UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)

Financial Statements
(With Management's Discussion and Analysis)

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

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The following discussion and analysis provides an overview of the financial position and activities of the University of Connecticut Health Center John Dempsey Hospital (21002 Fund) (the Hospital) as of and for the years ended June 30, 2010, 2009, and 2008. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Through the Hospital (a licensed acute care hospital with a certified 224 bed inpatient facility; 204 general acute care beds, and 20 nursery beds), the University of Connecticut Health Center provides specialized and routine inpatient and outpatient services. The Hospital also provides comprehensive healthcare services for Connecticut's incarcerated inmates through a contract with the Correctional Managed Health Care (CHMC) program. The Hospital has long been regarded as the premier facility in the region for neonatal intensive care and high-risk maternity. It also is recognized for its cardiovascular program (interventional cardiology and surgery), cancer, musculoskeletal, and behavioral mental health services which include geriatric as well as locked inpatient psychiatric units, ambulatory partial hospitalization, and outpatient treatment programs. Additionally, the Hospital is home to the only Emergency Department in Connecticut's fast-growing Farmington Valley.

Overview of the Financial Statements

This annual report consists of management's discussion and analysis and the financial statements. The basic financial statements (statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows) present the financial position of the Hospital at June 30, 2010 and 2009, and the results of its operations and its financial activities for the years then ended. These financial statements report information about the Hospital using accounting methods similar to those used by private-sector companies. The statements of net assets include all of the Hospital's assets and liabilities. The statements of revenues, expenses, and changes in net assets reflects the year's activities on the accrual basis of accounting, i.e., when services are provided or obligations are incurred, not necessarily when cash is received or paid. These financial statements report the Hospital's net assets and how they have changed. Net assets (the difference between assets and liabilities) is one way to measure financial health or position. The statements of cash flows provide relevant information about each year's cash receipts and cash payments and classifies them as to operating, investing, and capital and related financing activities.

Financial Highlights

Hospital discharges decreased 217 cases to 9,513 from fiscal 2009 to fiscal 2010. Outpatient visits decreased by19,249, or 5.21%, from the prior year. The Hospital was significantly affected by increases in staffing costs as represented by salaries and internal contractual support. In the current year, the Hospital also spent a significant amount of funds on affiliation, and regulatory consulting costs, reported under other purchased services.

Despite continued focus on revenue enhancement and cost containment strategies, the Hospital finished the year with an operating loss of $24.3 million compared to an operating loss of $15.5 million in the prior year. These losses are offset by non-operating revenue of $14.1 million and $3.9 million in fiscal year 2010 and 2009, respectively.

The Hospital's financial position at June 30, 2010, included assets of approximately $108.5 million and liabilities of approximately $43.1 million. Net assets, which represent the residual interest in the Hospital's assets after liabilities are deducted, increased approximately $9.3 million to $65.4 million despite the $24.3 million operating loss at June 30, 2010. The increase in net assets is attributable to the following: $13.5 million state appropriation and $19.5 million of transfers from the Health Center. Health Center transfers included $4.9 million of fringe recovery related to support services paid against the institutions general fund allotment, $3.1 million in miscellaneous cash transfers from the Health Center to fund capital projects, and approximately $11.5 million of cash transfers allocated from the Health Center's 2009 deficit appropriation. A similar transfer is not expected for the current year shortfall.

Changes in net assets represent the activity of the Hospital, which results from revenues, expenses, gains, and losses, and are summarized for the years ended June 30, 2010, 2009, and 2008, including other changes in net assets, as follows:

	2010	2009	2008
		(In thousands)	
Summary of assets and liabilities at June 30:			
Current assets	$ 53,156	$ 53,875	$ 55,010
Assets limited as to use, net of current portion	—	18,879	16,638
Other assets	613	601	692
Capital assets, net	54,712	59,574	61,170
Total assets	$ 108,481	$ 132,929	$ 133,510
Current liabilities	$ 33,538	$ 47,936	$ 50,588
Long term debt excluding current installments	1,246	2,076	2,906
Capital lease liabilities, net of current portion	1,087	2,318	4,302
Accrued compensated absences, net of current portion	7,203	6,224	6,693
Estimated malpractice costs, net of current portion	—	18,315	16,332
Net assets restricted for research and education	148	144	146
Unrestricted net assets	14,942	3,550	1,808
Invested in capital assets, net of related debt	50,317	52,366	50,735
Total liabilities and net assets	$ 108,481	$ 132,929	$ 133,510
Summary of revenues, expenses, and transfers for the year ended June 30:			
Operating revenues	$ 247,237	$ 250,309	$ 232,827
Operating expenses	(271,527)	(265,782)	(248,924)
Operating loss	(24,290)	(15,473)	(16,097)
Nonoperating revenue , net	14,122	3,944	1,244
Net asset transfers	19,516	14,900	—
Increase (decrease) in net assets	$ 9,348	$ 3,371	$ (14,853)

(Continued)

Capital Assets

At June 30, 2010, the Hospital had plant and equipment of $187.1 million before accumulated depreciation compared to $183.6 million at June 30, 2009, as shown in the table below:

	2010	2009	2008
		(In thousands)	
Land	$ 183	$ 183	$ 183
Construction in progress	6,030	5,578	8,458
Buildings	98,454	97,404	94,736
Equipment	68,630	66,609	61,791
Capital leases	13,776	13,776	13,777
	$ 187,073	$ 183,550	$ 178,945

The Hospital's fiscal 2011 capital budget projects spending at approximately $11.1 million on various capital improvement projects. More detailed information about the Hospital's plant and equipment is presented in note 6 to the financial statements.

