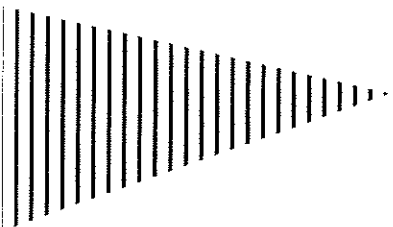


CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Norwalk Hospital Association
Period From January 1, 2014 to September 30, 2014, and Period From
October 1, 2013 to December 31, 2013
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Norwalk Hospital Association

Consolidated Financial Statements and Supplementary Information

Period From January 1, 2014 to September 30, 2014, and
Period From October 1, 2013 to December 31, 2013

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Report of Independent Auditors

The Board of Directors
Western Connecticut Health Network, Inc.

We have audited the accompanying consolidated financial statements of Norwalk Hospital Association and Subsidiary, which comprise the consolidated balance sheet as of September 30, 2014, and the related consolidated statements of operations and changes in net assets and cash flows for the period from January 1, 2014 to September 30, 2014, and the period from October 1, 2013 to December 31, 2013, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Norwalk Hospital Association and Subsidiary at September 30, 2014, and the consolidated results of their operations and changes in net assets and their cash flows for the period from January 1, 2014 to September 30, 2014, and the period from October 1, 2013 to December 31, 2013, in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheet and statements of operations are presented for purposes of additional analysis and are not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

February 27, 2015

Norwalk Hospital Association

Consolidated Balance Sheet

September 30, 2014

Assets	
Current assets:	
Cash and cash equivalents	\$ 76,395,746
Investments	8,764,926
Patient accounts receivable, less allowance for uncollectible accounts of \$23,903,000	41,424,323
Due from related parties	135,428
Inventories	2,060,859
Prepaid expenses and other	4,118,127
Total current assets	<u>132,899,409</u>
Assets limited as to use:	
Beneficial interest in charitable remainder trust	8,007,837
Construction funds	23,405,407
Assets held in trust for self-insurance	327
Total assets limited as to use	<u>31,413,571</u>
Investments	116,864,243
Other assets	35,129,456
Beneficial interest in Norwalk Hospital Foundation, Inc.	47,837,445
Investment in joint venture	1,640,000
Interest rate swap	2,510,102
Property, plant, and equipment:	
Land and land improvements	27,918,025
Buildings and building improvements	209,965,564
Equipment and other	259,999,163
Construction in progress (estimated cost to complete \$36,000,000)	78,197,484
	<u>576,080,236</u>
Less accumulated depreciation	329,979,646
Total property, plant, and equipment	<u>246,100,590</u>
Total assets	<u>\$ 614,394,816</u>
Liabilities and net assets	
Current liabilities:	
Accounts payable	\$ 32,977,502
Payroll-related accruals	18,581,815
Due to third-party payors	36,052,621
Due to related parties	1,096,562
Interest payable	782,231
Current portion of long-term debt	7,039,141
Other accrued expenses	72,140
Total current liabilities	<u>96,602,012</u>
Accrued pension liability and other	46,163,686
Medical malpractice claims reserves	34,724,445
Long-term debt, less current portion	121,951,412
Total liabilities	<u>299,441,555</u>
Net assets:	
Unrestricted attributable to Norwalk Hospital	265,756,007
Unrestricted attributable to noncontrolling interest	2,005,199
Temporarily restricted	37,730,403
Permanently restricted	9,461,652
Total net assets	<u>314,953,261</u>
Total liabilities and net assets	<u>\$ 614,394,816</u>

See accompanying notes.

Norwalk Hospital Association

Consolidated Statements of Operations and Changes in Net Assets

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
	Unrestricted revenues:	
Net patient service revenue	\$ 269,437,864	\$ 89,916,566
Provision for uncollectible accounts	21,801,052	3,862,124
Net patient service revenue less provision for uncollectible accounts	247,636,812	86,054,442
Net assets released from restrictions	866,277	289,746
Other operating revenue	11,735,292	2,906,894
	260,238,381	89,251,082
Expenses:		
Salaries, benefits, and fees	126,936,378	42,904,089
Supplies and other	92,376,571	28,410,829
Insurance	3,971,559	145,475
Depreciation and amortization	14,499,173	4,516,449
Interest	1,769,653	622,187
	239,553,334	76,599,029
Income from operations	20,685,047	12,652,053
Nonoperating gains (losses):		
Investment income, net	1,593,370	669,517
Change in unrealized gains and losses on investments	2,156,725	4,182,701
Change in interest in unrestricted net assets of Norwalk Hospital Foundation, Inc.	3,125,357	-
Loss on equipment disposal	(668,566)	-
Interest rate swap activity:		
Interest cost on interest rate swap	(161,828)	(55,792)
Change in value of interest rate swap	(2,502,627)	458,703
	(2,664,455)	402,911
	3,542,431	5,255,129
Excess of revenues over expenses, before noncontrolling interest in joint venture	24,227,478	17,907,182
Less: Net income attributable to noncontrolling interest	(1,116,608)	(529,496)
Excess of revenues over expenses	23,110,870	17,377,686

Norwalk Hospital Association

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

	Period From January 1, 2014 to September 30, 2014	Predecessor Company
		Period From October 1, 2013 to December 31, 2013
Unrestricted net assets:		
Excess of revenues over expenses (continued)	\$ 23,110,870	\$ 17,377,686
Net assets released from restrictions used for capital	3,443,973	—
Change in pension obligations	(36,139,390)	14,342,633
Transfer to related party	(6,167,638)	(1,334,881)
Transfer from Western Connecticut Health Network, Inc.	28,507,477	—
Funding of operations of Norwalk Hospital Foundation, Inc.	180,727	(180,727)
Net unrestricted other changes in joint venture	(598,746)	(430,439)
Net income attributable to noncontrolling interest	1,116,608	529,496
Increase in unrestricted net assets	13,453,881	30,303,768
Temporarily restricted net assets:		
Transfer from Western Connecticut Health Network, Inc.	8,007,837	—
Net assets released from restrictions used for capital	(3,443,973)	—
Net assets released from restrictions	(866,277)	(289,746)
Transfer from Norwalk Hospital Foundation, Inc.	4,310,250	289,746
Change in beneficial interest in Norwalk Hospital Foundation, Inc.	(2,426,003)	1,968,334
Increase in temporarily restricted net assets	5,581,834	1,968,334
Permanently restricted net assets:		
Change in beneficial interest in Norwalk Hospital Foundation, Inc.	—	6,800
Increase in permanently restricted net assets	—	6,800
Increase in net assets	19,035,715	32,278,902
Net assets at beginning of period	295,917,546	247,243,369
Net assets at end of period	\$ 314,953,261	\$ 279,522,271

See accompanying notes.

