

AUDITED COMBINED FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Windham Community Memorial Hospital, Inc., and Affiliates Years Ended September 30, 2012 and 2011

Ernst & Young LLP



Audited Combined Financial Statements and Supplementary Information

Years Ended September 30, 2012 and 2011

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Ernst & Young LLP Goodwin Square 225 Asylum Street Hartford, CT 06103-1506

Tel: +1 860 247 3100 Fax: +1 860 725 6040 www.ey.com

Report of Independent Auditors

Board of Trustees Windham Community Memorial Hospital, Inc., and Affiliates

We have audited the accompanying combined balance sheets of Windham Community Memorial Hospital, Inc., and Affiliates (the Hospital) as of September 30, 2012 and 2011, and the related combined statements of operations and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits. We did not audit the financial statements of The Hatch Hospital Corporation which statements reflect total assets of \$983,206 and \$846,394 as of September 30, 2012 and 2011, respectively, and total revenues of \$2,818,779 and \$2,314,010 for the years then ended. 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 The Hatch Hospital Corporation, 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. We were not engaged to perform an audit of the Hospital's internal control over financial reporting. Our audits included 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Windham Community Memorial Hospital, Inc. and Affiliates as of September 30, 2012 and 2011, and the combined results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the accompanying combined financial statements, in 2012 the Hospital changed its method of reporting estimated insurance claims receivable and estimated insurance claims liabilities with the adoption of the Accounting Standards Update No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*.

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Combined Balance Sheets

	September 30		
	2012	2011	
Assets			
Current assets:			
Cash and cash equivalents	\$ 4,122,969	\$ 2,502,682	
Current portion of assets whose use is limited	654,986	771,378	
Accounts receivable, less allowances of approximately			
\$3,039,000 in 2012 and \$2,312,000 in 2011	20,670,040	14,881,466	
Other receivables	4,081,376	1,462,066	
Inventories of supplies	1,105,978	1,113,332	
Prepaid expenses	147,588	839,664	
Pledges receivable	314,961	205,369	
Total current assets	31,097,898	21,775,957	
Other assets:			
Investments	406,468	325,966	
Assets whose use is limited:			
Donor restricted investments	1,597,574	1,477,742	
Funds held in trust	2,831,893	2,505,394	
Investments in real estate, net of accumulated depreciation of approximately \$771,000 in 2012 and \$712,000			
in 2011	787,225	824,378	
Unamortized bond issuance expense	273,015	282,429	
Debt service reserve fund	1,439,934	1,439,934	
Deposits and other assets	2,063,002	929,932	
Total other assets	9,399,111	7,785,775	
Property, plant and equipment, net of accumulated			
depreciation	39,646,124	36,807,762	
Total assets	\$ 80,143,133	\$ 66,369,494	

	September 30		
	2012	2011	
Liabilities and net assets			
Current liabilities:			
Trade accounts payable	\$ 7,315,960	\$ 5,154,628	
Salaries, wages, payroll taxes and amounts withheld from			
employees	1,194,930	813,367	
Accrued vacation and holiday pay	618,658	986,188	
Other accrued expenses	3,210,837	499,932	
Current portion of accrued pension liability and other	5,125,668	4,648,892	
Due to third-party reimbursement agencies	1,499,004	71,283	
Due to related party	2,842,244	668,962	
Current portion of long-term debt and capital lease			
obligations	11,337,796	3,773,980	
Total current liabilities	33,145,097	16,617,232	
Long-term liabilities:			
Accrued pension liability	64,662,899	56,931,181	
Other liabilities	1,036,975	_	
Long-term debt, less current portion	19,376,083	19,388,119	
Interest rate swap obligation	4,387,733	4,248,129	
Capital lease obligations, less current portion	57,293	234,406	
Total liabilities	122,666,080	97,419,067	
Net assets:			
Unrestricted	(47,943,489)	(35,978,450)	
Temporarily restricted	1,453,029	1,318,536	
Permanently restricted	3,967,513	3,610,341	
Total net assets	(42,522,947)	(31,049,573)	
Total liabilities and net assets	\$ 80,143,133	\$ 66,369,494	

See accompanying notes.

Combined Statements of Operations and Changes in Net Assets

	Year Ended September 30 2012 2011		
Unrestricted operating revenues:			
Net patient revenue	\$ 90,160,381	\$ 85,855,448	
Provision for bad debts	3,122,185	3,021,253	
Net revenue from patients less provision for bad debts	87,038,196	82,834,195	
Other operating revenues	5,420,274	2,697,011	
Net assets released from restriction	341,424	347,228	
Total operating revenues	92,799,894	85,878,434	
Operating expenses:			
Salaries	42,907,325	41,345,796	
Employee benefits	15,336,446	16,084,939	
Physician fees	930,637	693,799	
Consulting, legal and auditing fees	960,210	871,661	
Supplies	9,080,128	9,296,970	
Insurance	789,345	885,340	
Purchased services	9,425,502	6,605,187	
Other nonsalary expenses	7,708,599	6,996,478	
Provision for non-patient bad debts	717,092	343,929	
Depreciation and amortization	4,147,105	4,545,850	
Interest	1,325,543	1,476,666	
Total operating expenses	93,327,932	89,146,615	
Loss from operations before loss on early extinguishment			
of debt	(528,038)	(3,268,181)	
Loss on early extinguishment of debt	_	(471,621)	
Loss from operations	(528,038)	(3,739,802)	
Nonoperating income (loss):			
Interest loss, net	(163)	(16,806)	
Gifts and bequests	698,728	265,347	
Net realized and unrealized gain (loss) on investments	52,251	(10,172)	
Net gain from investment in real estate	16,056	14,300	
Other nonoperating activities	(952,170)	(575,677)	
Net nonoperating loss	(185,298)	(323,008)	
Deficiency of revenues over expenses	(713,336)	(4,062,810)	

