603</u>
Reserve for losses and loss adjustment expenses	-	8,103,682
Long-term debt and capital leases	63,081,570	38,405,050
Accrued pension liability	133,575,280	79,249,647
Self-insurance and other long-term liabilities	22,880,829	13,734,696
Total liabilities	<u>273,140,311</u>	<u>197,410,678</u>
Net assets:		
Unrestricted	178,222,407	209,046,453
Temporarily restricted	26,776,206	24,361,771
Permanently restricted	23,116,669	22,781,910
Total net assets	<u>228,115,282</u>	<u>256,190,134</u>
Total liabilities and net assets	<u>\$ 501,255,593</u>	<u>\$ 453,600,812</u>

See accompanying notes.

The Hospital of Central Connecticut

Consolidated Statements of Operations and Changes in Net Assets

	<b>Year Ended September 30</b>	
	<b>2014</b>	<b>2013</b>
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 367,170,206	\$ 381,649,799
Provision for bad debts	5,458,239	9,742,308
Net patient service revenue less provision for bad debts	<u>361,711,967</u>	371,907,491
Other operating revenues	11,024,317	12,233,898
Net premiums earned	-	35,380
Net assets released from restrictions for operations	<u>1,351,596</u>	1,885,094
	<u><b>374,087,880</b></u>	<u>386,061,863</u>
Operating expenses:		
Salaries and wages	148,416,218	168,706,840
Employee benefits	45,122,344	51,728,525
Supplies and other	49,864,651	52,640,973
Purchased services	96,257,337	81,019,311
Depreciation and amortization	18,225,335	19,479,333
Losses and loss adjustment expenses	-	(868,854)
Interest	1,418,199	1,563,598
	<u><b>359,304,084</b></u>	<u>374,269,726</u>
Income from operations	<u><b>14,783,796</b></u>	11,792,137
Non-operating income:		
Income from investments, gifts and bequests, net	<u>9,562,104</u>	11,638,482
Excess of revenues over expenses	<u><b>24,345,900</b></u>	23,430,619

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The Hospital of Central Connecticut

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

	<b>Year End September 30</b>	
	<b>2014</b>	<b>2013</b>
Unrestricted net assets:		
Excess of revenues over expenses (continued)	\$ 24,345,900	\$ 23,430,619
Change in pension funding obligation	(53,361,191)	76,581,478
Transfer to affiliates	(4,477,163)	(2,056,097)
Other	-	325,544
Change in net unrealized loss on investments	(537,514)	(926,615)
Net assets released from restrictions for the purchase of capital	3,205,922	1,296,085
(Decrease) increase in unrestricted net assets	<u>(30,824,046)</u>	<u>98,651,014</u>
Temporarily restricted net assets:		
Net realized and unrealized gain on investments	55,162	1,805,832
Income from investments	663,693	106,093
Return on interest in investments held by Endowment LLC	3,159,360	2,387,951
Restricted contributions	3,093,738	3,227,949
Net assets released from restrictions for operations	(1,351,596)	(1,885,094)
Net assets released from restrictions for the purchase of capital	(3,205,922)	(1,296,085)
Increase in temporarily restricted net assets	<u>2,414,435</u>	<u>4,346,646</u>
Permanently restricted net assets		
Change in unrealized gains and losses on funds held in trust by others	334,759	989,162
Increase in permanently restricted net assets	<u>334,759</u>	<u>989,162</u>
(Decrease) increase in net assets	<u>(28,074,852)</u>	<u>103,986,822</u>
Net assets at beginning of year	<u>256,190,134</u>	<u>152,203,312</u>
Net assets at end of year	<u>\$ 228,115,282</u>	<u>\$ 256,190,134</u>

See accompanying notes.

The Hospital of Central Connecticut  
Consolidated Statements of Cash Flows

	<b>Year Ended September 30</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities</b>		
(Decrease) increase in net assets	\$ (28,074,852)	\$ 103,986,822
Adjustments to reconcile change in net assets to net cash provided by operating activities and other income:		
Noncash items:		
Depreciation and amortization	18,225,335	19,479,333
Provision for patient bad debts	5,458,239	9,742,308
Change in pension funding obligation	53,361,191	(76,581,478)
Net realized and unrealized gains on investments and assets whose use is limited	(945,561)	(9,850,503)
Change in investment return in Endowment LLC	(11,628,310)	(6,044,309)
Other changes in net assets:		
Restricted contributions and investment income	(3,757,431)	(3,334,042)
Changes in operating assets and liabilities, net ( <i>Note 14</i> )	(31,520,442)	(21,383,165)
Net cash provided by operating activities	1,118,169	16,014,966
<b>Cash flows from investing activities</b>		
Purchases of property, plant and equipment	(28,585,565)	(32,859,254)
Net decrease in assets whose use is limited	11,859,291	19,582,021
Net increase in investments in affiliates	(357,157)	(79,336)
Net cash used in investing activities	(17,083,431)	(13,356,569)
<b>Cash flows from financing activities</b>		
Payments on long-term debt, capital leases and line of credit	(9,690,234)	(2,235,150)
Proceeds from borrowings of long-term debt	32,909,941	3,103,389
Restricted contributions and investment income	3,757,431	3,334,042
Net cash provided by financing activities	26,977,138	4,202,281
Increase in cash and cash equivalents	11,011,876	6,860,678
Cash and cash equivalents at beginning of year	39,433,385	32,572,707
Cash and cash equivalents at end of year	\$ 50,445,261	\$ 39,433,385

*See accompanying notes.*



# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements

For the Years Ended September 30, 2014 and 2013

### **1. Significant Accounting Policies**

The accounting policies that affect significant elements of The Hospital of Central Connecticut (the Hospital) consolidated financial statements are summarized below and in Note 2.