Norwalk Hospital Association

Consolidated Statements of Cash Flows

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
	Operating activities	
Change in net assets	\$ 19,035,715	\$ 32,278,902
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	14,499,173	4,516,449
Loss on disposal of property, plant, and equipment	668,566	-
Provision for uncollectible accounts	21,801,052	3,862,124
Change in unrealized gains and losses on investments	(2,156,725)	(4,182,701)
Change in pension obligations	36,139,390	(14,342,633)
Transfer from Western Connecticut Health Network, Inc.	(35,819,079)	-
Change in beneficial interest in Norwalk Hospital Foundation, Inc.	(699,354)	(1,975,134)
Changes in operating assets and liabilities <i>(Note 12)</i>	(32,014,469)	(8,606,543)
Net cash provided by operating activities	<u>21,454,269</u>	<u>11,550,464</u>
Investing activities		
Net decrease in assets whose use is limited	27,463,467	8,840,112
Purchase of investments, net	(2,004,868)	(645,376)
Additions to property, plant, and equipment	(48,695,981)	(12,796,037)
Net cash used by investing activities	<u>(23,237,382)</u>	<u>(4,601,301)</u>
Financing activities		
Proceeds from long-term debt	3,020,470	-
Change in value of interest rate swap	2,502,627	(458,703)
Payments on long-term debt	(4,367,012)	(3,842,708)
Net cash provided by (used in) financing activities	<u>1,156,085</u>	<u>(4,301,411)</u>
(Decrease) increase in cash and cash equivalents	<u>(627,028)</u>	<u>2,647,752</u>
Cash and cash equivalents		
Beginning of period	77,022,774	74,375,022
End of period	<u>\$ 76,395,746</u>	<u>\$ 77,022,774</u>

See accompanying notes.

Norwalk Hospital Association

Notes to Consolidated Financial Statements

Period From January 1, 2014 to September 30, 2014, and
Period From October 1, 2013 to December 31, 2013

1. Organization and Significant Accounting Policies

Norwalk Hospital Association (the Hospital), a not-for-profit organization incorporated under the General Statutes of the State of Connecticut, was a wholly owned subsidiary of Norwalk Health Services Corporation (NHSC) through October 1, 2014.

Affiliation

On January 1, 2014 (the Transaction Date), Western Connecticut Health Network (WCHN) became the sole corporate member of NHSC, and a corporate affiliation was completed. All assets and liabilities were revalued to fair value as of January 1, 2014. The Hospital is consolidated in WCHN's financial statements for the period from January 1, 2014 to September 30, 2014.

In connection with the affiliation, the assets acquired and liabilities assumed were marked to fair value at the Transaction Date. The increase to the Hospital's net assets at the Transaction Date was \$16,395,275 when reported at fair value, as compared to the historical value of the net assets as reported by the predecessor company of \$279,522,271. The \$16,395,275 increase in the Hospital's net assets comprised the following (impacting unrestricted net assets):

Property, plant, and equipment	\$ 41,190,025
Goodwill	(13,843,749)
Intangible assets	(5,760,171)
Investment in joint venture	(627,986)
Bond issuance costs, net	(1,255,873)
Medical malpractice claims reserves	652,000
Long-term debt	(3,958,971)
	<u>\$ 16,395,275</u>

The Hospital has elected to apply pushdown accounting, use of the acquirer's basis of accounting in the preparation of the acquiree's separate financial statements, consistent with Accounting Standards Update (ASU) 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*, a consensus of the FASB Emerging Issues Task Force.

The accompanying consolidated financial statements present the results of operations for the period prior to the Transaction Date, which is reported as the predecessor company based upon historical value, and the financial position and results of operations subsequent to the affiliation, which are reported using fair values as the initial cost basis established at the Transaction Date.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

The accompanying consolidated statements of operations and changes in net assets and cash flows disclose activity related to the periods from January 1, 2014 to September 30, 2014, and from October 1, 2013 to December 31, 2013, respectively, and are hereafter referred to collectively as the "Periods under Audit."

On September 30, 2014, a grant agreement was entered into between NHSC and the Hospital under which all of NHSC's cash, investments, and real estate assets were transferred to the Hospital through WCHN. NHSC's liabilities were also transferred to the Hospital through WCHN. The transfer consisted of the following:

Cash and cash equivalents	\$ 696,235
Investments	26,977,706
Beneficial interest in trust	8,007,837
Property, plant, and equipment	1,075,506
Accounts payable	<u>(241,970)</u>
	<u>\$ 36,515,314</u>

The transfer was reported as follows in the consolidated statement of operations and changes in net assets for the nine-month period ended September 30, 2014:

Unrestricted net assets	\$ 28,507,477
Temporarily restricted net assets	8,007,837
	<u>\$ 36,515,314</u>

Principles of Consolidation

The Hospital's consolidated financial statements include the accounts of the Hospital and its majority interest in Norwalk Surgery Center, LLC. All significant intercompany accounts and transactions are eliminated in consolidation.

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 amounts reported in the financial statements and accompanying notes. There is at least a

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates. Significant estimates reflected in the consolidated financial statements include the contractual and allowance for uncollectible accounts for patient service revenue and the related patient accounts receivable, estimated revenue settlements due to or from third parties, the asset retirement obligation, fair value accounting associated with the affiliation, reserves for malpractice, workers' compensation and other self-insured liabilities, and benefit plan assumptions.

Income Taxes

The Hospital, is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital is also exempt from state and local taxes. Norwalk Surgery Center, LLC is a limited liability corporation and is treated as a partnership for income tax purposes.

The Hospital has net operating loss carryforwards from unrelated business activities of approximately \$3,267,000, which will begin expiring in 2022. These losses generate a potential deferred tax asset of approximately \$1,307,000, which is offset by a corresponding valuation allowance of the same amount due to the uncertainty of utilizing the deferred tax asset in future periods.

Regulatory Matters

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

Cash and Cash Equivalents

The Hospital and its subsidiary consider all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, other than amounts held in the investment portfolio and assets limited as to use. The carrying value of cash equivalents approximates its fair value.

Cash and cash equivalents are maintained with domestic institutions. Management monitors the financial strength of those institutions.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Investments

The Hospital's investment portfolio reported in the accompanying consolidated balance sheet is designated as trading. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value, based upon quoted market prices. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Alternative investments (nontraditional, not-readily-marketable assets), some of which are structured such that the Hospital holds limited partnership interests, are reported based upon net asset value and derived from the application of the equity method of accounting. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Valuations of these investments and, therefore, the Hospital's holdings may be determined by the investment manager or general partner, and for "fund of funds" investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The Hospital accounts for these investments using the equity method of accounting and reports its share of the increase or decrease in the funds' value as investment gain or loss. The financial statements of the investees are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with the Hospital's annual consolidated financial statement reporting.

