



**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Financial Statements and  
Consolidating Information

July 31, 2016 and September 30, 2015

(With Independent Accountants' Review Report Thereon)

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Financial Statements and  
Consolidating Information

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## Independent Accountants' Review Report

The Board of Directors  
Saint Mary's Hospital, Inc.:

We have reviewed the accompanying consolidated financial statements of Saint Mary's Health System, Inc. (the System), which comprise the consolidated balance sheet as of July 31, 2016, and the related consolidated statement of operations, changes in net assets, and cash flows for the ten-month period ended July 31, 2016, and the related notes to the consolidated financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of Company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the consolidated financial statements as a whole. Accordingly, we do not express such an opinion.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Accountants' Responsibility*

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with U.S. generally accepted accounting principles. We believe that the results of our procedures provide a reasonable basis for our conclusion.

### *Accountants' Conclusion*

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements as of and for the ten-month period ended July 31, 2016, in order for them to be in accordance with U.S. generally accepted accounting principles.

### *Other Matter- Prior Period*

The accompanying September 30, 2015 balance sheet of the System was audited by us and we expressed an unmodified opinion on it in our report dated February 24, 2016. We have not performed any auditing procedures since that date.

### *Other Matter- Supplementary Information*

The supplementary consolidating information included in Exhibits 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The information is the representation of management. We have not audited or reviewed such information and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on it.

**KPMG LLP**

April 7, 2017  
Hartford, Connecticut

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Balance Sheets

July 31, 2016 (Unaudited - See Accompanying Independent Accountants' Review Report) and September 30, 2015

(In thousands)

<b>Assets</b>	<b>2016</b>	<b>2015</b>
Current assets:		
Cash and cash equivalents	\$ 28,867	14,091
Restricted cash	—	1,000
Short-term investments	23	17
Current portion of assets whose use is limited	3,418	3,418
Accounts receivable, net of estimated uncollectible amounts of \$6,552 in 2016 and \$6,042 in 2015	31,563	32,905
Other current assets	10,319	11,619
Total current assets	<u>74,190</u>	<u>63,050</u>
Marketable securities	<u>4,555</u>	<u>4,244</u>
Assets whose use is limited:		
By donor and held in trust by others	15,459	14,764
For estimated self-insurance liability	23,899	26,309
Pledged collateral	21,816	20,160
Other	6	6
Total assets whose use is limited	<u>61,180</u>	<u>61,239</u>
Less current portion of assets whose use is limited	<u>3,418</u>	<u>3,418</u>
Noncurrent assets whose use is limited	<u>57,762</u>	<u>57,821</u>
Property and equipment, net	<u>70,841</u>	<u>70,291</u>
Other assets:		
Investments in joint venture arrangements	8,750	9,574
Other noncurrent assets	4,441	1,880
Total other assets	<u>13,191</u>	<u>11,454</u>
Total assets	\$ <u><u>220,539</u></u>	\$ <u><u>206,860</u></u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 3,370	3,409
Accounts payable	18,864	22,665
Salaries, wages, and payroll withholdings	8,039	6,002
Due to third-party payors, net	1,966	727
Accrued expenses and other current liabilities	14,312	12,980
Total current liabilities	<u>46,551</u>	<u>45,783</u>
Long-term liabilities:		
Long-term obligations, net of current portion	8,631	11,018
Estimated self-insurance liability	14,612	17,751
Pension and deferred compensation	74,611	74,894
Other long-term liabilities	9,182	6,311
Total long-term liabilities	<u>107,036</u>	<u>109,974</u>
Net assets:		
Unrestricted Hospital	47,434	32,395
Noncontrolling interest in subsidiaries	1,014	955
Total unrestricted	<u>48,448</u>	<u>33,350</u>
Temporarily restricted	1,978	1,922
Permanently restricted	16,526	15,831
Total net assets	<u>66,952</u>	<u>51,103</u>
Total liabilities and net assets	\$ <u><u>220,539</u></u>	\$ <u><u>206,860</u></u>

See accompanying notes to consolidated financial statements.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Statement of Operations

For the ten months ended July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	<u>2016</u>
Revenues:	
Revenue from patient services, net of contractual allowances	\$ 264,211
Provision for uncollectible accounts, net of recoveries	<u>(7,524)</u>
Net revenue from patient services	256,687
Other operating revenues	<u>9,039</u>
Total revenues	<u>265,726</u>
Expenses:	
Salaries and wages	110,216
Employee benefits	28,306
Supplies and other expenses	108,145
Depreciation and amortization	10,110
Interest	<u>210</u>
Total expenses	<u>256,987</u>
Operating income	<u>8,739</u>
Nonoperating gains (losses):	
Investment income, net	1,263
Equity in earnings of joint ventures	50
Other	<u>32</u>
Total nonoperating gains, net	<u>1,345</u>
Excess revenues over expenses	10,084
Net assets released from restriction for capital expenditures	348
Capital transactions with affiliates	(285)
Change in unrealized gains on marketable securities and other assets whose use is limited	1,279
Change in accumulated pension credits to unrestricted net assets	<u>3,672</u>
Increase in unrestricted net assets	<u>\$ 15,098</u>

See accompanying notes to consolidated financial statements.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Statement of Changes in Net Assets

For the ten months ended July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	<u>2016</u>
Unrestricted net assets:	
Excess of revenues over expenses	10,084
Net assets released from restriction for capital expenditures	348
Capital transactions with affiliates	(285)
Change in unrealized gains on marketable securities and other assets whose use is limited	1,279
Change in accumulated pension credits to unrestricted net assets	<u>3,672</u>
Increase in unrestricted net assets	<u>15,098</u>
Temporarily restricted net assets:	
Change in net assets of Foundation, including releases for capital expenditures	137
Change in net assets of Cancer Center, including releases for capital expenditures	<u>(81)</u>
Increase in temporarily restricted net assets	<u>56</u>
Permanently restricted net assets:	
Net earnings on assets held in trust by others	1,228
Appropriation for expenditure	<u>(533)</u>
increase in permanently restricted net assets	<u>695</u>
Increase in net assets	15,849
Net assets – beginning of year	<u>51,103</u>
Net assets – end of period	<u>\$ 66,952</u>

See accompanying notes to consolidated financial statements.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidated Statement of Cash Flows