Statements of Cash Flows

The statements of cash flows provide additional information about the Hospital's financial results by reporting the major sources and uses of cash. A summary of the statements of cash flows for the years ended June 30, 2010, 2009, and 2008 is as follows:

	2010	2009	2008
		(in thousands)	
Cash received from operations	$ 257,336	$ 250,009	$ 239,184
Cash expended for operations	(297,883)	(247,799)	(235,401)
Net cash (used in) provided by operations	(40,547)	2,210	3,783
Net cash provided by (used in) investing activities	20,116	(13,047)	(1,903)
Net cash provided by noncapital financing activities	14,348	4,100	726
Net cash provided by (used in) capital and related financing activities	6,083	6,737	(2,606)
Net change in cash	$ —	$ —	$ —

(Continued)

Significant Variances in Financial Statements

In this section, the Hospital explains the reasons for those financial statement items with significant variances relating to fiscal 2010 amounts, compared to fiscal 2009.

Summary of Assets* and *Liabilities

Changes in assets are comprised of the following:

Due from Other State and Health Center Agencies – increased from $249,000 in 2009 to $12.8 million in 2010 as a result of increases in the amount of cash advanced to the University of Connecticut Health Center Finance Corporation (Finance Corporation) for purchases to be made on the Hospital's behalf.

Inventory – increased from June 30, 2009 to June 30, 2010 by approximately $1.2 million or 20.1%. Increases in inventory have been primarily driven by increased service lines offered by the Hospital, the continued rapid growth in both pharmaceutical and medical supply costs, and the required safety stock necessitated by patient demands. Such factors have offset continued management focus on cost containment activities such as utilization of just-in-time principles, rightsizing, standardization, and utilization of consignment arrangements.

Assets Limited as to Use – decreased from June 30, 2009 to June 30, 2010 by approximately $25.8 million. Decreases in assets limited as to use is the result of a transfer to the Health Center of the Malpractice Trust Fund in conjunction with implementing Public Act No. 09-3. Additional detail may be found in note 9.

Capital Assets, net – decreased from June 30, 2009 to June 30, 2010 by $4.9 million or 8.2% primarily as the result of depreciation and retirement of capital assets outpacing capital additions in the current year. Additional detail may be found in note 6.

Changes in liabilities are comprised of the following:

Cash overdraft – decreased from June 30, 2009 to June 30, 2010 by approximately $10.3 million or 77.1%, to a net overdraft position of $3.1 million. This fiscal year $11.5 million was transferred into the Hospital to fund the prior year operating loss. Despite the transfer, the Hospital is still in an overdraft position as a result of current year operating losses, continued capital spending and debt service payments, and funding of the malpractice reserve.

Accounts payable and accrued expenses – increased from June 30, 2009 to June 30, 2010 by approximately $1.1 million or 11.1%. This represents the result of increased purchasing activity and normal business practices.

Due to/from third-party payors – changed from an asset at from June 30, 2009 to a liability at June 30, 2010. The change of approximately $5.5 million related to estimated settlements of open cost reports. These amounts are the result of the Hospital's analysis of outstanding Medicare and Medicaid cost reports.

Capital Leases – decreased from June 30, 2009 to June 30, 2010 by approximately $2 million or 46.1%. The decrease is the result of the Hospital's repayment of current year lease obligation installments.

Estimated Malpractice Costs – decreased from June 30, 2009 to June 30, 2010 by $25.2 million. The decrease in estimated malpractice costs is the result of a transfer to the Health Center of the Malpractice Trust Fund in conjunction with implementing Public Act No. 09-3. Additional detail may be found in note 9.

Summary of Revenues, Expenses, and Changes in Net Assets

Operating revenue – decreased from June 30, 2009 to June 30, 2010 by approximately $3.1 million or 1.2%. Net patient revenue was essentially flat with the prior year. Contract and other revenue decreased by approximately $2.3 million or 68.5%; which was driven by decreases in amounts received from agreements with outside organizations.

Operating expenses – increased from June 30, 2009 to June 30, 2010 by approximately $5.7 million or 2.2%, primarily due to increases in internal contractual support, medical and dental house staff and repairs and maintenance costs. There were decreases in drugs and medical supplies as well as insurance and outside and other purchase services..

State appropriations – increased from June 30, 2009 to June 30, 2010 by approximately $9.9 million, primarily due to increases related to the funding from Public Act 09-3 regarding in-kind fringe benefits; as part of the act the Hospital will receive an additional $13.5 for in-kind fringe benefits in fiscal year 2011.

Transfer from Health Center – increased from June 30, 2009 to June 30, 2010 by approximately $4.6 million or 31%, primarily due to fringe benefit recovery related to administrative support services paid against the institutions general fund allotment.

