

COMBINED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Windham Community Memorial Hospital, Inc., and Affiliates
Years Ended September 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Financial Statements
and Supplementary Information

Years Ended September 30, 2014 and 2013

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Report of Independent Auditors

The Board of Directors
Hartford HealthCare Corporation

We have audited the accompanying combined financial statements of Windham Community Memorial Hospital, Inc., and Affiliates, which comprise the combined balance sheets as of September 30, 2014 and 2013, and the related combined statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Windham Community Memorial Hospital, Inc., and Affiliates at September 30, 2014 and 2013, 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.

Supplementary Information

Our audits were performed for the purpose of forming an opinion on the combined financial statements as a whole. The combining balance sheets and statements of operations and changes in net assets are presented for the purposes of additional analysis and are 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 28, 2015

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Balance Sheets

	September 30	
	2014	2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,754,329	\$ 7,567,700
Accounts receivable, less allowances for doubtful accounts of approximately \$3,500,000 in 2014 and \$3,800,000 in 2013	9,382,464	11,874,718
Other receivables	975,649	4,195,533
Due from affiliates	689,258	1,055,387
Inventories of supplies	1,188,268	1,150,602
Prepaid expenses and other assets	492,503	346,482
Current portion of assets whose use is limited	563,637	560,838
Total current assets	20,046,108	26,751,260
Assets whose use is limited:		
Interest in investments held by Endowment LLC	78,598	72,341
Investments and other assets	418,008	378,132
Donor-restricted interest in investments held by Endowment LLC	1,992,363	1,833,758
Investments for restricted purposes	88,526	83,070
Funds designated for debt service	1,439,934	1,439,934
	4,017,429	3,807,235
Funds held in trust by others	3,181,515	3,030,775
Other assets	2,628,082	2,404,148
Property, plant, and equipment, net	42,365,469	44,147,690
Total assets	\$ 72,238,603	\$ 80,141,108
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 1,700,399	\$ 3,318,546
Salaries, wages, payroll taxes, and amounts withheld from employees	2,298,079	2,000,093
Accrued expenses	1,593,684	979,326
Due to affiliates	3,926,518	1,344,594
Estimated third-party payor settlements	3,379,397	1,340,072
Current portion of long-term debt	4,421,510	15,740,918
Current portion of accrued pension liability	1,162,087	1,008,330
Current portion of other liabilities	338,822	-
Total current liabilities	18,820,496	25,731,879
Long-term debt	31,550,036	19,355,130
Accrued pension liability	42,664,520	30,339,257
Interest rate swap obligation	3,011,359	2,701,010
Other liabilities	9,400,121	9,463,289
Total liabilities	105,446,532	87,590,565
Net assets:		
Unrestricted	(39,450,280)	(13,430,049)
Temporarily restricted	1,876,620	1,786,651
Permanently restricted	4,365,731	4,193,941
Total net assets	(33,207,929)	(7,449,457)
Total liabilities and net assets	\$ 72,238,603	\$ 80,141,108

See accompanying notes.

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Statements of Operations and Changes in Net Assets

	Year Ended September 30	
	2014	2013
Unrestricted revenues, gains, and other support:		
Net patient service revenue	\$ 82,055,365	\$ 80,793,701
Provision for bad debts	4,548,371	4,079,212
Net patient service revenue less provision for bad debts	77,506,994	76,714,489
Other operating revenue	5,365,283	5,690,246
Net assets released from restrictions for operations	126,404	175,864
	82,998,681	82,580,599
Operating expenses:		
Salaries and wages	38,236,090	41,730,362
Employee benefits	9,508,077	12,666,864
Supplies and other	10,587,934	10,582,667
Purchased services	22,406,648	20,516,387
Depreciation and amortization	4,216,020	4,154,949
Provision for nonpatient bad debts	407,870	608,820
Interest	1,430,212	1,107,869
	86,792,851	91,367,918
Operating loss	(3,794,170)	(8,787,319)
Nonoperating income (loss):		
Income from investments, gifts, and bequests, net	222,836	498,134
Other	(961,845)	1,070,641
	(739,009)	1,568,775
Deficiency of revenues over expenses	(4,533,179)	(7,218,544)

Continued on next page.

Windham Community Memorial Hospital, Inc., and Affiliates

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

	Year Ended September 30	
	2014	2013
Unrestricted net assets:		
Deficiency of revenues over expenses	\$ (4,533,179)	\$ (7,218,544)
Net assets released from restriction for purchase of property and equipment	89,875	22,202
Change in pension and postretirement funding obligation	(18,365,590)	34,385,130
Transfer (to) from affiliates	(3,211,337)	7,324,652
(Decrease) increase in unrestricted net assets	<u>(26,020,231)</u>	<u>34,513,440</u>
Temporarily restricted net assets:		
Restricted contributions	143,997	325,222
Restricted investment income	19,399	22,215
Return on interest in investments held by Endowment LLC	142,852	184,251
Net assets released from restrictions for operations	(126,404)	(175,864)
Net assets released from restriction for purchase of property and equipment	(89,875)	(22,202)
Increase in temporarily restricted net assets	<u>89,969</u>	<u>333,622</u>
Permanently restricted net assets:		
Restricted contributions	–	4,662
Restricted investment income	5,297	7,464
Return on interest in investments held by Endowment LLC	15,753	15,420
Change in unrealized gains of funds held in trust	150,740	198,882
Increase in permanently restricted net assets	<u>171,790</u>	<u>226,428</u>
(Decrease) increase in net assets	<u>(25,758,472)</u>	<u>35,073,490</u>
Net assets at beginning of year	<u>(7,449,457)</u>	<u>(42,522,947)</u>
Net assets at end of year	<u>\$ (33,207,929)</u>	<u>\$ (7,449,457)</u>

See accompanying notes.