#### **Organization**

The Hospital, a voluntary, tax-exempt association incorporated under the General Statutes of the State of Connecticut, is a wholly owned subsidiary of Central Connecticut Health Alliance (CCHA or the Alliance) and is a subsidiary of Hartford HealthCare Corporation (HHC). The Board of Directors is appointed by CCHA and oversees the operations of the Hospital. Prior to October 1, 2013, the Hospital had a wholly owned subsidiary, Grand Indemnity Company, Ltd. (GIC), which was incorporated under the laws of Bermuda, as a Class 2 insurer, on January 6, 2009. Effective October 1, 2013, GIC merged with Hartford HealthCare Indemnity Services, Ltd. (HHCISL) (previously known as CHS Insurance Limited or CHS), an insurance company incorporated in Bermuda and a wholly owned subsidiary of HHC. Prior to October 1, 2013, GIC underwrote claims-made hospital medical professional liability and general liability insurance on behalf of the Hospital. GIC also underwrote provider medical insurance for the individual physicians in private practice who support the Hospital.

#### **Use of Estimates**

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

#### **Regulatory Matters**

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

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

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

#### **Cash and Cash Equivalents**

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

#### **Patient Accounts Receivable**

Patient accounts receivable result from the health care services provided by the Hospital. Additions to the allowance for doubtful accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage and other collection indicators. See Note 2 for additional information relative to third party payor programs.

The Hospital's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of patient accounts receivable include 35% and 19% and, 39% and 17% for Medicare and Medicaid, respectively, for the fiscal years ending September 30, 2014 and 2013, respectively.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 1. Significant Accounting Policies (continued)

#### Interest in Investments Held by Hartford Healthcare Endowment LLC

Effective August 29, 2011, Hartford HealthCare Endowment LLC (Endowment LLC) was created to maintain and manage, on a pooled basis, the endowment funds of the Hospital; Windham Community Memorial Hospital, Inc.; Hartford Hospital; MidState Medical Center; HHC; and Hartford HealthCare at Home, Inc. Endowment LLC, a wholly owned subsidiary of HHC, acts as manager, and is named fiduciary for HHC within established investment guidelines. As of April 1, 2013, \$131,830,710 of the Hospital's investments were sold to Endowment LLC, at which time all previously unrealized gains and losses on the sold investments were realized. As of September 30, 2014 and 2013, the Hospital has an interest in investments held by Endowment LLC, which is reflected in the accompanying consolidated balance sheets and represents the Hospital's pro rata share of Endowment LLC.

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

#### **Investments**

The Hospital's investment portfolio is classified as trading, excluding the interest in Endowment LLC, with unrealized gains and losses included in the excess of revenues over expenses. At September 30, 2013, GIC's investments were classified as available for sale with unrealized gains and losses excluded from excess of revenues over expenses. Unrealized gains and losses were included in unrestricted net assets within the accompanying statements of operations and changes in net assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the balance sheet date. Alternative investments, those assets whose market value is not readily determinable, are stated at fair value as estimated in an unquoted market. Valuations of those investments, and therefore the Hospital's holdings, may be determined by the investment manager and are primarily based on the underlying securities. Assets temporarily and permanently restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost. Investment income (including realized gains and losses on investments, interest and dividends, and the change in unrealized gains and losses) is included in nonoperating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

The Hospital has invested in a joint venture, which is accounted for under the equity method of accounting. As of September 30, 2014 and 2013, the Hospital owned 43% of the New Britain MRI Limited Partnership.

#### **Inventories of Supplies**

Inventories, used in general operations of the Hospital, are stated using the average cost method.

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

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

Conditional asset retirement obligations recorded under the provisions of Accounting Standards Codification (ASC) 410-20, *Asset Retirement Obligations*, amounted to \$1,339,725 and \$1,370,379 as of September 30, 2014 and 2013, respectively. These obligations are recorded in self-insurance and other long-term liabilities in the accompanying consolidated balance sheets. There are no assets that are legally restricted for purposes of settling asset retirement obligations. During 2014 and 2013, asset retirement obligations incurred and settled were not significant. In addition, accretion expense was immaterial for the years ended September 30, 2014 and 2013.

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

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

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those assets whose use by the Hospital has been limited by donors to a specific time frame or purpose. Permanently restricted net assets have been restricted by donors and are maintained by the Hospital in perpetuity. The Hospital is a partial beneficiary to various perpetual trust agreements. Assets recorded under these agreements are recognized at fair value. The investment income generated from these trusts is expendable to support healthcare services, and the assets are classified as permanently restricted.

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

Pledges receivable to be received after one year are recorded as temporarily restricted net assets, discounted to present value and an allowance for uncollectible pledges is recorded. Amortization of the discount is recognized as revenue and is reflected in accordance with donor-imposed restrictions, if any, on the contributions.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

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

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

#### **Bond Issuance Costs**

Bond issuance costs associated with long-term debt for capital projects are amortized over the term of the debt using a method that approximates the effective interest method. Bond issuance costs of \$974,448 and \$513,282 are recorded in other assets in the consolidated balance sheets as of September 30, 2014 and 2013, respectively. During 2014, the Hospital paid \$485,276 in additional bond issuance costs.

#### **Other Operating Revenues**

Other operating revenues include services to other institutions, electronic health record incentive program revenue, rental income, grant income, research income, cafeteria income and income from investments accounted for under the equity method.

#### **Nonoperating Income**

Nonoperating income includes income on investments including the return on Endowment LLC, realized and unrealized gains and losses on trading investments, and income on unrestricted gifts and bequests.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

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

The consolidated statements of operations and changes in net assets include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include the changes in pension funding obligation, net assets released from restrictions for the purchase of property and equipment, unrealized gains and losses on other than trading investments, and permanent transfers of assets to and from affiliates.

#### **Professional Liability Insurance**

Coverage for medical malpractice insurance is provided on a claims-made basis. As of January 1, 2013, the primary coverage is with HHCISL. See also Note 9.

#### **Unpaid Losses and Loss Adjustment Expenses**

Prior to October 1, 2013, the reserve for losses and loss adjustment expenses and related reinsurance recoverable includes case basis estimates of reported losses, plus supplemental amounts calculated based upon loss projections utilizing actuarial studies, the Hospital's own historical data and industry data. In establishing this reserve and the related reinsurance recoverable, GIC utilized the findings of an independent consulting actuary.