For the ten months ended July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	<u>2016</u>
Cash flows from operating activities:	
Increase in net assets	\$ 15,849
Adjustments to reconcile increase in net assets to net cash provided by operating activities:	
Depreciation and amortization	10,110
Change in unrealized gains on investments	(1,279)
Change in net assets of Cancer Center	81
Change in accumulated pension credits to unrestricted net assets	(3,672)
Change in permanently restricted net assets	(695)
Investment income, net	(1,263)
Equity in earnings of joint ventures	(50)
(Increase) decrease in operating assets:	
Accounts receivable, net	1,342
Other current assets	1,300
Other noncurrent assets	(2,561)
Increase (decrease) in operating liabilities:	
Due to third-party payors, net	1,239
Accounts payable and other current liabilities	395
Estimated self-insurance liability	(3,139)
Pension, deferred compensation, and other long-term liabilities	6,260
Net cash provided by operating activities	<u>23,917</u>
Cash flows from investing activities:	
Purchases of property and equipment	(11,072)
Investments in joint venture arrangements	793
Change in other assets whose use is limited	1,322
Change in assets held in trust by others	695
Transfer of cash from restricted	1,000
Net decrease in investments	<u>962</u>
Net cash used in investing activities	<u>(6,300)</u>
Cash flows from financing activities:	
Payments on long-term obligations	<u>(2,841)</u>
Net cash used in financing activities	<u>(2,841)</u>
Net increase in cash and cash equivalents	14,776
Cash and cash equivalents – beginning of year	<u>14,091</u>
Cash and cash equivalents – end of period	<u>\$ 28,867</u>
Supplemental disclosure of cash flow information:	
Cash paid during the period for interest	\$ 210
Supplemental disclosure of noncash item:	
Assets acquired under capital lease	\$ 415

See accompanying notes to consolidated financial statements.

## **SAINT MARY'S HEALTH SYSTEM, INC.**

### Notes to Consolidated Financial Statements

July 31, 2016

#### **(1) Organization**

Saint Mary's Health System, Inc. (SMHS or the System) is a not-for-profit, nonstock Connecticut holding company. It is the sole member of Saint Mary's Hospital, Inc. (the Hospital) and Saint Mary's Hospital Foundation, Inc. (the Foundation).

The Hospital is an acute care hospital located in Waterbury, Connecticut. The Hospital was founded in 1907 and is licensed for 347 beds and 32 newborn bassinets. The Hospital currently staffs 168 beds and 20 newborn bassinets. The Hospital provides a broad range of inpatient and outpatient services including a number of medical and surgical specialties, obstetrics, pediatrics, mental health, alcohol and substance abuse rehabilitation (outpatient) and off-site ambulatory services.

The Hospital has five consolidated subsidiaries: Franklin Medical Group, P.C. (Franklin), a for-profit Connecticut corporation; Saint Mary's Indemnity Company, LLC (the Indemnity Company) a Vermont limited liability company; Diagnostic Imaging of Southbury, LLC (the Diagnostic Center), a for-profit Connecticut corporation, Naugatuck Valley MRI, LLC (NVMRI) a Connecticut limited liability company and Saint Mary's Physician Partners, LLC (Physician Partners) a Connecticut limited liability company.

The Indemnity Company was formed during June 2009 to provide professional and general liability insurance to the Hospital, Franklin, Scovill, Partners, and community physicians.

The Hospital has a 60% equity interest in the Diagnostic Center, which provides diagnostic imaging services. The remaining interest is accounted for as noncontrolling interest in the accompanying consolidated financial statements.

Physician Partners was formed during July 2014 as a Medicare Shared Savings Plan (MSSP) Accountable Care Organization (ACO).

The Hospital has a 78.3% equity interest in Naugatuck Valley MRI, which provides diagnostic imaging services. The remaining interest is accounted for as noncontrolling interest in the accompanying consolidated financial statements.

The Foundation was organized to raise funds to support the Hospital.

The assets, liabilities and operations of the Hospital's Auxiliary have not been reflected in the accompanying consolidated financial statements. Such amounts are not considered significant to the Hospital's consolidated financial position or results of its operations.

On August 1, 2016, the Health System became a member of Trinity Health New England as part of a member substitution.

#### **(2) Community Benefit**

The Hospital is a community teaching hospital that serves the healthcare needs of the Central Naugatuck Valley area. Like other healthcare providers across the nation, the Hospital is faced with the challenge of serving those in need with fewer resources. Although the Hospital cannot meet community needs alone, it



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Notes to Consolidated Financial Statements

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is committed to seek out unmet community needs and to be a catalyst in efforts to ensure an adequate community-wide response from government and public organizations in fulfilling community needs.

**(a) Charity and Uncompensated Care**

As part of fulfilling its mission, the Hospital provides care to all patients in need, regardless of their ability to pay. The Hospital has a formalized charity care policy that identifies which patients are deemed "charity care". During the ten-month period ended July 31, 2016, the costs associated with the charges foregone, measured using a ratio of cost to charge, related to charity care were approximately \$1,749,000.

In addition, the Hospital provides care to patients covered by governmental healthcare programs. During the ten-month period ended July 31, 2016, the Hospital estimates that the cost of providing this care exceeded compensation by \$16,700,000.

**(b) Education, Research and Training**

As a community teaching hospital affiliated with Yale School of Medicine, the Hospital has residency programs for general surgery, internal medicine and dental. These programs educate in excess of 50 residents and medical students per year. In addition to its residency programs, the Hospital furthers its educational mission by offering allied health programs affiliated with area educational facilities.

**(c) Wellness and Health Promotional Activities**

The Hospital provides many activities to promote the concept of healthy lifestyles, including the publishing and free distribution of Thrive, which reaches more than 30,000 community households, health risk screenings, health fairs, support groups, a web-based physician search tool, and a health content library available via the Hospital's website ([www.stmh.org](http://www.stmh.org)).

**(d) Leadership, Advocacy and Voluntarism**

The Hospital's employees are responsive to the community in the areas of planning, governance and service by annually providing thousands of hours of volunteer services, participating on boards of directors and advisory councils, testifying before public policy bodies and working with other healthcare organizations to develop healthcare policies for all persons. The Hospital also provides volunteer opportunities for community residents. The Hospital recognizes donated goods and services at their appraised or estimated value if they create or enhance nonfinancial assets or require specialized skills and would typically be purchased if not provided by donation. The volunteer services the Hospital received do not meet this criteria for recognition in the accompanying consolidated financial statements, but the volunteers donate a significant amount of time to the Hospital. In the ten-month period ended July 31, 2016, approximately 152 volunteers spent more than 13,800 hours of service in Hospital departments.

**(e) Dollar, Time and In-kind Donations**

The Hospital also provides services to neighborhood schools and organizations at no cost. Contributions are made to programs, organizations and foundations for efforts on behalf of the poor, the disadvantaged and the general population. The Hospital also provides a variety of in-kind services

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Notes to Consolidated Financial Statements

July 31, 2016

including education on parenting and child abuse prevention and use of Hospital space for community meetings.

**(f) Other Support Services**

The Hospital provides outreach and social support services to patients. Programs such as the Sleep Disorders Support Group and the Chronic Lung Disorders/Pulmonary Support Group are integral to the healing of patients, and represent the Hospital's overall commitment to the continuum of care.

**(3) Summary of Significant Accounting Policies**

**(a) Basis of Presentation**

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. All intercompany transactions have been eliminated in consolidation.