Windham Community Memorial Hospital, Inc., and Affiliates

Combined Statements of Cash Flows

	Year Ended September 30	
	2014	2013
Cash flows from operating activities		
(Decrease) increase in net assets	\$ (25,758,472)	\$ 35,073,490
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	4,216,020	4,154,949
Amortization of bond premium	(7,692)	-
Change in unrealized gains and losses on investments	(37,439)	(26,529)
Change in investments held by Endowment LLC	(164,862)	(202,156)
Change in unrealized gains and losses on funds held in trust by others	(150,740)	(198,882)
Provision for patient bad debts	4,548,371	4,079,212
Provision for non-patient bad debts	407,870	608,820
Change in net assets related to pension and postretirement funding obligations	18,365,590	(34,385,130)
Transfer to (from) affiliates	3,211,337	(7,324,652)
Change in fair value of interest rate swap agreements	310,349	(1,686,723)
Other changes in net assets:		
Changes in assets and liabilities, net (Note 14)	(864,508)	3,072,218
Restricted contributions and investment income	(168,693)	(359,563)
Net cash provided by operating activities	<u>3,907,131</u>	<u>2,805,054</u>
Cash flows from investing activities		
Investment in real estate	61,315	55,869
Purchase of property, plant, and equipment, net	(2,421,207)	(8,133,991)
Increase in assets whose use is limited, net	(10,692)	(40,426)
Net cash used in investing activities	<u>(2,370,584)</u>	<u>(8,118,548)</u>
Cash flows from financing activities		
Proceeds from long-term debt	12,532,797	-
Payments on long-term debt	(12,783,117)	(396,734)
Net borrowings under line of credit agreement	4,133,510	4,199,086
Payment of deferred financing costs	(190,464)	-
Transfer (to) from affiliates	(6,211,337)	4,596,310
Restricted contributions and investment income	168,693	359,563
Net cash (used in) provided by financing activities	<u>(2,349,918)</u>	<u>8,758,225</u>
Net (decrease) increase in cash and cash equivalents	<u>(813,371)</u>	<u>3,444,731</u>
Cash and cash equivalents at beginning of year	7,567,700	4,122,969
Cash and cash equivalents at end of year	<u>\$ 6,754,329</u>	<u>\$ 7,567,700</u>

See accompanying notes.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements

September 30, 2014

1. Significant Accounting Policies

The accounting policies that affect significant elements of Windham Community Memorial Hospital, Inc. and Affiliates' (Windham or the Hospital) financial statements are summarized below and in Note 2.

Organization

Windham Community Memorial Hospital, Inc. is a voluntary association incorporated under the General Statutes of the State of Connecticut, and as of March 2009, is a subsidiary 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 combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

Windham Community Memorial Hospital, Inc., and Affiliates

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.

Fair Value of Financial Instruments

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

Cash and Cash Equivalents

Cash and cash equivalents include cash, commercial paper, and corporate and government bonds, that 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 bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

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

The Hospital's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Hospital manages the receivables by regularly reviewing its patient accounts and contracts, and by providing appropriate allowances for uncollectible amounts. Significant concentrations of patient accounts receivable include 33% and 17%, and 30% and 12%, for Medicare and Medicaid, respectively, for the fiscal years ending September 30, 2014 and 2013, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Interest in Investments Held by Hartford Healthcare Endowment LLC

Effective August 29, 2011, Hartford HealthCare Endowment LLC (Endowment LLC) was created to maintain and manage, on a pooled basis, the endowment funds of the Hospital; MidState Medical Center; Hartford Hospital; The Hospital of Central Connecticut at New Britain General and Bradley Memorial; HHC; and Hartford HealthCare at Home, Inc. Endowment LLC, a wholly owned subsidiary of HHC, acts as manager, and is named fiduciary for HHC within established investment guidelines. As of April 1, 2013, \$1,796,350 of the Hospital's investments were sold to Endowment LLC, at which time all previously unrealized gains and losses on the sold investments were realized. As of September 30, 2014 and 2013, the Hospital has an interest in investments held by Endowment LLC, which is reflected in the accompanying combined balance sheets and represents the Hospital's pro rata share of Endowment LLC.

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

Investments

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value using quoted market prices or model-driven valuations at the balance sheet date. Assets temporarily and permanently restricted (by donor) are recorded at fair value at the date of donation, which is then considered cost. Investment income (including realized gains and losses on investments, interest and dividends, and the change in unrealized gains and losses) is included in non-operating income unless the income or loss is restricted by the donor or law. The cost of securities sold is based on the specific identification method.

Inventories of Supplies

Inventories are stated at the lower of cost or market. The Hospital values its inventories using the first-in, first-out method.

Property, Plant, and Equipment

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

Assets Whose Use is Limited

Assets whose use is limited includes assets that are set aside internally by management or by the Board of Directors for future capital improvements, research, donor-restricted assets, education, escrow funds, and debt service funds for existing obligations on outstanding long-term debt. Amounts that are restricted by the Board of Directors are not available for use without the approval of the Board of Directors. Investments for restricted purposes are those restricted based on donors' intents.

Temporarily and Permanently Restricted Net Assets

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

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 non-operating revenue.

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

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the 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 combined 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 \$441,472 and \$263,600, are recorded in other assets in the accompanying combined balance sheets as of September 30, 2014 and 2013, respectively. During 2014, the Hospital paid \$190,464 in additional bond issuance costs.

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 may be exposed to credit loss in the event of non-performance 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 excess of revenues over expenses in the accompanying combined statements of operations and changes in net assets.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

Other Operating Revenue

Other operating revenue includes services to other institutions, electronic health record (EHR) incentive program revenue, rental income, grant income, research income, cafeteria income, school tuition, and unrestricted contributions. See Note 12.

Nonoperating Income

Nonoperating income includes income on investments, realized and unrealized gains and losses on trading investments, restricted gifts, bequests, and changes in fair value of swap agreements.

Deficiency of Revenues over Expenses

The combined statements of operations and changes in net assets include the deficiency of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from the deficiency of revenues over expenses, include the changes in pension and postretirement funding obligation, net assets released from restrictions for the purchase of property and equipment, and transfers of assets to and from affiliates.