Management believes that its aggregate reserve for losses and loss adjustment expenses and related reinsurance recoverable at September 30, 2013 represents its best estimate, based on the available data, of the amount necessary to cover the ultimate cost of losses and the amount of such losses that will be recovered under reinsurance programs; however, because of the nature of the insured risks and limited historical experience, actual loss experience may not conform to the amounts used in determining the estimated amounts for such asset and liability at the consolidated balance sheet dates. Accordingly, the ultimate asset and liability could be significantly in excess of or less than the amount indicated in these consolidated financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

#### **Recognition of Premium Revenues**

Prior to October 1, 2013, premiums written for GIC were earned on a pro-rata basis over the related policy period. The portion of premiums that will be earned in the future was deferred and reported as unearned premiums.

#### **Reinsurance**

Prior to October 1, 2013, in the normal course of business, GIC sought to reduce its loss exposure by reinsuring certain levels of risk with reinsurers. Premiums ceded were expensed over the term of their related policies.

#### **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. At times, the Hospital is involved with activities that subject minor amounts of unrelated business income to federal income tax, which are paid as they come due in accordance with the Code and the regulations thereunder. Such amounts are not material to the Hospital's consolidated financial statements. Certain net operating loss carry forwards of \$2,471,000 and \$1,099,000 from unrelated business activities, at September 30, 2014 and 2013, respectively, generate a potential deferred tax asset of approximately \$922,000 and \$439,600 at September 30, 2014 and 2013, respectively. No deferred tax asset has been recorded as this amount is offset by a valuation allowance of the same amount.



# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

#### **Electronic Health Record Incentive Program**

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospital uses a grant accounting model to recognize EHR incentive revenues. EHR incentive revenues are recognized ratably over the relevant cost report period to determine the amount of reimbursement. The Hospital recognized \$2,011,703 and \$3,173,235 of EHR revenues during the fiscal years ended September 30, 2014 and 2013, respectively. Correspondingly, the Medicare and Medicaid components, respectively, of EHR revenues are \$1,485,132 and \$526,571, and \$2,383,378 and \$789,857 for 2014 and 2013, respectively. EHR incentive revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 1. Significant Accounting Policies (continued)

#### New Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of ASU 2014-09 is required on October 1, 2017, and management is currently evaluating the effect of this guidance on its consolidated financial statements.

#### Reclassifications

Certain reclassifications, including change in unrealized gains and losses on investments, have been made to the year ended September 30, 2013, balances previously reported in the consolidated balance sheet and statement of operations and changes in net assets in order to conform with the fiscal year ended September 30, 2014, presentation.

### 2. Net Patient Service Revenue and Charity Care

Revenues from the Medicare and Medicaid programs, respectively, accounted for approximately 36% and 16% of the Hospital's net patient service revenue for the fiscal years ended September 30, 2014 and 2013. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

The following table summarizes net patient service revenue:

	<b>Year Ended September 30</b>	
	<b>2014</b>	<b>2013</b>
Gross revenue from patients:		
Inpatients	<b>\$ 370,675,621</b>	\$ 410,328,218
Outpatients	<b>493,933,756</b>	484,233,051
	<b>864,609,377</b>	894,561,269
Deductions:		
Allowances and discounts	<b>480,182,282</b>	496,600,768
Charity Care	<b>17,256,889</b>	16,310,702
Net patient service revenue	<b>367,170,206</b>	381,649,799
Provision for bad debts	<b>5,458,239</b>	9,742,308
Net patient service revenue less provision for bad debts	<b>\$ 361,711,967</b>	\$ 371,907,491

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The difference is accounted for as allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service, discounted charges, and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Estimates of revenue are recorded in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. During 2014 and 2013, the Hospital recorded net changes in estimates of approximately \$3,530,000 and \$7,100,000, respectively, which primarily related to better than previously estimated third-party payor settlements.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

The Hospital has established estimates based on information presently available of amounts due to or from Medicare, Medicaid, and third-party payors for adjustments to current and prior year payment rates, based on industry-wide and Hospital-specific data. Such amounts are included in the accompanying consolidated balance sheets. Additionally, certain payors' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

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

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

The Hospital's policy is to reserve a portion of all self-pay receivables, including amounts due from the uninsured and amounts related to co-payments and deductibles, as these charges are recorded. The Hospital's allowance for doubtful accounts for self-pay patients increased to 48% of self-pay accounts receivable at September 30, 2014 from 39% of self-pay accounts receivable at September 30, 2013. On a monthly basis, the Hospital reviews its accounts receivable balances, the effectiveness of the Hospital's reserve policies, and various analytics to support the basis for its estimates. These efforts primarily consist of reviewing the following:

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

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

The Hospital provides services without charge or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such services are not reported as revenue. For patients who were determined by the Hospital to have the ability to pay but did not, the uncollected amounts are recorded as part of the provision for bad debts. In distinguishing charity care from the provision for bad debts, a number of factors are considered, certain of which require a high degree of judgment. In fiscal 2014, the Hospital changed its financial assistance policy to process self-pay patients as charity care prior to collections being pursued. This resulted in additional patients qualifying for charity care in the current fiscal year.

Patient service revenue, net of contractual allowances and discounts and before the provision for bad debts, recognized in the period from major payor sources for the fiscal years ended September 30, 2014 and 2013, is as follows:

	<u>2014</u>	<u>2013</u>
Medicare	<b>36%</b>	36%
Medicaid	<b>16</b>	16
Self-pay	<b>6</b>	5
All other	<b>42</b>	43
	<u><b>100%</b></u>	<u>100%</u>

The estimated cost of charity care provided was \$7,562,400 and \$6,965,012 for the years ended September 30, 2014 and 2013, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**3. Net Assets**

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

	<u>2014</u>	<u>2013</u>
Free beds	\$ 1,104,952	\$ 1,039,438
Research	308,488	282,914
Education	1,177,588	1,065,889
Capital replacement	10,538,654	10,621,866
Other health care services	13,646,524	11,351,664
	<u>\$ 26,776,206</u>	<u>\$ 24,361,771</u>

Permanently restricted net assets at September 30 are restricted for:

	<u>2014</u>	<u>2013</u>
Investments to be held in perpetuity, the income from which is expendable to support health care services	\$ 6,807,551	\$ 6,807,551
Restricted funds held in trust by others, the income from which is expendable to support health care services	16,309,118	15,974,359
	<u>\$ 23,116,669</u>	<u>\$ 22,781,910</u>

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

The Board of Directors of the Hospital has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 3. Net Assets (continued)

restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted funds:

- 1) The duration and preservation of the fund
- 2) The purposes of the Hospital and the donor-restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of the Hospital
- 7) The investment policies of the Hospital.