FY 2011 Outlook:

As we look forward to fiscal year 2011, the Hospital's main concern continues to be clinical volume. Discharges for May and June exceeded budget and prior year actual. This trend needs to continue. Average daily census at the Hospital was below budget for most of fiscal year 2010. Management is addressing these concerns in part by implementing a new clinically focused advertising campaign and a significant faculty recruiting effort to increase the number of practicing physicians in core areas such as surgery, orthopedics and dermatology.

On June 4, 2010 Governor M. Jodi Rell signed into law plans to establish the UConn Health Network (the Network) – a unique partnership with area hospitals aimed at creating jobs and improving access to quality health care in the state. The centerpiece of the partnership is a new patient care tower and renovations to John Dempsey Hospital at the Health Center. The plan will also include increased classroom and lab space for more medical and dental students aimed at alleviating an expected shortage of doctors and dentists in the state. The governor estimates the state "stands to gain 5,000 new jobs in the years to come." The UConn Health Network would involve the cooperation of all the area hospitals including Hartford Hospital, St. Francis Hospital and Medical Center, Connecticut Children's Medical Center, and other health care facilities and providers.

The plan is estimated to cost $352 million and includes $237 million in borrowing. Twenty-five million of that will be reallocated from bonds originally earmarked for other UConn Health Center projects. Connecticut is also applying for a $100 million federal grant. Features of the Network include:

1. **Neonatal Intensive Care Unit:** The operations will be managed by Connecticut Children's Medical Center. Patients will continue to be treated at the Health Center; NICU physicians and staff will remain Health Center employees. A Certificate of Need application will be filed to seek approval for the transfer.

2. **Nationally recognized cancer center:** The goal will be to achieve National Institutes of Health designation as a Comprehensive Cancer Center, making it the second in the state outside of Yale.

3. **Regional Simulation Center:** It will train up to 2,000 medical practitioners each year on newest equipment and technology in simulated care settings and will be located at Hartford Hospital.

4. **Primary Care Institute:** It will be located at St. Francis Hospital and will develop new models of chronic disease management and primary care delivery and education. It will also serve to address the impending shortage of primary care providers in Connecticut.

5. **Health Disparities Institute:** It will promote enhanced healthcare research, training and delivery to minority communities.

6. **Institute for Clinical and Translational Sciences:** It will be a super-site by network partners and will speed lab-to-bedside clinical trials and breakthrough medicine.

7. **Bioscience Enterprise Zone:** It will offer state tax breaks to private companies that create jobs and work with UConn Health Network partners.

Contacting the Hospital's Financial Management

This financial report provides the reader with a general overview of the Hospital's finances and operations. If you have questions about this report or need additional financial information, please contact the Office of Chief Financial Officer, University of Connecticut Health Center, Farmington, Connecticut 06030-3800.

KPMG

KPMG LLP
One Financial Plaza
755 Main Street
Hartford, CT 06103

Independent Auditors' Report

Joint Audit and Compliance Committee of the
University of Connecticut Health Center:

We have audited the accompanying statements of net assets of University of Connecticut Health Center, John Dempsey Hospital (21002 Fund) (the Hospital), an enterprise fund of the State of Connecticut, as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of University of Connecticut Health Center, John Dempsey Hospital (21002 Fund) as of June 30, 2010 and 2009, and the results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Management's Discussion and Analysis (MD&A) on pages 1 to 7 is not a required part of the basic financial statements of University of Connecticut Health Center, John Dempsey Hospital (21002 Fund) but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

December 21, 2010

UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)

Statements of Net Assets

June 30, 2010 and 2009

Assets	**2010**	**2009**
Current assets:		
Patient accounts receivable, net of estimated uncollectibles of $24,399,000 and $21,934,000 at June 30, 2010 and 2009, respectively	$ 29,752,888	$ 33,764,998
Due from other State and Health Center agencies	12,789,049	248,842
Inventory	7,090,582	5,904,591
Contract and other receivables	477,986	1,054,879
Prepaid expenses	3,045,246	3,314,862
Due from third-party payors	—	2,676,748
Assets limited as to use, current portion (note 9)	—	6,910,000
Total current assets	53,155,751	53,874,920
Noncurrent assets:		
Assets limited as to use, net of current portion (note 9)	—	18,879,282
Other assets	613,242	601,145
Capital assets, net (note 6)	54,711,812	59,573,794
Total noncurrent assets	55,325,054	79,054,221
Total assets	$ 108,480,805	$ 132,929,141
Liabilities and Net Assets		
Current liabilities:		
Cash overdraft	$ 3,082,016	$ 13,431,939
Accounts payable and accrued expenses	11,160,327	10,049,629
Accrued payroll	6,506,559	6,460,153
Due to State of Connecticut	2,888,485	2,751,256
Due to third-party payors	2,833,399	—
Accrued compensated absences, current portion (note 7)	5,005,189	5,519,181
Long-term debt, current installments (note 7)	830,396	830,396
Capital leases, current portion, (note 7)	1,231,751	1,983,114
Estimated malpractice costs, current portion (note 9)	—	6,910,000
Total current liabilities	33,538,122	47,935,668
Noncurrent liabilities:		
Accrued compensated absences, net of current portion (note 7)	7,202,589	6,223,758
Long-term debt, excluding current installments (note 7)	1,245,595	2,075,991
Liabilities under capital leases, net of current portion (note 7)	1,086,613	2,318,364
Estimated malpractice costs, net of current portion (note 9)	—	18,315,000
Total noncurrent liabilities	9,534,797	28,933,113
Total liabilities	43,072,919	76,868,781
Net assets:		
Invested in capital assets, net of related debt	50,317,457	52,365,929
Restricted for research and educational	148,123	144,180
Unrestricted	14,942,306	3,550,251
Total net assets	65,407,886	56,060,360
Total liabilities and net assets	$ 108,480,805	$ 132,929,141

See accompanying notes to financial statements.

UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010 and 2009

	2010	2009
Operating revenues:		
Net patient service revenues (note 4)	$ 246,155,547	$ 246,880,983
Contract and other revenues	1,081,457	3,428,058
Total operating revenues	247,237,004	250,309,041
Operating expenses:		
Salaries and wages	88,764,151	93,580,336
Fringe benefits	38,825,799	38,552,482
Medical/dental house staff	15,292,507	11,966,675
Medical contractual support	3,203,566	4,850,019
Internal contractual support	16,645,836	—
Outside agency per diems	1,931,044	1,145,303
Depreciation and amortization	10,571,031	10,790,380
Loss on disposal	13,970	43,278
Pharmaceutical/medical supplies	50,645,210	52,655,058
Utilities	2,668,129	3,162,879
Outside and other purchased services	29,950,586	32,997,531
Insurance	3,357,735	8,257,896
Repairs and maintenance	6,153,452	4,894,048
Other expenses	3,504,128	2,886,123
Total operating expenses	271,527,144	265,782,008
Operating loss	(24,290,140)	(15,472,967)
Nonoperating revenues (expenses):		
Gift income	847,835	500,000
State appropriations	13,500,000	3,600,000
Interest income	49,785	259,902
Interest expense	(275,340)	(415,932)
Net nonoperating revenues	14,122,280	3,943,970
Loss before transfers	(10,167,860)	(11,528,997)
Transfer from Health Center - unrestricted	19,515,386	14,900,000
Increase in net assets	9,347,526	3,371,003
Net assets, beginning of year	56,060,360	52,689,357
Net assets, end of year	$ 65,407,886	$ 56,060,360

See accompanying notes to financial statements.

UNIVERSITY OF CONNECTICUT HEALTH CENTER
JOHN DEMPSEY HOSPITAL (21002 FUND)

Statements of Cash Flows

Years ended June 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from patients and third-party payors	$ 255,677,804	$ 246,849,610
Cash received from contract and other revenue	1,658,350	3,159,277
Cash paid to employees for salaries and fringe benefits	(118,238,424)	(131,461,242)
Cash paid for other than personal services	(179,645,214)	(116,337,515)
Net cash (used in) provided by operating activities	(40,547,484)	2,210,130
Cash flows from investing activities:		
Malpractice trust fund	25,789,282	(4,192,800)
Bond sinking fund	—	123,447
Investment income	49,785	259,902
Additions to property and equipment	(5,723,019)	(9,237,143)
Net cash provided by (used in) investing activities	20,116,048	(13,046,594)
Cash flows from noncapital financing activities:		
Gifts received	847,835	500,000
State appropriations	13,500,000	3,600,000
Net cash provided by noncapital financing activities	14,347,835	4,100,000
Cash flows from capital and related financing activities:		
Interest paid	(268,352)	(422,128)
Transfer from Health Center	19,515,386	14,900,000
Net repayments on cash overdraft	(10,349,923)	(4,513,946)
Repayment of long-term debt	(2,813,510)	(3,227,462)
Net cash provided by capital and related financing activities	6,083,601	6,736,464
Net change in cash	$ —	$ —
Reconciliation of operating loss to net cash (used in) provided by operating activities:		
Operating loss	(24,290,140)	(15,472,967)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	10,571,031	10,790,380
Loss on disposal	13,970	43,278
Changes in operating assets and liabilities:		
Patients accounts receivable, net	4,012,110	246,912
Due from other State and Health Center agencies	(12,540,207)	2,317,213
Inventory	(1,185,991)	227,252
Contract and other receivables	576,893	(268,781)
Prepaid expenses	269,616	719,103
Due from third-party payors, net	5,510,147	(278,285)
Other assets	(12,097)	90,464
Accounts payable and accrued expenses	1,103,710	539,297
Deferred revenue	—	(7,160)
Due to other State and Health Center agencies	(9,862,771)	(18,248)
Accrued payroll	46,406	(2,082)
Accrued compensated absences	464,839	(651,246)
Estimated malpractice costs	(15,225,000)	3,935,000
Net cash (used in) provided by operating activities	$ (40,547,484)	$ 2,210,130

See accompanying notes to financial statements.