Professional Liability Insurance

Coverage for medical malpractice insurance is provided on a claims-made basis. The primary coverage is with Hartford HealthCare Indemnity Services, Limited (previously known as CHS Insurance Limited or CHS), a captive insurance company that, effective October 1, 2012, became a wholly owned subsidiary of HHC.

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

Malpractice claims are discounted at 1.72% and 2.08% for the incurred-but-not-reported liability, which was approximately \$349,000 and \$317,000 at September 30, 2014 and 2013, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

In addition, medical malpractice insurance recoveries and the related claim liabilities of approximately \$339,000 and \$366,000 as of September 30, 2014 and 2013, respectively, are included in other current assets and other current liabilities, and medical malpractice insurance recoveries and the related claim liabilities of approximately \$1,085,000 and \$850,000 as of September 30, 2014 and 2013, respectively, are included in other long-term assets and other long-term current liabilities.

Income Taxes

Windham, Hatch, and the Foundation are not-for-profit corporations as described in Section 501 (c) (3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501 (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 provide incentive payments for the meaningful use of certified EHR technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS.

The Medicare EHR incentive program provides annual incentive payments to eligible professionals, hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospital uses a grant accounting model to recognize EHR incentive revenues. EHR incentive revenues are recognized ratably over the relevant cost report period to determine the amount of reimbursement. The Hospital recognized no EHR revenues during the fiscal year ended September 30, 2014 and approximately \$1,800,000 of EHR revenues during the fiscal year ended September 30, 2013. The Medicare and Medicaid components of 2013 EHR revenues are \$1,500,000 and \$300,000, respectively. EHR incentive revenues are included in other operating revenue in the accompanying combined statements of operations and changes in net assets.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

1. Significant Accounting Policies (continued)

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 Pronouncements

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

Reclassifications

Certain reclassifications have been made to the fiscal year ended September 30, 2013 balances previously reported in the combined balance sheet and statement of operations and changes in net assets in order to conform with the fiscal year ended September 30, 2014, presentation.

2. Net Patient Service Revenue and Charity Care

Revenues from Medicare and Medicaid programs, respectively, accounted for approximately 35% and 12%, and 39% and 8%, of the Hospital's net patient service revenue for the fiscal years ended September 30, 2014 and 2013, 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.

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.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

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

The following table summarizes net revenues for the year ended September 30 from services to patients:

	<u>2014</u>	<u>2013</u>
Gross revenues from patients:		
Inpatients	\$ 55,857,478	\$ 68,069,832
Outpatients	142,607,313	137,339,554
	<u>198,464,791</u>	<u>205,409,386</u>
Deductions:		
Allowances and discounts	113,778,465	121,754,445
Charity care	2,630,961	2,861,240
Net patient service revenue	<u>82,055,365</u>	<u>80,793,701</u>
Provision for bad debts	4,548,371	4,079,212
Net patient service revenue less provision for bad debts	<u>\$ 77,506,994</u>	<u>\$ 76,714,489</u>

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. 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 2014 and 2013, the Hospital recorded net changes in estimates of approximately (\$63,000) and \$308,000, respectively.

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. Additionally, certain payers' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

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

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

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

The Hospital's policy is to reserve a portion of all self-pay receivables, including amounts due from the uninsured and amounts related to co-payments and deductibles, as these charges are recorded. The Hospital's allowance for doubtful accounts for self-pay patients decreased to 66% of self-pay accounts receivable at September 30, 2014 from 70% of self-pay accounts receivable at September 30, 2013. On a monthly basis, the Hospital reviews its accounts receivable balances, the effectiveness of the Hospital's reserve policies, and various analytics to support the basis for its estimates. These efforts primarily consist of reviewing the following:

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

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

The Hospital provides services without charge or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such services are not reported as revenue. For patients who were determined by the Hospital to have the ability to pay but did not,

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

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

the uncollected amounts are recorded as part of the provision for bad debts. In distinguishing charity care from the provision for bad debts, a number of factors are considered, certain of which require a high degree of judgment.

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

	2014	2013
Medicare	35%	39%
Medicaid	12	8
Self-pay	9	10
All other	44	43
	100%	100%

The estimated cost of charity care provided was \$1,137,782 and \$1,287,417 for the years ended September 30, 2014 and 2013, respectively. The estimated cost of charity care is based on the ratio of cost to charges, as determined by hospital-specific data.

3. Net Assets

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

	2014	2013
Free beds	\$ 203,620	\$ 102,112
Education	364,491	304,704
Capital replacement	235,359	256,999
Other health care services	1,073,150	1,122,836
	\$ 1,876,620	\$ 1,786,651

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

Permanently restricted net assets at September 30 are restricted for:

	<u>2014</u>	<u>2013</u>
Investments to be held in perpetuity, the income from which is expendable to support health care services	\$ 1,184,216	\$ 1,163,166
Restricted funds held in trust by others, the income from which is expendable to support health care services	3,181,515	3,030,775
	<u>\$ 4,365,731</u>	<u>\$ 4,193,941</u>

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

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

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 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.

The Hospital has a policy of appropriating for distribution each year 4% of the four quarter average market value of each fiscal year in which the distribution is planned. 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. The Hospital also evaluates endowment spending based on need and current market conditions as well as long-term investment goals.