Fair Value Measurements

The Hospital records investments in the financial statements at fair value. Fair value is a market-based measurement based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering assumptions, a three-tier fair value hierarchy has been established which prioritizes the inputs used to measure fair value. The three levels of the fair value hierarchy under this principle are as follows:

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.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

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

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

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value of Financial Instruments

The carrying value of financial instruments classified as current assets and current liabilities as of September 30, 2014, approximates fair value based on current market conditions. The fair value of long-term debt at September 30, 2014, based on current market rates for similar debt was approximately \$128,868,000, categorized as Level 2 in the fair value hierarchy. The carrying value of debt was \$128,990,553 at September 30, 2014.

Assets Limited as to Use

Assets limited as to use represent assets held by trustees under bond indenture agreements, beneficial interest in charitable remainder trust, and assets held by trustee for self-insurance.

Patient Accounts Receivable

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

The Hospital's estimation of the allowance for uncollectible 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

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

charges are recorded. On a monthly basis, the Hospital reviews its accounts receivable balances 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
- Cash collections as a percentage of net patient revenue less the provision for uncollectible accounts
- Trending of days revenue in accounts receivable

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 uncollectible accounts.

The Hospital's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies and private patients.

The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts.

Beneficial Interest in Charitable Remainder Trust

The Hospital has been named sole or participating beneficiary in a remainder trust. Under the terms of this trust, the Hospital has the irrevocable right to receive the remaining principal and income earned on the trust assets. The Hospital has recorded the fair value of the Hospital's proportionate interest in the assets held in the remainder trust. In 2014, no distributions were received from this trust.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Inventories

The Hospital uses the first-in, first-out method, in the valuation of its inventory.

Investments in Joint Ventures

The Hospital has invested in a joint venture that is accounted for under the equity method of accounting. The Hospital has a 50% noncontrolling interest in Reef Road Associates, II, LLC (the Joint Venture), which represents property, on which the Joint Venture plans to construct a medical office building.

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost or, if received as a donation, at the fair value on the date received. The Hospital provides for depreciation of property, plant, and equipment using the straight-line method in amounts sufficient to amortize the cost of the assets over their estimated useful lives. Useful lives range from 3 to 40 years.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time frame or purpose. Temporarily restricted net assets primarily consist of the Hospital's interest in the Norwalk Hospital Foundation, Inc. (NHF) related to contributions restricted for health care services and assets held in trust by others. Permanently restricted net assets consist of the Hospital's interest in NHF related to endowment gifts that have been restricted by donors and are to be maintained in perpetuity.

Interest in the Norwalk Hospital Foundation, Inc.

Interest in NHF represents the Hospital's interest in the net assets of NHF and is accounted for in accordance with Accounting Standards Codification 958-20, *Not-for-Profit Entities – Financially Interrelated Entities*.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Medical Malpractice Claims Reserves

From October 1, 2005 through February 28, 2014, the Hospital was insured for general liability and professional liability claims by Maple Street Indemnity Company, Ltd. (MSI) on a claims-made basis. MSI, previously structured as a wholly owned subsidiary of NHSC, was a captive insurance company, incorporated under the laws of the Bermuda Monetary Authority. The Hospital had professional liability coverage through MSI of \$35,000,000 per claim and \$48,000,000 in the aggregate. MSI purchased \$30,000,000 of excess reinsurance coverage above a self-insured retention of \$5,000,000 per claim and \$18,000,000 in the aggregate.

Effective March 1, 2014, MSI merged with Western Connecticut Health Network Insurance Co., Ltd. (WCHNIC), a wholly owned subsidiary of Danbury Hospital. All claims prior to March 1, 2014, that were previously insured by MSI were assumed by WCHNIC through a loss portfolio transfer, and all risk was transferred.

Coverage for medical malpractice insurance with WCHNIC is on a claims-made basis. Effective March 1, 2014, the coverage limits are \$5,000,000 per claim and \$25,000,000 in the aggregate. The excess indemnity coverage is \$40,000,000 per claim and \$40,000,000 in the aggregate. The Hospital has recorded a liability of \$3,618,000 at September 30, 2014, based on a discount rate of 3.5% for incurred-but-not-reported claims, which is included in accrued pension liability and other on the accompanying consolidated balance sheet. In addition, medical malpractice insurance recoveries and the related claim liabilities of \$34,724,445 are included in other assets and medical malpractice claims reserves, respectively, as of September 30, 2014.

Excess of Revenues over Expenses

The accompanying consolidated statements of operations include the excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from excess of revenues over expenses include changes in pension obligations, the permanent transfer of assets to and from affiliates for other than goods and services, net income attributable to noncontrolling interest, and net unrestricted other changes in joint venture.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Nonoperating Gains (Losses)

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating gains (losses) primarily consist of investment income, changes in unrealized gains and losses on investments, loss on equipment disposal, interest rate swap activity, and changes in the interest in unrestricted assets of NHF.

Asset Retirement Obligation

The Hospital records a liability for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. The fair value of a liability for a conditional asset retirement obligation is recognized in the period in which the obligation is incurred if a reasonable estimate of fair value can be made. As of September 30, 2014, \$8,907,306 is included in accrued pension liability and other relating to such obligations. During the Periods under Audit, the Hospital recorded accretion expense of \$323,757 and \$107,919, respectively, which are recorded on the statements of operations within supplies and other. During the Periods under Audit, retirement obligations settled were \$304,967 and \$209,153, respectively.

Electronic Health Record Incentive Program

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in calendar year 2011 for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology. The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. Under this accounting policy, EHR incentive payments are recognized as revenues when attestation that the EHR meaningful use criteria for the required period of time was demonstrated. Accordingly, the Hospital recognized \$1,562,219 of EHR revenue during the period from January 1, 2014 to September 30, 2014, comprising \$1,190,826 and \$371,393 of Medicare and Medicaid revenues, respectively. The Hospital did not recognize any EHR revenue during the period from October 1, 2013 to December 31, 2013. EHR revenues are included in other operating revenues in the accompanying consolidated statements of operations and changes in net assets.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

New Accounting Pronouncement

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

2. Revenues From Services to Patients and Charity Write-Offs

The following table summarizes revenues from services to patients:

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
Gross patient service revenue	\$ 698,276,789	\$232,912,085
Deductions:		
Allowances	416,398,325	138,634,518
Charity care (at charges)	12,440,600	4,361,001
	428,838,925	142,995,519
Net patient service revenue	269,437,864	89,916,566
Provision for uncollectible accounts	21,801,052	3,862,124
Net patient service revenue less provision for uncollectible accounts	\$ 247,636,812	\$ 86,054,442

Revenues and patient accounts receivable are recorded when patient services are performed. Amounts received from certain payors are different from established billing rates, and these differences are accounted for as allowances.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

2. Revenues From Services to Patients and Charity Write-Offs (continued)

As a result of the affiliation described in Note 1, patients accounts receivable was adjusted to fair value on the Transaction Date. In connection with the acquisition, the allowance for uncollectible accounts previously recorded was eliminated. Such amounts totaled approximately \$5,828,000.

