

THE WATERBURY HOSPITAL AND SUBSIDIARIES

**CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION**

SEPTEMBER 30, 2011 AND 2010

THE WATERBURY HOSPITAL AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
The Waterbury Hospital

We have audited the accompanying consolidated balance sheets of The Waterbury Hospital (the Hospital) as of September 30, 2011 and 2010, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Waterbury Hospital as of September 30, 2011 and 2010, and the consolidated results of their operations and changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Marcum LLP

Hartford, CT
January 27, 2012

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2011 AND 2010

	2011	2010
Assets		
Current Assets		
Cash and cash equivalents	\$ 15,410,669	\$ 21,406,848
Short-term investments	401,931	391,878
Other assets required for current liabilities	--	582,693
Patient accounts receivable, less allowance ((\$7,726,000 in 2011 and \$7,925,000 in 2010))	36,400,710	31,845,438
Grants and other receivables	2,466,833	1,728,061
Inventories of supplies	858,762	812,360
Prepaid insurance and other expenses	1,747,158	1,376,780
Due from third-party reimbursement agencies	2,858,086	--
Due from affiliates	3,848,949	--
Total Current Assets	63,993,098	58,144,058
Other Assets		
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee:		
Construction fund	3,958,301	--
Debt service fund	--	582,693
Debt service reserve fund	--	2,020,082
	3,958,301	2,602,775
Less other assets required for current liabilities	--	(582,693)
	3,958,301	2,020,082
Funds held in trust by others	37,339,264	39,561,090
Long-term investments	8,760,627	10,067,386
Board-designated endowment funds	2,615,009	2,787,502
Other receivables	3,240	136,573
Due from affiliates, less current portion	--	5,695,627
Goodwill	1,813,567	--
CHEFA obligations issue expense, less amortization	360,656	575,582
	50,892,363	58,823,760
Property, plant and equipment:		
Land	287,549	287,549
Buildings and improvements	88,987,893	86,741,575
Equipment	180,860,538	168,836,349
Construction in progress (estimated additional cost to complete: 2011 - \$10,300,000)	3,023,126	1,688,586
	273,159,106	257,554,059
Less accumulated depreciation	(223,542,449)	(214,263,664)
	49,616,657	43,290,395
	\$ 168,460,419	\$ 162,278,295

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

SEPTEMBER 30, 2011 AND 2010

	2011	2010
Liabilities and Net Assets		
Current Liabilities		
Accounts payable and accrued expenses	\$ 27,318,723	\$ 18,963,920
Salaries, wages, payroll taxes and amounts withheld from employees	10,097,040	9,204,942
Due to third-party reimbursement agencies	--	230,310
Current portion of CHEFA obligations	423,779	865,000
Current portion of notes payable	584,216	472,875
Due to affiliates	--	179,137
Total Current Liabilities	<u>38,423,758</u>	<u>29,916,184</u>
Other Noncurrent Liabilities	<u>19,806,617</u>	<u>14,667,421</u>
CHEFA Obligations - less current portion and discount	<u>25,207,100</u>	<u>18,142,716</u>
Notes Payable - less current portion	<u>1,499,034</u>	<u>736,885</u>
Net Assets		
Unrestricted	33,733,004	45,216,062
Temporarily restricted	6,477,454	8,315,873
Permanently restricted	40,131,275	42,353,101
Total Net Assets Excluding Noncontrolling Interests	80,341,733	95,885,036
Noncontrolling Interests	<u>3,182,177</u>	<u>2,930,053</u>
Total Net Assets	<u>83,523,910</u>	<u>98,815,089</u>
	<u>\$ 168,460,419</u>	<u>\$ 162,278,295</u>

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF OPERATIONS
AND CHANGES IN NET ASSETS**

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
Unrestricted Revenues		
Net revenues from services to patients	\$ 265,862,860	\$ 254,787,935
Other operating revenues	7,877,475	6,638,378
Net assets released from restrictions	<u>5,919,545</u>	<u>5,405,414</u>
	<u>279,659,880</u>	<u>266,831,727</u>
Operating Expenses		
Salaries	134,272,520	120,504,090
Employee benefits	35,381,121	32,692,483
Supplies and other	95,039,162	87,611,221
Bad debts	11,658,167	15,699,588
Depreciation	9,313,313	9,597,526
Operations improvement	285,998	2,695,434
Interest and amortization	<u>1,202,403</u>	<u>1,803,577</u>
	<u>287,152,684</u>	<u>270,603,919</u>
Loss from Operations	(7,492,804)	(3,772,192)
Nonoperating Gains (Losses)		
Unreimbursed start-up costs	(202,579)	(946,925)
Unrestricted gifts and bequests	276,737	157,191
Investment income	1,682,054	1,641,803
Net realized gains on sales of investments	--	4,056
Loss on extinguishment of debt	<u>(1,082,212)</u>	<u>--</u>
	<u>674,000</u>	<u>856,125</u>
Deficiency of Revenues over Expenses Before Changes in Net Unrealized (Losses) Gains on Investments	(6,818,804)	(2,916,067)
Changes in Net Unrealized (Losses) Gains on Investments	<u>(529,738)</u>	<u>145,455</u>
Deficiency of Revenues over Expenses	(7,348,542)	(2,770,612)
Less Excess of Revenues over Expenses Attributable to Noncontrolling Interests	<u>(1,111,268)</u>	<u>(1,030,015)</u>
Deficiency of Revenues Over Expenses Attributable to Controlling Interest	<u>(8,459,810)</u>	<u>(3,800,627)</u>