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

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 801,076	\$ 1,163,166	\$ 1,964,242
Investment return:			
Investment income	19,399	5,297	24,696
Net appreciation (realized and unrealized)	142,852	15,753	158,605
Total investment return	162,251	21,050	183,301
Appropriation of endowment assets for expenditure	(12,720)	-	(12,720)
Endowment net assets, end of year	\$ 950,607	\$ 1,184,216	\$ 2,134,823

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

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

	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 872,497	\$ 1,119,866	\$ 1,992,363
Investments for restricted purposes	39,361	49,165	88,526
Current portion of assets whose use is limited	38,749	15,185	53,934
	<u>\$ 950,607</u>	<u>\$ 1,184,216</u>	<u>\$ 2,134,823</u>

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

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 611,924	\$ 1,135,620	\$ 1,747,544
Investment return:			
Contributions	–	4,662	4,662
Investment income	22,215	7,464	29,679
Net appreciation (realized and unrealized)	184,251	15,420	199,671
Total investment return	206,466	27,546	234,012
Appropriation of endowment assets for expenditure	(17,314)	–	(17,314)
Endowment net assets, end of year	<u>\$ 801,076</u>	<u>\$ 1,163,166</u>	<u>\$ 1,964,242</u>

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

	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ 729,645	\$ 1,104,113	\$ 1,833,758
Investments for restricted purposes	43,888	39,182	83,070
Current portion of assets whose use is limited	27,543	19,873	47,416
	<u>\$ 801,076</u>	<u>\$ 1,163,168</u>	<u>\$ 1,964,244</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

3. Net Assets (continued)

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

4. Assets Whose Use is Limited

Included in assets whose use is limited at September 30 are the following amounts:

	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	\$ 559,000	\$ 550,805
Money market funds	1,444,572	1,449,967
Interest in investments held by Endowment LLC	2,070,961	1,906,099
Equity securities:		
U.S.	110,647	107,426
Mutual funds:		
U.S.	326,574	289,816
International	58,267	53,214
Alternative investments and other	11,045	10,746
	<u>\$ 4,581,066</u>	<u>\$ 4,368,073</u>

During 2013, a significant portion of the Hospital's assets whose use is limited was transferred to Endowment LLC, as discussed in Note 1.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

4. Assets Whose Use is Limited (continued)

The composition and presentation of income from investments, gifts, and bequests, net, which is included in nonoperating income (loss) in the accompanying combined statements of operations and changes in net assets, are as follows:

	<u>2014</u>	<u>2013</u>
Gifts and bequests	\$ 170,626	\$ 449,084
Return on interest in investments held by Endowment LLC	6,257	2,485
Unrealized gains on investments, net	32,396	22,030
Realized gains on investments	–	13,472
Interest and dividend income	13,557	11,063
	<u>\$ 222,836</u>	<u>\$ 498,134</u>

5. Fair Values of Financial Instruments

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

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

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

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

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

Windham Community Memorial Hospital, Inc., and Affiliates

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 and Endowment LLC, are classified in the following tables below in one of the three categories described above:

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 6,754,329	\$ —	\$ —	\$ 6,754,329
Assets whose use is limited:				
Cash and cash equivalents	559,000	—	—	559,000
Money market funds	1,444,572	—	—	1,444,572
Equity securities:				
U.S.	110,647	—	—	110,647
Mutual funds:				
U.S.	179,675	146,899	—	326,574
International	42,553	15,714	—	58,267
Funds held in trust by others	—	3,181,515	—	3,181,515
	\$ 9,090,776	\$ 3,344,128	\$ —	\$ 12,434,904
Liabilities				
Interest rate swaps	\$ —	\$ 3,011,359	\$ —	\$ 3,011,359

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 7,567,700	\$ —	\$ —	\$ 7,567,700
Assets whose use is limited:				
Cash and cash equivalents	550,805	—	—	550,805
Money market funds	1,449,967	—	—	1,449,967
Equity securities:				
U.S.	107,426	—	—	107,426
Mutual funds:				
U.S.	166,307	123,509	—	289,816
International	38,381	14,833	—	53,214
Funds held in trust by others	—	3,030,775	—	3,030,775
	\$ 9,880,586	\$ 3,169,117	\$ —	\$ 13,049,703
Liabilities				
Interest rate swaps	\$ —	\$ 2,701,010	\$ —	\$ 2,701,010

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

5. Fair Values of Financial Instruments (continued)

The amounts reported in the preceding tables do not include alternative investments totaling \$11,045 and \$10,746 as of September 30, 2014 and 2013, respectively, that were accounted for under the equity method of accounting.

The Hospital has \$2,070,961 and \$1,906,099 of financial assets as of September 30, 2014 and 2013, respectively, that are held by Endowment LLC (refer to Note 1). Financial assets classified within the trust are 54.3% Level 1, 20.9% Level 2, and 24.8% in alternative investments accounted for under the equity method as of September 30, 2014, and 56.3% Level 1, 22.0% Level 2, and 21.7% in alternative investments accounted for under the equity method as of September 30, 2013.

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

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is based upon model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers, and brokers. The interest rate swap agreements are valued based on a determination of market expectations relating to the future cash flows associated with the swap contract using sophisticated modeling based on observable market-based inputs, such as interest rate curves.

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

6. Property, Plant, and Equipment

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

	<u>2014</u>	<u>2013</u>
Land and land improvements	\$ 5,651,801	\$ 5,574,820
Buildings and building improvements	60,835,951	58,711,867
Equipment	55,027,577	53,688,385
	<u>121,515,329</u>	<u>117,975,072</u>
Less accumulated depreciation	79,258,891	74,173,393
	<u>42,256,438</u>	<u>43,801,679</u>
Construction-in-progress (estimated cost to complete – \$110,000)	109,031	346,011
	<u>\$ 42,365,469</u>	<u>\$ 44,147,690</u>

The Hospital capitalized interest expense of \$0 and \$173,650 for the years ended September 30, 2014 and 2013, respectively.

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

The benefits are based on years of service and the employees' compensation during the last five years of employment. The Hospital makes contributions in amounts sufficient to fund the pension plan's current service cost, and funding policy is to contribute amounts to these plans sufficient to meet the minimum funding requirements set forth by federal government regulations.

The Hospital has a defined contribution 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. Expense for employer contributions was approximately \$1,769,000 and \$1,937,000 in 2014 and 2013, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

7. Pension and Other Postretirement Benefits (continued)

Effective July 1, 2013, Windham amended the postretirement welfare plan to reduce the employer subsidy of the new post-65 coverage offering. Eligible employees are offered a choice between a group Medicare Advantage plan with prescription drug coverage and a Supplemental Retiree Medical Plan with prescription drug coverage.