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue under third-party payor agreements is subject to audit and retroactive adjustments due to ongoing and future audits, reviews, and investigations. Provisions for estimated third-party payor settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Inpatient acute care services rendered to Medicare program recipients are paid at prospectively determined rates per discharge varying according to the intensity of services required. Inpatient acute care services are paid based on diagnosis-related groups, inpatient rehabilitation services are paid based on case mix groups, and inpatient psychiatry services are paid on a prospective per diem rate. Outpatient services are paid by Medicare on an ambulatory payment classification basis and fee screens. Hospital claims for reimbursement are subject to review and audit. The Hospital's Medicare costs reports have been final-settled with the Medicare fiscal intermediary through 2010.

Inpatient Medicaid reimbursement through the Connecticut Department of Social Services (DSS) is paid on a per diem basis with settlement cost reports based on discharges filed in the subsequent fiscal year. Outpatient activity through DSS is paid based on fee schedules in effect at the time the service is provided. Managed Medicaid services are paid according to per diems and fee schedules in place at the time the service is provided.

The Hospital has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the Hospital receives fee-for-service payments for covered services based upon discounted fee schedules.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

2. Revenues From Services to Patients and Charity Write-Offs (continued)

The mix of net patient service revenue from patients and third-party payors for the Periods under Audit is as follows:

	Period From January 1, 2014 to September 30, 2014	Period From October 1, 2013 to December 31, 2013
Commercial/other	58%	60%
Medicare	28	25
Medicaid	10	10
Self pay	4	5
	<u>100%</u>	<u>100%</u>

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at September 30, 2014, is as follows:

Commercial/other	62%
Medicare	27
Medicaid	8
Self pay	3
	<u>100%</u>

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and are subject to interpretation. While the Hospital believes it is in compliance with all such applicable laws and regulations, compliance with such laws and regulations is subject to government review and interpretation and can result in significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates can change by material amounts. In addition, changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital. During the Periods under Audit, the Hospital recorded decreases in net patient service revenue of approximately \$550,000 and \$1,100,000, respectively, related to changes in previously estimated third-party payor settlements.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

2. Revenues From Services to Patients and Charity Write-Offs (continued)

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Hospital. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Hospital utilizes the generally recognized poverty income levels for the state, but also includes certain cases where incurred charges are significant when compared to income published in the Federal Register. For the Periods under Audit, the estimated cost of charity care provided was approximately \$4,331,000 and \$1,457,000, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by Hospital-specific data.

3. Investments and Assets Limited as to Use

The composition of investments and assets limited as to use as of September 30, 2014, is as follows:

Cash and cash equivalents	\$ 32,170,660
Mutual funds	116,501,741
Private equity fund	<u>362,502</u>
	<u>\$ 149,034,903</u>

Also included within assets limited as to use is a beneficial interest in a charitable remainder trust of \$8,007,837.

As described in Note 1, investments are recorded at fair value. The Hospital endeavors to utilize the best available information in measuring fair value. The following table presents the financial instruments carried at fair value as of September 30, 2014:

	Level 1	Level 2	Level 3	Fair Value
Investments and assets limited as to use				
Cash and cash equivalents	\$ 32,170,660	\$ -	\$ -	\$ 32,170,660
Mutual funds	116,501,741	-	-	116,501,741
	<u>\$ 148,672,401</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 148,672,401</u>

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

3. Investments and Assets Limited as to Use (continued)

The amounts reported in the table above do not include alternative investments totaling \$362,502 as of September 30, 2014, that are accounted for under the equity method of accounting.

Investment income, net included in nonoperating gains (loss) for the Periods under Audit consists of interest income of \$1,593,370 and \$669,617, respectively.

4. Leases

The Hospital leases property and equipment under noncancelable operating leases that expire in various years through 2028. Certain leases may be renewed at the end of their term.

Future minimum payments under noncancelable operating leases, and future receipts under noncancelable subleases where the Hospital is receiving rental receipts, with initial terms of one year or more consisted of the following at September 30, 2014:

	Operating Lease Payments	Sublease Rental Receipts
2015	\$ 7,926,746	\$ 2,919,588
2016	7,970,194	2,992,577
2017	7,659,174	3,067,392
2018	7,244,951	2,836,032
2019	6,794,337	2,107,619
Thereafter	46,003,103	4,707,544
	<u>\$ 83,598,505</u>	<u>\$ 18,630,752</u>

Rental expense for the Periods under Audit was approximately \$6,551,040 and \$2,111,158, respectively, and is included within supplies and other in the accompanying consolidated statements of operations. Rental revenue for the Periods under Audit was approximately \$2,210,000 and \$710,580, respectively, and is included within other operating revenue in the accompanying consolidated statements of operations.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt

Long-term debt consisted of the following:

Norwalk Hospital revenue bonds financed with CHEFA:	
Series G	\$ 22,104,000
Series H	7,584,500
Series I	8,904,300
Series J	84,696,457
Norwalk Hospital – Connecticut Hospital Association Trust	132,786
Norwalk Hospital – CHEFA loan	2,898,294
Norwalk Surgery Center – term loan	2,670,216
	128,990,553
Less current portion	7,039,141
	\$ 121,951,412

The following table summarizes the future maturities and sinking fund requirements on long-term debt outstanding as of September 30, 2014:

	Norwalk Hospital	Norwalk Surgery Center, LLC	Total
2015	\$ 6,316,051	\$ 723,090	\$ 7,039,141
2016	6,769,094	754,277	7,523,371
2017	6,666,221	786,810	7,453,031
2018	6,180,000	406,039	6,586,039
2019	6,420,000	–	6,420,000
Thereafter	90,010,000	–	90,010,000
	122,361,366	2,670,216	125,031,582
Less: Current portion of long-term debt	6,316,051	723,090	7,039,141
Long-term debt	\$ 116,045,315	\$ 1,947,126	\$ 117,992,441

During the Periods under Audit, the Hospital paid interest of \$3,108,182 and \$1,663,260, respectively, on its long-term debt obligations. Interest capitalized for the year ended September 30, 2014, was approximately \$2,125,519.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

On March 18, 2014, Norwalk Surgery Center, LLC obtained a \$3,020,470 four-year term loan from Siemens Financial Services. The loan bears interest at a fixed rate of 4.23%. Monthly payments of principal and interest are required based upon a four-year amortization schedule. The loan is secured by a first lien on all business assets of Norwalk Surgery Center, LLC. The proceeds of the loan were used to pay off the then-outstanding balance of a prior term loan with the Bank of Fairfield.