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

	Year Ended September 30		
		2012	2011
Unrestricted net assets:			_
Deficiency of revenues over expenses	\$	(713,336) \$	(4,062,810)
Change in pension funding and post retirement obligations		(11,323,642)	(6,778,013)
Net assets released from restriction for capital		71,939	66,188
Decrease in unrestricted net assets		(11,965,039)	(10,774,635)
Temporarily restricted net assets:			
Gifts and bequests		301,983	199,308
Investment income, net		43,674	37,801
Realized gain on investments		24,097	26,775
Unrealized gain (loss) on investments		178,102	(70,221)
Net assets released from restrictions for operations		(341,424)	(347,228)
Net assets released from restriction for capital		(71,939)	(66,188)
Increase (decrease) in temporarily restricted net assets		134,493	(219,753)
Permanently restricted net assets:			
Gifts and bequests		4,200	_
Investment income (loss), net		1,107	(207)
Realized gain on investments		25,366	4,011
Unrealized loss on investments		_	(6,404)
Transfer to unrestricted and temporarily restricted net assets		_	(14,451)
Change in fair value of funds held in trust		326,499	(102,411)
Increase (decrease) in permanently restricted net assets		357,172	(119,462)
Decrease in net assets		(11,473,374)	(11,113,850)
Net assets, beginning of year		(31,049,573)	(19,935,723)
Net assets, end of year	\$	(42,522,947) \$	(31,049,573)

See accompanying notes.

Combined Statements of Cash Flows

	Year Ended Septen 2012		
Cash flows from operating activities			
Change in net assets	\$ (11,473,374)	\$ (11,113,850)	
Adjustments to reconcile change in net assets to net cash			
provided by operating activities:			
Noncash items:			
Depreciation and amortization	4,147,105	4,545,850	
Change in unrealized gains and losses on investments	(178,101)	(76,625)	
Change in unrealized gains and losses on investments			
on funds held in trust by others	(326,499)	102,411	
Provision for patient bad debts	3,122,185	3,021,253	
Provision for non-patient bad debts	717,092	343,929	
Change in net assets related to post retirement and			
pension plans	11,323,642	6,778,013	
Loss on early extinguishment of debt	_	471,621	
Change in fair value of interest rate swap agreements	139,604	1,062,660	
Restricted contributions, realized gains and losses, and			
investment income	(400,427)	(267,688)	
Other changes in net assets:	,		
Changes in assets and liabilities, net (See Note 12)	(6,371,880)	(4,126,980)	
Net cash provided by operating activities	699,347	740,594	
Cash flows from investing activities			
Net purchase of property, plant and equipment	(6,985,467)	(5,126,201)	
Investment in real estate	37,153	55,939	
Purchases of investments and assets limited as to use, net	94,160	418,326	
Net cash used in investing activities	(6,854,154)	(4,651,936)	
Cash flows from financing activities			
Payments on debt	(3,782,229)	(19,966,847)	
Proceeds of debt service funds	_	658,326	
Proceeds from refinancing	_	18,740,776	
Proceeds from line of credit	11,156,896	3,400,000	
Restricted contribution, realized gains and losses, and			
investment income	400,427	267,688	
Net cash provided by financing activities	7,775,094	3,099,943	
Net decrease in cash and cash equivalents	1,620,287	(811,399)	
Cash and cash equivalents at beginning of year	2,502,682	3,314,081	
Cash and cash equivalents at end of year	\$ 4,122,969	\$ 2,502,682	

See accompanying notes.

Notes to Combined Financial Statements

September 30, 2012

1. Significant Accounting Policies

The accounting policies that affect significant elements of Windham Community Memorial Hospital, Inc. and Affiliate's financial statements are summarized below and in Note 2.

Organization

Windham Community Memorial Hospital, Inc. (Windham or the Hospital) is a voluntary association incorporated under the General Statutes of the State of Connecticut, and as of March 2009, is an affiliate of Hartford HealthCare Corporation (HHC). The Board of Trustees of Windham, appointed by HHC, controls the operations of Windham. The accompanying combined financial statements include Windham Community Memorial Hospital, Inc., The Hatch Hospital Corporation, and the Windham Hospital Foundation, Inc. (together, the Hospital). All material intercompany accounts and transactions have been eliminated in the accompanying combined financial statements.

Windham, located in Willimantic, Connecticut, is a nonprofit acute care hospital. Windham provides inpatient, outpatient and emergency care services for residents of Northeastern Connecticut.

The Hatch Hospital Corporation (Hatch) is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. Its purpose is to promote, foster, aid, carry out and fulfill the aims, objectives and purposes of the trust created under the Tenth Clause of the will of George Hatch. Periodically, amounts are transferred from the trust to Hatch for expenses as the need arises.

Windham Hospital Foundation, Inc. (Foundation) is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. Its purpose is to promote and solicit charitable support for the purposes of Windham.

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 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.

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Regulatory Matters

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

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 other financial instruments are disclosed in the respective notes and/or in Note 5.

Cash and Cash Equivalents

Cash and cash equivalents include cash, commercial paper and corporate and government bonds, 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 these institutions.

Patient Accounts Receivable

Patient accounts receivable result from the health care services provided by the Hospital. Additions to the allowance for doubtful accounts result from the provision for uncollectible accounts. 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

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of net patient accounts receivable are comprised of 38%, 14% and 28% and 41%, 15% and 24%, for Medicare, Medicaid and Commercial insurers, respectively, for the fiscal years ending September 30, 2012 and 2011, respectively.

Investments

The Hospital's investment portfolio is classified as trading, with unrealized gains and losses included in the deficiency of revenues over expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value at the balance sheet date. 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.

Inventories

Inventory consists of medical supplies and instruments and is valued at the lower of cost or market. Cost is determined on a first-in, first-out basis.

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 using the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives. Amortization of equipment held under capital leases is included in depreciation expense.

Conditional asset retirement obligations recorded under the provisions of Accounting Standards Codification (ASC) 410-20, *Asset Retirement Obligations*, amounted to \$102,087 and \$99,077 as of September 30, 2012 and 2011, respectively. These obligations are recorded in other noncurrent liabilities in the accompanying combined balance sheets. There are no assets that are legally restricted for purposes of settling asset retirement obligations. During 2012 and 2011, retirement obligations incurred and settled were minimal.

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Assets Whose Use is Limited

Assets whose use is limited includes assets that are set aside internally for nursing support and other health care services. Investments for restricted purposes are those restricted based on donors' intents.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those where use by the Hospital has been limited by donors, to a specific time frame or purpose. Temporarily restricted net assets are available to provide for the support of the new emergency room renovations, purchase of equipment, free care, nursing support, scholarships and various other special purposes. 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 funds 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 discounted utilizing a discount rate commensurate with the related risks involved. Amortization of the discount is recognized as revenue and is reflected in accordance with donor-imposed restrictions, if any, on the contributions.