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic benefit cost:

	Pension Benefits		Other Postretirement Benefits	
	2014	2013	2014	2013
Unrecognized actuarial loss	\$ 50,601,106	\$ 35,694,252	\$ 12,902,571	\$ 11,066,651
Unrecognized prior service credit	-	-	(10,745,421)	(12,368,236)
	\$ 50,601,106	\$ 35,694,252	\$ 2,157,150	\$ (1,301,585)

The actuarial loss in 2014 primarily relates to changes in the discount rate and mortality table used to measure the benefit obligation, and the actuarial gain in 2013 primarily relates to changes in the discount rate used to measure the benefit obligation.

The actuarial loss and prior service credit included in unrestricted net assets at September 30, 2014, and expected to be recognized in net periodic benefit cost during the fiscal year ending September 30, 2015, are as follows:

Unrecognized actuarial loss	\$ (2,810,618)
Unrecognized prior service credit	1,614,073
	<u>\$ (1,196,545)</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

7. Pension and Other Postretirement Benefits (continued)

The following table sets forth the plans funded status and amounts recognized in the combined balance sheets:

	Pension Benefits		Other Postretirement Benefits	
	2014	2013	2014	2013
Change in benefit obligation				
Benefit obligation at beginning of year	\$ (104,112,127)	\$ (116,044,600)	\$ (17,669,720)	\$ (32,720,084)
Service cost	(275,000)	(275,000)	(50,838)	(83,418)
Interest cost	(5,120,645)	(4,693,968)	(812,161)	(1,045,845)
Participant contributions	—	—	(138,384)	(114,089)
Benefits paid	4,175,188	4,160,159	1,425,484	1,671,301
Plan amendments	—	—	—	13,032,024
Medicare part D adjustments	—	—	—	(68,000)
Actuarial (loss) gain	(17,038,625)	12,741,282	(3,022,694)	1,658,391
Benefit obligation at end of year	(122,371,209)	(104,112,127)	(20,268,313)	(17,669,720)
Change in plan assets				
Fair value of plan assets at beginning of year	90,434,259	79,084,118	—	—
Actual return on plan assets	7,864,095	10,876,300	—	—
Employer contribution	4,689,750	4,634,000	1,287,100	1,557,212
Participant contribution	—	—	138,384	114,089
Benefits paid	(4,175,188)	(4,160,159)	(1,425,484)	(1,671,301)
Fair value of plan assets at end of year	98,812,916	90,434,259	—	—
Underfunded status	\$ (23,558,293)	\$ (13,677,868)	\$ (20,268,313)	\$ (17,669,720)

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

7. Pension and Other Postretirement Benefits (continued)

	Pension Benefits		Other Postretirement Benefits	
	2014	2013	2014	2013
Components of net periodic benefit cost				
Service cost	\$ 275,000	\$ 275,000	\$ 50,838	\$ 83,418
Interest cost	5,120,645	4,693,968	812,161	1,045,845
Expected return on plan assets	(6,679,680)	(5,833,357)	—	—
Net amortization and deferral	947,356	1,582,899	(421,963)	274,333
Benefit cost included in the statements of operations and changes in net assets	<u>\$ (336,679)</u>	<u>\$ 718,510</u>	<u>\$ 441,036</u>	<u>\$ 1,403,596</u>

The accumulated benefit obligation for the plans was \$122,371,209 and \$104,112,127 as of September 30, 2014 and 2013, respectively.

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

	Pension Benefits		Other Postretirement Benefits	
	2014	2013	2014	2013
Discount rate for determining benefit obligation at year-end	4.40%	5.00%	4.20%	4.70%
Discount rate for net periodic benefit cost	5.00%	4.10%	4.70%	3.85–3.90%
Expected rate of return on plan assets	7.50%	7.50%	—	—

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

Assumed health care cost trend rates for 2014 are as follows:

Health care trend rate assumed for next year	7.50%
Rate to which the cost rate trend rate is assumed to decline (the ultimate trend rate)	5.00%
Year that the rate reaches the ultimate trend rate	2019

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

7. Pension and Other Postretirement Benefits (continued)

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	One-Percentage-Point	
	Increase	Decrease
Effect on total of service and interest cost components	\$ 85,874	\$ (73,961)
Effect on postretirement benefit obligation	\$ 2,247,052	\$ (1,895,107)

Plan Assets

The Hospital's pension plan weighted-average asset allocations at September 30, by asset category, are as follows:

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

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

Contributions

The Hospital expects to make no contributions in fiscal year 2015 related to its defined benefit pension plan. The Hospital expects to make contributions of \$1,162,087 in fiscal year 2015 related to its postretirement benefit plan.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

7. Pension and Other Postretirement Benefits (continued)

Estimated Future Benefit Payments

Future benefit payments are expected to be paid as follows:

Fiscal Year:	Pension Benefits	Other Postretirement Benefits
2015	\$ 4,225,462	\$ 1,162,087
2016	4,548,611	1,218,275
2017	4,908,295	1,271,782
2018	5,388,483	1,303,183
2019	5,375,490	1,364,809
Years 2020–2024	33,659,820	6,752,168

8. Long-Term Debt

Details of long-term debt are as follows:

	2014	2013
Intercompany debt with HHC:		
Series A, consisting of a tax-exempt serial bond and term bonds; interest at rates ranging from 4.4% to 5.0%	\$ 18,485,936	\$ 18,689,808
Series D, taxable fixed rate of 5.75%	12,532,797	-
Revolving line of credit	4,105,361	15,355,981
Promissory mortgage note with a bank bearing interest at 6%, payments are due in equal installments through November 1, 2032, secured by a mortgage on the related real property	262,294	269,478
Capital lease obligations	234,171	422,103
Premium on bonds	350,987	358,678
	35,971,546	35,096,048
Less current portion	(4,421,510)	(15,740,918)
	\$ 31,550,036	\$ 19,355,130