On December 7, 2012, the Hospital financed a portion of the construction of an outpatient pavilion and other equipment through the issuance of the State of Connecticut Health and Educational Facilities Authority (CHEFA) Revenue Bonds, Series J, in the original principal amount of \$82,000,000. Interest-only payments are required for the first two years of the Series J Bonds. Thereafter, monthly payments of principal and interest are required in accordance with the repayment schedule. The Series J Bonds are subject to mandatory tender on December 1, 2024, and bear interest at a rate per annum equal to 70% of the sum of the one-month LIBOR Rate plus 300 basis points. The interest rate on the Series J Bonds is reset monthly. The repayment of the Series J Bonds is secured by the Gross Receipts pledged by the Hospital and NHF (collectively, the Obligated Group) under the Amended and Restated Master Trust Indenture dated as of December 1, 2012 (the Master Indenture). The Master Indenture also establishes a debt service coverage ratio requirement and restricts the incurrence of certain indebtedness by the Obligated Group. No violations of financial covenants existed as of September 30, 2014.

On December 7, 2012, the Obligated Group entered into an interest rate swap agreement to reduce interest rate volatility on the Series J Bonds. The swap confirmation has a notional amount of \$82,000,000. Under the terms of the confirmation, the Hospital pays a fixed rate of 1.2343% to the counterparty, and the counterparty pays a variable rate of 70% of one-month LIBOR to the Obligated Group. The payments under the swap confirmation are based on the outstanding notional amount; the notional amount will amortize at the same rate as the Series J Bonds. The payments under the swap confirmation effectively produce a synthetic fixed rate of 3.3343% on the Series J Bonds through December 1, 2024. The fair value of the interest rate swap at September 30, 2014, based on the present value of future cash flows based on the mid-market gross value for similar financial instruments, was \$2,510,102, categorized as Level 2 in the fair value hierarchy.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

In 2011, the Hospital financed the construction of the parking garage and other equipment through a private placement of CHEFA Revenue Bonds, Series G, H, and I, in the aggregate principal amount of \$46,840,000. The repayment of the Series G, H, and I Bonds is also secured by the Obligated Group's pledge of Gross Receipts under the Master Indenture. The Master Indenture also establishes a debt service coverage ratio requirement and restricts the incurrence of certain indebtedness by the Obligated Group. No violations of financial covenants existed as of September 30, 2014.

The Series G Bonds initially totaling \$25,000,000 mature serially through 2025 with interest at an annual rate of 5.12%. Interest on the bonds is payable semiannually each June 1 and December 1.

The Series H Bonds initially totaling \$10,040,000 mature serially through 2020 with interest at an annual rate of 3.49%. Interest on the bonds is payable semiannually each June 1 and December 1.

The Series I Bonds initially totaling \$11,800,000 mature serially through 2020 with interest at an annual rate of 3.4%. Interest on the bonds is payable semiannually each June 1 and December 1.

In 2011, Norwalk Surgery Center, LLC obtained a \$4,000,000 seven-year term loan from The Bank of Fairfield. The loan bears interest at a fixed rate of 4.875%. Monthly payments of interest only are required for the first 18 months of the loan. Thereafter, monthly payments of principal and interest are required based upon a five-and-one-half-year amortization schedule. The loan is secured by a first lien on all business assets of Norwalk Surgery Center, LLC. On March 18, 2014, the loan was paid in full.

In 2007, the Hospital financed certain equipment related to an energy project through CHEFA, which issued \$9,066,025 in debt under a Master Financing Agreement (the Agreement), dated as of April 1, 2007, with Bank of America Public Capital Corp. as the lender (the Lender). The loan is payable in 120 equal installments of \$93,432 beginning June 3, 2007, with interest of 4.38%. The Hospital has granted a collateral interest to the Lender in the equipment financed.

In connection with this borrowing, the Hospital applied to the Department of Public Utility Control (DPUC) for a capital grant for customer-side distributed resources. Pursuant to the application, DPUC has approved a rate reduction subsidy with regard to certain of the equipment

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

financed under this Agreement. Effective July 3, 2010, the rate reduction subsidy of \$1,302 per month is remitted by the Connecticut Light and Power Company directly to the Lender and is recorded as a reduction to interest expense.

In 2007, the Hospital entered into an agreement with the Connecticut Hospital Association Trust (the Trust) to borrow up to \$2,000,000 from the energy conservation and loan management loan fund. The loan, which is interest-free, will enable the Hospital to convert electrical energy and to manage its electrical energy needs. The loan is payable in 84 equal monthly installments of \$22,462, beginning April 1, 2008.

In connection with the affiliation described in Note 1, long-term debt was adjusted to fair value, and the existing unamortized bond discount was written off. The fair value adjustment included a decrease in the carrying value of \$724,000, \$199,500, \$234,300, \$2,696,458, and \$104,713 related to the Series G, H, I, and J Bonds and the CHEFA loan, respectively, that will be amortized as interest expense using the effective-interest method over the remaining life of the bonds. Approximately \$1,255,873 of unamortized bond issuance costs was written off.

6. Benefit Plans

The Hospital has a defined benefit pension plan (the Plan) covering all eligible employees. The benefits are based on years of service and the employee's average compensation (as defined in the Plan document). The Hospital's funding policy is to contribute, at a minimum, for each plan year, an amount necessary to satisfy the Employee Retirement Income Security Act (ERISA) minimum funding requirements.

Effective September 30, 2013, the Plan was frozen for all purposes (except as provided below) for those participants who are not covered by the collective bargaining agreement between the Hospital and the Connecticut Health Care Associates, National Union of Hospital and Health Care Employees, AFSCME, AFL-CIO Nurses' Union (Non-Union Participants). Subsequent to September 30, 2013, no Non-Union Participants shall accrue benefits under the Plan and no compensation or service after that date shall be taken into account in determining such participants' accrued benefits under the Plan, provided, however, that interest credits shall continue to be credited as required by applicable law. Plan participants who are members of the Connecticut Health Care Associates, National Union of Hospital and Health Care Employees, AFSCME, and AFL-CIO Nurses' Union, and who were employed by the Hospital on or before December 31, 2006 (when the Plan was frozen for all new hires), shall continue to accrue benefits under the Plan.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

Effective December 31, 2006, the Plan was amended to provide that no employees hired on or after January 1, 2007, would be eligible to participate in the Plan. Employees hired before that date, who satisfied the Plan's eligibility requirements, participated and earned benefits under the Plan until it was frozen as described above.

The amount included as a reduction of unrestricted net assets as of September 30, 2014, that is not yet recognized as a component of net periodic benefit cost related to the Plan is \$34,628,423. The amount of net actuarial loss expected to be recognized in net periodic benefit cost in 2015 is \$932,272.