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

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

reported in the combined statements of operations and changes in net assets as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are unrestricted contributions in the accompanying 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 \$273,015 and \$282,429 are recorded in other assets in the combined balance sheets as of September 30, 2012 and 2011, respectively.

Interest Rate Swap Agreements

The Hospital utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. The Hospital does not hold or issue derivative financial instruments for trading purposes. The Hospital is exposed to credit loss in the event of nonperformance by the counterparties to its interest rate swap agreements.

Interest rate swap agreements are reported at fair value. Changes in fair value are recognized in the performance indicator in the statements of operations and changes in net assets.

Other Operating Revenue

Other operating revenue includes electronic health record incentive program revenue, rental income, grant income, and unrestricted contributions.

Nonoperating Revenues

Activities, other than in connection with providing healthcare services, are considered to be nonoperating. Nonoperating gains consist primarily of income earned on invested funds, realized and unrealized gains and losses on unrestricted funds, change in fair value of interest rate swap agreements, and gifts and bequests.

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Deficiency of Revenues over Expenses

The combined statements of operations and changes in net assets include deficiency of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from deficiency of revenues over expenses include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), changes in pension funding and postretirement obligations, and net asset transfers.

Professional Liability Insurance

Coverage for professional liability insurance is provided on a claims-made basis. The primary level of coverage is \$10,000,000 per medical incident and \$39,000,000 in the aggregate. The excess indemnity coverage is layered with four different insurance companies at \$15,000,000 per claim and \$15,000,000 in the aggregate. The primary and excess coverage is with CHS Insurance Limited, a captive insurance company. Malpractice claims are discounted at 2.49% and a liability for incurred but not reported claims was \$298,000 at September 30, 2012 and 2011.

Income Taxes

Windham, Hatch and the Foundation are nonprofit corporations as described in Section 50l(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 50l(a) of the Code.

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 provides 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, eligible 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

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

meaningfully use certified EHR technology. The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. The Hospital records EHR incentive payments as revenues when attestation that the EHR meaningful use criteria for the required period of time was demonstrated. Such revenues were recognized ratably over the relevant cost report period to determine the amount of reimbursement. Accordingly, the Hospital recognized approximately \$2,400,000 of EHR revenues during the year ended September 30, 2012, approximately \$1,900,000 and \$500,000 relating to Medicare and Medicaid, respectively. EHR incentive revenues are included in other operating revenues in the accompanying combined statements of operations and changes in net assets.

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

New Accounting Standards

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Recoveries* (ASU 2010-24), which provides clarification to companies in the health care industry on the accounting for professional liability and similar insurance. ASU 2010-24 states that insurance liabilities should not be presented net of insurance recoveries and that an insurance receivable should be recognized on the same basis as the liabilities, subject to the need for a valuation allowance for uncollectible accounts. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010 and was adopted by the Hospital on October 1, 2011. The adoption of this standard increased other current assets and other current liabilities by approximately \$338,000, and other assets and other long-term liabilities by approximately \$1.0 million in the combined balance sheet as of September 30, 2012 as compared to September 30, 2011.

In July 2011, FASB issued ASU 2011-07, Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts (ASU 2011-07). The provisions of ASU 2011-07 require certain health care entities to present the provision for

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

bad debts associated with patient revenue as a deduction from patient revenue (net of contractual allowances and discounts) rather than as an operating expense. Additional disclosures relating to sources of patient revenue and the allowance for doubtful accounts will also be required. The guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The Hospital adopted those provisions as of and for the year ended September 30, 2012 and retrospectively applied the presentation requirements to all periods presented. See Note 1 and Note 2 for additional disclosures required by ASU 2011-07. There was no material impact to the Hospital's combined financial statements aside from the required changes in presentation.

In August 2010, the FASB issued ASU 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). ASU 2010-23 requires that the level of charity care provided be presented based on the direct and indirect costs of the charity services provided. ASU 2010-23 also requires separate disclosure of the amount of any cash reimbursements received for providing charity care. ASU 2010-23 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Hospital adopted this guidance in 2012 which had no material impact to the combined financial statements. Refer to Note 2 for disclosure.

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2011 balances previously reported in the combined balance sheets and statements of operations and changes in net assets in order to conform with the year ended September 30, 2012 presentation.

2. Revenues from Services to Patients and Charity Care

Revenues from Medicare, Medicaid, Anthem and Self Pay accounted for approximately 43%, 8%, 20%, and 8% and 41%, 8%, 20%, and 10% for the years ended September 30, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

Notes to Combined Financial Statements (continued)

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

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

The following table summarizes the combined gross and net revenues from services to patients:

	Year Ended September 30			
	2012	2011		
Gross revenues from patients:				
Inpatients:				
Routine services	\$ 17,346,577	\$ 17,117,272		
Special services	51,593,403	55,105,246		
	68,939,980	72,222,518		
Outpatients	141,210,109	127,160,607		
Gross revenues from patients	210,150,089	199,383,125		
Deductions:				
Allowances	116,283,387	110,493,786		
Charity care	3,706,321	3,033,891		
Net patient revenue	90,160,381	85,855,448		
Provision for bad debts	3,122,185	3,021,253		
Net patient revenue less provision for bad debts	\$ 87,038,196	\$ 82,834,195		

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.

Notes to Combined Financial Statements (continued)

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

Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations. During fiscal 2012 and 2011 the Hospital recorded net changes in estimate of approximately \$538,000 and (\$404,000), respectively, which relate to previously estimated third party payor settlements.

The Hospital has established estimates based on information presently available, of amounts due to or from Medicare, Medicaid and third-party payors for adjustments to current and prior year payment rates, based on industry-wide and Hospital-specific data. Such amounts are included in the accompanying combined balance sheets.

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

The Hospital's estimation of the allowance for doubtful accounts is based primarily upon the type and age of the patient accounts receivable and the effectiveness of the Hospital's collection efforts.

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

- Historical write-off and collection experience using a hindsight or look-back approach;
- 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.

Notes to Combined Financial Statements (continued)

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

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

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 but also includes certain cases where incurred charges are significant when compared to incomes. These charges are not included in net patient service revenues for financial reporting purposes.