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

8. Long-Term 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 HHC 2011 Bonds, an obligated group was formed. The members of the obligated group are HHC, Hartford Hospital, The Hospital of Central Connecticut at New Britain General and Bradley Memorial, Windham Community Memorial Hospital, and MidState Medical Center (collectively referred to as the Obligated Group). Effective January 2014, The William W. Backus Hospital became part of the Obligated Group. On March 26, 2014, HHC issued approximately \$163,180,000 of Taxable Bonds Series D (the HHC Series D Bonds) and approximately \$83,790,000 of CHEFA Revenue Bonds Series E (the HHC Series E Bonds) concurrently (collectively referred to as the HHC 2014 Bonds). Obligated Group members are jointly and severally liable under a Master Trust Indenture (MTI) to make all payments required with respect to obligations under the MTI. HHC does have the right to name designated affiliates, although presently none exist. Though designated affiliates are not obligated to make debt service payments on the obligations under the MTI, each designated affiliate has an independent designated affiliate agreement and promissory note with HHC with stipulated repayment terms and conditions, each subject to the governing law of the Obligated Groups' state of incorporation. In addition, HHC may cause each designated affiliate to transfer such amounts as necessary to enable the Obligated Group members to comply with the terms of the MTI, including payment of the outstanding obligations.

The HHC 2011 and 2014 Bonds were issued to refund portions of existing debt under HHC and to obtain funds for future capital needs. As such, the HHC 2011 and 2014 Bonds are reflected as intercompany debt in the preceding schedule. The Hospital is party to the HHC Series A Revenue Bonds and to the HHC Series D Bonds. The HHC Series A Revenue Bonds consist of serial bonds that mature annually from July 1, 2014 through July 1, 2023, and term bonds that mature from July 1, 2024 through July 1, 2041. The HHC Series D Bonds consist of term bonds that mature on April 1, 2044. During 2014, the Hospital made advance payments of \$67,957 to HHC for the bonds maturing in 2015.

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 or for the fiscal years ended September 30, 2014 or 2013.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

8. Long-Term Debt (continued)

The fair value of the HHC 2011 and 2014 Bonds was approximately \$680,006,000 at September 30, 2014 and the fair value of the HHC 2011 Bonds was approximately \$377,885,000 at September 30, 2013. The carrying value of the HHC 2011 and 2014 Bonds was \$620,015,000 at September 30, 2014 and the carrying value of the HHC 2011 Bonds was \$375,815,000 as of September 30, 2013. The fair value of the HHC 2011 and 2014 Bonds was determined by using a market approach that uses prices and other relevant information generated by market transactions involving identical or comparable liabilities and categorized as Level 2 in the fair value hierarchy described in Note 5. The carrying value of the Hospital's other long-term debt approximates fair value at September 30, 2014 and 2013.

In conjunction with a debt instrument that has subsequently been terminated, the Hospital entered into two interest rate swap agreements with a financial institution, with an original notional amount of \$19,745,000. The Hospital receives a variable rate equal to 67% of one month LIBOR and pays a fixed rate of 3.38%. These agreements terminate on July 1, 2037. The fair value of the swap agreements were \$3,011,359 and \$2,701,010 at September 30, 2014 and 2013, respectively. The change in fair market value of these agreements are reported in the accompanying combined statements of operations and changes in net assets as a component of other non-operating income along with the net cash receipts on the swap agreements.

As part of the HHC 2011 Bonds, the Obligated Group entered into a line of credit for \$20,000,000. This line expires in March 2015. As of September 30, 2014 and 2013, the Hospital had not drawn on this line of credit. In 2012, the Obligated Group obtained an additional \$60,000,000 line of credit. In August 2013, the Obligated Group entered into an amendment increasing this line of credit to \$100,000,000. This line of credit expires in April 2015. As of September 30, 2014 and 2013, the Hospital had drawn \$4,105,361 and \$15,355,981 on this line of credit, respectively, with variable rates of 0.85% and 0.92%, respectively, and is included in current portion of long-term debt.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

8. Long-Term Debt (continued)

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

Fiscal year ending September 30:	
2015	\$ 4,421,510
2016	375,427
2017	319,635
2018	340,247
2019	358,843
Thereafter	29,804,897
	<u>\$ 35,620,559</u>

Interest paid for the fiscal years ended September 30, 2014 and 2013, was \$1,376,813 and \$1,052,132, respectively.

9. Pledges Receivable

Pledges receivable included in assets whose use is limited and other assets, include the following unconditional promises to give as of September 30:

	<u>2014</u>	<u>2013</u>
Within one year	\$ 206,538	\$ 173,543
Less allowance	<u>(30,860)</u>	<u>(25,760)</u>
Net pledges receivable	<u>\$ 175,678</u>	<u>\$ 147,783</u>

The allowance recognizes the estimated uncollectible portion of the pledges.

10. Commitments and Contingencies

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

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

10. Commitments and Contingencies (continued)

At September 30, 2014 and 2013, respectively, approximately 80% and 77% of employees are covered by various collective bargaining agreements. All of those bargaining agreements are either under negotiation currently or will be within the upcoming year.

The Hospital has several operating lease agreements for certain real estate, medical equipment, and computer equipment. Certain of these leases have renewal options for periods up to five years and escalation clauses. Rent is payable in equal monthly installments. Rent expense was \$1,176,390 and \$1,049,240 for the years ended September 30, 2014 and 2013, respectively.

The future minimum lease payments are as follows:

	<u>Amount</u>
2015	\$ 557,294
2016	467,853
2017	463,195
2018	469,588
2019	476,172
Thereafter	859,301
	<u>\$ 3,293,403</u>

11. Related-Party Transactions

The Hospital obtains services from various HHC affiliates that are recorded at cost that represent an allocation of shared expenditures. Services provided by affiliates for the fiscal years ended September 30, 2014 and 2013, were approximately \$8,053,000 and \$5,930,000, respectively. The Hospital also leases space to affiliated entities. Rental income from the affiliates was \$574,774 and \$328,406 for the fiscal years ended September 30, 2014 and 2013, respectively.