**(b) Patient Service Revenue**

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**(c) Charity Care and Provision for Uncollectible Accounts**

The Hospital provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than its established rates. Because the Hospital does not anticipate collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Additions to the allowance for uncollectible accounts are made by means of the provision for uncollectible accounts. Accounts written off as uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

**(d) Cash and Cash Equivalents**

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

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The System invests its surplus operating funds in overnight repurchase agreement investments. These investments are collateralized with securities issued by the United States Government or its agencies and are not covered by FDIC insurance.

**(e) *Assets Whose Use is Limited***

Assets whose use is limited primarily include assets held by others pursuant to donor restrictions, pledged as collateral under debt agreements, and by the Hospital's wholly owned captive insurance company for professional and general liability insurance.

**(f) *Marketable Securities***

Investments in equity securities, mutual funds and all investments in debt securities are reported at fair value based on readily determinable fair market values or estimated fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized 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. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities or are considered to be other than temporarily impaired.

The System has followed a policy of reviewing all investments that have been below cost by at least 25% for three quarters. Unless specific evidence exists to the contrary, the adjustments of these investments to fair value (i.e. new cost basis) is reflected as an other than temporary impairment. The System recorded no other than temporary impairments on investments in the ten-month period ended July 31, 2016.

Investment securities, in general, are exposed to various risks. Recent market conditions have resulted in an unusually high degree of volatility and increased the risks and short term liquidity of certain investments held by the System which could impact the value of investments after the date of these consolidated financial statements.

**(g) *Property and Equipment***

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Costs for repairs and maintenance are expensed as incurred.

Gifts of long-lived assets are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restriction that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

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The System reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its fair value and may not be recoverable.

**(h) Investments In Joint Venture Arrangements**

Investments in joint venture arrangements, generally in the form of partnership interests, are accounted for using the equity method of accounting.

**(i) Fair Value of Financial Instruments**

FASB ASC 820 establishes a framework for measuring fair value which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

*Level 1* – Inputs into the valuation methodology are the unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.

*Level 2* – Inputs into the valuation methodology include quoted prices for similar assets or liabilities in active and inactive markets, other than quoted prices that are observable for specific assets or liabilities, and values that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified contractual term, the value must be observable for substantially the full term of the asset or liability.

*Level 3* – Inputs into the valuation methodology are unobservable and significant to the fair value measurement.

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.

Assets held in trust by others represents a donor established perpetual trust held and administered by an outside trustee. The Hospital owns an interest in the trust rather than in the securities underlying the trust, and therefore it is generally required to consider such investments as Level 3 for the purposes of applying ASC 820. Such classification is based on the inability to redeem the investment, even though the underlying securities may not be difficult to value or may be readily marketable. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments.

The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the System 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 fair value measurement at the reporting date.

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The carrying amount of patient accounts receivable, accounts payable, and accrued expenses approximate fair value because of the short maturity of these accounts.

**(j) Net Asset Categories**

To ensure observance of limitations and restrictions placed on the use of resources available to the System, the accounts of the System are maintained in the following net asset categories:

Unrestricted – Unrestricted net assets represent available resources other than donor restricted contributions. Included in unrestricted net assets are assets designated by the board of directors for future capital improvements or for other purposes, as deemed appropriate.

Temporarily Restricted – Temporarily restricted net assets represent contributions that are restricted by the donor either as to purpose or as to time of expenditure.

Permanently Restricted – Permanently restricted net assets represent contributions received with the donor restriction that the principal be invested in perpetuity and that only the income earned that the trustee does not reinvest be available for operations. The net appreciation of the value of investments held in trust by others remains in permanently restricted net assets until cash is transferred to the System.

**(k) Excess of Revenues over Expenses**

Excess of revenues over expenses included in the consolidated statement of operations reflects the System's performance measure. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, except for losses that are deemed to be other than temporary, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets). Nonoperating gains and losses, and equity in earnings of joint ventures are considered in the performance measure.

**(l) Income Taxes**

The System, Hospital, and Foundation are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code and are generally exempt from income taxes. The accompanying consolidated financial statements have been prepared on the basis that this tax-exempt status will be maintained.

Franklin is a for-profit organization subject to income taxes. Franklin has net operating loss carryforwards. A valuation allowance has been recorded as management believes realization of such carryforwards is doubtful.

The Diagnostic Center and NVMRI are pass-through entities. The Indemnity Company and Physician Partners are disregarded entities. The tax consequences of their operating results are assessed at the member level.

The System recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount of

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

benefit that is greater than fifty percent likely to be realized upon settlement. Changes in measurement are reflected in the period in which the change in judgment occurs. The System did not recognize the effect of any income tax positions in the ten-month period ended July 31, 2016.

***(m) Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Financial statement areas where management applies the use of assumptions and estimates consist primarily of the allowance for uncollectible accounts, contractual allowances and related third-party accounts, the pension liability, and the estimated self-insurance liability.

***(n) Professional and General Liability***

The liability for unpaid losses and loss adjustment expenses includes estimates for reported losses, plus supplemental amounts calculated based upon loss projections utilizing the Indemnity Company's and insureds' historical data. In establishing this reserve, the Indemnity Company utilizes the findings of an independent consulting actuary. Management believes that its aggregate liability for unpaid losses and loss adjustment expenses at year-end represents its best estimate, based upon available data, of the amount necessary to cover the ultimate cost of losses.

The ultimate liability and receivable could be significantly in excess of or less than the amount indicated in the consolidated financial statements. As adjustments to these estimates become necessary, such adjustments will be reflected in current operations.

***(o) Goodwill***

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is amortized over 10 years on a straight line basis.

***(p) Recently Issued Accounting Pronouncements***

In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-07, Fair Value Measurement (Topic 820) – Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent), which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. ASU 2015-07 also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Reporting entities will be required to disclose the amount of investments measured at net asset value (or its equivalent) using the practical expedient to reconcile total investments in the fair value hierarchy to total investments measured at fair value. ASU 2015-07 is effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The effective date for all other entities is fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

Management is currently evaluating the effect of this guidance on its consolidated financial statements.

**(4) Net Revenue from Patient Services**

A substantial portion of net revenue from patient services is derived from funds provided on behalf of patients under federal and state medical assistance programs. Revenue from some of these sources is determined by the application of reimbursement principles and is subject to audit by the applicable agencies. In the opinion of management, such principles have been properly applied in the determination of net patient service revenue. Settlement notices have been received from the Medicare program through 2013 and tentative settlements from the Medicaid program through 2015. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or as years are no longer subject to audits, reviews and investigations. Adjustments related to prior year estimates increased the System's net revenues by approximately \$1,046,000 for the ten-month period ended July 31, 2016.