(1) Description of Reporting Entity and Summary of Significant Accounting Policies

Reporting Entity

The financial statements include those asset, liability, revenue, and expense accounts reflected in the accounting records of the John Dempsey Hospital (the Hospital) including the Dental Clinics, and the University of Connecticut Health Center's malpractice self-insurance fund (which was transferred to the Health Center in 2010), which are accounted for in the 21002 Fund of the University of Connecticut Health Center (the Health Center). There are 21 members of the Board of Trustees. Five serve as ex officio, voting members by virtue of other positions: The Governor is President of the Board, the Commissioners of Agriculture, Education, and Economic and Community Development are Board members, and the Chair of the Health Center Board of Directors is a member. Two Board members are elected by alumni for four-year terms (and may be re-elected once, in succession). One undergraduate student is elected by undergraduates for a two-year term. One graduate or professional student is elected by graduate and professional students for a two-year term. Twelve members are appointed by the Governor, subject to confirmation by the General Assembly, for six-year terms, and may be reappointed without limit.

There are 18 members of the University of Connecticut Health Center Board of Directors. Three serve as ex officio voting members and serve concurrently with their positions: The Commissioner of Public Health, The Secretary or a designated under-secretary of the Office of Policy and Management and the President of the University. All other terms are for three years and include: three members appointed by the Governor, three members appointed by the chair of the Board of Trustees (two of which must be members of the Board of Trustees and last who serves at the chair of the Board of Directors), and 9 at-large members appointed by the Board of Directors itself.

Reference is made to note 8 for related party transactions.

The Hospital is an enterprise fund of the State of Connecticut ("the State") and is therefore generally exempt from federal income taxes under Section 115 of the Internal Revenue Code of 1986.

The Finance Corporation was established pursuant to Public Act No 87-458. The purpose of the Finance Corporation is to provide greater flexibility for the Hospital and to promote the more efficient provision of health care services. As such, the Finance Corporation has been empowered to purchase supplies and equipment, acquire facilities, approve write-offs of Hospital accounts receivable, process malpractice claims on behalf of the Hospital (Health Center beginning in 2010), as well as negotiate joint ventures, shared service, and other agreements for the benefit of the Hospital.

Basis of Presentation

The Hospital's financial statements are prepared in accordance with all relevant Governmental Accounting Standards Board (GASB) pronouncements. GASB No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, states that proprietary activities may elect to apply the provisions of Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989 that do not conflict with or contradict GASB pronouncements. The Health Center has not made this election.

The Hospital has adopted Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* as amended by GASB Statements No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities, and No. 37, Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments: Omnibus*, as of July 1, 2001.

John Dempsey Hospital also adopted GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, as of July 1, 2001. These GASB pronouncements established financial reporting standards for state and local governmental entities, including net asset presentation, certain classifications of revenues and expenses and management's discussion and analysis.

Use of Estimates

The preparation of financial statements in conformity 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 contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial statement areas where management applies the use of estimates consist primarily of the allowance for uncollectible accounts, third-party reimbursement reserves and the estimated self-insurance liability.

Proprietary Fund Accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. All revenues and expenses are subject to accrual.

Cash and Cash Overdraft

Cash includes cash in banks. Cash overdraft positions, which occur when total outstanding issued checks exceed available cash balances at the end of each reporting period, are presented as a liability within the balance sheet. See note 2 for discussion regarding the Hospital's available borrowing.

Accounts Receivable and Net Patient Service Revenues

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

Contract and Other Revenues

Contract and other revenues primarily consist of net receipts resulting from contractual revenue with area hospitals.

Capital Assets

Property and equipment acquisitions are recorded at cost. Betterments and major renewals are capitalized, and maintenance and repairs are expensed as incurred.

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings have an estimated useful life of 5 to 50 years and equipment has an estimated useful life of 2 to 25 years. Assets acquired under capital leases and leasehold improvements are depreciated no longer than the lease term.

Inventory

Inventory is recorded at cost, being determined by the first-in, first-out (FIFO) method. Short-term or minor supplies are expensed as incurred.

Fair Value of Financial Instruments

Reference is made to note 5 (Assets Limited as to Use). For other assets and liabilities such as accounts receivable, contract and other receivables, cash overdraft, accounts payable and accrued expenses and accrued payroll, the carrying amount approximates fair value because of the short maturity of these instruments.

Retirement Plans

Eligible Hospital employees, as defined, may participate in the following State of Connecticut retirement plans: the State Retirement System Tier I, Tier II, Tier IIa, and the Teachers' Retirement System defined benefit plans; and the Alternate Retirement Plan which is a defined contribution plan. These plans are funded by contributions from the State as well as payroll deductions from employees, except for the Tier II Plan, which is noncontributory.

In addition, eligible employees may participate in a State of Connecticut defined contribution deferred compensation plan, which is funded by payroll deductions from employees.

In 2008, the State of Connecticut implemented Government Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The State provides post retirement health care and life insurance benefits to eligible Health Center employees, including those of John Dempsey Hospital, in accordance with Sections 5-257(d) and 5-259(a) of the Connecticut General Statutes. Upon retirement, liability for retirement and other benefits rests with the State of Connecticut. Therefore, the liability is reported by the State of Connecticut and not recognized in the financial statements of the Hospital. When employees retire, the State pays up to 100% of their health care insurance premium cost (including the cost of dependent coverage). The State finances the cost of post retirement health care and life insurance benefits on a pay-as-you-go basis through an appropriation in the General Fund.

(Continued)

Information is not available from the State of Connecticut specifically allocating pension benefits; plan assets, obligations, and expenses applicable to employees of the Hospital. (Reference is also made to note 8).