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

11. Related-Party Transactions (continued)

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

	<u>2014</u>	<u>2013</u>
Due from HHC	\$ 511,054	\$ —
Due from Clinical Laboratory Partners	128,486	339,574
Due from Hartford HealthCare at Home	28,119	—
Due from Rushford	9,744	—
Due from Natchaug Hospital	8,753	—
Due from MidState Medical Center	3,102	—
Due from Windham Foundation	—	468,132
Due from Hartford HealthCare Medical Group	—	247,681
	<u>\$ 689,258</u>	<u>\$ 1,055,387</u>

Amounts due to affiliates related to these services as of September 30 are as follows:

	<u>2014</u>	<u>2013</u>
Due to HHC	\$ (2,890,009)	\$ (1,343,859)
Due to Hartford Hospital	(953,199)	—
Due to Hartford HealthCare Rehabilitation Network	(54,003)	—
Due to Hartford HealthCare Medical Group	(24,445)	—
Due to Backus Hospital	(4,862)	—
Due to Natchaug Hospital	—	(735)
	<u>\$ (3,926,518)</u>	<u>\$ (1,344,594)</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

12. Other Operating Revenues

Other operating revenues consist of the following:

	<u>2014</u>	<u>2013</u>
Services to other organizations	\$ 1,858,132	\$ 1,211,110
Expense recovery	1,458,723	1,293,329
Rental income	853,753	573,792
Grants	810,254	509,029
School Tuition	182,336	210,635
HER revenues	—	1,800,000
Other	202,085	92,351
	<u>\$ 5,365,283</u>	<u>\$ 5,690,246</u>

13. Functional Expenses

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

	<u>2014</u>	<u>2013</u>
Health care services	\$ 48,999,172	\$ 50,753,686
Support services	37,793,679	40,614,232
	<u>\$ 86,792,851</u>	<u>\$ 91,367,918</u>

Windham Community Memorial Hospital, Inc., and Affiliates

Notes to Combined Financial Statements (continued)

14. Supplemental Cash Flow Information

The changes in assets and liabilities are as follows:

	Year Ended September 30	
	2014	2013
(Increase) decrease in accounts receivable	\$ (2,056,117)	\$ 4,701,274
Decrease (increase) in other receivables	2,812,014	(640,683)
Decrease (increase) in due from affiliates	366,129	(1,044,352)
(Increase) decrease in inventories of supplies and prepaid expenses	(183,687)	26,703
(Increase) decrease in other assets	(107,377)	632,562
Decrease in accounts payable	(1,618,147)	(3,916,885)
Increase in salaries, wages, payroll taxes, and amounts withheld from employees	297,986	191,253
Increase in accrued expenses	953,180	49,196
Increase in due to affiliates	2,581,924	1,017,204
Increase (decrease) in third-party payor settlements	2,039,325	(158,932)
Decrease in accrued pension liability	(5,886,570)	(3,752,965)
(Decrease) increase in other liabilities	(63,168)	5,967,843
	<u>\$ (864,508)</u>	<u>\$ 3,072,218</u>

15. Subsequent Events

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

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

Supplementary Information

Windham Community Memorial Hospital, Inc., and Affiliates

Combining Balance Sheets

	September 30, 2014						September 30, 2013
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	Combined	Combined
Assets							
Current assets:							
Cash and cash equivalents	\$ 5,941,479	\$ 16,359	\$ 796,491	\$ -	\$ 6,754,329	\$ 7,567,700	
Accounts receivable, less allowance for doubtful accounts of approximately \$3,500,000	9,382,464	-	-	-	9,382,464	11,874,718	
Other receivables	975,649	-	-	-	975,649	4,195,533	
Due from affiliates	796,282	-	-	(107,024)	689,258	1,055,387	
Inventories of supplies	1,188,268	-	-	-	1,188,268	1,150,602	
Prepaid expenses and other assets	362,420	-	130,083	-	492,503	346,482	
Current portion of assets whose use is limited	559,945	3,692	-	-	563,637	560,838	
Total current assets	19,206,507	20,051	926,574	(107,024)	20,046,108	26,751,260	
Assets whose use is limited:							
Interest in investments held by Endowment LLC	78,598	-	-	-	78,598	72,341	
Investments and other assets	-	418,008	-	-	418,008	378,132	
Donor-restricted interest in investments held by Endowment LLC	1,992,363	-	-	-	1,992,363	1,833,758	
Investments for restricted purposes	49,165	39,361	-	-	88,526	83,070	
Funds designated for debt service	1,439,934	-	-	-	1,439,934	1,439,934	
	3,560,060	457,369	-	-	4,017,429	3,807,235	
Funds held in trust by others	2,459,958	721,557	-	-	3,181,515	3,030,775	
Other assets	2,567,539	-	60,543	-	2,628,082	2,404,148	
Property, plant, and equipment, net	42,365,465	4	-	-	42,365,469	44,147,690	
Total assets	\$ 70,159,529	\$ 1,198,981	\$ 987,117	\$ (107,024)	\$ 72,238,603	\$ 80,141,108	

Windham Community Memorial Hospital, Inc., and Affiliates

Combining Balance Sheets (continued)