Net patient service revenues consist of inpatient revenues, principally from routine patient care and ancillary services and outpatient revenues from ancillary services, after considering allowances under agreements with various third-party payors and provisions for uncollectible accounts. A reconciliation of gross revenues to net revenues from patient services after allowance for the ten-month period ended July 31, 2016 is as follows (in thousands):

	<b>Saint Mary's Hospital</b>	<b>Subsidiaries</b>	<b>2016 Total</b>
Gross revenue from patient services	\$ 681,057	82,380	763,437
Contractual and other allowances	(447,155)	(50,322)	(497,477)
Charity care	(1,749)	—	(1,749)
Provision for uncollectible accounts, net of recoveries	(5,901)	(1,623)	(7,524)
Net revenue from patient services	<u>\$ 226,252</u>	<u>30,435</u>	<u>256,687</u>

The System recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of discounted rates based on the self-pay discount policy. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts related to uninsured patients in the period the

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services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

	<b>Governmental and other third-party payors</b>	<b>Self-pay</b>	<b>Total all payors</b>
	<hr/>	<hr/>	<hr/>
Revenue from patient services, net of contractual allowances, as of July 31, 2016	\$ 258,400	5,811	264,211

The System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of gross receivables from private pay patients and third-party payors at July 31, 2016 and September 30, 2015 was as follows:

	<b>2016</b>	<b>2015</b>
	<hr/>	<hr/>
Medicare (including Medicare managed care)	33.8%	31.4%
Medicaid	10.6	16.1
Other third-party payors	38.1	35.4
Private pay patients	17.5	17.1
	<hr/>	<hr/>
	100.0%	100.0%
	<hr/>	<hr/>

The System's exposure to risk of nonpayment from private pay patients is more significant than other payors. However, the System has recorded an estimate for uncollectible accounts, which, in management's opinion, is sufficient to provide for such risk. This estimate is based on a variety of factors including historical experience, the current economic environment and recent payment patterns.

**(5) Regulatory and Legislative Matters**

**(a) State of Connecticut Regulatory Environment**

Connecticut's acute care hospital regulatory system is currently administered by the State of Connecticut Office of Health Care Access (OHCA). The Hospital is subject to a regulatory system that includes the administration of a pool resulting in distribution of monies by the State to the Hospital.

The Hospital is subject to legislation enacted in 2011 imposing a tax on certain net patient service revenues of hospitals and changes to the disproportionate share hospital payments (DSH) pursuant to 2011 Conn. Pub. Acts 6 (145-149), as amended by 2011 Conn. Pub. Acts 44 (102-103) and Conn. Pub. Acts 61 (79). The tax is paid on a quarterly basis. The Hospital recorded a tax of \$10,579,538 for the ten-month period ended July 31, 2016 which has been recorded in supplies and other expenses.



**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

The Hospital recorded \$4,059,660 of DSH payments and is recorded in contractual allowances for the ten-month period ended July 31, 2016.

**(b) Federal Regulatory Environment**

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse and security and privacy of health information. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

**(6) Marketable Securities and Assets Whose Use is Limited**

A comparison of cost and fair values of short-term investments, marketable securities, and assets whose use is limited, including the fair value of investments with unrealized losses that are not deemed other-than-temporarily impaired and the length of time the individual securities have been in a continuous unrealized loss position, at July 31, 2016 and September 30, 2015, is as follows (in thousands):

	2016					
	Total		Less than 12 months		12 months or more	
	Fair value	Cost	Fair value	Unrealized losses	Fair value	Unrealized losses
Cash and cash equivalents	\$ 13,620	13,620	—	—	—	—
Corporate bonds	12,837	12,425	—	—	—	—
U.S. government and agency obligations	9,424	9,276	48	(6)	—	—
Mutual funds	25,586	22,354	1,359	(72)	—	—
Equities	1,615	1,450	287	(117)	—	—
	<u>\$ 63,082</u>	<u>59,125</u>	<u>1,694</u>	<u>(195)</u>	<u>—</u>	<u>—</u>

**SAINT MARY'S HEALTH SYSTEM, INC.**

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	2015					
	Total		Less than 12 months		12 months or more	
	Fair value	Cost	Fair value	Unrealized losses	Fair value	Unrealized losses
Cash and cash equivalents	\$ 5,909	5,909	—	—	—	—
Corporate bonds	14,879	14,963	4,670	(89)	4,309	(149)
U.S. government and agency obligations	11,552	11,473	1,484	(6)	1,185	(10)
Mutual funds	29,096	27,114	3,531	(497)	—	—
Equities	1,308	1,620	394	(272)	—	—
	<u>\$ 62,744</u>	<u>61,079</u>	<u>10,079</u>	<u>(864)</u>	<u>5,494</u>	<u>(159)</u>

The above tables include permanently restricted assets held by others whose fair value exceeded cost by \$1,040,000 at July 31, 2016 and \$27,000 at September 30, 2015.

Assets whose use is limited for estimated self-insurance includes approximately \$2,670,000 and \$2,750,000 of other assets, substantially receivables, as of July 31, 2016 and September 30, 2015, respectively.

The following table sets forth by level, within the fair value hierarchy, the System's financial instruments at fair value as of July 31, 2016 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 12,416	—	—	12,416
Domestic corporate bonds	—	8,982	—	8,982
U.S. government and agency obligations	—	9,424	—	9,424
Equity mutual funds	16,288	—	—	16,288
Equity funds	513	—	—	513
Total	29,217	18,406	—	47,623
Assets held in trust by others:				
Perpetual trust	—	—	15,459	15,459
Total	<u>\$ 29,217</u>	<u>18,406</u>	<u>15,459</u>	<u>63,082</u>

**SAINT MARY'S HEALTH SYSTEM, INC.**

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The following table sets forth by level, within the fair value hierarchy, the System's financial instruments at fair value as of September 30, 2015 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 5,010	—	—	5,010
Domestic corporate bonds	—	13,425	—	13,425
U.S. government and agency obligations	—	9,692	—	9,692
Equity mutual funds	18,873	—	—	18,873
Fixed income mutual funds	522	—	—	522
Equity funds	458	—	—	458
<b>Total</b>	<b>24,863</b>	<b>23,117</b>	<b>—</b>	<b>47,980</b>
Assets held in trust by others:				
Perpetual trust	—	—	14,764	14,764
<b>Total</b>	<b>\$ 24,863</b>	<b>23,117</b>	<b>14,764</b>	<b>62,744</b>

Mutual funds and equities are traded actively on exchanges and price quotes for these shares are readily available.

For domestic and foreign bonds and U.S. government obligations multiple prices and price types are obtained from pricing vendors whenever possible, which enables cross-provider validations. A primary price source is identified based on asset type, class or issue for each security. The fair values of fixed-income securities are based on evaluated prices that reflect observable market information, such as actual trade information of similar securities, adjusted for observable differences.

The redemption period for the System's financial instruments ranges from daily to monthly and require notification of one to five days.

The following table presents additional information about investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the ten-month period ended July 31, 2016 (in thousands):

<u>Perpetual trust</u>	<u>2016</u>
Fair value at beginning of the year	\$ 14,764
Net realized and change in unrealized gains and losses	1,228
Appropriation of endowment assets for expenditure	<u>(533)</u>
Fair value at end of the year	<u>\$ 15,459</u>

Assets held in trust by others represents a donor established perpetual trust held and administered by an outside trustee. The Hospital receives a specific portion of the return on the underlying assets of the

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

perpetual trust. The investment income is recorded as net assets released from restriction in other operating revenues.