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF OPERATIONS
AND CHANGES IN NET ASSETS (CONTINUED)**

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
Unrestricted Net Assets, Controlling Interest		
Deficiency of revenues over expenses	\$ (8,459,810)	\$ (3,800,627)
Net assets released from restrictions used for purchase of property and equipment	1,207,613	135,818
Transfer of assets from Network	--	1,327,462
Interest rate swap adjustment	(2,414,415)	--
Pension liability adjustments	<u>(1,816,446)</u>	<u>(1,719,951)</u>
Decrease in Unrestricted Net Assets, Controlling Interest	<u>(11,483,058)</u>	<u>(4,057,298)</u>
Unrestricted Net Assets, Noncontrolling Interest		
Excess of revenues over expenses	1,111,268	1,030,015
Distributions and other	<u>(859,144)</u>	<u>(630,307)</u>
Increase in Unrestricted Net Assets, Noncontrolling Interest	<u>252,124</u>	<u>399,708</u>
Temporarily Restricted Net Assets		
Gifts and bequests	446,319	571,957
Income from investments	481,072	427,309
Net realized and unrealized (losses) gains on investments	(347,727)	568,896
Grants	4,709,075	4,523,991
Net assets released from restrictions	<u>(7,127,158)</u>	<u>(5,541,232)</u>
(Decrease) Increase in Temporarily Restricted Net Assets	<u>(1,838,419)</u>	<u>550,921</u>
Permanently Restricted Net Assets		
Gifts and bequests	--	20
(Decrease) increase in fair value of funds held in trust by others	<u>(2,221,826)</u>	<u>1,696,112</u>
(Decrease) Increase in Permanently Restricted Net Assets	<u>(2,221,826)</u>	<u>1,696,132</u>
Decrease in Net Assets	(15,291,179)	(1,410,537)
Net Assets - Beginning	<u>98,815,089</u>	<u>100,225,626</u>
Net Assets - End	<u>\$ 83,523,910</u>	<u>\$ 98,815,089</u>

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
Operating Activities and Nonoperating Revenues		
Change in net assets	\$ (15,291,179)	\$ (1,410,537)
Adjustments to reconcile change in net assets to net cash provided by operating activities and nonoperating revenues:		
Provision for bad debts	11,658,167	15,699,588
Depreciation and amortization	9,437,478	10,160,576
Loss on extinguishment of debt	1,082,212	--
Pension liability adjustments	1,816,446	1,719,951
Distributions to noncontrolling interests	859,144	630,307
Net realized and unrealized losses and (gains) and change in fair value of funds held in trust by others	3,099,291	(2,414,519)
Restricted gifts, bequests and income from investments	(927,391)	(999,286)
Change in market value of interest rate swap	2,414,415	--
Net transfer of property, plant and equipment and debt from GWMRI	--	(1,157,286)
	<u>14,148,583</u>	<u>22,228,794</u>
Changes in operating working capital other than cash and cash equivalents:		
Other assets required for current liabilities	582,693	(8,806)
Patient accounts receivable, net	(16,213,439)	(15,169,262)
Grants and other receivables	(738,772)	(626,323)
Inventories of supplies	(46,402)	(228,021)
Prepaid insurance and other expenses	(370,378)	(2,042)
Accounts payable and accrued expenses	8,354,803	3,145,195
Salaries, wages, payroll taxes and amounts withheld from employees	892,098	1,012,484
Due to third-party reimbursement agencies	(3,088,396)	(792,868)
Increase in other noncurrent liabilities	908,338	302,257
	<u>(9,719,455)</u>	<u>(12,367,386)</u>
Net Cash Provided by Operating Activities and Nonoperating Revenues	<u>4,429,128</u>	<u>9,861,408</u>

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
Cash Flows from Investing Activities		
Purchases of investments	\$ (5,672,215)	\$ (1,365,931)
Sales of investments	6,063,449	1,327,922
Due from affiliates	1,667,541	285,986
Other assets	(4,409,404)	(1,510,731)
Additions to property, plant and equipment	<u>(15,639,575)</u>	<u>(5,488,470)</u>
Net Cash Used in Investing Activities	<u>(17,990,204)</u>	<u>(6,751,224)</u>
Cash Flows from Financing Activities		
Restricted gifts, bequests and income from investments	927,391	999,286
Distributions to noncontrolling interests	(859,144)	(630,307)
Proceeds from issuance of debt	27,373,773	550,194
Principal payments on debt obligations	<u>(19,877,123)</u>	<u>(1,229,019)</u>
Net Cash Provided by (Used in) Financing Activities	<u>7,564,897</u>	<u>(309,846)</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(5,996,179)	2,800,338
Cash and Cash Equivalents - Beginning	<u>21,406,848</u>	<u>18,606,510</u>
Cash and Cash Equivalents - End	<u>\$ 15,410,669</u>	<u>\$ 21,406,848</u>

Supplemental Cash Flow Information

Cash paid during the year for interest on borrowings was \$1,197,462 and \$1,199,837 for the years ended September 30, 2011 and 2010, respectively.

The accompanying notes are an integral part of these financial statements.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

ORGANIZATION

The Waterbury Hospital (the Hospital), a voluntary association incorporated under the General Statutes of the State of Connecticut, is a wholly-owned subsidiary of Greater Waterbury Health Network, Inc. (sole member) (the Network). The Board of the Hospital, which is appointed by the Network, controls the operations of the Hospital. In addition to the Hospital, the accompanying financial statements include Access Rehab Centers LLC (Access), Greater Waterbury Imaging Center Limited Partnership (GWIC), Imaging Partners, LLC and Alliance Medical Group, Inc. (AMG) and Cardiology Associates of Greater Waterbury, LLC to the extent of the Hospital's ownership interest in these affiliated entities.