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 bad debt expense. In distinguishing charity care from bad debt expense, a number of factors are considered, certain of which require a high degree of judgment.

The estimated cost of charity care provided was \$1,696,172 and \$1,388,439 for the years ended September 30, 2012 and 2011, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

3. Net Assets

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

	2012		2011	
Purchase of equipment	C	262 664	Ф	155 010
1 1	\$	262,664	Ф	155,010
Free care		80,941		62,553
Nursing support		245,218		446,773
Other purpose restrictions		864,206		654,200
Total temporarily restricted net assets	\$	1,453,029	\$	1,318,536

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

Permanently restricted net assets at September 30 are restricted for:

2012	2011
\$ 1,135,620	\$ 1,104,947
2,831,893	2,505,394
\$ 3,967,513	\$ 3,610,341
	\$ 1,135,620 2,831,893

The Hospital's endowment consists of various finds established for a variety of purposes. The endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor imposed restrictions.

The Board of Trustees of the Hospital has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently net restricted assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time of 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.

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

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 the policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce a real return, net of inflation and investment management costs, of at least a 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 alternative investments to achieve its long-term objective within prudent risk constraints.

Management evaluates endowment spending in light of capital replacement and expansion plans. The spending policy does not apply a prescribed rate of spending in a given year, but does consider expenditures based on need and current market conditions as well as long-term invest goals.

This is consistent with the Hospital's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment returns.

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

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

		emporarily Restricted	2012 Permanently Restricted	Total
Endowment net assets at beginning of year	\$	647,096	\$ 1,104,947	\$ 1,752,043
Investment return: Investment income Net appreciation (realized and unrealized) Total investment return		43,674 202,199 245,873	1,107 25,366 26,473	44,781 227,565 272,346
Appropriation of endowment assets for expenditure Endowment net assets at end of year	<u>\$</u>	(281,045) 611,924	<u> </u>	(281,045) \$ 1,743,344
Endowment net assets at end of year	J	011,724	2011	ψ 1,/ 13,311
		emporarily Restricted	Permanently Restricted	Total
Endowment net assets at beginning of year	\$	934,457	\$ 1,121,998	\$ 2,056,455
Investment return: Investment income Net depreciation (realized and unrealized) Total investment return		37,801 (43,446) (5,645)	(207) (2,393) (2,600)	37,594 (45,839) (8,245)
Contributions		350	_	350
Appropriation of endowment assets for expenditure	\$	(282,066) 647,096	(14,451) \$ 1,104,947	(296,517) \$ 1,752,043

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowments funds may fall below the level that the donor of UPMIFA requires the Hospital to retain as a fund of perpetual duration. These deficiencies result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. There were no significant deficiencies of this nature which are reported in unrestricted net assets as of September 30, 2012 or 2011.

4. Investments and Assets Whose Use is Limited

Investments and assets whose use is limited are stated at fair value at September 30 as follows:

	2012	2011
Cash and cash equivalents	\$ 654,986	\$ 771,378
Marketable equity securities	311,301	337,050
Corporate and government obligations	112,549	162,773
Mutual funds	1,580,192	1,303,885
	\$ 2,659,028	\$ 2,575,086

The composition and presentation of unrestricted investment (loss) income which is included in nonoperating income (loss) are comprised of the following for the years ended September 30:

	2012	2011
Nonoperating income:		
Interest loss, net	\$ (163)	\$ (16,806)
Net realized gain and unrealized (loss) on investments	52,251	(10,172)
	\$ 52,088	\$ (26,978)

Notes to Combined Financial Statements (continued)

4. Investments and Assets Whose Use is Limited (continued)

Investments in real estate at September 30 are as follows:

	2012	2011
Professional building Coventry Medical Building	\$ 889,087 669,352 1,558,439	\$ 885,444 650,869 1,536,313
Less accumulated depreciation Net investment in real estate	771,214 \$ 787,225	711,935 \$ 824,378

5. Fair Values of Financial Instruments

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

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

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

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

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

Notes to Combined Financial Statements (continued)

5. Fair Values of Financial Instruments (continued)

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

	September 30, 2012				
	Level 1	Level 2	Level 3	Total	
Assets					
Cash and cash equivalents	\$ 4,122,969	\$ -	\$ -	\$ 4,122,969	
Investments and assets limited as to use:					
Cash and cash equivalents	654,986	_	_	654,986	
Domestic equity securities	311,301	_	_	311,301	
Domestic fixed income securities		112,549		112,549	
Mutual funds:					
U.S.	1,534,014	_	_	1,534,014	
International	46,178	_	_	46,178	
Funds held in trust		2,831,893		2,831,893	
Debt service reserve fund:					
Money market funds	1,439,934	_	_	1,439,934	
Liabilities					
Interest rate swap agreements	_	4,387,733	_	4,387,733	

Notes to Combined Financial Statements (continued)

5. Fair Values of Financial Instruments (continued)

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

	September 30, 2011					
	Level 1	Level 2	Level 3	Total		
Assets				_		
Cash and cash equivalents	\$ 2,502,682	\$ -	\$ -	\$ 2,502,682		
Assets limited as to use:						
Cash and cash equivalents	1,106,956	_	_	1,106,956		
Domestic equity securities	263,145	_	_	263,145		
Domestic fixed income securities	_	162,773	_	162,773		
Mutual funds:						
U.S.	977,117	_	_	977,117		
International	65,094	_	_	65,094		
Funds held in trust	_	2,505,394	_	2,505,394		
Debt service reserve fund:						
Money market funds	1,439,934	_	_	1,439,934		
Liabilities						
Interest rate swap agreements	_	4,248,129	_	4,248,129		

Financial assets carried at fair value included in the defined pension plan as of September 30, 2012 are held in a master trust. The Hospital owns participant units in the trust which was established on May 1, 2012. Financial assets classified within the trust are 43.3% Level 1, 45.4% Level 2 and 11.3% for Level 3.