**(7) Property and Equipment**

A summary of property and equipment at July 31, 2016 and September 30, 2015 is as follows (in thousands):

	<b>2016</b>	<b>2015</b>
Land and land improvements (5–25 yrs)	\$ 8,344	8,316
Buildings and building improvements (10–40 yrs)	72,669	71,478
Equipment (3–25 yrs)	142,954	137,853
Projects in process	5,738	2,316
	229,705	219,963
Less accumulated depreciation and amortization	(158,864)	(149,672)
Property and equipment, net	\$ 70,841	70,291

Property under capital leases had a net book value of \$1,275,000 and \$611,000 at July 31, 2016 and September 30, 2015, respectively.

**(8) Long-Term Obligations**

In March 2015, the Hospital obtained a \$15.0 million bank loan that has a five year term with \$250,000 principal due each month and corresponding interest at the current LIBOR rate plus 110 basis points (1.6% and 1.3% at July 31, 2016 and September 30, 2015, respectively). The loan matures in February 2020. The bank loan is collateralized by securities pledged for such purposes. The Hospital is required to comply with certain financial covenants for the loan, including a debt service coverage ratio requirement of at least 1.25.

Other long-term obligations consist of capital equipment financing notes and capital leases.

Long-term obligations at July 31, 2016 and September 30, 2015 are as follows (in thousands):

	<b>2016</b>	<b>2015</b>
Bank loan	\$ 11,000	13,500
Capital leases	1,001	927
	12,001	14,427
Less current portion	(3,370)	(3,409)
	\$ 8,631	11,018

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

Principal payments on the Hospital's long-term obligations and capital leases are as follows (in thousands):

	<u>Long-term obligations</u>	<u>Capital leases</u>
Year ending September 30:		
2017	\$ 3,000	370
2018	3,000	203
2019	3,000	167
2020	2,000	166
2021	—	95
Thereafter	—	—
	<u>\$ 11,000</u>	<u>1,001</u>
Interest payments		<u>66</u>
		<u>\$ 1,067</u>

**(9) Line of Credit**

The Hospital maintains a financing agreement with a bank for a \$1,000,000 line of credit which had an August 13, 2016 maturity date. Interest on the line of credit is at the Hospital's choice of either the lending institution's prime rate or at the LIBOR rate plus 110 basis points. At July 31, 2016 and September 30, 2015, there was no outstanding balance under this line of credit agreement.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

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**(10) Unrestricted, Temporarily and Permanently Restricted Net Assets**

The changes in consolidated unrestricted net assets attributable to the System and noncontrolling interest for the ten-month period ended July 31, 2016 were as follows (in thousands):

	<u>Total</u>	<u>Controlling interest</u>	<u>Noncontrolling interest</u>
Unrestricted net assets, beginning of year	\$ 33,350	32,395	955
Excess of revenues over expenses	10,084	9,755	329
Net assets released from restriction for capital expenditures	348	348	—
Transfers to affiliates	(285)	(15)	(270)
Change in unrealized gains on marketable securities and other assets whose use is limited	1,279	1,279	—
Change in accumulated pension charges to unrestricted net assets	3,672	3,672	—
Unrestricted net assets, end of year	<u>\$ 48,448</u>	<u>47,434</u>	<u>1,014</u>

Temporarily restricted net assets are available for the following purposes at July 31, 2016 and September 30, 2015 (in thousands):

	<u>2016</u>	<u>2015</u>
Cancer	\$ 178	241
Building and equipment	236	236
Community services	583	421
Education	209	215
Other	772	809
	<u>\$ 1,978</u>	<u>1,922</u>

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

Permanently restricted net assets at July 31, 2016 and September 30, 2015 are restricted to (in thousands):

	<b>2016</b>	<b>2015</b>
Investments held by trustee in perpetuity, the income from which is expendable to support Hospital operations	\$ 15,476	14,781
Investments held by Hospital Foundation in perpetuity, the income from which is expendable to support:		
Hospital operations	900	900
Medical education	150	150
	<b>\$ 16,526</b>	<b>15,831</b>

**(11) Endowment**

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) adopted by the State of Connecticut (Act) provides standards to guide investing in a prudent manner and eliminated the restriction that endowment funds could not be spent below historical dollar value.

The System's endowment consists of funds established for a variety of purposes including donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. At July 31, 2016 and September 30, 2015, the System has no funds designated by the Board of Directors as endowment.

The System has interpreted 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. The System 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 System in a manner consistent with the standard of prudence prescribed by the Act.

The System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds; the duration and preservation of the fund, the purposes of the System and the donor-restricted endowment funds, general economic conditions, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, other resources of the System, and the investment policies of the System.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

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Endowment funds consist of the following at July 31, 2016 and September 30, 2015 (in thousands):

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds at July 31, 2016	\$ 409	16,526	16,935
Donor-restricted endowment funds at September 30, 2015	\$ 409	15,831	16,240

Changes in endowment funds for the ten-month period ended July 31, 2016 is as follows (in thousands):

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, September 30, 2015	\$ 409	15,831	16,240
Investment return:			
Investment income	—	208	208
Net appreciation	—	1,020	1,020
Total investment return	—	1,228	1,228
Contributions	—	—	—
Appropriation of endowment assets for expenditure	—	(533)	(533)
Endowment net assets, July 31, 2016	\$ <u>409</u>	<u>16,526</u>	<u>16,935</u>

The System 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 the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the System must hold in perpetuity or for a donor-specified period. Funds held in trust by others represents a donor established perpetual trust held and administered by an outside trustee and are not within the System's control as to spending and investment policies.

To satisfy its long term rate-of-return objectives, the System 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 System targets a diversified asset allocation that places emphasis on investments in equities and fixed income investments to achieve its long-term return objectives with prudent risk constraints.



## SAINT MARY'S HEALTH SYSTEM, INC.

### Notes to Consolidated Financial Statements

July 31, 2016

The System follows a policy of spending an amount that approximates the investment income earned, in addition to specific purchases of capital equipment. Accordingly, the System expects its spending policy will allow its endowment funds to be maintained in perpetuity by growing at a rate at least equal to the planned payouts. Additional real endowment growth will be provided through new gifts and any excess investment return.

#### **(12) Professional and General Liability**

Prior to July 1, 2009, the Hospital purchased limits of professional and general liability from Partners Interinsurance Exchange (PIE) to cover risks up to specified limits. Within PIE the Hospital maintained retentions net to its own account by type of coverage. A claims made reinsurance contract was purchased each fiscal year that provided coverage above these retentions. Beginning January 1, 2002, the professional liability coverage provided for total limits, with respect to professional liability, of \$18 million per claim and \$27 million in the aggregate, with a retention inside that limit of \$3,000,000 per incident applying as net to the Hospital's account within PIE. The general liability coverage provided limits of \$16 million per claim and \$19 million in the aggregate with a retention of \$1,000,000 per incident and \$4,000,000 in the annual aggregate retained as net to the Hospital's account within PIE. The Hospital paid an actuarially determined premium to PIE for the purpose of setting aside assets to cover the reasonable value of ultimate expected loss retained as net within PIE.