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

To satisfy its long-term rate-of-return objectives, the Hospital relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Hospital targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 3. Net Assets (continued)

Endowment net asset composition by type (excluding funds held in trust by others) of fund as of September 30, 2014, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 5,168,404	\$ 6,807,551	\$ 11,975,955
Board-designated endowment funds	118,173,085	—	—	118,173,085
	<u>\$ 118,173,085</u>	<u>\$ 5,168,404</u>	<u>\$ 6,807,551</u>	<u>\$ 130,149,040</u>

Changes in endowment funds for the fiscal year ended September 30, 2014, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 109,829,752	\$ 4,574,678	\$ 6,807,551	\$ 121,211,981
Investment income:				
Investment income	2,394,760	196,983	—	2,591,743
Net appreciation (realized and unrealized)	6,083,562	778,396	—	6,861,958
Total investment return	<u>8,478,322</u>	<u>975,379</u>	<u>—</u>	<u>9,453,701</u>
Contributions	246,426	4,277	—	250,703
Appropriation of endowment assets for expenditure	<u>(381,415)</u>	<u>(385,930)</u>	<u>—</u>	<u>(767,345)</u>
Endowment net assets, end of year	<u>\$ 118,173,085</u>	<u>\$ 5,168,404</u>	<u>\$ 6,807,551</u>	<u>\$ 130,149,040</u>



# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 3. Net Assets (continued)

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ —	\$ 4,574,678	\$ 6,807,551	\$ 11,382,229
Board-designated endowment funds	109,829,752	—	—	109,829,752
	<u>\$ 109,829,752</u>	<u>\$ 4,574,678</u>	<u>\$ 6,807,551</u>	<u>\$ 121,211,981</u>

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 99,205,579	\$ 3,639,981	\$ 6,600,444	\$ 109,446,004
Investment income:				
Investment income	1,166,241	159,556	—	1,325,797
Net appreciation (realized and unrealized)	9,454,688	992,678	—	10,447,366
Total investment return	<u>10,620,929</u>	<u>1,152,234</u>	<u>—</u>	<u>11,773,163</u>
Contributions	37,730	4,198	—	41,928
Transfer of funds held in trust by others to donor-restricted investments	—	—	207,107	207,107
Appropriation of endowment assets for expenditure	(34,486)	(221,735)	—	(256,221)
Endowment net assets, end of year	<u>\$ 109,829,752</u>	<u>\$ 4,574,678</u>	<u>\$ 6,807,551</u>	<u>\$ 121,211,981</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor, as stipulated by UPMIFA, requires the Hospital to retain as a fund of perpetual duration. These deficiencies periodically result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions, in which case the Board of Directors may deem imprudent the continuation of appropriation for a limited period. There were no material deficiencies as of September 30, 2014 and 2013.

The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**4. Assets Whose Use is Limited**

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

	<b>September 30</b>	
	<b>2014</b>	<b>2013</b>
Cash and cash equivalents	<b>\$ 107,499</b>	\$ 306,029
Money market funds	<b>16,303,490</b>	2,532,172
Interest in investments held by Endowment LLC	<b>147,085,079</b>	138,002,713
Equity securities:		
U.S.	<b>425,288</b>	450,342
International	<b>203,819</b>	197,780
Fixed income bonds:		
U.S.	<b>197,158</b>	126,207
International	<b>42,918</b>	41,439
Alternative investments and other	<b>253,570</b>	8,811,000
	<b>\$ 164,618,821</b>	\$ 150,467,682

On October 1, 2013, a significant portion of the alternative investments and other assets relating to GIC were transferred to HHCISL as part of the merger, as discussed in Note 1. During 2013, a significant portion of the Hospital's assets whose use is limited were transferred to Endowment LLC, as discussed in Note 1.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 4. Assets Whose Use is Limited (continued)

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

	Year Ended September 30	
	2014	2013
Interest and dividend income	\$ 246,747	\$ 1,076,638
Realized gain on investments, net	735,598	4,554,612
Return on interest in investments held by Endowment LLC	8,468,950	3,003,140
Change in unrealized gains and losses on investments	–	2,962,485
Other	110,809	41,607
	<u>\$ 9,562,104</u>	<u>\$ 11,638,482</u>

### 5. Fair Values of Financial Instruments

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

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

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

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

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

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 50,445,261	\$ -	\$ -	\$ 50,445,261
Assets whose use is limited:				
Cash and cash equivalents	107,499	-	-	107,499
Funds designated for debt service	16,303,490	-	-	16,303,490
Equity securities:				
U.S.	425,288	-	-	425,288
International	203,819	-	-	203,819
Fixed income bonds:				
U.S.	-	197,158	-	197,158
International	-	42,918	-	42,918
Alternative investments:				
U.S.	-	253,570	-	253,570
Other assets:				
Mutual funds:				
U.S.	3,518,554	602,560	-	4,121,114
International	1,980,085	-	-	1,980,085
Funds held in trust by others	-	16,309,118	-	16,309,118
<b>Total</b>	<b>\$ 72,983,996</b>	<b>\$ 17,405,324</b>	<b>\$ -</b>	<b>\$ 90,389,320</b>