The following is a summary of the changes in the projected benefit obligation and plan assets:

	<u>September 30, 2014</u>	<u>December 31, 2013</u>
Accumulated benefit obligation	\$ 216,482,528	\$ 192,676,388
Change in projected benefit obligation		
Benefit obligation, beginning of period	\$ 187,980,011	\$ 198,076,350
Service cost	1,284,059	456,999
Interest cost	7,302,818	2,379,719
Actuarial loss	32,701,032	(10,523,754)
Benefits paid	(6,975,896)	(2,409,303)
Benefit obligation, end of period	<u>222,292,024</u>	<u>187,980,011</u>
Change in plan assets		
Fair value of plan assets, beginning of period	194,441,064	185,014,617
Actuarial return on plan assets	8,968,349	10,210,750
Contributions	4,875,000	1,625,000
Benefits paid	(6,975,896)	(2,409,303)
Fair value of plan assets, end of period	<u>201,308,517</u>	<u>194,441,064</u>
Funded status of the plan	<u>\$ (20,983,507)</u>	<u>\$ 6,461,053</u>

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

Components of net periodic benefit cost for the Periods under Audit:

	January 1, 2014 to September 30, 2014	October 1, 2013 to December 31, 2013
Service cost	\$ 1,284,059	\$ 456,999
Interest cost	7,302,818	2,379,719
Expected return on plan assets	(10,895,740)	(3,529,350)
Net amortization and deferral	—	790,650
Net periodic benefit (income) cost	<u>\$ (2,308,863)</u>	<u>\$ 98,018</u>

The actuarial loss in 2014 primarily relates to changes in the discount rate and mortality table used to measure the benefit obligation.

As a result of the affiliation described in Note 1, the funded status of the Plan was adjusted to fair value on the Transaction Date.

Assumptions

The weighted-average assumptions used to determine the year-end benefit obligation at September 30, 2014, are as follows:

Discount rate	4.64%
Rate of compensation increase	3.50

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The weighted-average assumptions used to determine net periodic benefit (income) cost for the Periods under Audit are as follows:

	January 1, 2014 to September 30, 2014	October 1, 2013 to December 31, 2013
Discount rate	5.29%	4.90%
Expected return on assets	7.50	8.00
Rate of compensation increase	3.50	3.50

The Hospital's expected long-term rate of return on assets assumption is derived from a review of anticipated future long-term performance of individual asset classes and consideration of the appropriate asset allocation strategy given the anticipated requirements of the Plan to determine the average rate of earnings expected on the funds invested to provide for the pension plan benefits. While the review gives appropriate consideration to recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Plan Assets

The Hospital's pension plan asset allocations at September 30, 2014, are as follows:

Equity securities	66%
Debt securities	34
	<u>100%</u>

The Hospital maintains target allocation percentages among various asset classes based on an investment policy established for the Plan which is designed to achieve long-term objectives of return, while mitigating against downside risk and considering expected cash flows. The current weighted-average target asset allocation is 64% equity securities and 36% debt securities. The investment policy is reviewed from time to time to ensure consistency with the long-term objective of funding the Plan to a level sufficient to pay benefits as they become due.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

The defined benefit plan assets categorization is based upon the lowest level of input that is significant to the fair value measurement within the valuation hierarchy. The following table summarizes the fair values of investments by major type held by the Plan at September 30, 2014:

	Level 1	Level 2	Level 3	Fair Value
Cash and cash equivalents	\$ 1,412,772	\$ —	\$ —	\$ 1,412,772
Mutual funds	199,739,203	—	—	199,739,203
Unallocated immediate participation group annuity contract	—	156,542	—	156,542
	\$ 201,151,975	\$ 156,542	\$ —	\$ 201,308,517

Contributions

The Hospital expects to contribute \$6,500,000 to the Plan in fiscal 2015.

Estimated Future Benefit Payments

The following future benefit payments are expected to be paid:

	Benefit Payments
Fiscal years:	
2015	\$ 8,084,717
2016	8,341,208
2017	8,681,561
2018	8,801,692
2019	9,277,093
2020 to 2023	55,371,930

The Hospital also sponsors a defined contribution savings plan covering substantially all of its employees. Effective January 1, 2007, the plan was split into two parts. Part I is for eligible employees who have a date of employment on or before December 31, 2006. Part II is for eligible employees who have a date of employment on January 1, 2007, or thereafter. Elective deferrals and after-tax contributions are made pursuant to a salary reduction agreement for Part I and Part II employees.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

6. Benefit Plans (continued)

For Part I employees, the Hospital provides a partial matching contribution on the first 3% of an employee's elective deferred and/or after-tax contributions. Effective October 1, 2013, Part II employees will also receive a required employer contribution equal to 3% of such employee's compensation.

For Part II employees, the Hospital provides a partial matching contribution on the first 3% of an employee's elective deferral and/or after-tax contributions. Part II employees will also receive a required employer contribution equal to 3% of such employee's compensation.

Expense related to the Hospital's defined contribution plan was approximately \$5,330,479 and \$1,402,387 for the Periods under Audit, respectively.

7. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets of \$37,730,403 as of September 30, 2014, represent the Hospital's interest in NHF and are available to the Hospital for health care services and include beneficial interest in a charitable remainder trust, the income of which is expendable to support health care services. Permanently restricted net assets of \$9,461,652 as of September 30, 2014, represent the Hospital's interest in NHF investments to be held in perpetuity, the income from which is expendable to support health care services.

8. Endowments

The NHF endowment funds consist of donor-restricted funds to be invested in perpetuity to provide a permanent source of income. The net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

NHF classifies net assets of donor-restricted endowment funds for organizations subject to an enacted Uniform Prudent Management of Institutional Funds Act (UPMIFA). Connecticut enacted its UPMIFA statute effective October 1, 2007. This standard requires not-for-profit organizations subject to an enacted version of UPMIFA to classify the portion of the endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure by the organization. The portion to be classified as temporarily restricted consists of accumulated unspent income and appreciation.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

8. Endowments (continued)

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

- (1) The duration and preservation of the fund
- (2) The purposes of NHF 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 NHF
- (7) The investment policies of NHF

Prior to enactment of UPMIFA, NHF followed the provisions of the Uniform Management of Institutional Funds Act.

Endowment net asset composition by type of fund as of September 30, 2014:

	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 3,905,371	\$ 9,461,652	\$ 13,367,023

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

8. Endowments (continued)

Changes in endowment net assets for the year ended September 30, 2014:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 3,194,224	\$ 9,454,852	\$ 12,649,076
Investment return:			
Investment income	286,005	–	286,005
Net realized and unrealized gains and loss	542,468	–	542,468
Total investment return	828,473	–	828,473
Contributions	–	6,800	6,800
Appropriation of endowment assets for expenditures	(117,326)	–	(117,326)
Endowment net assets end of year	\$ 3,905,371	\$ 9,461,652	\$ 13,367,023

The primary long-term management objective for NHF's endowment funds is to maintain the permanent nature of each endowment fund, while providing a predictable, stable, and constant stream of earnings. Consistent with that objective, the primary investment goal is to earn annual interest and dividends.