During June 2009, the Hospital established the Indemnity Company as a successor to the Hospital's financial interest in PIE. On July 1, 2009 the Hospital's account in PIE was transferred to the Indemnity Company. The Hospital and certain affiliates continue to purchase limits of professional and general liability from the Indemnity Company at levels previously purchased from PIE.

Professional liability claims have been asserted against the Hospital by various claimants. The claims are in various stages of assessment and resolution. There are also known and unknown incidents that have occurred through July 31, 2016 that may result in the assertion of additional claims. Actuarially determined premiums are paid in order to set aside assets to cover the reasonable value of ultimate expected losses. Hospital management, along with its consulting actuaries, accrued its best estimate of professional and general liabilities. The resolution of these claims, including those unasserted, involves extended evaluation of the facts, including the involvement of independent specialists. As a result, the estimates made are reassessed periodically and subject to change. Hospital management believes that the ultimate settlement of these claims will not have a material impact on the Hospital's consolidated financial position or results of their operations, as adequate self-insurance reserves, Indemnity Company assets and reinsurance are in place.

The Indemnity Company entered into a loss portfolio transfer (LPT) on July 1, 2009 with PIE. The losses associated with this transaction did not transfer insurance risk to the Indemnity Company. As such, this LPT is accounted for using deposit accounting, which requires offsetting assets and liabilities.

**SAINT MARY'S HEALTH SYSTEM, INC.**

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July 31, 2016

Activity in the reserves for premiums held on deposit included in self-insurance liability is summarized as follows (in thousands):

	<u>2016</u>
Reserves for premiums held on deposit at beginning of year	\$ 41
Current period payments from loss escrow	—
Change in reserve for premiums held on deposit for loss portfolio transfer	—
Current period payments from reserves for premiums held on deposit	<u>(50)</u>
Reserves for premium held on deposit at end of year	<u><u>\$ (9)</u></u>

Activity in the self-insurance liability for unpaid losses and loss adjustment expenses for prospective losses is summarized as follows (in thousands):

	<u>2016</u>
Balance at beginning of period	\$ 18,087
Less reinsurance recoverable	<u>(2,750)</u>
Net balance at beginning of period	<u>15,337</u>
Incurred related to:	
Current period	4,072
Prior years	<u>(4,769)</u>
Total incurred	<u>(697)</u>
Paid related to:	
Current period	49
Prior years	<u>1,976</u>
Total paid	<u>2,025</u>
Net balance at end of period	12,615
Add reinsurance recoverable	<u>2,670</u>
Balance at end of period	<u><u>\$ 15,285</u></u>

The provision for incurred losses related to prior years (relating to loss incurred subsequent to the loss portfolio transfer from Partner Interinsurance Exchange at July 1, 2009) totaled (\$4,769,000) for the ten-month period ended July 31, 2016, the result of development on outstanding claims.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

**(13) Retirement Plans**

**(a) Defined Benefit Plan**

The Hospital has a noncontributory, defined benefit pension plan (the Plan) for most employees, which is funded with available cash flow. The Plan is qualified as a "Church Plan" and is therefore exempt from a majority of ERISA regulations. Plan benefits are not guaranteed by the Pension Benefit Guaranty Corporation. The Plan was frozen to new entrants in 1997. In 2004, the Plan's benefits were curtailed to eliminate participants' earnings of additional benefits for future services.

The following table sets forth the Plan's funded status as of September 30, 2015, the Plan measurement date, (in thousands):

	<u><b>2015</b></u>
Projected benefit obligation	\$ (141,031)
Fair value of plan assets	<u>67,013</u>
Funded status	<u><u>\$ (74,018)</u></u>
Amounts recognized in consolidated balance sheets consist of:	
Noncurrent liabilities	\$ (74,018)
Accumulated charges to unrestricted net assets, consisting of net actuarial losses	<u>59,111</u>
Net amount recognized	<u><u>\$ (14,907)</u></u>

The net actuarial loss that will be amortized from accumulated charges to unrestricted net assets into net periodic benefit cost over the remainder of fiscal year is estimated to be \$734,500

The accumulated benefit obligation for the pension plan was \$141,031,000 at September 30, 2015. Net periodic benefit cost recognized in the ten-month period ended July 31, 2016 is (in thousands):

Interest cost	\$ 5,258
Expected return on plan assets	(4,542)
Net amortization and deferral	<u>3,672</u>
Net periodic benefit cost	<u><u>\$ 4,388</u></u>

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

Weighted average assumptions used to determine benefit obligations and net periodic benefit cost as of September 30, 2015 were as follows:

	<b>2015</b>
Weighted average assumptions at September 30:	
Discount rate for benefit obligations	4.60%
Discount rate for net periodic benefit cost	4.55
Expected return on plan assets	8.00

The discount rate is based on high-grade bond yield curve under which benefits were projected and discounted at spot rates along the curve. The discount rate was then determined as a single rate yielding the same present values.

The following table sets forth by level, within the fair value hierarchy, the pension plan's financial instruments at fair value as of September 30, 2015 (in thousands):

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 8,078	—	—	8,078
U.S. government and agency obligations	—	41	—	41
Equity mutual funds	39,130	—	—	39,130
Fixed income mutual funds	19,764	—	—	19,764
Total	\$ 66,972	41	—	67,013

The redemption period for the Plan's financial instruments ranges from daily to monthly and require notification of one to five days.

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the target allocation of each class. Equity securities are expected to return 9% to 10% over the long-term, while debt securities are expected to return between 4% and 7%. Money market funds are held to pursue market opportunities.

The investment policy, as established by the Investment Committee, is to earn a total return in any five-year period that will have exceeded the interest assumption in the actuarial plan valuation for that five-year period. For performance evaluation purposes, all rates of return will be examined on a net-of-fee basis. The pension assets are to be broadly diversified so as to limit the impact of large losses in individual investments on the total portfolio. The asset allocation is reviewed on a quarterly basis.

In the aggregate, contributions to the pension plan are expected to be \$7,600,000 in the next fiscal year.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

The following benefit payments are expected to be paid (in thousands):

2017	\$	8,060
2018		8,387
2019		8,681
2020		8,925
2021		9,189
2022 through 2026		<u>47,746</u>
	\$	<u><u>90,988</u></u>

**(b) Defined Contribution Plan**

The Hospital established a defined contribution plan when it reduced the benefits of the Plan via amendment in 1997. The defined contribution plan provides for a Hospital match up to a certain percentage of employee contributions. Expenses related to the defined contribution plan amounted to \$3,446,000 in the ten-month period ended July 31, 2016 and are included in employee benefits expense in the accompanying consolidated statement of operations.