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 39,433,385	\$ –	\$ –	\$ 39,433,385
Assets whose use is limited:				
Cash and cash equivalents	306,029	–	–	306,029
Funds designated for debt services	2,532,172	–	–	2,532,172
Equity securities:				
U.S.	450,342	–	–	450,342
International	197,780	–	–	197,780
Fixed income bonds:				
U.S.	–	126,207	–	126,207
International	–	41,439	–	41,439
Alternative investments:				
U.S.	–	261,339	–	261,339
International	–	2,789,942	5,759,720	8,549,662
Other assets:				
Mutual funds:				
U.S.	2,752,496	515,005	–	3,267,501
International	1,850,594	–	–	1,850,594
Funds held in trust by others	–	15,974,359	–	15,974,359
<b>Total</b>	<b>\$ 47,522,798</b>	<b>\$ 19,708,291</b>	<b>\$ 5,759,720</b>	<b>\$ 72,990,809</b>

The Hospital has \$147,085,079 and \$138,002,713 of financial assets as of September 30, 2014 and 2013, respectively, that are held by Endowment LLC (refer to Note 1). Financial assets classified within the trust are 54.3% Level 1, 20.9% Level 2, and 24.8% in alternative investments accounted for under the equity method as of September 30, 2014 and 56.3% Level 1, 22.0% Level 2, and 21.7% in alternative investments accounted for under the equity method as of September 30, 2013.

Financial assets carried at fair value included in the cash balance retirement plan are held in an HHC master trust. The Hospital owns participant units in the trust. Financial assets classified within the trust are 52.3% Level 1, 37.1% Level 2, and 10.6% Level 3 as of September 30, 2014, and 53.3% Level 1, 34.4% Level 2, and 12.3% Level 3 as of September 30, 2013.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is based upon model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers.

Assets that are valued using 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 NAV of the fund. As the NAV reported by each fund is used as a practical expedient to estimate the fair value of the Hospital's interest therein. The Hospital routinely monitors and assesses methodologies and assumptions used in valuing these interests. The Level 3 assets include certain liquidity restrictions that may require 90 days advance notice for redemptions.

The changes in the fair value of assets measured using significant unobservable inputs (Level 3) were comprised of the following for the years ended September 30:

	<u>2014</u>	<u>2013</u>
Beginning balance at October 1	\$ 5,759,720	\$ 27,493,156
Change in unrealized gains and losses	-	457,473
Transfer of assets to Endowment LLC	-	(22,190,909)
Transfer to HHCISL	<b>(5,759,720)</b>	-
Ending balance at September 30	<u>\$ -</u>	<u>\$ 5,759,720</u>

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

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 6. Property, Plant, and Equipment

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

	2014	2013
Land and land improvements	\$ 6,065,007	\$ 6,065,007
Buildings and building improvements	256,359,967	245,286,683
Equipment	125,887,736	123,388,103
	388,312,710	374,739,793
Less accumulated depreciation	(248,041,258)	(230,869,746)
	140,271,452	143,870,047
Construction in progress (estimated cost to complete – \$19,800,000)	33,898,993	19,940,168
	\$ 174,170,445	\$ 163,810,215

The Hospital capitalized interest expense of \$1,265,666 and \$445,536 for the year ended September 30, 2014 and 2013, respectively.

### 7. Pensions and Other Postretirement Benefits

The Hospital has two noncontributory, defined benefit pension plans (New Britain and Bradley campuses) covering substantially all of its employees hired prior to January 1, 2006 (collectively, the pension plans). The benefits are based on years of service and the employees' compensation during the last five years of employment. Employees hired after January 1, 2006, are eligible to participate in a defined contribution plan, as the defined benefit plans are closed to employees hired after January 1, 2006.

Contributions to the pension plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to the plan participants. The assets of the pension plans are available to pay the benefits of eligible employees for participating entities based on their allocated share of assets. The service cost component of net periodic pension cost and all other components are actuarially determined as defined by each plan.

## The Hospital of Central Connecticut

### Notes to the Consolidated Financial Statements (continued)

#### **7. Pensions and Other Postretirement Benefits (continued)**

The Hospital makes contributions in amounts sufficient to fund the pension plans' current service cost, and the funding policy is to contribute amounts to these plans sufficient to meet the minimum funding requirements set forth by federal government regulations.

The Hospital has a defined contribution benefit plan, which became effective January 1, 2006. Substantially all full-time employees hired after January 1, 2006, are eligible to participate in the new plan. Employees may contribute a percentage of their annual contribution subject to IRS limitations and the Hospital contributes up to 4% of annual compensation for employees that work greater than 20 hours a week and 3% of annual compensation for employees that work less than 20 hours a week. The Hospital has made employer contributions to this plan totaling \$2,166,567 and \$2,210,871 for 2014 and 2013, respectively. Employees become vested in the Hospital's contributions over three years. The portion of the employer contributions unvested upon termination of an employee are forfeited and used to reduce future contributions made by the Hospital on a dollar-for-dollar basis.

In addition, the Hospital has a Supplementary Executive Retirement Plan (SERP) under Section 457(b) and 457(f) of the Internal Revenue Code of 1986, as amended. The SERP has been established to supplement the retirement benefits of eligible employees designated by the Hospital's Board of Directors. The fair value of the assets relating to the SERP are \$6,101,199 and \$5,118,094 as of September 30, 2014 and 2013, respectively, and are recorded in other assets in the accompanying consolidated balance sheets. The accrued liability relating to the SERP, amounted to \$6,443,181 and \$7,813,034 as of September 30, 2014 and 2013, respectively. The expenses incurred related to the SERP amounted to \$1,006,664 and \$1,150,059 for 2014 and 2013, respectively.

Included in unrestricted net assets at September 30, 2014 and 2013, is \$93,640,688 and \$40,958,262, respectively, of unamortized actuarial loss that has not yet been recognized in net periodic benefit cost. The actuarial loss in 2014 primarily relates to changes in the discount rate and mortality table used to measure the benefit obligation, and the actuarial gain in 2013 primarily relates to changes in the discount rate used to measure the benefit obligation. The amortization of these items expected to be recognized in net periodic benefit costs for the fiscal year ending September 30, 2015, is \$6,435,788.