9. Related-Party Transactions

The Hospital has recorded amounts due from related parties at September 30, 2014, as follows:

Norwalk Health Care, Inc.	\$ 38,409
Norwalk Hospital Foundation, Inc.	48,068
SWC Corporation	40,489
Western Connecticut Health Network Affiliates, Inc.	8,462
	\$ 135,428

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

9. Related Party Transactions (continued)

The Hospital has recorded amounts due to related parties at September 30, 2014, as follows:

Norwalk Hospital Physicians & Surgeons	\$ 438,121
The Danbury Hospital	558,219
Western Connecticut Medical Group, P.C.	100,222
	<u>\$ 1,096,562</u>

The Hospital earned income from related parties for the Periods under Audit as follows:

	January 1, 2014 to September 30, 2014	October 1, 2013 to December 31, 2013
Norwalk Hospital Physicians & Surgeons	\$ 1,341,504	\$ 109,740
Norwalk Hospital Foundation, Inc.	81,270	27,090
SWC Corporation	150,773	50,258
	<u>\$ 1,573,547</u>	<u>\$ 187,088</u>

The Hospital paid expenses to related parties for the Periods under Audit as follows:

	January 1, 2014 to September 30, 2014	October 1, 2013 to December 31, 2013
Norwalk Hospital Physicians & Surgeons	\$ 10,549,295	\$ 3,616,568
SWC Corporation	2,693,961	953,813
Maple Street Indemnity Company, Ltd.	730,672	1,096,009
Western Connecticut Medical Group, P.C.	100,222	-
	<u>\$ 14,074,150</u>	<u>\$ 5,666,390</u>

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

10. Norwalk Surgery Center, LLC

On May 31, 2012, the Hospital transferred assets associated with its off-site ambulatory surgery business to Norwalk Surgery Center, LLC. The Hospital owns 64.11% of Norwalk Surgery Center, LLC at September 30, 2014. The Hospital has consolidated noncontrolling interests relating to its investment in Norwalk Surgery Center, LLC. These noncontrolling interests represent the portion of the Norwalk Surgery Center, LLC not controlled by the Hospital, but are required to be presented on the Hospital's consolidated balance sheet under GAAP. These interests were approximately \$2,005,000 as of September 30, 2014.

Changes in consolidated unrestricted net assets attributable to the noncontrolling interest are as follows:

	<u>Noncontrolling Interest</u>
Balance at September 30, 2013 (Predecessor Company)	\$ 1,388,280
Excess of revenues over expenses (from continuing operations)	529,496
Other changes	<u>(430,439)</u>
Balance at December 31, 2013 (Predecessor Company)	1,487,337
Excess of revenues over expenses (from continuing operations)	1,116,608
Other changes	<u>(598,746)</u>
Balance at September 30, 2014	<u><u>\$ 2,005,199</u></u>

11. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the Hospital. While the outcomes of the lawsuits and claims cannot be determined at this time, management believes that any loss that may arise from these lawsuits and claims will not have a material adverse effect on the financial position or on the net assets of the Hospital.

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

11. Commitments and Contingencies (continued)

The Hospital has received requests for information from governmental authorities relating to, among other things, patient billings. These requests relate to compliance with certain laws and regulations. Management is cooperating with these governmental authorities in their information requests and ongoing investigations. While management does not believe that any of these inquiries or investigations will result in a material future loss, the ultimate results of these inquiries and investigations, including the impact on the Hospital, cannot be determined at this time.

12. Change in Components of Operating Assets and Liabilities

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
(Increase) decrease in operating assets:		
Patient accounts receivable	\$ (32,028,219)	\$ (7,321,920)
Due from related parties	2,141,004	(930,172)
Prepaid expenses and other	13,069,705	(385,727)
Inventories	393,824	(150,294)
	<u>(16,423,686)</u>	<u>(8,788,113)</u>
Increase (decrease) in operating liabilities:		
Accounts payable	2,718,782	3,424,591
Payroll-related accruals	3,558,067	(7,144,561)
Due to third-party payors	(194,228)	5,762,163
Due to related parties	(1,198,155)	1,442,959
Interest payable	424,718	(461,181)
Accrued pension liability and other	(20,899,967)	(2,842,401)
	<u>(15,590,783)</u>	<u>181,570</u>
Decrease in operating assets and liabilities	<u>\$ (32,014,469)</u>	<u>\$ (8,606,543)</u>

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

13. Functional Expenses

The Hospital and its subsidiary provide general health care services to residents within their geographic location. Expenses related to providing these services are as follows:

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
Health care services	\$ 149,768,744	\$ 47,889,713
General and administrative	89,784,590	28,709,316
	<u>\$ 239,553,334</u>	<u>\$ 76,599,029</u>

14. Other Operating Revenue

Other operating revenue consisted of the following for the Periods under Audit:

	Period From January 1, 2014 to September 30, 2014	Predecessor Company Period From October 1, 2013 to December 31, 2013
Rental income	\$ 4,491,799	\$ 1,119,590
Grants	1,534,276	487,132
Cafeteria	1,215,557	388,046
EHR incentive payments	1,562,219	-
Patient services	913,172	294,701
Administrative services	742,089	255,717
Other	1,276,180	361,708
	<u>\$ 11,735,292</u>	<u>\$ 2,906,894</u>

Norwalk Hospital Association

Notes to Consolidated Financial Statements (continued)

15. Subsequent Events

The Hospital and its subsidiary have performed an evaluation of subsequent events through February 27, 2015, the date the consolidated financial statements were issued, and noted the following subsequent event.

On October 1, 2014, NHSC merged into WCHN. At that time, WCHN became the sole corporate member of the Hospital. As a result of this transaction, two subsidiaries of NHSC, NHF and Norwalk Hospital Physicians & Surgeons (NHP&S), were merged into the Hospital as of October 1, 2014. NHP&S is a not-for-profit organization incorporated under the General Statutes of the State of Connecticut with net assets of approximately (\$776,000) at October 1, 2014. NHF is a not-for-profit organization incorporated under the General Statutes of the State of Connecticut. NHF net assets were previously recognized by the Hospital as described in Note 1.