**(c) Supplemental Pension Plan**

In addition, the Hospital has an unfunded supplemental pension plan for a small group of long term employees, who are now retired. The Hospital's recorded liability was \$957,000 as of July 31, 2016 and September 30, 2015.

**(14) Leases and Rental Expenses**

Rental expense aggregated approximately \$5,120,000 for the ten-month period ended July 31, 2016. Minimum future rental commitments on all noncancelable operating leases with initial or remaining terms of more than one year are as follows (in thousands):

Fiscal year:		
2016	\$	696
2017		4,177
2018		3,297
2019		2,818
2020		2,363
2021		2,221
2022 and thereafter		<u>7,830</u>
	\$	<u><u>23,402</u></u>

**(15) Cancer Center**

During 1997, the Hospital entered into an agreement with Waterbury Hospital to develop a joint Cancer Care Center, known as the Harold Leever Regional Cancer Center (HLRCC) that provides treatment services to cancer patients in the greater Waterbury area. The Hospital is entitled to distributions at the

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

discretion of HLRCC's Board of Directors, which is selected by Waterbury Hospital and the Hospital on a 50/50 basis. The Hospital's investment in HLRCC is carried on the equity basis, and the carrying value is approximately \$8,533,000 and \$9,356,000 at July 31, 2016 and September 30, 2015, respectively. Equity in earnings (losses) was approximately (\$688,000) for the ten months ended July 31, 2016.

**(16) Heart Center of Greater Waterbury**

The Hospital and Waterbury Hospital operate an advanced cardiac care program known as the Heart Center of Greater Waterbury, Inc. (HCGW). Patients at the Hospital and Waterbury Hospital are provided access to services such as angioplasty and open heart surgery. Procedures are performed at both hospitals, each recording related revenues and expenses. The HCGW, a MSO that provides administrative support and management functions to the program, has a Board of Directors selected by Waterbury Hospital and the Hospital on a 50/50 basis. HCGW incurs costs, which are funded by the hospitals, to market the program and derives no net assets from its activities. The Hospital expensed \$88,000 of funding for the ten months ended July 31, 2016.

**(17) Other Operating Revenues**

Components of other operating revenues for the ten months ended July 31, 2016 are as follows (in thousands):

	<u>2016</u>
Investment income related to short-term investments	\$ 88
Net assets released from restriction	625
Contributions	715
Cafeteria	1,044
Outside services	205
State grants	619
Parking fees	183
Day care	657
Rentals	1,127
Meaningful Use	1,043
Rebates/discounts	510
Other grants	1,578
Other	<u>645</u>
Total	<u>\$ 9,039</u>

**SAINT MARY'S HEALTH SYSTEM, INC.**

Notes to Consolidated Financial Statements

July 31, 2016

**(18) Functional Expenses**

The System provides general health care services to residents within its geographic location. Expenses related to providing these services for the ten months ended July 31, 2016 are as follows (in thousands):

	<u>2016</u>
Health care services	\$ 204,329
General and administrative	52,053
Fundraising	<u>605</u>
	<u>\$ 256,987</u>

**(19) Subsequent Events**

The System has evaluated events through April 7, 2017, which represents the date the consolidated financial statements were available to be issued and noted no subsequent events that would have impacted the System's consolidated financial statements except as disclosed below:

On August 1, 2016, the Health System became a member of Trinity Health New England as part of a member substitution.

Effective August 1, 2016, Saint Mary's Health System, Inc. merged into Saint Mary's Hospital, Inc.

On August 1, 2016, the Hospital paid off the remaining outstanding bank loan balance using proceeds from the sale of pledged collateral investments.

In October 2016, Saint Mary's Indemnity Company, LLC declared a dividend in the amount of \$13,422,000. Of which cash of \$3,649,000 would be released to Saint Mary's Hospital, Inc. and the remaining amount would not be disbursed, but rather used to eliminate the receivables from the Hospital totaling \$9,773,000.

Effective March 1, 2017, Saint Mary's Indemnity Company, LLC merged into Trinity Assurance, Ltd., a Cayman Islands exempted company.

SAINT MARY'S HEALTH SYSTEM, INC.

Consolidating Balance Sheet

July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	Saint Mary's Hospital	Franklin Medical Group, P.C.	Saint Mary's Physician Partners, LLC	Saint Mary's Indemnity Company, LLC	Naugatuck Valley MRI, LLC	Diagnostic Imaging of Southbury	Eliminations	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation, Inc.	Saint Mary's Health System Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
Current assets:												
Cash and cash equivalents	\$ 26,931	305	23	—	101	308	—	27,668	1,190	9	—	28,867
Short-term investments	23	—	—	—	—	—	—	23	—	—	—	23
Current portion of assets whose use is limited	—	—	—	3,418	—	—	—	3,418	—	—	—	3,418
Accounts receivable, net	27,043	3,760	—	5,090	238	480	(5,090)	31,521	42	—	—	31,563
Other current assets	10,373	225	—	5,948	154	19	(6,506)	10,213	6	—	100	10,319
Total current assets	64,370	4,290	23	14,456	493	807	(11,596)	72,843	1,238	9	100	74,190
Marketable securities	124	—	—	—	—	—	—	124	4,431	—	—	4,555
Assets whose use is limited:												
By donor and held in trust by others	15,459	—	—	—	—	—	—	15,459	—	—	—	15,459
For estimated self-insurance liability	—	—	—	23,899	—	—	—	23,899	—	—	—	23,899
Pledged collateral	21,816	—	—	—	—	—	—	21,816	—	—	—	21,816
Net interest in Foundation	5,509	—	—	—	—	—	—	5,509	—	—	(5,509)	—
Other	6	—	—	—	—	—	—	6	—	—	—	6
Total assets whose use is limited	42,790	—	—	23,899	—	—	—	66,689	—	—	(5,509)	61,180
Less current portion of assets whose use is limited	—	—	—	3,418	—	—	—	3,418	—	—	—	3,418
Noncurrent assets whose use is limited	42,790	—	—	20,481	—	—	—	63,271	—	—	(5,509)	57,762
Property and equipment, net	65,320	1,932	—	—	832	1,449	—	69,533	3	1,305	—	70,841
Other assets:												
Investments in joint venture arrangements	29,787	—	—	—	—	—	(21,037)	8,750	—	—	—	8,750
Other noncurrent assets	2,784	—	—	—	1,657	—	—	4,441	—	—	—	4,441
Total other assets	32,571	—	—	—	1,657	—	(21,037)	13,191	—	—	—	13,191
Total assets	\$ 205,175	6,222	23	34,937	2,982	2,256	(32,633)	218,962	5,672	1,314	(5,409)	220,539