On August 17, 2011, the Network entered into a nonbinding letter of intent to enter into a joint venture known as Southwest Connecticut Health System, LLC (JV) being formed among LHP Hospital Group, Inc., its subsidiary, LHP Southwest Connecticut, LLC (LHP Sub) and Saint Mary's Health System, Inc. (Saint Mary's) which will combine the two health systems in Waterbury, Connecticut and construct a replacement hospital.

The obligations of the parties to close the transaction will be subject to the negotiation of definitive agreements, the receipt of all required regulatory approvals, licenses and permissions, the lack of a material adverse change to the condition or results of operations of GWHN, the solvency of the parties and other customary closing obligations.

During November, 2010, the Hospital established a new limited liability company by the name of Cardiology Associates of Greater Waterbury, LLC (CAGW) to operate a cardiology practice. CAGW acquired the assets of Cardiology Associates of Waterbury (CAW) that were used by CAW physicians in the performance of their professional services.

Waterbury Hospital also acquired the assets of CAW that were used by CAW to perform diagnostic ancillary services. The Hospital converted these ancillary services to provider-based services, which are provided at a diagnostic center located near the Hospital. The goodwill recorded on the September 30, 2011 consolidated balance sheet relates to the purchase of CAW.

Effective January 1, 2010, net assets totaling \$1,327,462 were transferred from Greater Waterbury Management Resources, Inc. (GWMRI) and Alliance Medical Group of Greater Waterbury, P.C. (Alliance) to AMG as part of the capitalization of AMG. AMG is a tax exempt 501(c)(3) medical foundation formed to provide health care services in a variety of specialties.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION

During June 2010, the Hospital entered into an arrangement with certain gastroenterology physician-members of the Hospital's medical staff to form Waterbury Gastroenterology Co-Management Company, LLC (GI Co-Management Company), a Connecticut limited liability company. This company was formed as a collaborative effort between the Hospital and the physicians for the purpose of improving the quality and efficiency of the gastroenterology service line at the Hospital. The Hospital's investment of \$50,000 in the GI Co-Management Company is included in the Hospital's consolidated financial statements in long-term investments.

The Hospital entered into a members' agreement, making it an equal member with St. Mary's Hospital, located in Waterbury, Connecticut, in a joint venture to form The Harold Leever Regional Cancer Center, Inc. (the Cancer Center). The Cancer Center is a Connecticut non-stock corporation exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The purpose of the joint venture is to develop, construct, own and operate the Cancer Center. Both member hospitals transferred the revenue and related expenses of their respective radiation oncology services to the Cancer Center in October 2002. Both member hospitals made working capital advances to the Cancer Center. The Cancer Center is not included in the Hospital's consolidated financial statements.

The Hospital's major accounting policies are as summarized below and in Note 2.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Hospital and the affiliated entities. Recognition has been given to noncontrolling interests in the affiliates which is reflected as a component of unrestricted net assets. All significant intercompany accounts and transactions are eliminated in consolidation.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectible accounts receivable for services to patients, and liabilities, including estimated net settlements with third-party reimbursement agencies and professional liabilities, and disclosure of contingent assets and contingent liabilities at the date of the financial statements. Estimates also affect the amounts of revenues and expenses reported during the 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.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

REGULATORY MATTERS

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

TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are available to provide grant related services, free care, and educational seminars. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity or in funds held in trust by others.

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 net assets 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.

PROMISES TO GIVE

Unconditional promises to give are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises to give are received. Amortization of the discounts is included in gifts and bequests on the statements of operations and changes in net assets.

CASH AND CASH EQUIVALENTS

The Hospital considers all highly liquid investments with remaining maturities of three months or less at date of purchase to be cash equivalents. Cash and cash equivalents are held at a limited number of financial institutions and at times, the amounts on deposit exceed insured limits.

ACCOUNTS RECEIVABLE

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

The amount of the allowance for uncollectible 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 net patient service revenue and third-party payor programs.

INVENTORIES

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

INVESTMENTS

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) and unrealized gains and losses are included in the deficiency of revenues over expenses unless the income or loss is restricted by donor or law.

Unrealized gains and losses on investments related to permanently restricted net assets and certain temporarily restricted net assets are included in temporarily restricted net assets under State law which allows the Board of Trustees to appropriate as much of the net appreciation of investments as is prudent considering the Hospital's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Reference is made to Note 5.

OTHER ASSETS

Other assets include assets held by trustees under indenture agreements relating to financing activities with the State of Connecticut Health and Education Facilities Authority. The portion of these amounts required for funding current liabilities in 2010 is included in current assets.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost. The Hospital provides for depreciation of property, plant and equipment and amortization of assets recorded under capital leases using the straight-line method in amounts sufficient to amortize the cost of the assets over their estimated useful lives.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Financial Accounting Standards Board (FASB) ASC 410-20, *Accounting for Asset Retirement Obligations* (ASC 410-20), provides guidance on accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Asset retirement obligations include, but are not limited to, certain types of environmental issues which are legally required to be remediated upon an asset's retirement as well as contractually required asset retirement obligations. ASC 410-20 provides clarifying guidance on conditional asset retirement obligations. Conditional asset retirement obligations are obligations whose settlement may be uncertain.

ASC 410-20's guidance requires such conditional asset retirement obligations to be estimated and recognized. Application of these pronouncements affects the Hospital with respect to required future asbestos remediation.

Conditional asset retirement obligations of \$2,716,459 and \$2,639,365 as of September 30, 2011 and 2010, respectively, are recorded in other noncurrent liabilities. During 2011, there were no retirement obligations incurred or settled. During 2010, \$82,000 of retirement obligations were incurred and \$58,175 were settled.

GOODWILL

Goodwill, which has an indefinite life, is not amortized and is evaluated for impairment at least annually.

IMPAIRMENT OF LONG-LIVED ASSETS

The Hospital records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. There were \$291,731 of impairment losses recorded in 2010 and no impairment losses recorded in 2011.