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

Supplementary Information

The Norwalk Hospital Association

Consolidating Balance Sheet

September 30, 2014

	Norwalk Hospital Association	Norwalk Surgery Center, LLC	Eliminations	Total
Assets				
Current assets:				
Cash and cash equivalents	\$ 74,550,518	\$ 1,845,228	\$ -	\$ 76,395,746
Investments	8,764,926	-	-	8,764,926
Patient accounts receivable, net	40,426,872	997,451	-	41,424,323
Due from related parties	135,428	-	-	135,428
Inventories	1,774,961	285,898	-	2,060,859
Prepaid expenses and other	4,016,372	101,755	-	4,118,127
Total current assets	129,669,077	3,230,332	-	132,899,409
Assets limited as to use:				
Beneficial interest in charitable remainder trust	8,007,837	-	-	8,007,837
Construction funds	23,405,407	-	-	23,405,407
Assets held in trust for self-insurance	327	-	-	327
Total assets limited as to use	31,413,571	-	-	31,413,571
Investments	116,864,243	-	-	116,864,243
Other assets	35,109,229	20,227	-	35,129,456
Beneficial interest in Norwalk Hospital Foundation, Inc.	47,837,445	-	-	47,837,445
Investment in joint venture	1,640,000	-	-	1,640,000
Interest rate swap	2,510,102	-	-	2,510,102
Goodwill	-	4,142,240	(4,142,240)	-
Property, plant, and equipment:				
Land and land improvements	27,918,025	-	-	27,918,025
Buildings and building improvements	209,965,564	-	-	209,965,564
Equipment and other	257,351,553	2,343,786	303,824	259,999,163
Construction in progress	78,197,484	-	-	78,197,484
Accumulated depreciation	(328,979,797)	(999,849)	-	(329,979,646)
Total property, plant, and equipment	244,452,829	1,343,937	303,824	246,100,590
Total assets	\$ 609,496,496	\$ 8,736,736	\$ (3,838,416)	\$ 614,394,816

The Norwalk Hospital Association

Consolidating Balance Sheet (continued)

September 30, 2014

	Norwalk Hospital Association	Norwalk Surgery Center, LLC	Eliminations	Total
Liabilities and net assets				
Current liabilities:				
Accounts payable	\$ 32,811,276	\$ 166,226	\$ -	\$ 32,977,502
Payroll-related accruals	18,445,669	136,146	-	18,581,815
Due to third-party payors	36,052,621	-	-	36,052,621
Due to related parties	1,096,562	-	-	1,096,562
Interest payable	778,518	3,713	-	782,231
Current portion of long-term debt	6,316,051	723,090	-	7,039,141
Other accrued expenses	-	72,140	-	72,140
Total current liabilities	95,500,697	1,101,315	-	96,602,012
Accrued pension liability and other	46,106,859	56,827	-	46,163,686
Medical malpractice claims reserves	34,724,445	-	-	34,724,445
Long-term debt, less current portion	120,004,287	1,947,125	-	121,951,412
Total liabilities	296,336,288	3,105,267	-	299,441,555
Net assets:				
Unrestricted attributable to Norwalk Hospital	265,968,153	3,626,270	(3,838,416)	265,756,007
Unrestricted attributable to noncontrolling interest	-	2,005,199	-	2,005,199
Temporarily restricted	37,730,403	-	-	37,730,403
Permanently restricted	9,461,652	-	-	9,461,652
Total net assets	313,160,208	5,631,469	(3,838,416)	314,953,261
Total liabilities and net assets	\$ 609,496,496	\$ 8,736,736	\$ (3,838,416)	\$ 614,394,816

The Norwalk Hospital Association

Consolidating Statement of Operations

Period From January 1, 2014 to September 30, 2014

	Norwalk Hospital Association	Norwalk Surgery Center, LLC	Eliminations	Total
Unrestricted revenues				
Net patient service revenue	\$ 261,683,203	\$ 7,754,661	\$ -	\$ 269,437,864
Provision for bad debt	21,663,955	137,097	-	21,801,052
Net patient service revenue less provision for uncollectible accounts	240,019,248	7,617,564	-	247,636,812
Net assets released from restrictions	866,277	-	-	866,277
Other operating revenue	11,734,345	947	-	11,735,292
	252,619,870	7,618,511	-	260,238,381
Expenses				
Salaries, benefits, and fees	125,637,663	1,298,715	-	126,936,378
Supplies and other	89,565,727	2,810,844	-	92,376,571
Insurance	3,971,559	-	-	3,971,559
Depreciation and amortization	14,210,592	288,581	-	14,499,173
Interest	1,656,814	112,839	-	1,769,653
	235,042,355	4,510,979	-	239,553,334
Income from operations	17,577,515	3,107,532	-	20,685,047
Nonoperating gains (losses)				
Investment income, net	1,589,288	4,082	-	1,593,370
Change in unrealized gains and losses on investments	2,156,725	-	-	2,156,725
Change in interest in unrestricted net assets of Norwalk Hospital Foundation, Inc.	3,125,357	-	-	3,125,357
Loss on equipment disposal	(668,566)	-	-	(668,566)
Interest rate swap activity:				
Interest cost on interest rate swap	(161,828)	-	-	(161,828)
Change in value of interest rate swap	(2,502,627)	-	-	(2,502,627)
	(2,664,455)	-	-	(2,664,455)
Total nonoperating gains	3,538,349	4,082	-	3,542,431
Excess of revenues over expenses, before noncontrolling interest in joint venture	21,115,864	3,111,614	-	24,227,478
Less: Net income attributable to noncontrolling interest	-	(1,116,608)	-	(1,116,608)
Excess of revenues over expenses	\$ 21,115,864	\$ 1,995,006	\$ -	\$ 23,110,870

The Norwalk Hospital Association

Consolidating Statement of Operations

Period From October 1, 2013 to December 31, 2013 (Predecessor Company)

	Norwalk Hospital Association	Norwalk Surgery Center, LLC	Eliminations	Total
Unrestricted revenues				
Net patient service revenue	\$ 86,892,527	\$ 3,024,039	\$ -	\$ 89,916,566
Provision for bad debt	3,855,228	6,896	-	3,862,124
Net patient service revenue less provision for uncollectible accounts	83,037,299	3,017,143	-	86,054,442
Net assets released from restrictions	289,746	-	-	289,746
Other operating revenue	2,906,294	600	-	2,906,894
	86,233,339	3,017,743	-	89,251,082
Expenses				
Salaries, benefits, and fees	42,382,592	521,497	-	42,904,089
Supplies and other	27,519,055	891,774	-	28,410,829
Insurance	145,475	-	-	145,475
Depreciation and amortization	4,427,214	89,235	-	4,516,449
Interest	582,292	39,895	-	622,187
	75,056,628	1,542,401	-	76,599,029
Income from operations	11,176,711	1,475,342	-	12,652,053
Nonoperating gains (losses)				
Investment income, net	669,331	186	-	669,517
Change in unrealized gains and losses on investments	4,182,701	-	-	4,182,701
Interest rate swap activity:				
Interest cost on interest rate swap	(55,792)	-	-	(55,792)
Change in value of interest rate swap	458,703	-	-	458,703
	402,911	-	-	402,911
Total nonoperating gains	5,254,943	186	-	5,255,129
Excess of revenues over expenses, before noncontrolling interest in joint venture	16,431,654	1,475,528	-	17,907,182
Less: Net income attributable to noncontrolling interest	-	(529,496)	-	(529,496)
Excess of revenues over expenses	\$ 16,431,654	\$ 946,032	\$ -	\$ 17,377,686

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