**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidating Balance Sheet

July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	Saint Mary's Hospital	Franklin Medical Group, P.C.	Saint Mary's Physician Partners, LLC	Saint Mary's Indemnity Company, LLC	Naugatuck Valley MRI, LLC	Diagnostic Imaging of Southbury	Eliminations	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation, Inc.	Saint Mary's Health System Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
<b>Current liabilities:</b>												
Current portion of long-term obligations	\$ 3,122	—	—	—	165	83	—	3,370	—	—	—	3,370
Accounts payable	18,104	583	—	—	50	96	—	18,833	31	—	—	18,864
Salaries, wages, and payroll withholdings	5,319	2,345	—	—	15	360	—	8,039	—	—	—	8,039
Due to third-party payors, net	1,966	—	—	—	—	—	—	1,966	—	—	—	1,966
Accrued expenses and other current liabilities	20,450	526	125	4,531	102	131	(11,596)	14,269	132	(189)	100	14,312
<b>Total current liabilities</b>	<b>48,961</b>	<b>3,454</b>	<b>125</b>	<b>4,531</b>	<b>332</b>	<b>670</b>	<b>(11,596)</b>	<b>46,477</b>	<b>163</b>	<b>(189)</b>	<b>100</b>	<b>46,551</b>
<b>Long-term liabilities:</b>												
Long-term obligations, net of current portion	8,000	—	—	—	313	318	—	8,631	—	—	—	8,631
Estimated self-insurance liability	2,754	—	—	11,858	—	—	—	14,612	—	—	—	14,612
Pension and deferred compensation	74,611	—	—	—	—	—	—	74,611	—	—	—	74,611
Other long-term liabilities	8,282	900	—	—	—	—	—	9,182	—	—	—	9,182
<b>Total long-term liabilities</b>	<b>93,647</b>	<b>900</b>	<b>—</b>	<b>11,858</b>	<b>313</b>	<b>318</b>	<b>—</b>	<b>107,036</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>107,036</b>
<b>Net assets (deficit):</b>												
Unrestricted	44,063	1,868	(102)	18,548	2,337	1,268	(22,051)	45,931	2,524	1,503	(2,524)	47,434
Noncontrolling interest in subsidiaries	—	—	—	—	—	—	1,014	1,014	—	—	—	1,014
<b>Total unrestricted</b>	<b>44,063</b>	<b>1,868</b>	<b>(102)</b>	<b>18,548</b>	<b>2,337</b>	<b>1,268</b>	<b>(21,037)</b>	<b>46,945</b>	<b>2,524</b>	<b>1,503</b>	<b>(2,524)</b>	<b>48,448</b>
Temporarily restricted	1,978	—	—	—	—	—	—	1,978	1,935	—	(1,935)	1,978
Permanently restricted	16,526	—	—	—	—	—	—	16,526	1,050	—	(1,050)	16,526
<b>Total net assets</b>	<b>62,567</b>	<b>1,868</b>	<b>(102)</b>	<b>18,548</b>	<b>2,337</b>	<b>1,268</b>	<b>(21,037)</b>	<b>65,449</b>	<b>5,509</b>	<b>1,503</b>	<b>(5,509)</b>	<b>66,952</b>
<b>Total liabilities and net assets</b>	<b>\$ 205,175</b>	<b>6,222</b>	<b>23</b>	<b>34,937</b>	<b>2,982</b>	<b>2,256</b>	<b>(32,633)</b>	<b>218,962</b>	<b>5,672</b>	<b>1,314</b>	<b>(5,409)</b>	<b>220,539</b>

See accompanying independent accountants' review report.

**SAINT MARY'S HEALTH SYSTEM, INC.**

Consolidating Statement of Operations

For the ten months ended July 31, 2016

(In thousands)

(Unaudited - See Accompanying Independent Accountants' Review Report)

	Saint Mary's Hospital	Franklin Medical Group, P.C.	Saint Mary's Physician Partners, LLC	Saint Mary's Indemnity Company, LLC	Naugatuck Valley MRI, LLC	Diagnostic Imaging of Southbury	Eliminations	Saint Mary's Hospital, Inc. Consolidated	Saint Mary's Hospital Foundation, Inc.	Saint Mary's Health System Inc.	Eliminations	Saint Mary's Health System, Inc. Consolidated
<b>Revenues:</b>												
Revenue from patient services, net of contractual allowances	\$ 232,153	25,325	—	—	1,613	5,120	—	264,211	—	—	—	264,211
Provision for uncollectible accounts, net of recoveries	(5,901)	(1,623)	—	—	—	—	—	(7,524)	—	—	—	(7,524)
Net revenue from patient services	226,252	23,702	—	—	1,613	5,120	—	256,687	—	—	—	256,687
Other operating revenues	11,616	3,034	—	3,683	4	7	(9,924)	8,420	837	137	(355)	9,039
Total revenues	237,868	26,736	—	3,683	1,617	5,127	(9,924)	265,107	837	137	(355)	265,726
<b>Expenses:</b>												
Salaries and wages	76,717	31,838	78	—	344	1,021	—	109,998	186	32	—	110,216
Employee benefits	23,921	4,015	—	—	60	252	—	28,248	49	9	—	28,306
Supplies and other expenses	101,142	8,199	335	(319)	994	2,915	(5,466)	107,800	369	113	(137)	108,145
Depreciation and amortization	9,482	283	—	—	128	151	—	10,044	1	65	—	10,110
Interest	192	—	—	—	6	12	—	210	—	—	—	210
Total expenses	211,454	44,335	413	(319)	1,532	4,351	(5,466)	256,300	605	219	(137)	256,987
Operating income (loss)	26,414	(17,599)	(413)	4,002	85	776	(4,458)	8,807	232	(82)	(218)	8,739
<b>Nonoperating gains (losses):</b>												
Investment income, net	926	—	—	337	—	—	—	1,263	—	—	—	1,263
Equity in earnings of joint ventures	50	—	—	—	—	—	—	50	—	—	—	50
Change in net assets of Foundation	—	—	—	—	—	—	—	—	—	—	—	—
Net (loss) gain on disposal of assets	—	—	—	—	—	—	—	—	—	—	—	—
Other	31	—	—	—	1	—	—	32	—	—	—	32
Total nonoperating gains (losses), net	1,007	—	—	337	1	—	—	1,345	—	—	—	1,345
Excess (deficiency) of revenues over expenses	27,421	(17,599)	(413)	4,339	86	776	(4,458)	10,152	232	(82)	(218)	10,084
Net assets released from restriction	348	—	—	—	—	—	—	348	—	—	—	348
Capital transactions, net	(16,068)	16,068	275	—	(100)	(620)	174	(271)	(322)	—	308	(285)
Change in unrealized gains on marketable securities and other assets whose use is limited	1,279	—	—	664	—	—	(664)	1,279	554	—	(554)	1,279
Change in accumulated pension credits to unrestricted net assets	3,672	—	—	—	—	—	—	3,672	—	—	—	3,672
Increase (decrease) in unrestricted net assets	\$ 16,652	(1,531)	(138)	5,003	(14)	156	(4,948)	15,180	464	(82)	(464)	15,098

See accompanying independent accountants' review report.