NONOPERATING GAINS (LOSSES)

Activities, other than in connection with providing health care services, are considered to be nonoperating. Nonoperating gains (losses) consist primarily of income on invested funds, gains and losses on sales of securities, changes in unrestricted unrealized gains and losses and unrestricted gifts and bequests.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Start up costs of \$202,579 and \$946,925 related to investments in medical practices are included with other nonoperating expenses in the consolidated statements of operations and changes in net assets for the years ended September 30, 2011 and 2010, respectively, as these costs did not meet the criteria for capitalization and were considered nonoperating due to the fact that the expenses related to investing activities rather than providing health care services.

DEFICIENCY OF REVENUES OVER EXPENSES

The 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, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), cumulative effect of change in accounting principle, pension liability adjustments, interest rate swap adjustments and net asset transfers.

Operations improvement expenses represent consulting and other costs incurred by the Hospital in 2010 and 2011 to improve the revenue cycle, increase cash flows, and improve the Hospital's overall financial performance. These costs are not expected to recur in 2012.

INCOME TAXES

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The Hospital is also exempt from state income taxes. Access, GWIC and Imaging Partners LLC are partnerships. For tax purposes, these partnerships are pass-through entities. Taxation does not occur at the partnership level. Accordingly, no provision for taxes is included. Alliance Medical is tax exempt under Section 501 (c)(3) of the code.

Management has analyzed the tax positions taken and has concluded that as of September 30, 2011, there are no uncertain tax positions taken or expected to be taken in that would require recognition of a liability (or asset) or disclosure in the financial statements. The Hospital is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes the Hospital is no longer subject to income tax examinations prior to 2008.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

MEDICAL MALPRACTICE AND WORKERS' COMPENSATION INSURANCE

The Hospital has a policy of self-insuring the deductible portion of its workers' compensation claims. The deductible limit is \$400,000 per claim. The Hospital maintains a letter of credit with a bank in support of its self-insured workers' compensation program. This letter of credit limit was \$3.5 million at September 30, 2011 and 2010. Management records its best estimate of losses as they occur. The accrued workers' compensation self-insurance liabilities of \$7,763,172 and \$6,815,650 at September 30, 2011 and 2010, respectively, have been discounted at 2.25% and 2.5%, respectively.

Effective October 1, 2006, the Hospital obtained "claims-made" medical malpractice insurance coverage, through the Network, from Healthcare Alliance Insurance Company, Ltd. (HAIC). HAIC is a multi-provider captive insurance company domiciled in the Cayman Islands. The Network is a one third owner of the HAIC with two other local hospitals that each hold one third ownership. The Hospital's insurance coverage is \$1,500,000 per occurrence and \$5,000,000 (\$4,500,000 for 2010) in the aggregate. In addition to the coverage from HAIC, the Hospital recorded reserves of approximately \$1,732,980 and \$1,345,955 at September 30, 2011 and 2010, respectively, related to claims that were incurred subsequent to October 1, 2006, but not yet reported. These reserves were discounted at 2.25% and 2.5% at September 30, 2011 and 2010, respectively.

The Hospital also obtains excess insurance coverage for professional and general liability, through the Network, from HAIC. These policies have limits of \$25,000,000 per claim and \$25,000,000 aggregate, in excess of the underlying limits in the primary layer, for both professional and general liability.

The Hospital also purchased a loss transfer insurance policy which provides \$1,000,000 of coverage for each medical incident that was incurred between October 1, 2003 and October 1, 2006 and specifically reported to the insurance company on the effective date of the transfer policy (February 7, 2008) in addition to medical incidents incurred during the aforementioned period which are first reported after the effective date of the policy. This policy also provides \$1,000,000 of coverage for general liability incurred but not reported claims that occurred after October 1, 2003 through October 1, 2006 and were first reported after the effective date of the policy.

The policy has annual aggregate limits of \$4,500,000 for medical incidents and \$3,000,000 for general liability cases with a combined \$16,500,000 total limit for all policy years. These aggregate limits are eroded by claims previously paid by the Hospital or other insurance.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

RETIREMENT BENEFIT PLANS

The Hospital maintains a defined benefit pension plan for eligible individuals. Reference is made to Note 9.

RISKS AND UNCERTAINTIES

The Hospital invests in a variety of investment securities which are exposed to various risks, such as interest rate risk, financial market risk, currency risk and credit risk. Due to the level of risk associated with investment securities, coupled with the economic events, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the Hospital's September 30, 2011 financial statements, in addition to the funded status of its defined benefit pension plan.

SUBSEQUENT EVENTS

The Hospital evaluates the impact of subsequent events, events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the financial statements as of the balance sheet date or for disclosure in the notes to the financial statements. The Hospital evaluated events occurring subsequent to September 30, 2011 through January 27, 2012, the date on which the accompanying consolidated financial statements were available to be issued. During this period, there were no subsequent events that required disclosure or recognition in the consolidated financial statements.

ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions*, which establishes accounting and disclosure requirements for how a not-for-profit entity determines whether a combination is a merger or an acquisition, how to account for each, and the required disclosures. In addition, ASU 2010-07 includes amendments to FASB's Accounting Standards Codification (the Codification, or ASC) Topic 350, *Intangibles – Goodwill and Other*, and ASC Topic 810, *Consolidation*, to make both applicable to not-for-profit entities. ASC Topic 350 clarifies the accounting for goodwill and indefinite-lived identifiable intangible assets recognized in a not-for-profit entity's acquisition of a business or nonprofit activity. Such assets are not amortized and are tested for impairment at least annually. ASC

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES AND ORGANIZATION (CONTINUED)

Topic 810 clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of net assets. The Hospital adopted the guidance relative to ASU 2010-07 related to its accounting for noncontrolling interests and reclassified the 2010 financial statements to conform to the 2011 presentation.