	September 30, 2014						September 30, 2013
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	Combined	
Liabilities and net assets							
Current liabilities:							
Accounts payable	\$ 1,697,218	\$ -	\$ 3,181	\$ -	\$ 1,700,399	\$	3,318,546
Salaries, wages, payroll taxes, and amounts withheld from employees	2,298,079	-	-	-	2,298,079		2,000,093
Accrued expenses	1,581,136	-	12,548	-	1,593,684		979,326
Due to affiliates	3,926,518	-	107,024	(107,024)	3,926,518		1,344,594
Estimated third-party payor settlements	3,379,397	-	-	-	3,379,397		1,340,072
Current portion of long-term debt and capital leases	4,421,510	-	-	-	4,421,510		15,740,918
Current portion of accrued pension liability	1,162,087	-	-	-	1,162,087		1,008,330
Current portion of other liabilities	338,822	-	-	-	338,822		-
Total current liabilities	<u>18,804,767</u>	<u>-</u>	<u>122,753</u>	<u>(107,024)</u>	<u>18,820,496</u>		<u>25,731,879</u>
Long-term debt	31,550,036	-	-	-	31,550,036		19,355,130
Accrued pension liability	42,664,520	-	-	-	42,664,520		30,339,257
Interest rate swap obligation	3,011,359	-	-	-	3,011,359		2,701,010
Other liabilities	9,400,121	-	-	-	9,400,121		9,463,289
Total liabilities	<u>105,430,803</u>	<u>-</u>	<u>122,753</u>	<u>(107,024)</u>	<u>105,446,532</u>		<u>87,590,565</u>
Net assets:							
Unrestricted	(40,278,384)	434,371	393,733	-	(39,450,280)		(13,430,049)
Temporarily restricted	1,362,936	43,053	470,631	-	1,876,620		1,786,651
Permanently restricted	3,644,174	721,557	-	-	4,365,731		4,193,941
Total net assets	<u>(35,271,274)</u>	<u>1,198,981</u>	<u>864,364</u>	<u>-</u>	<u>(33,207,929)</u>		<u>(7,449,457)</u>
Total liabilities and net assets	<u>\$ 70,159,529</u>	<u>\$ 1,198,981</u>	<u>\$ 987,117</u>	<u>\$ (107,024)</u>	<u>\$ 72,238,603</u>	<u>\$</u>	<u>\$ 80,141,108</u>

Windham Community Memorial Hospital, Inc., and Affiliates
Combining Statements of Operations and Changes in Net Assets

	Year Ended September 30, 2014					Year Ended September 30, 2013 Combined
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	
Unrestricted revenues, gains, and other support:						
Net patient service revenue	\$ 79,031,876	\$ 3,023,489	\$ –	\$ –	\$ 82,055,365	\$ 80,793,701
Provision for bad debts	4,380,991	167,380	–	–	4,548,371	4,079,212
Net patient service revenue less provision for bad debts	74,650,885	2,856,109	–	–	77,506,994	76,714,489
Other operating revenue	5,056,838	308,445	–	–	5,365,283	5,690,246
Net assets released from restrictions for operations	111,497	–	14,907	–	126,404	175,864
	79,819,220	3,164,554	14,907	–	82,998,681	82,580,599
Operating expenses:						
Salaries and wages	36,782,283	1,404,241	49,566	–	38,236,090	41,730,362
Employee benefits	9,141,194	349,248	17,635	–	9,508,077	12,666,864
Supplies and other	10,162,806	388,280	36,848	–	10,587,934	10,582,667
Purchased services	21,576,638	824,357	5,653	–	22,406,648	20,516,387
Depreciation and amortization	4,060,870	155,150	–	–	4,216,020	4,154,949
Provision for nonpatient bad debts	374,998	14,327	18,545	–	407,870	608,820
Interest	1,377,580	52,632	–	–	1,430,212	1,107,869
	83,476,369	3,188,235	128,247	–	86,792,851	91,367,918
Operating loss	(3,657,149)	(23,681)	(113,340)	–	(3,794,170)	(8,787,319)
Loss transferred to Windham	(23,681)	23,681	–		–	–
Nonoperating income (loss):						
Income from investments, gifts, and bequests, net	15,386	42,223	165,227	–	222,836	498,134
Other	(949,645)	(12,200)	–	–	(961,845)	1,070,641
	(934,259)	30,023	165,227	–	(739,009)	1,568,775
(Deficiency) excess of revenues over expenses	(4,615,089)	30,023	51,887	–	(4,533,179)	(7,218,544)

Windham Community Memorial Hospital, Inc., and Affiliates

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

	Year Ended September 30, 2014					Year Ended September 30, 2013 Combined
	Windham Community Memorial Hospital, Inc.	The Hatch Hospital Corporation	Windham Hospital Foundation, Inc.	Eliminations	Combined	
Unrestricted net assets:						
(Deficiency) excess of revenues over expenses	\$ (4,615,089)	\$ 30,023	\$ 51,887	\$ –	\$ (4,533,179)	\$ (7,218,544)
Net assets released from restriction for purchase of property and equipment	–	12,720	77,155	–	89,875	22,202
Change in pension and postretirement funding obligations	(18,365,590)	–	–	–	(18,365,590)	34,385,130
Transfer (to) from affiliates	(3,211,337)	–	–	–	(3,211,337)	7,324,652
Transfer from temporarily restricted net assets	–	–	–	–	–	–
Transfer (to) from Foundation	(15,331)	–	15,331	–	–	–
(Decrease) increase in unrestricted net assets	(26,207,347)	42,743	144,373	–	(26,020,231)	34,513,440
Temporarily restricted net assets:						
Restricted contributions	–	–	143,997	–	143,997	325,222
Restricted investment income	1,113	18,286	–	–	19,399	22,215
Return on interest in investments held by Endowment LLC	142,852	–	–	–	142,852	184,251
Change in unrealized gains on investments	–	–	–	–	–	–
Net assets released from restriction for operations	–	–	(126,404)	–	(126,404)	(175,864)
Net assets released from restriction for purchase of property and equipment	–	(12,720)	(77,155)	–	(89,875)	(22,202)
Increase (decrease) in temporarily restricted net assets	143,965	5,566	(59,562)	–	89,969	333,622
Permanently restricted net assets:						
Restricted contributions	–	–	–	–	–	4,662
Restricted investment income	5,297	–	–	–	5,297	7,464
Return on interest in investments held by Endowment LLC	15,753	–	–	–	15,753	15,420
Change in unrealized gains and losses of funds held in trust	88,783	61,957	–	–	150,740	198,882
Increase in permanently restricted net assets	109,833	61,957	–	–	171,790	226,428
(Decrease) increase in net assets	(25,953,549)	110,266	84,811	–	(25,758,472)	35,073,490
Net assets at beginning of year	(9,317,725)	1,088,715	779,553	–	(7,449,457)	(42,522,947)
Net assets at end of year	\$ (35,271,274)	\$ 1,198,981	\$ 864,364	\$ –	\$ (33,207,929)	\$ (7,449,457)

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