Compensated Absences

The Hospital's employees earn vacation, personal, compensatory and sick time at varying rates depending on their collective bargaining units. Employees may accumulate sick leave up to a specified maximum. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments at varying rates, depending on the employee's contract. Amounts recorded on the statements of net assets are based on historical experience. All other compensated absences are accrued at 100% of their balance. Compensated absences have been allocated between current and noncurrent based on historical information.

Third Party Payors

Laws governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Each year as the Office of Inspector General (OIG) work plan changes, new areas of scrutiny surface. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in any given period.

Medical Malpractice

Health care providers and support staff of the Hospital are fully protected by State statutes from any claim for damage or injury, not wanton, reckless or malicious, caused in the discharge of their duties or within the scope of their employment (statutory immunity). Any claims paid for actions brought against the State as permitted by waiver of statutory immunity have been charged against the Health Center's malpractice self-insurance fund. Prior to 2010 the malpractice trust fund was controlled by John Dempsey Hospital, which annually retained a qualified actuary to assist with calculating and determining the appropriate malpractice reserve (approximately $25.2 million at June 30, 2009) and provision (approximately $7,977,000 in 2009). The calculated actuarial reserve, was also equally funded as was required by Section 10a-256 (the public act that established the malpractice trust fund). As more fully described in note 9, beginning in 2010, the State of Connecticut passed Public Act No. 09-3, resulting in the fund being transferred to the Health Center. As a result of the transfer, the Health Center now allocates an annual malpractice premium to John Dempsey Hospital, designed to reflect an estimate for the current year's cash claims to be processed. For the year ended June 30, 2010 such premium was approximately $3,064,000 and is included in the Hospital's statements of revenues, expenses, and changes in net assets.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase on construction of those assets. Expendable funds for research and education represent balances held for use in promoting various Hospital initiatives. All other assets are classified as unrestricted net assets.

(Continued)

Regulatory Matters

The Hospital is required to file semi-annual and annual operating information with the State of Connecticut Office of Health Care Access (OHCA) and is required to file annual cost reports with Medicare and Medicaid.

Reclassifications

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation.

(2) Hypothecation

In accordance with State Statute, John Dempsey Hospital can borrow from the State up to 90% of its net patient receivables, contract and other receivables to fund operations. As of June 30, 2010 and 2009, the Hospital had drawn down $3,082,016 and $13,431,939, respectively. As of June 30, 2010 and 2009, the Hospital has available $24,125,771 and $17,905,950, respectively, under the State Statute.

(3) Charity Care

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. During 2010 and 2009, the Hospital provided charity care services of $1,013,714 and $840,699, respectively. The cost basis of these services was $502,625 and $416,379. Expenses associated with these procedures were included in operating expenses.

(4) Net Patient Service Revenues

The Hospital provides health care services primarily to residents of the region. Revenues from the Medicare programs accounted for approximately 37% and 35% of the Hospital’s net patient service revenues for the years ended June 30, 2010 and 2009, respectively. Revenues from the Medicaid programs accounted for approximately 27% and 26% of the Hospital’s net patient service revenues for the years ended June 30, 2010 and 2009, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries are outstanding, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

Patient accounts receivable included approximately 29% and 34% due from Medicare and approximately 13% due from Medicaid at June 30, 2010 and 2009.

(Continued)

Patient service revenue is reported net of allowances for the years ended June 30, was:

		2010		2009
Gross patient service revenue	$	514,239,006	$	469,647,440
Less contractual allowances		(260,249,422)		(218,514,352)
Less provision for bad debt		(7,834,037)		(4,252,105)
Net patient service revenue	$	246,155,547	$	246,880,983

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. Services to Medicare beneficiaries are paid based on a prospective payment system (PPS) based on the classification of each case into a Diagnostic-Related Group (DRG). Inpatient psychiatric services are reimbursed via a new PPS system established for inpatient psychiatric patients based on pre-determined hospital specific per diems. The Hospital is reimbursed for Direct Graduate Medical Education and Medicare Bad Debts at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through fiscal year 2005.

Medicaid

In-patient services rendered to Medicaid program beneficiaries are reimbursed, in part, under the Tax Equity and Fiscal Responsibility Act (TEFRA) reimbursement methodology which provides for a cost-based reimbursement subject to a maximum target rate amount per discharge with the exception of individuals who are eligible for care under the state managed Medicaid program where reimbursement is based on contracts with other managed care companies. The Hospital is reimbursed at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

Outpatient services rendered to patients are reimbursed based on the cost of services provided except for individuals in the managed Medicaid program where reimbursement is based on contracts as described above. The Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through 1997. Unaudited cost reports have been submitted as requested by Department of Social Services (DSS) through fiscal year 2007.

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Commercial Insurance and Managed Care

The Hospital has agreements with certain commercial insurance carriers and Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. In addition, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

(5) Assets Limited as to Use

Prior to the transfer of the malpractice trust fund to the Health Center, the funds in the malpractice trust fund were invested in the State of Connecticut Short-Term Investment Fund, which consisted of cash and cash equivalents. The cost of these funds approximates market value. During fiscal year 2010 all balances in the malpractice trust fund were transferred to the Health Center in conjunction with implementing Public Act No. 09-3. See note 9 for additional details.