The adoption of this guidance did not have a significant impact on the Hospital's consolidated financial statements for the year ended September 30, 2011.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amended certain of the disclosures required under ASC 820, *Fair Value Measurements*, and requires the following additional disclosures:

- Transfers in and out of Level 1 and Level 2 classification categories, including the dollar amount and the reasons for the transfers.
- Level 3 rollforward detail disclosures for purchases, sales, issuances, settlements on a gross basis.

The adoption of this guidance did not have a significant impact on the Hospital's consolidated financial statements for the year ended September 30, 2011.

NOTE 2 – REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE

The following table summarizes net revenues from services to patients:

	2011	2010
Gross revenues from services to patients	<u>\$ 900,764,110</u>	<u>\$ 867,081,831</u>
Deductions (additions)		
Allowances	634,142,056	612,466,449
Free care	3,361,605	3,081,466
Regulatory	<u>(2,602,411)</u>	<u>(3,254,019)</u>
	<u>634,901,250</u>	<u>612,293,896</u>
Net revenues from services to patients	<u>\$ 265,862,860</u>	<u>\$ 254,787,935</u>

Patient accounts receivable and revenues are recorded when patient services are performed.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 2 – REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

Amounts received from most payors are different from the established billing rates of the Hospital, and these differences are accounted for as allowances. Gross revenues have been affected by the State of Connecticut Disproportionate Share program in 2011 and 2010.

Net 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. For the years ended September 30, 2011 and 2010, the Hospital recorded approximately \$3,900,000 and \$700,000, respectively, as an increase to net revenues from services to patients as changes in estimates related to third-party payor settlements and adjustments to accruals recorded in prior years.

During 2011 and 2010, approximately 45% and 43%, respectively, of net revenue from services to patients was received under the Medicare program, 14% and 10%, respectively, under the state Medicaid program, and 35% and 40%, respectively, from contracts with other third-parties.

Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Hospital.

The significant concentrations of net accounts receivable for services to patients include 42% from Medicare, 16% from Medicaid, 27% from commercial insurance carriers and 15% from others at September 30, 2011 (40%, 11%, 34% and 15%, respectively, in 2010).

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. 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. The Hospital believes that it is in compliance with all applicable laws and regulations. Cost reports for the Hospital, which serve as a basis for final settlement with government payors, have been settled by final settlement through 2006 for Medicare and 1995 for Medicaid. Other years remain open for settlement.

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

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 2 – REVENUES FROM SERVICES TO PATIENTS AND CHARITY CARE (CONTINUED)

The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to the established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is possible. In assessing a patient's inability to pay, the Hospital utilizes the generally recognized Federal poverty income levels, but also includes certain cases where incurred charges are significant when compared to incomes and assets. These charges are not included in net patient service revenues for financial reporting purposes.

NOTE 3 – INVESTMENTS

The composition of investments, including other assets and funds held in escrow is set forth in the following table. Investments are stated at fair value:

	2011		2010	
	Cost	Fair Value	Cost	Fair Value
Escrow funds for long-term debt:				
U.S. Government obligations	\$ --	\$ --	\$ 580,868	\$ 580,016
Guaranteed investment contract	--	--	2,020,082	2,020,082
Cash and money market funds	3,958,301	3,958,301	2,677	2,677
	<u>\$ 3,958,301</u>	<u>\$ 3,958,301</u>	<u>\$ 2,603,627</u>	<u>\$ 2,602,775</u>
Investments of funds held				
in trust by others	<u>\$ 35,350,210</u>	<u>\$ 37,339,264</u>	<u>\$ 35,233,635</u>	<u>\$ 39,561,090</u>
Long-term investments and				
Board-designated funds:				
Certificates of deposit and				
money market funds	\$ 679,841	\$ 679,841	\$ 856,170	\$ 856,170
Marketable equity securities	23,464	72,852	23,464	63,210
U.S. Government obligations	108,451	168,683	1,799,023	1,895,973
Corporate bonds	3,217,875	3,147,411	2,243,881	2,433,338
Mutual funds	7,968,107	6,984,013	6,485,454	7,283,361
	<u>\$ 11,997,738</u>	<u>\$ 11,052,800</u>	<u>\$ 11,407,992</u>	<u>\$ 12,532,052</u>

The Hospital had long-term investments in partnerships and joint ventures that were recorded at cost of \$322,836 as of September 30, 2011 and 2010 as it was not practicable to estimate fair value.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 3 – INVESTMENTS (CONTINUED)

Unrestricted investment income, including income on funds held in trust by others, and gains and (losses) are comprised of the following for the years ended September 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Income		
Investment income	\$ 1,682,054	\$ 1,641,803
Realized gains on sales of investments	--	4,056
Changes in net unrealized (losses) gains on investments	<u>(529,738)</u>	<u>145,455</u>
	<u>\$ 1,152,316</u>	<u>\$ 1,791,314</u>

A summary of interest cost and investment income on borrowed funds held by the trustee under revenue bond indentures during the years ended September 30, 2011 and 2010 follows:

	<u>2011</u>	<u>2010</u>
Interest charged to operations	<u>\$ 1,108,105</u>	<u>\$ 1,156,778</u>
Investment income credited to other operating revenues	<u>\$ 26,989</u>	<u>\$ 116,842</u>

NOTE 4 – FAIR VALUE MEASUREMENTS

The Hospital categorizes assets and liabilities for disclosure purposes based on whether the inputs used to determine their fair values are observable or unobservable. The Hospital utilizes a three-level fair value hierarchy that prioritizes the inputs used to measure assets at fair value. Level inputs are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Hospital has the ability to access on the reporting date.