Notes to Combined Financial Statements (continued)

5. Fair Values of Financial Instruments (continued)

Financial assets carried at fair value included in the defined benefit cash balance retirement plan as of September 30, 2011 are classified in the table below in one of the three categories described above:

	Level	1]	Level 2	12 Level 3		13	Total		
Pension fund assets:									
Cash and cash equivalents	\$ 495,9	917	\$	_	\$	_	\$	495,917	
Mutual funds:									
U.S.	54,363,0)99		_		_	54	4,363,099	
International	6,750,5	546		_		_	(6,750,546	
Domestic common collective									
funds		_	4,460,74	43		_	4	4,460,743	

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 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 public market participants, dealers and brokers.

6. Property, Plant and Equipment

A summary of property, plant and equipment at September 30, is as follows:

2012	2011
\$ 5,258,997 47,562,746	\$ 5,223,872 47,246,557
51,579,545	48,399,667
104,401,288	100,870.096
70,034,957	66,077,045
34,366,331	34,793,051
5,279,793	2,014,711
\$ 39,646,124	\$ 36,807,762
	\$ 5,258,997 47,562,746 51,579,545 104,401,288 70,034,957 34,366,331 5,279,793

The Hospital capitalized interest expense of \$124,835 and \$146,951 for the years ended September 30, 2012 and 2011.

Notes to Combined Financial Statements (continued)

7. DebtDebt arrangements at September 30 include the following:

	2012	2011
Intercompany debt with HHC:		_
HHC 2011 Series A, consisting of a tax exempt serial		
bond and term bonds; interest at rates ranging from		
4.4% to 5.0%	\$ 18,740,776	\$ 18,740,776
Line of credit, variable rate at .92%	8,152,133	_
Line of credit, variable rate at .92%	3,004,763	_
Commercial revolving loan with a bank bearing interest at		
a rate per annum equal to the Prime Rate; aggregate		
amount of loan plus all interest due April 1, 2012	_	3,400,000
Promissory mortgage note with a bank bearing interest at		
6%, payments are due in equal installments through		
Authority:		
Series, A, B, A-1 and B-1 November 1, 2032, secured		
by a mortgage on the related real property	276,239	282,558
Premium on long-term debt	366,062	371,390
	30,539,973	22,794,724
Less current portion	11,163,890	3,406,605
Total long-term debt	\$ 19,376,083	\$ 19,388,119

The future minimum principal payments of long-term debt are as follows:

Year ending September 30:	
2013	\$ 11,163,890
2014	215,254
2015	243,097
2016	289,726
2017	4,048,883
Thereafter	14,579,123
	\$ 30,539,973

Notes to Combined Financial Statements (continued)

7. Debt (continued)

On September 29, 2011, HHC issued approximately \$375,815,000 of CHEFA Revenue Bonds Series A, B, and C (the HHC 2011 Bonds). In conjunction with the issuance of the 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital and MidState Medical Center (collectively referred to as the "Obligated Group").

Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist. Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate would have an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the obligated groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the obligated group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 Bonds were issued to refund portions of existing debt under HHC, and to obtain funds for future capital needs. As such, the HHC 2011 Bonds are reflected as intercompany debt in the preceding schedule. The Hospital is party to the HHC Series A Revenue Bonds. The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023 and the term bonds mature from July 1, 2024 through July 1, 2041.

The MTI and Supplemental MTI provide for the potential establishment and maintenance of a Debt Service Reserve Fund, a pledge of gross receipts, as defined, and parity with the HHC Series A Revenue Bonds that remain outstanding. The MTI and loan agreements establish certain restrictive covenants, including a debt service coverage ratio and days cash on hand requirement. No violations of covenants existed as of September 30, 2012 or 2011.

Notes to Combined Financial Statements (continued)

7. Debt (continued)

The fair value of the HHC 2011 Bonds was approximately \$396,836,000 and \$375,815,000 at September 30, 2012 and 2011, respectively. The carrying value of the HHC 2011 Bonds was \$375,815,000 as of September 30, 2012 and 2011. The fair value of the HHC 2011 Bonds was determined by HHC's investment advisor using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities. The carrying value of the Hospital's other long-term debt approximates fair value at September 30, 2012 and 2011.

As part of the HHC 2011 Bonds, the Obligated Group entered into a line of credit for \$20,000,000 from Bank of America. The line expires in March 2014. As of September 30, 2012, the Hospital had not drawn on this line of credit. In 2012, HHC obtained a new \$60,000,000 line of credit with another bank. As of September 30, 2012 the Hospital drew \$11,156,896 on this line of credit, which is also included in current portion of long-term debt that has a variable rate of 0.92% which expires March 2013.

In conjunction with the issuance of the Series D CHEFA Bonds, the Hospital entered into two interest rate swap agreements with a financial institution, with an original notional amount of \$19,745,000, to fix the debt at a rate of 4.15%. The Total Return Swap Transaction was terminated on September 29, 2011 in conjunction with the extinguishment of the Windham Series D Bonds. On September 29, 2011, HHC modified certain terms of the Schedule to the ISDA Master Agreement between Merrill Lynch Capital Services, Inc. and the Hospital in connection with the fixed payer interest rate swap agreement entered into on November 30, 2007.

No financial terms of the swap agreement were modified. The fair value of the swap agreements were \$4,387,733 and \$4,248,129 at September 30, 2012 and 2011, respectively, and are recorded in the accompanying balance sheets. Although the swap agreements represent economic hedges of the interest rate on the bonds, they do not qualify for hedge accounting. The changes in fair value of these agreements are reported in the accompanying statements of operations and changes in net assets as a component of other nonoperating activities along with the net cash receipts on the swap agreements.

8. Capital Leases

The Hospital has entered into numerous agreements to lease equipment that meet the requirements of a capital lease.

Notes to Combined Financial Statements (continued)

8. Capital Leases (continued)

Capital lease obligations as of September 30 include the following:

	2012	2011
Capital lease obligations	\$ 231,199	\$ 601,782
Less current portion	173,906	367,376
Long-term capital lease obligations	\$ 57,293	\$ 234,406

The following is a schedule of future minimum lease payments under capital leases as of September 30:

	2012
2013 2014	\$ 183,487 58,380
Total minimum lease payments	241,867
Less amount representing interest Present value of net minimum lease payments	10,668 \$ 231,199

9. Pension and Other Postretirement Benefits

The Hospital has a pension plan that provides for both a contributory and noncontributory defined benefit plan for eligible employees providing for retirement and certain death benefits. The benefits are based on years of service and the employee's compensation during the last five years of employment. The Hospital makes contributions in amounts sufficient to fund the pension plan's minimum funding requirements under the Employee Retirement Income Security Act.