(6) Capital Assets, Net

Capital assets at June 30 consist of the following:

	2010	2009
Land	$ 183,137	$ 183,137
Construction in progress (estimated cost to complete $2.9 million)	6,030,347	5,577,936
Buildings	98,453,605	97,403,562
Equipment	68,629,917	66,608,686
Capital leases	13,776,275	13,776,275
	187,073,281	183,549,596
Less accumulated depreciation and amortization	132,361,469	123,975,802
Capital assets, net	$ 54,711,812	$ 59,573,794

Plant and equipment activity for the years ended June 30, 2010 and 2009 was as follows:

	2009	Additions	Deletions	2010
Land	$ 183,137	—	—	$ 183,137
Construction in progress	5,577,936	2,466,871	(2,014,460)	6,030,347
Buildings	97,403,562	1,050,043	—	98,453,605
Equipment	66,608,686	4,220,565	(2,199,334)	68,629,917
Capital leases	13,776,275	—	—	13,776,275
	$ 183,549,596	7,737,479	(4,213,794)	$ 187,073,281

	2008	Additions	Deletions	2009
Land	$ 183,137	—	—	$ 183,137
Construction in progress	8,458,325	2,107,348	(4,987,737)	5,577,936
Buildings	94,735,862	2,667,700	—	97,403,562
Equipment	61,791,108	9,449,832	(4,632,254)	66,608,686
Capital leases	13,776,275	—	—	13,776,275
	$ 178,944,707	14,224,880	(9,619,991)	$ 183,549,596

Related information on accumulated depreciation and amortization for the years ended June 30, 2010 and 2009 was as follows:

	2009	Additions	Deletions	2010
Buildings	$ 68,317,171	2,839,758	—	$ 71,156,929
Equipment	46,119,058	5,983,328	(2,185,364)	49,917,022
Capital leases	9,539,573	1,747,945	—	11,287,518
Total	$ 123,975,802	10,571,031	(2,185,364)	$ 132,361,469

	2008	Additions	Deletions	2009
Buildings	$ 65,536,032	2,781,139	—	$ 68,317,171
Equipment	44,863,917	5,844,117	(4,588,976)	46,119,058
Capital leases	7,374,449	2,165,124	—	9,539,573
Total	$ 117,774,398	10,790,380	(4,588,976)	$ 123,975,802

(7) Long-Term Liabilities

Long-term liability activity for the years ended June 30, 2010 and 2009 were as follows:

	June 30, 2009 balance	Additions	Reductions	June 30, 2010 balance	Amounts due within 1 year
Accrued compensated absences	$ 11,742,939	10,770,227	(10,305,388)	$ 12,207,778	$ 5,005,189
Estimated malpractice costs	25,225,000	—	(25,225,000) *	—	—
Capital leases	4,301,478	—	(1,983,114)	2,318,364	1,231,751
Long-term debt	2,906,387	—	(830,396)	2,075,991	830,396
Total long-term liabilities	$ 44,175,804	10,770,227	(38,343,898)	$ 16,602,133	$ 7,067,336

* See note 9 for additional details

	June 30, 2008 balance	Additions	Reductions	June 30, 2009 balance	Amounts due within 1 year
Accrued compensated absences	$ 12,394,185	8,483,367	(9,134,613)	$ 11,742,939	$ 5,519,181
Estimated malpractice costs	21,290,000	8,789,693	(4,854,693)	25,225,000	6,910,000
Capital leases	6,679,361	—	(2,377,883)	4,301,478	1,983,114
Loans payable	3,736,783	—	(830,396)	2,906,387	830,396
Long-term debt	19,183	—	(19,183)	—	—
Total long-term liabilities	$ 44,119,512	17,273,060	(17,216,768)	$ 44,175,804	$ 15,242,691

Long-term debt and capital lease obligations as of June 30, 2010 and 2009 consisted of the following:

	2010	2009
Leasehold note-People's Bank, fixed rate beginning December 1, 2006 and maturing November 30, 2012 at a fixed rate of 6.35%.	$ 2,075,991	2,906,387
Capital lease obligation - Citicorp Leasing, Inc. Beginning January 18, 2008. Payments of principal and interest at 2.7%, begin April 1, 2008 and continue until January 13, 2013, collateralized by financed equipment.	1,685,232	2,268,158
Capital lease obligation – GE Capital: Phillips Medical Beginning in 2005 for five years at 4.8%	360,698	1,330,186
Capital lease obligation – GE Capital: Medical Equipment Beginning in 2006 for five years at 5.2%	272,434	703,134
Total	4,394,355	7,207,865
Less current portion	2,062,147	2,813,510
Long-term debt, less current portion	$ 2,332,208	4,394,355

Aggregate maturities of notes payable at June 30, 2010 were:

	Leasehold note
Fiscal year:	
2011	$ 830,396
2012	830,396
2013	415,199
	$ 2,075,991

Aggregate maturities of capital leases at June 30, 2010 were:

		Capital leases
Fiscal year:		
2011	$	1,284,679
2012		633,484
2013		475,041
Total minimum lease payments		2,393,204
Less amount representing interest		74,840
Present value of minimum lease payments	$	2,318,364