The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**7. Pensions and Other Postretirement Benefits (continued)**

The following table sets forth the pension plans' funded status and amount recognized in the consolidated balance sheets:

	<u>2014</u>	<u>2013</u>
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ (366,036,733)	\$ (401,999,473)
Service cost	(8,724,346)	(10,283,701)
Interest cost	(18,751,185)	(16,874,732)
Benefits paid	12,716,911	10,372,864
Actuarial (loss) gain	(59,031,556)	52,748,309
Benefit obligation at end of year	<u>(439,826,909)</u>	<u>(366,036,733)</u>
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	291,922,682	251,847,745
Actual return on plan assets	25,739,056	36,297,801
Employer contribution	7,408,000	14,150,000
Benefits paid	(12,716,911)	(10,372,864)
Fair value of plan assets at end of year	<u>312,352,827</u>	<u>291,922,682</u>
Underfunded status of the plans	<u>\$ (127,474,082)</u>	<u>\$ (74,114,051)</u>

	<u>2014</u>	<u>2013</u>
<b>Components of net periodic benefit cost</b>		
Service cost	\$ 8,724,346	\$ 10,283,701
Interest cost	18,751,185	16,874,732
Expected return on plan assets	(21,062,758)	(19,971,366)
Net amortization and deferral	994,067	6,793,736
Net periodic benefit cost	<u>\$ 7,406,840</u>	<u>\$ 13,980,803</u>

The accumulated benefit obligation for the pension plans was \$394,738,120 and \$325,434,897 as of September 30, 2014 and 2013, respectively.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 7. Pensions and Other Postretirement Benefits (continued)

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

	2014	2013
Discount rate for determining benefit obligation at year-end	4.40-4.45%	5.00-5.10%
Rate of compensation increase	3.50%	3.50%
Discount rate for net periodic benefit cost	5.00-5.10%	4.10-4.15%
Expected rate of return on plan assets	7.50%	7.50%
Rate of compensation increase	3.50%	3.50%

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

#### Plan Assets

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

	Target	2014	2013
Equity securities	57%	59%	60%
Fixed income/debt securities	25	22	24
Commodities/inflation/real assets	8	6	6
Other	10	13	10
Total	100%	100%	100%

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

The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**7. Pensions and Other Postretirement Benefits (continued)**

**Contributions**

The Hospital expects to make contributions of approximately \$6,840,000 and \$350,000 in fiscal year 2015, related to its pension plans and its SERP, respectively.

**Estimated Future Benefit Payments**

Future benefit payments are expected to be paid as follows:

<b>Fiscal Year</b>	<b>Pension Benefits</b>
2015	\$ 12,742,079
2016	13,513,253
2017	14,667,844
2018	15,935,316
2019	17,285,781
Years 2020–2024	113,529,703

The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**8. Long-Term Debt**

Details of long-term debt are as follows:

	<b>September 30</b>	
	<b>2014</b>	<b>2013</b>
Intercompany debt with HHC:		
Series A, consisting of a tax-exempt serial bond and term bonds; interest at rates ranging from 4.4% to 5.0%	<b>\$ 32,496,036</b>	\$ 32,866,281
Series C, taxable variable rate term bond; interest rates of 0.12% and 0.14% at September 30, 2014 and 2013, respectively	<b>4,544,163</b>	4,544,163
Series E, consisting of tax-exempt serial bond and term bonds; interest at rates ranging from 4.0% to 5.0%	<b>25,005,657</b>	–
Capital lease obligations for medical equipment, subject to liens, due in monthly installments, at varying rates of imputed interest from 2.25% to 3.84%	<b>652,997</b>	1,367,288
Revolving line of credit	–	1,325,511
Premium on bonds	<b>1,255,147</b>	631,050
	<b>63,954,000</b>	40,734,293
Less current portion	<b>(872,430)</b>	(2,329,243)
	<b>\$ 63,081,570</b>	\$ 38,405,050

On September 29, 2011, HHC issued approximately \$375,815,000 of CHEFA Revenue Bonds Series A, B, and C (the HHC 2011 Bonds). In conjunction with the issuance of the HHC 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital, and MidState Medical Center (collectively referred to as the Obligated Group). Effective January 2014, The William W. Backus Hospital became part of the Obligated Group. On March 26, 2014, HHC issued approximately \$163,180,000 of Taxable Bonds Series D (the HHC Series D Bonds) and approximately \$83,790,000 of CHEFA Revenue Bonds Series E (the HHC Series E Bonds) concurrently (collectively referred to as the HHC 2014 Bonds). Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

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

Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate has an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the Obligated Groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the Obligated Group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 and 2014 Bonds were issued to refund portions of existing debt under HHC and to obtain funds for future capital needs. As such, the HHC 2011 and 2014 Bonds are reflected as intercompany debt in the preceding schedule. The Hospital is party to the HHC Series A, Series C and Series E Revenue Bonds. During 2013, the Hospital was allocated an additional \$1,756,248 of previously unallocated Series A Revenue Bonds. The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023, and term bonds that mature from July 1, 2024 through July 1, 2041. During 2014, the Hospital made advance payments of \$101,417 to HHC for the bonds maturing in 2015. The HHC 2011 Series C Revenue Bonds consist of term bonds that mature from July 1, 2042 through July 1, 2049. The HHC 2011 Series C Revenue Bonds are secured by an irrevocable letter of credit issued by JP Morgan Chase Bank that expires on October 1, 2016. The reimbursement terms of the letters of credit for the HHC Series C Revenue Bonds are such that in the event a letter of credit is drawn upon due to a failed remarketing, the components available shall equal the aggregate principal and interest amount of bonds outstanding. The HHC Series E Bonds consist of term bonds that mature from July 1, 2025 through July 1, 2042.

The MTI and Supplemental MTI provide for the potential establishment and maintenance of a debt service reserve fund, a pledge of gross receipts, as defined, and parity with the HHC Series A and E Revenue Bonds that remain outstanding. The MTI and loan agreements establish certain restrictive covenants, including a debt service coverage ratio and days cash on hand requirement. No violations of covenants existed as of or for the fiscal years ended September 30, 2014 or 2013.