Effective January 1, 2004, Windham began sponsoring the Windham Community Memorial Hospital 401(k) Plan. Under the terms of the plan, eligible employees receive a basic contribution of 2%, and the Hospital matches 50% of the employee's salary contribution up to an additional 3% of the employee's compensation. Effective April 1, 2006, all nonunion employees hired prior to April 1, 2004 have ceased their participation in the defined benefit

Notes to Combined Financial Statements (continued)

9. Pension and Other Postretirement Benefits (continued)

plan, and their pension accruals have been frozen as of that date. A second defined contribution plan known as the Windham Hospital Defined Contribution Plan was established for nonunion employees hired prior to April 1, 2004. Under the terms of the plan, eligible employees receive a basic contribution of 5% with no matching contribution. Effective January 1, 2010, all non-union employees in the 401(k) plan were transferred into the Defined Contribution Plan. Expense for employer contributions was approximately \$1,851,000 and \$1,728,000 in 2012 and 2011, respectively.

The following table sets forth the funded status and amounts recognized in the combined balance sheets for the pension and postretirement benefits:

	Pension Benefits			Other Postretirement Benefits				
		2012		2011		2012		2011
Change in benefit obligation								
Benefit obligation at beginning of year	\$	(97,664,397)	\$	(94,607,331)	\$	(29,877,981)	\$	(25,562,300)
Service cost		(275,000)		(275,000)		(92,677)		(91,367)
Interest cost		(5,055,459)		(4,743,159)		(1,498,044)		(1,222,531)
Participant contributions		_				(133,843)		
Benefits paid		3,536,038		3,458,662		1,585,550		1,105,780
Medicare part D adjustments		· · · -		_		(83,000)		_
Actuarial loss		(16,585,782)		(1,497,569)		(2,620,089)		(4,107,563)
Benefit obligation at end of year	\$	(116,044,600)	\$	(97,664,397)	\$	(32,720,084)	\$	(29,877,981)
Change in plan assets Fair value of plan assets at beginning of								
year	\$	66,070,305	\$	62,581,311	\$	_	\$	_
Actual return on plan assets		10,969,851		250,588		_		_
Employer contribution		5,580,000		6,697,068		1,451,707		1,105,780
Participant contribution				<u> </u>		133,843		_
Benefits paid		(3,536,038)		(3,458,662)		(1,585,550)		(1,105,780)
Fair value of plan assets at end of year		79,084,118		66,070,305		_		
Unfunded status	\$	(36,960,482)	\$	(31,594,092)	\$	(32,720,084)	\$	(29,877,981)

The accumulated benefit obligations for the defined benefit pension plan and other postretirement benefit plan at September 30, 2012 and 2011 are \$148,764,684 and \$127,542,378, respectively.

Notes to Combined Financial Statements (continued)

9. Pension and Other Postretirement Benefits (continued)

The following table sets forth the unrecognized items impacting the pension and the postretirement plans as of September 30:

	Pension Benefits			C	ther Postreti	ment Benefits		
		2012		2011		2012		2011
Unrecognized net loss from past experience different from that assumed								
and effects of changes in assumptions	\$	55,061,376	\$	45,451,056	\$	14,162,198	\$	12,724,910
Unrecognized prior service cost		_		_		(445,777)		(882,812)

Amounts included in unrestricted net assets at September 30, 2012 and expected to be recognized in net periodic benefit cost during the year ended September 30, 2013 are as follows:

Amortization of prior service cost	\$ (437,035)
Amortization of net loss	2,931,686
	\$ 2,494,651

	Pension Benefits					Other Postretirement Benefits			
		2012		2011		2012		2011	
Components of net periodic benefit cost								_	
Service cost	\$	275,000	\$	275,000	\$	92,677	\$	91,367	
Interest cost		5,055,459		4,743,159		1,498,044		1,222,531	
Return on plan assets		(5,263,220)		(4,977,532)		_		_	
Net amortization and deferral		1,268,831		3,229,089		741,807		324,974	
Benefit cost	\$	1,336,070	\$	3,269,716	\$	2,332,528	\$	1,638,872	

The weighted-average discount rates used in determining the actuarial present value of the projected benefit obligation of the defined benefit plan were 4.10% and 5.25% in 2012 and 2011, respectively. The weighted average discount rates used in determining net periodic benefit cost of the defined benefit plan were 5.25% and 5.08% in 2012 and 2011, respectively. The expected long-term rate of return on plan assets was 8.00% and 8.25% in 2012 and 2011, respectively. The rate of return for fiscal year 2013 will be 7.50%. The expected long-term rate of return assumption is determined by adding expected inflation to expected long-term real returns of various asset classes, taking into account expected volatility and correlation between the returns of various asset classes.

Notes to Combined Financial Statements (continued)

9. Pension and Other Postretirement Benefits (continued)

The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) is assumed to grade from 8.5% per year in fiscal year 2011 to 5% in fiscal year 2018. This health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, a 1% point increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by \$4,098,863, at September 30, 2012. A 1% point decrease in the assumed health care cost trend rate would decrease the accumulated postretirement benefit obligation \$3,437,654 at September 30, 2012.

The Hospital's pension plan weighted-average asset allocations by asset category are as follows:

	Target Allocation	2012	2011
Equity securities	57%	41%	64%
Fixed income/debt securities	25%	14%	28%
Commodities/inflation/real estate	8%	34%	_
Other	10%	11%	8%
Total	100%	100%	100%

The asset mix was determined by evaluating the expected return against the plan's long-term objectives. Performance is monitored on a monthly basis, and the portfolio is rebalanced back to target levels to ensure the targets are within range. The investment policy describes which securities are allowed in the portfolios and the financed objectives of the plan which the Investment Committee of the Hospital Board oversees. The Investment Committee monitors the investment performance annually to determine the continued feasibility of achieving the investment objectives and the appropriateness of the investment policy.

Contributions

The Hospital expects to contribute approximately \$ 6,837,000 to its pension plan in fiscal year 2013. The Hospital funds its other postretirement plan for actual expenses incurred.