The Hospital also participates in operating lease agreements under the University for which its departments are allocated expenses based on square footage occupied. Rent expense was $2,081,928 and $2,356,464 in 2010 and 2009, respectively. Aggregate minimum lease payments for the leases are as follows:

		Amount
Fiscal year:		
2011	$	1,356,862
2012		1,184,840
2013		1,187,180
2014		1,189,520
2015		554,139
Thereafter		1,883,417
Total	$	7,355,958

(8) Related Party Transactions

The expenses reported in the statements of revenues, expenses, and changes in net assets do not include undetermined amounts for salaries, services, and expenses provided to and received from The University of Connecticut Health Center and other state agencies. Complete allocations have not been made for salaries and other services incurred by the Hospital on behalf of other Health Center entities. In addition, certain activities accounted for in the 21002 Fund are periodically evaluated and transferred to/from other funds depending on the overall objectives of the Health Center.

The Hospital is party to an agreement with the University of Connecticut Health Center whereby the salaries of certain administrative employees are reimbursed by the Hospital. The non- clinical support services provided to the Hospital from Health Center have been reported in the financials as part of the internal contractual support.

As more fully described in note 9, beginning in 2010, the Health Center charges the Hospital with an annual premium for medical malpractice costs which is determined by the Health Center under this self-insured program. The Hospital is not liable beyond the annual premium, but may have future operational subsidies affected by the performance of the malpractice trust fund.

As described in note 1, the Hospital participates in certain State of Connecticut retirement plans. The State charges the Hospital for these and other fringe benefits. During the years ended June 30, 2010 and 2009, the Hospital incurred $38,825,799 and $38,552,482, respectively, for employee fringe benefits. The State subsidized approximately $13.5 million and $3.6 million of employee fringe benefits for the years ended June 30, 2010 and 2009, respectively. Related salary costs were $88,764,151 and $93,580,336, respectively.

Contributions to the State for an assessment of postemployment benefits other than pension benefits are also included in employee benefits expense. The related accrued postemployment benefit liability is a liability of the State.

The Hospital provides medical services to correctional managed health care patients under a Health Center contract with the State of Connecticut Department of Correction (CTDOC). Revenue recorded under this contract was approximately $10,218,000 and $9,526,000 for the years ended June 30, 2010 and 2009, respectively, and is included in net patient service revenues in the statements of revenues, expenses, and changes in net assets.

In 2010, the Health Center transferred $11.5 million of cash to the Hospital to subsidize the prior year loss, $4.9 million related to fringe benefit recoveries for support services paid by the general fund and $3.7 million miscellaneous transfers to fund capital projects. These transfers are reflected as a net asset transfer in the statements of revenues, expenses, and changes in net assets.

In 2010 and 2009, the Hospital recorded the liability for Finance Corporation purchases directly in accounts payable and accrued expenses in the statements of net assets.

(9) Reporting of the Malpractice Trust Fund

The Health Center is self-insured with respect to medical malpractice risks. Estimated losses from asserted and unasserted claims identified under the Health Center's incident reporting system and an estimate of incurred but not reported claims are accrued based on actuarially determined estimates that incorporate the Health Center's past experience as well as other considerations, including the nature of each claim or incident and relevant trend factors. The Hospital provides timely incident reporting to the Health Center to assist the Health Center in maintaining appropriate reserve balances.

During fiscal year 2010, the State of Connecticut passed Public Act No. 09-3, *AN ACT CONCERNING EXPENDITURES AND REVENUE FOR THE BIENNIUM ENDING JUNE* 30, 2011, (Public Act) . Sec. 74. of the Public Act states "(Effective from passage) (a) Notwithstanding the provisions of section 10a-256 of the general statutes, the sum of $10,000,000 shall be transferred from The University of Connecticut Health Center Medical Malpractice Trust Fund and credited to the resources of the General Fund for each of the fiscal years ending June 30, 2010, and June 30, 2011." The Public Act also states "the amount of funding necessary to protect the Health Center for malpractice shall be determined and approved by the Board of Trustees of the University of Connecticut." Since the State effectively removed control and responsibility for maintaining and managing the malpractice fund from the Hospital, the Fund was transferred from the Hospital to the Health Center. Accordingly, beginning in 2010, the reporting of the trust fund is now reflected in the Health Center's financial statements. Also beginning in 2010, the Health Center charges each affiliate or clinical area with an annual malpractice premium that is designed to approximate the current year claim payments of the Malpractice Trust Fund. To the extent that claims for cases exceed current year premium charged by the Health Center, the Health Center may petition the State to make up the difference. The Hospital is not responsible for amounts beyond the annual premium allocated by the Health Center. However, operational subsidies from the State and/or the Health Center may be affected by the performance of the Health Center's malpractice program. At June 30, 2010, the Health Center Malpractice Trust Fund had actuarial reserves of approximately $18.3 million and assets of approximately $12.6 million. In fiscal year 2011, an additional $10 million will be transferred to the State of Connecticut's General Fund, resulting in a further reduction of the trust assets.

(10) Subsequent Events

The Hospital has evaluated subsequent events through December 21, 2010, which represents the date the financial statements were available to be issued and noted no subsequent events that would have impacted the Hospital's financial statements.