Level 2 – Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specific (Contractual) term, a Level 2 input must be observable for substantially the full term of the asset.

Level 3 – Inputs that are unobservable for the asset or liability.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 4 – FAIR VALUE MEASUREMENTS (CONTINUED)

The fair values of Level 1 securities were determined through quoted market prices, while fair values of Level 2 securities were determined primarily through prices obtained from third party pricing sources, where quoted market prices for such securities are not available. The fair values of Level 3 securities were determined primarily through information obtained from the relevant counterparties for such assets or liabilities, as information on which these fair values are based is generally not readily available in the market.

The fair value of the interest rate swap was determined by the counterparty based on an estimate of the net present value of the expected cash flows using relevant mid-market data inputs and based on the assumption of no unusual market conditions or forced liquidation.

The following table summarizes fair value measurements, by level, at September 30, 2011, for all assets and liabilities which are measured at fair value on a recurring basis in the financial statements:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 21,581,247	\$ --	\$ --	\$ 21,581,247
Common stock-Insurance	72,852	--	--	72,852
Mutual funds:				
U.S. large cap	18,394,401	--	--	18,394,401
U.S. mid cap	2,815,051	--	--	2,815,051
U.S. small cap	1,771,662	--	--	1,771,662
International developed	3,671,285	--	--	3,671,285
Emerging markets	1,841,832	--	--	1,841,832
Bonds	451,851	--	--	451,851
Fixed income securities:				
Investment grade taxable	2,720,140	10,381,908	--	13,102,048
International developed bonds	5,829	638,299	--	644,128
Global high yield taxable	237,905	1,794,477	--	2,032,382
U.S. Government obligations	168,683	--	--	168,683
Mortgage backed securities	--	863,883	--	863,883
Real estate investment trusts	598,921	137,515	--	736,436
Other	15,224	--	--	15,224
Total investments at fair value	\$ 54,346,883	\$ 13,816,082	\$ --	\$ 68,162,965
Liabilities:				
Interest rate swap	\$ --	\$ 2,414,415	\$ --	\$ 2,414,415

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 4 – FAIR VALUE MEASUREMENTS (CONTINUED)

The following table summarizes fair value measurements, by level, at September 30, 2010, for all assets and liabilities which are measured at fair value on a recurring basis in the financial statements:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 24,347,581	\$ --	\$ --	\$ 24,347,581
Common stock-Insurance	63,210	--	--	63,210
Mutual funds:				
U.S. large cap	20,150,276	--	--	20,150,276
U.S. mid cap	3,399,501	--	--	3,399,501
U.S. small cap	2,304,871	--	--	2,304,871
International developed	3,581,773	--	--	3,581,773
Emerging markets	1,586,574	--	--	1,586,574
Fixed income securities:				
Investment grade taxable	2,978,044	11,184,187	--	14,162,231
International developed bonds	9,571	767,596	--	777,167
Global high yield taxable	238,885	1,740,156	--	1,979,041
U.S. Government obligations	1,328,181	1,147,808	--	2,475,989
Fixed income other	--	6,638	--	6,638
Mortgage backed securities	2,213	860,705	--	862,918
Real estate investment trusts	448,442	330,023	--	778,465
Other	18,408	--	--	18,408
Total investments at fair value	\$ 60,457,530	\$ 16,037,113	\$ --	\$ 76,494,643

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 5 – RESTRICTED ENDOWMENTS

The Hospital's endowments consist of donor-restricted endowment funds and Board designated endowment funds. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

The Hospital's Board of Directors has interpreted the Connecticut 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, if applicable (c) accumulations to the permanent endowment made in accordance with the related gift's donor instructions. 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 Hospital in a manner consistent with the standard for expenditure as proscribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making determinations to appropriate or accumulate donor-restricted endowment 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

RETURN OBJECTIVES AND RISK PARAMETERS

For the permanently restricted endowment funds, the bank, acting in its capacity as trustee, determines and directs the investment policy and asset allocation. For the unrestricted and temporarily restricted endowment funds, the Hospital's Board of Directors has adopted investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. The Hospital expects these endowment funds, over time, to provide an average rate of return that exceeds the rate of inflation by 3.5% annually. Actual returns in any given year may vary from this amount.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

STRATEGIES EMPLOYED FOR ACHIEVING OBJECTIVES

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 investments to achieve its long-term return objectives within prudent risk constraints.

SPENDING POLICY AND HOW THE INVESTMENT OBJECTIVES RELATE TO SPENDING POLICY

The Hospital has a policy of evaluating the spending decisions for each endowment fund based upon the intentions of the donors and specific contractual agreements. In determining the annual amount to be spent, the Hospital considers the long-term expected return on its endowment. The spending policy is designed to limit spending to the expected long-term real rate of return. The annual distribution from the endowment funds is expected to be contained within a range of 4-6% of the trusts' market value. 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 return.

ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ --	\$ 5,696,591	\$ 40,131,275	\$ 45,827,866
Board-designated endowment funds	<u>2,615,009</u>	<u>--</u>	<u>--</u>	<u>2,615,009</u>
	<u>\$ 2,615,009</u>	<u>\$ 5,696,591</u>	<u>\$ 40,131,275</u>	<u>\$ 48,442,875</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

CHANGES IN ENDOWMENT NET ASSETS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 2,787,502	\$ 6,317,021	\$ 42,353,101	\$ 51,457,624
Investment return				
Investment income (loss)	70,866	(175,906)	--	(105,040)
Net depreciation (realized and unrealized)	<u>(119,892)</u>	<u>(338,055)</u>	<u>(2,221,826)</u>	<u>(2,679,773)</u>
Total investment return	(49,026)	(513,961)	(2,221,826)	(2,784,813)
Appropriation of endowment assets for expenditure	<u>(123,467)</u>	<u>(106,469)</u>	--	<u>(229,936)</u>
Endowment net assets, ending balance	<u>\$ 2,615,009</u>	<u>\$ 5,696,591</u>	<u>\$ 40,131,275</u>	<u>\$ 48,442,875</u>