Notes to Combined Financial Statements (continued)

9. Pension and Other Postretirement Benefits (continued)

Estimated Future Benefit Payments

The benefit payments, which reflect expected future services, are expected to be paid as follows:

	Pension Benefits	Other Postretirement Benefits
2013	\$ 3,730,404	\$ 1,395,264
2013	4,008,133	1,514,942
2015	4,363,593	1,632,004
2016	4,699,286	1,747,710
2017	5,084,747	1,860,734
2018-2022	30,725,454	10,370,541

10. Pledges Receivable

Pledges receivable as of September 30, are expected to be collected as follows:

	2012	2011
W. d.	Ø 240 5 21	Ф. 220.610
Within one year	\$ 340,721	\$ 230,619
Less reserve for uncollectible pledges	(25,760)	(25,250)
Net pledges receivable	\$ 314,961	\$ 205,369

11. 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 which may arise from these actions will not have a material adverse effect on the financial position or changes in net assets of the Hospital.

Notes to Combined Financial Statements (continued)

11. Commitments and Contingencies (continued)

Operating Leases

The Hospital rents certain equipment under terms of leases that qualify as operating leases. Rental and lease expense amounted to \$782,319 and \$857,867 for the years ended September 30, 2012 and 2011, respectively.

The future minimum lease payments are as follows:

2013	\$ 418,830
2014	412,869
2015	312,549
2016	228,592
2017	213,981
Thereafter	499,289
	\$ 2,086,110

12. Supplemental Cash Flow Information

The changes in assets and liabilities are as follows:

	Year Ended September 30				
		2012		2011	
Increase in accounts receivable	\$	(8,910,759)	\$	(4,155,992)	
Increase in other receivables		(3,336,402)		(429,837)	
Increase in pledge receivables		(109,592)		(40,326)	
Decrease (increase) in inventories of supplies and prepaid					
expenses		699,430		(497,319)	
Increase in estimated third-party payor settlements		1,427,721		1,657,000	
Increase in due to related party		2,842,244			
(Increase) decrease in deposits and other assets		(1,123,656)		247,233	
Increase in accounts payable		1,492,370		2,358,383	
Increase (decrease) in salaries, wages, payroll taxes and amounts withheld from employees and accrued vacation					
and holiday pay		14,033		(130,243)	
Increase (decrease) in other accrued expenses		2,710,905		(246,620)	
Decrease in other accrued pension and other liabilities		(2,078,174)		(2,889,259)	
	\$	(6,371,880)	\$	(4,126,980)	

Notes to Combined Financial Statements (continued)

13. Functional Expenses

Windham provides short-term general health care services to acute-care patients. Hatch provides care, treatment and rehabilitation to patients convalescing from acute or chronic illness or injury. Expenses related to providing these services for the years ended September 30, 2012 and 2011, are as follows:

	2012	2011
Health care services	\$ 52,841,856	\$ 49,388,094
General and administrative	40,486,076	40,230,142
	\$ 93,327,932	\$ 89,618,236

14. Subsequent Events

The Hospital evaluated subsequent events through January 25, 2013, which is the date the financial statements were issued. No events occurred that require disclosure or adjustment to the combined financial statements.



Ernst & Young LLP Goodwin Square 225 Asylum Street Hartford, CT 06103-1506

Tel: +1 860 247 3100 Fax: +1 860 725 6040 www.ey.com

Report of Independent Auditors on Supplementary Information

Board of Trustees Windham Community Memorial Hospital, Inc., and Affiliates

We have audited the combined financial statements of Windham Community Memorial Hospital, Inc., and Affiliates (the Hospital) as of and for the years ended September 30, 2012 and 2011, and have issued our report thereon dated January 25, 2013, which contained an unqualified opinion on those combined financial statements. Our audits were performed for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheet and statement of operations are presented for the purposes of additional analysis and is not a required part of the combined financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, based on our audit and the report of other auditors, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

Ernst + Young LLP

January 25, 2013

Combining Balance Sheets

			Sept	ember 30			
	-			Windham			
	Wind	ham Community	The Hatch	Hospital			
	Men	norial Hospital,	Hospital	Foundation,			September 30,
		Inc.	Corporation	Inc.	Eliminations	Combined	2011 Combined
Assets							
Current assets:							
Cash and cash equivalents	\$	3,805,389 \$	7,305	\$ 310,275		\$ 4,122,969	\$ 2,502,682
Current portion of assets whose use is limited		653,211	1,775			654,986	771,378
Accounts receivable, less allowances of approximately \$3,039,000		20,670,040				20,670,040	14,881,466
Other receivables		4,081,376				4,081,376	1,462,066
Inventories of supplies		1,105,978				1,105,978	1,113,332
Prepaid expenses		147,150		438		147,588	839,664
Pledges receivable		109,514		205,447		314,961	205,369
Total current assets	-	30,572,658	9,080	516,160		31,097,898	21,775,957
Other assets:		30,572,050	>,000	210,100		31,077,070	21,770,707
Investments		64,018	342,450			406,468	325,966
Assets whose use is limited:		04,018	342,430			400,400	323,700
Donor restricted investments		1 555 170	42,396			1 507 574	1,477,742
Funds held in trust		1,555,178				1,597,574	
		2,242,617	589,276			2,831,893	2,505,394
Investments in real estate, net of accumulated depreciation of							
approximately \$771,000		787,225				787,225	824,378
Unamortized bond discount and issuance expense		273,015				273,015	282,429
Debt service reserve fund		1,439,934				1,439,934	1,439,934
Deposits and other assets		1,887,919		175,083		2,063,002	929,932
Total other assets		8,249,906	974,122	175,083	-	9,399,111	7,785,775
Property, plant and equipment, net of accumulated depreciation						-	
Total assets		39,646,120	4			39,646,124	36,807,762
	\$	78,468,684 \$	983,206	\$ 691,243	\$ -	\$ 80,143,133	\$ 66,369,494
Liabilities and net assets							
Current liabilities:							
Trade accounts payable	\$	7,296,659		\$ 19,301		\$ 7,315,960	\$ 5,823,590
Salaries, wages, payroll taxes and amounts withheld from employees		1,194,930				1,194,930	813,367
Accrued vacation and holiday pay		618,658				618,658	986,188
Other accrued expenses		3,200,337	10,500			3,210,837	499,932
Current portion of accrued pension liability		5,125,668	.,			5,125,668	4,648,892
Due to third-party reimbursement agencies		1,499,004				1,499,004	71,283
Due to related party		2,842,244				2,842,244	71,203
Current portion of long-term debt and capital lease obligation		11,337,796				11,337,796	3,773,980
Total current liabilities	-		10.500	10.201			
Total current naomities		33,115,296	10,500	19,301	_	33,145,097	16,617,232
Comment and in a factor of a contract to the little		64.662.000				64.662.000	56 021 101
Current portion of accrued pension liability Other liabilities		64,662,899				64,662,899	56,931,181
		1,036,975				1,036,975	40.200.440
Long-term debt, less current portion		19,376,083				19,376,083	19,388,119
Interest rate swap obligation		4,387,733				4,387,733	4,248,129
Capital lease obligations, less current portion		57,293				57,293	234,406
Total liabilities		122,636,279	10,500	19,301	-	122,666,080	97,419,067
Net assets:							
Unrestricted		(48,579,469)	349,763	286,217		(47,943,489)	(35,978,450)
Temporarily restricted		1,033,637	33,667	385,725		1,453,029	1,318,536
Permanently restricted		3,378,237	589,276			3,967,513	3,610,341
Total net assets		(44,167,595)	972,706	671,942	-	(42,522,947)	(31,049,573)
Total liabilities and net assets	\$	78,468,684 \$	983,206	\$ 691,243	s –	\$ 80,143,133	\$ 66,369,494