The fair value of the HHC 2011 and 2014 Bonds was approximately \$680,006,000 at September 30, 2014 and the fair value of the HHC 2011 Bonds was approximately \$377,885,000 at September 30, 2013. The carrying value of the HHC 2011 and 2014 Bonds was \$620,015,000 at September 30, 2014 and the carrying value of the HHC 2011 Bonds was \$375,815,000 as of September 30, 2013. The fair value of the HHC 2011 and 2014 Bonds was determined by

## The Hospital of Central Connecticut

### Notes to the Consolidated Financial Statements (continued)

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

HHC's investment advisor using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities and categorized as Level 2 in the fair value hierarchy described in Note 5. The carrying value of the Hospital's other long-term debt approximates fair value at September 30, 2014 and 2013.

As part of the HHC 2011 Bonds, the Obligated Group entered into a line of credit for \$20,000,000. This line expires in March 2015. As of September 30, 2014 and 2013, the Hospital had not drawn on this line of credit. In 2012, the Obligated Group obtained an additional \$60,000,000 line of credit. In August 2013, the Obligated Group entered into an amendment increasing this line of credit to \$100,000,000. This line expires in April 2015. As of September 30, 2014 the Hospital had not drawn on this line of credit. As of September 30, 2013, the Hospital had drawn \$1,325,511 on this line of credit, with a variable rate of 0.88% and which is also included in the current portion of long-term debt. During 2014, the Hospital repaid this line of credit.

In February 2010, the Hospital entered into a five-year, \$1,450,000 capital lease agreement with CHEFA for MRI equipment. This lease has an interest rate of 3.84%. The bank has a lien on the MRI equipment. The outstanding balance on this lease as of September 30, 2014 and 2013, was \$131,730 and \$439,426, respectively, and the net book value of the leased equipment was \$344,379 and \$610,256, respectively.

In December 2010, the Hospital entered into a five-year, \$2,000,000 capital lease agreement with CHEFA for DaVinci Robotic equipment. This lease has an interest rate of 2.25%. The bank has a lien on the DaVinci equipment. The outstanding balance on this lease as of September 30, 2014 and 2013, was \$521,267 and \$927,863, respectively, and the net book value of the leased equipment was \$1,117,120 and \$1,436,297, respectively.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 8. Long-Term Debt (continued)

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

Fiscal year ending September 30:	
2015	\$ 872,430
2016	590,678
2017	522,776
2018	579,712
2019	613,356
Thereafter	59,519,901
	<u>\$ 62,698,853</u>

Interest paid for the fiscal years ended September 30, 2014 and 2013, was \$3,818,836 and \$2,006,550, respectively.

### 9. Professional Liability and Worker's Compensation Insurance

Coverage for medical malpractice insurance is provided on a claims-made basis. As of January 1, 2013, the primary coverage is with Hartford Healthcare Indemnity Services, Limited (HHCISL) (previously known as CHS Insurance Limited or CHS), a captive insurance company which is a wholly-owned subsidiary of HHC.

Prior to January 1, 2013, GIC provided professional and general liability coverage on a claims-made basis to the Hospital. The Hospital did not self-insure any malpractice risks other than exposures greater than its excess coverages.

As discussed in Note 1, effective October 1, 2013, GIC merged with HHCISL and the Hospital entered into agreement with HHCISL for the claims covered under the policies issued by GIC (GIC Claims) to be assumed by and operated through HHCISL. Under this agreement, HHCISL separately accounts for the GIC Claims and the Hospital will be entitled to the payment of funds previously held by GIC in excess of amounts needed to pay for the GIC Claims. The Hospital will also be required to pay additional amounts to HHCISL should such funds be insufficient to cover the GIC Claims. In relation to this agreement, the Hospital has recorded a receivable from HHCISL of \$14,920,107 as of September 30, 2014, which is included in other receivables on the accompanying consolidated balance sheet.

## The Hospital of Central Connecticut

### Notes to the Consolidated Financial Statements (continued)

#### 9. Professional Liability and Worker's Compensation Insurance (continued)

Effective October 1, 2013, the policy limits for the primary coverage are \$7,500,000 per claim and \$39,000,000 in the aggregate. The primary layer of the excess coverage of \$20,000,000 is shared with two insurance carriers. The secondary layer is \$20,000,000 with a single insurance carrier. The third and fourth layers are \$10,000,000 each with two other insurance carriers. The top layer is \$20,000,000 for a total excess coverage of \$80,000,000.

Activity in the reserve for losses and loss adjustment expenses is summarized as follows for the year ended September 30, 2013:

	<b>2013</b>
Net reserve, beginning of year	\$ 9,455,032
Incurred related to:	
Current year	600,000
Prior years	(1,468,854)
Total incurred	(868,854)
Paid related to:	
Current year	—
Prior years	(4,157,496)
Total paid	(4,157,496)
Net reserve, end of year	4,428,682
Plus: reinsurance recoverable	3,675,000
Gross balance, end of the year	\$ 8,103,682

As a result of changes in estimates of insured events in prior years, the reserve for losses and loss adjustment expenses decreased by \$1,468,854 in 2013.

Malpractice claims are discounted at 1.72% and 2.08% for the incurred-but-not-reported liability, which was approximately \$1,989,000 and \$1,987,000 as of September 30, 2014 and 2013, respectively. In addition, medical malpractice insurance recoveries and the related claim liabilities of approximately \$2,178,000 and \$822,000 as of September 30, 2014 and 2013, respectively, are included in other current assets and other current liabilities, and medical malpractice insurance recoveries and the related claim liabilities of approximately \$10,639,000 and \$1,900,000 as of September 30, 2014 and 2013, respectively, are included in other long-term assets and other long-term current liabilities.



# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### **9. Professional Liability and Worker's Compensation Insurance (continued)**

The ultimate settlement of losses may vary significantly from the reserves recorded. In particular, ultimate settlements on medical malpractice claims depend, among other things, on the resolution of litigation, the outcome of which is difficult to predict. In addition, since the reserves have been discounted, there is the possibility that the timing of loss payments and income earned on invested assets will be significantly different than anticipated.