ENDOWMENT NET ASSET COMPOSITION BY TYPE OF FUND AS OF SEPTEMBER 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ --	\$ 6,317,021	\$ 42,353,101	\$ 48,670,122
Board-designated endowment funds	<u>2,787,502</u>	--	--	<u>2,787,502</u>
	<u>\$ 2,787,502</u>	<u>\$ 6,317,021</u>	<u>\$ 42,353,101</u>	<u>\$ 51,457,624</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 5 – RESTRICTED ENDOWMENTS (CONTINUED)

CHANGES IN ENDOWMENT NET ASSETS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning balance	\$ 2,673,155	\$ 5,978,741	\$ 40,656,969	\$ 49,308,865
Investment return				
Investment income	65,913	211,422	--	277,335
Net appreciation (realized and unrealized)	<u>180,036</u>	<u>575,876</u>	<u>1,696,112</u>	<u>2,452,024</u>
Total investment return	245,949	787,298	1,696,112	2,729,359
Appropriation of endowment assets for expenditure	(131,602)	(449,018)	--	(580,620)
Contributions	<u>--</u>	<u>--</u>	<u>20</u>	<u>20</u>
Endowment net assets, ending balance	<u>\$ 2,787,502</u>	<u>\$ 6,317,021</u>	<u>\$ 42,353,101</u>	<u>\$ 51,457,624</u>

NOTE 6 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets at September 30, 2011 and 2010, are restricted amounts which are to be held in perpetuity, the income from which is expendable to provide free care, scholarships for the children of the Hospital's employees, and for the operations of the Hospital. Also included in permanently restricted net assets are funds held in trust by others. The Hospital is the restricted income beneficiary of funds held in trust by others. The total trust assets, as reported by the trustee, had an aggregate fair value at September 30, 2011 and 2010 of \$37,339,264 and \$39,561,090, respectively. Income of \$1,742,185 and \$1,597,759 earned on these assets for the years ended September 30, 2011 and 2010, respectively, is included in investment income.

Temporarily restricted net assets are available to provide psychiatric services, free care and educational seminars.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 6 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (CONTINUED)

During 2011, net assets were released from donor restrictions by incurring expenses which satisfied the restricted purposes in providing grant related services, free care, and various miscellaneous services in the amounts of \$4,709,075, \$695,241, and \$515,229, respectively in 2011 and \$4,497,224, \$521,983 and \$386,207, respectively in 2010. In addition, \$1,207,612 and \$135,818 were released for the purchase of property and equipment in 2011 and 2010, respectively.

NOTE 7 - DEBT

SERIES C AND D BOND FINANCING

On December 1, 1999, the Hospital entered into Series C financing arrangements with CHEFA under a Master Indenture for the financing of, among other things, renovations, equipment purchases or replacements, and the defeasance of the Series B Bonds. To finance the above, CHEFA sold \$27,140,000 of Series C revenue bonds with interest at a net average annual rate of approximately 5.48%.

Under the terms of the financing arrangements between the Hospital and CHEFA, the proceeds of the revenue bonds were loaned to the Hospital. Pursuant to the loan agreement, the Hospital was obligated to provide amounts which will be sufficient to enable CHEFA to pay the principal of and interest on the proceeds of the Series C Bonds.

Concurrently with the issuance and delivery of the Series C Bonds, the Hospital and U.S. Bank NA, as Trustee, entered into the Master Indenture and Supplemental Master Indenture Number 1 pursuant to which the Hospital was obligated to pay the amount due under the loan agreement with CHEFA. The Master Indenture and Supplemental Master Indenture provided for, among other things, the establishment and maintenance of a Debt Service Reserve Fund and a pledge of the gross receipts, as defined, of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital and provided for covenants regarding the Hospital's debt service coverage ratios, minimum levels of cash on hand, the ratio of long term debt to total capitalization, sale and lease of assets and other covenants similar in financings of this type.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 7 – DEBT (CONTINUED)

In December 2010, the Hospital refinanced its Series C bond financing and financed an additional \$8,000,000 for various capital projects to be completed over a two year period. The par amount of the new Series D debt was \$25,918,000 and interest is variable at the interest rate that is equal to the product of (i) sixty-eight percent (68%) and (ii) the sum of the LIBOR Rate and three hundred basis points (2.19% at September 30, 2011). The new bonds require monthly principal and interest payments, based upon a 10 year amortization schedule, from 2011 through 2020 with the remaining principal balance due in 2020.

The terms of the bonds provide for, among other things, a pledge of gross receipts of the Hospital, restriction on the incurrence of certain indebtedness of the Hospital and provide for covenants regarding the Hospital's debt service coverage ratios, minimum levels of cash on hand, sale and lease of assets and other covenants similar in financings of this type.

In connection with this refinancing, the Hospital entered into an interest rate swap with a bank which allowed it to convert its variable interest rate liability to a fixed interest rate liability of 4.475% without changing the structure of the underlying debt.

The Hospital uses the interest rate swap agreement to manage interest rate risk associated with its outstanding debt. At September 30, 2011, the notional value of outstanding interest rate swap was \$25,630,879.

The Hospital recognizes the fair value of its interest rate swap in the consolidated balance sheet as a liability, recorded in other noncurrent liabilities. At September 30, 2011, the fair value of interest rate swap was in a liability position of \$2,414,415.

The Hospital designated its interest rate swap as a cash flow hedge for accounting purposes, and accordingly defers gains or losses associated with the swap in net assets.