Combining Statements of Operations and Changes in Net Assets

	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	Year Ended September 30, 2011 Combined
Unrestricted operating revenues:						
Net patient revenue	\$ 87,529,888 \$			\$, ,	
Less: Provision for bad debts	3,031,329	90,856			3,122,185	3,021,253
Net revenue from patients less bad debts	84,498,559	2,539,637	_	_	87,038,196	82,834,195
Other operating revenue	5,482,556	279,142			5,761,698	3,044,239
Total operating revenues	89,981,115	2,818,779	-	-	92,799,894	85,878,434
Operating expenses:						
Salaries	41,565,280	1,245,802	96,243		42,907,325	41,345,796
Employee benefits	14,854,648	445,226	36,572		15,336,446	16,084,939
Physician fees	903,555	27,082			930,637	693,799
Consulting, legal and auditing fees	932,268	27,942			960,210	871,661
Supplies	8,815,183	264,210	735		9,080,128	9,296,970
Insurance	766,375	22,970			789,345	885,340
Purchased services	9,135,478	273,810	16,214		9,425,502	6,605,187
Other nonsalary expenses	7,463,447	223,696	21,456		7,708,599	6,996,478
Provision for non-patient bad debts	696,225	20,867			717,092	343,929
Depreciation and amortization	4,026,424	120,681			4,147,105	4,545,850
Interest	1,286,970	38,573			1,325,543	1,476,666
Total operating expenses	90,445,853	2,710,859	171,220	-	93,327,932	89,146,615
Loss from operations before loss on early extinguishment of debt						
and gain transferred to Windham	(464,738)	107,920	(171,220)	-	(528,038)	(3,268,181)
Gain transferred to Windham	107,920	(107,920)			-	
Loss on early extinguishment of debt	-					(471,621)
Loss from operations	(356,818)	-	(171,220)	-	(528,038)	(3,739,802)
Nonoperating (loss) income:						
Investment (loss) income, net	(9,245)	7,978	1,104		(163)	(16,806)
Gifts and bequests	190,721		508,007		698,728	265,347
Net realized and unrealized (loss) gain on investments	8,739	43,512			52,251	(10,172)
Net gains (loss) from investment in real estate	16,056				16,056	14,300
Other nonoperating activities	(937,549)	(14,621)	<u> </u>		(952,170)	(575,677)
Total nonoperating (loss) income	(731,278)	36,869	509,111	-	(185,298)	(323,008)
(Deficiency) excess of revenues over expenses	(1,088,096)	36,869	337,891	-	(713,336)	(3,591,189)

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

		Year Ended	September 30, 2	012			
	ham Community norial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined		Year Ended eptember 30, 2011 Combined
Unrestricted net assets:							
(Deficiency) excess of revenues over expenses	\$ (1,088,096) \$ 36,869	\$ 337,891		\$ (713	,336) \$	(4,062,810)
Change in pension funding and post retirement							
obligations	(11,323,642)			(11,323		(6,778,013)
Net assets released from restriction for capital		10,939	61,000		71	,939	66,188
Other						-	
Transfer from other entity						-	
Transfer from temporarily restricted net assets						-	
Transfer from (to) Foundation	 206,180	1	(206,180)			-	
(Decrease) increase in unrestricted net assets	 (12,205,558	47,808	192,711	-	(11,965	,039)	(10,774,635)
Temporarily restricted net assets:							
Gifts and bequests			301,983		301	,983	199,308
Investment income, net	27,593	16,081			43	,674	37,801
Realized gain on investments	24,097	•			24	,097	26,775
Unrealized (loss) gain on investments	178,102				178	,102	(70,221)
Transfer to permanently restricted net assets						-	_
Net assets released from restriction for operations	(281,036)	(60,388)		(341	,424)	(347,228)
Net assets released from restriction for capital		(10,939)	(61,000)		(71	,939)	(66,188)
(Decrease) increase in temporarily restricted net assets	(51,244	5,142	180,595	-	134	,493	(219,753)
Permanently restricted net assets:							
Gifts and bequests	4,200				4	,200	_
Investment loss, net	1,107	i			1	,107	(207)
Realized gain on investments	25,366	i			25	,366	4,011
Unrealized loss on investments						_	(6,404)
Transfer to unrestricted and temporarily restricted net assets						_	(14,451)
Change in fair value of funds held in trust	242,937	83,562			326	,499	(102,411)
(Decrease) increase in permanently restricted net assets	 273,610	83,562	_	_	357	,172	(119,462)
(Decrease) increase in net assets	 (11,983,192) 136,512	373,306	-	(11,473	,374)	(11,113,850)
Net assets, beginning of year	(32,184,403	836,194	298,636		(31,049	,573)	(19,935,723)
Net assets, end of year	\$ (44,167,595	\$ 972,706	\$ 671,942	\$ -	\$ (42,522	,947 \$	(31,049,573

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