The Hospital self-insures workers' compensation claims with retention on the first \$500,000 per claim. The Hospital has also purchased excess liability insurance, which provides coverage for workers' compensation claims in excess of \$500,000, and up to aggregate limits of \$1,000,000 per employers' liability claim. The self-insurance plan is unfunded.

During the year, potential workers' compensation losses from asserted and unasserted claims identified by the Hospital's risk management system are accrued based upon estimates that incorporate the Hospital's past experience, as well as the nature of each claim or incident and relevant trend factors.

The Hospital's year-end workers' compensation reserve, as estimated by Hospital management in conjunction with its independent actuaries, is included in self-insurance and other long-term liabilities on the consolidated balance sheets and is discounted at 3.0% and 0.5% in 2014 and 2013, respectively. The balances as of September 30, 2014 and 2013, are \$3,798,737 and \$3,564,039, respectively.

### **10. Commitments and Contingencies**

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. Such lawsuits and claims are either specifically covered by insurance as explained in Note 1 or are deemed to be immaterial. While the outcomes of the lawsuits cannot be determined at this time, management believes that any loss that may arise from these actions will not have a material adverse effect on the financial position or changes in net assets of the Hospital.

The Hospital has several operating lease agreements for certain real estate, medical equipment, and computer equipment. Certain of these leases have renewal options for periods up to five years and escalation clauses. Rent is payable in equal monthly installments. Rent expense was \$3,387,378 and \$3,817,405 for the years ended September 30, 2014 and 2013, respectively.

The Hospital of Central Connecticut

Notes to the Consolidated Financial Statements (continued)

**10. Commitments and Contingencies (continued)**

The future minimum lease payments are as follows:

<b>Year</b>	<b>Operating Leases</b>
2015	\$ 2,686,068
2016	1,784,581
2017	1,111,780
2018	811,791
2019	605,036
Thereafter	1,430,494
	<u>\$ 8,429,750</u>

**11. Related-Party Transactions**

The Hospital obtains services from various HHC affiliates representing an allocation of shared expenditures that were provided at cost. Services provided by affiliates for the years ended September 30, 2014 and 2013, were \$35,498,888 and \$16,093,221, respectively. Other inter-company activity with subsidiaries of the Hospital include recurring transactions associated with operations which have been eliminated in consolidation.

# The Hospital of Central Connecticut

## Notes to the Consolidated Financial Statements (continued)

### 11. Related-Party Transactions (continued)

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

	<b>2014</b>	<b>2013</b>
Due from Midstate Medical Center	\$ 688,475	\$ —
Due from HHC	434,867	4,794,973
Due from Practice Central	—	93,907
Other	66,495	136,061
	\$ 1,189,837	\$ 5,024,941
Due to HHC	\$ (2,120,357)	\$ (597,436)
Due to Hartford Hospital	(2,910,855)	(428,618)
Due to Hartford HealthCare Medical Group	(425,040)	(112,384)
Due to Hartford Healthcare Rehabilitation Network (formerly Eastern Rehabilitation Network)	(6,657)	(35,913)
Other	(62,010)	—
	\$ (5,524,919)	\$ (1,174,351)

### 12. Other Operating Revenues

Other operating revenues consist of the following:

	<b>Year Ended September 30</b>	
	<b>2014</b>	<b>2013</b>
Healthcare services to other institutions	\$ 2,874,010	\$ 2,828,922
EHR revenue	2,011,704	3,173,235
Food service income	1,591,448	1,647,300
Grant income	1,392,645	1,375,056
Rental income	854,170	1,039,016
Other income	2,300,340	2,170,369
	\$ 11,024,317	\$ 12,233,898

## The Hospital of Central Connecticut

### Notes to the Consolidated Financial Statements (continued)

#### 13. Functional Expenses

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

	2014	2013
Health care services	\$ 300,513,953	\$ 313,030,883
Support services	58,790,131	61,238,843
	\$ 359,304,084	\$ 374,269,726

#### 14. Supplemental Cash Flow Information

The changes in assets and liabilities for the year ended September 30 are as follows:

	2014	2013
Increase in accounts receivable	\$ (674,609)	\$ (6,543,234)
Decrease (increase) in premiums receivable	75,002	(39,316)
Decrease in reinsurance recoverable	3,675,000	3,830,995
Increase in other receivables	(14,167,251)	(1,173,591)
Decrease (increase) in due from affiliates	3,835,104	(4,940,183)
(Increase) decrease in inventories of supplies	(204,013)	522,646
Increase in debt service	(13,771,318)	(134,970)
Decrease in prepaid expenses and other assets	1,297,901	147,080
Increase in other assets	(10,734,993)	(4,336,870)
Decrease in accounts payable and accrued expenses	(10,945,944)	(617,166)
Decrease in salaries, wages, payroll taxes, and amounts withheld from employees	(2,550,060)	(223,882)
Increase (decrease) in estimated third-party settlements	7,413,014	(7,330,442)
Increase (decrease) in due to affiliates	4,350,568	(470,586)
Decrease in unearned premium	—	(26,654)
Decrease in reserve for losses and loss adjustment expenses	(8,103,682)	(8,857,345)
Increase in pension, self-insurance and other long-term liabilities	8,984,839	8,810,353
	\$ (31,520,442)	\$ (21,383,165)

## The Hospital of Central Connecticut

### Notes to the Consolidated Financial Statements (continued)

#### **15. Subsequent Events**

The Hospital evaluated subsequent events through January 28, 2015, which is the date the consolidated financial statements were issued, for potential recognition in the consolidated financial statements as of the balance sheet date for the year ended September 30, 2014.

During October 2014, the Hospital became a corporate guarantor of a five year, \$2,800,000 term loan entered into by an affiliate in which the Hospital has a minority ownership interest. This subsequent event did not require an adjustment to the consolidated financials as of September 30, 2014.

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

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