Future minimum payments by year and in the aggregate under the Series D bond financing are as follows at September 30, 2011:

2012	\$	423,779
2013		451,444
2014		472,136
2015		493,776
2016		516,408
Aggregate thereafter		<u>23,273,336</u>
	\$	<u>25,630,879</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 7 – DEBT (CONTINUED)

Access has a \$250,000 line of credit with a bank. There were no borrowings under this line of credit at September 30, 2011 and 2010.

The Hospital had a \$3.5 million letter of credit with a bank available at September 30, 2011 and September 30, 2010 to support its self-insured workers' compensation program that is collateralized by certain investments held by the bank. As of September 30, 2011 and 2010, there were no borrowings on this letter of credit.

The Hospital entered into an equipment lease during 2009. The lease call for equal monthly payments of \$7,278 through June 2011 and is secured by the equipment. The balance of the capital lease liability was zero at September 30, 2011 and \$64,625 at September 30, 2010.

Imaging Partners, LLC entered into a master equipment lease during 2006. The lease calls for unequal periodic payments through October 2011 and is secured by the equipment. The balance of the capital lease liability was \$20,318 at September 30, 2011 and \$252,959 at September 30, 2010.

AMG has a capital lease for equipment that calls for monthly payments of \$1,485 through April 2013 and is secured by the equipment. The balance of the capital lease liability was \$25,987 at September 30, 2011 and \$41,549 at September 30, 2010.

AMG has a capital lease for equipment that calls for monthly payments of \$593 through January 2014 and is secured by the equipment. The balance of the capital lease liability was \$14,365 at September 30, 2011 and \$18,600 at September 30, 2010.

AMG entered into an equipment lease during 2010. The lease calls for monthly payments of \$353 through March 2015 and is secured by the equipment. The balance of the capital lease liability was \$12,724 at September 30, 2011 and \$15,976 at September 30, 2010.

AMG entered into an equipment lease during 2010. The lease calls for monthly payments of \$447 through May 2015 and is secured by the equipment. The balance of the capital lease liability was \$17,140 at September 30, 2011 and \$20,853 at September 30, 2010.

The Hospital entered into a capital lease for equipment during 2011. The lease calls for equal monthly payments of \$20,885 through May 2016 and is secured by the equipment. The balance of the capital lease liability was \$1,048,436 at September 30, 2011.

The Hospital entered into a capital lease for equipment during 2011. The lease calls for equal monthly payments of \$14,031 through July 2013 and is secured by the equipment. The balance of the capital lease liability was \$295,505 at September 30, 2011.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 7 – DEBT (CONTINUED)

AMG entered into a term note during 2010 at an interest rate of 9.8%. The note calls for monthly payments of \$13,216 through November 2014 and is secured by the assets of AMG. The balance of the term note liability was \$427,917 at September 30, 2011 and \$536,950 at September 30, 2010.

AMG assumed a note payable during 2009 for the fit-up of office space. The original amount of the note was \$320,000 and is repayable in installments of principal plus interest at 7.50% totaling \$4,908 per month through January 2014. In addition, this note calls for a final payment of principal and interest of \$113,981 in February 2014. The balance of this note was \$220,858 at September 30, 2011 and \$258,248 at September 30, 2010.

Future minimum payments by year and in the aggregate for all obligations other than the CHEFA Series D bonds were as follows at September 30, 2011:

2012	\$ 584,216
2013	563,704
2014	519,395
2015	271,657
2016	144,278
	<u>\$ 2,083,250</u>

The fair value of the debt, using the discounted cash flow analyses, was approximately \$27,700,000 at September 30, 2011.

NOTE 8 – RENTAL EXPENSE AND LEASE COMMITMENTS

The Hospital has entered into operating leases for office space and office equipment. Rental expense for the years ended September 30, 2011 and 2010 was \$4,199,924 and \$4,252,891, respectively. The minimum rental commitments under all noncancellable operating leases with initial or remaining terms of more than one year are as follows:

2012	\$ 3,833,860
2013	3,665,371
2014	3,499,773
2015	3,161,768
2016	2,416,100
Thereafter	<u>3,366,827</u>
	<u>\$ 19,943,699</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS

The Hospital has a noncontributory defined benefit cash balance plan (the Plan). Under the Plan, each participant who elected to transfer their balances to the Plan from the former defined contribution plan receives a credit of 6% of compensation allocated to their cash balance accounts. All other participants receive a 3% credit. Additionally, each participant receives an interest credit to their cash balance account based on the yield to maturity on three-year treasury bills. The Plan covers substantially all non-union employees age 21 and older with one year of service. It is the Hospital's policy to make contributions to the Plan sufficient to meet the minimum funding requirements of applicable laws and regulations.

Following is a summary of the Plan's funded status using the measurement dates of September 30, 2011 and 2010 and amounts recognized in the Hospital's consolidated financial statements.

	2011	2010
Change in benefit obligation		
Benefit obligation beginning of year	\$ (37,725,464)	\$ (34,676,258)
Service cost	(1,212,075)	(1,150,693)
Interest cost	(1,740,830)	(1,830,619)
Actuarial gain (loss)	311,362	(1,326,106)
Benefits paid	2,993,524	1,258,212
Benefit obligation, end of year	<u>\$ (37,373,483)</u>	<u>\$ (37,725,464)</u>
Change in plan assets		
Fair value of plan assets, beginning of year	\$ 28,672,719	\$ 26,914,181
Actual return on plan assets	79,583	2,102,750
Employer contributions	781,735	914,000
Benefits paid	(2,993,524)	(1,258,212)
Fair value of plan assets, end of year	<u>\$ 26,540,513</u>	<u>\$ 28,672,719</u>
Funded status	<u>\$ (10,832,970)</u>	<u>\$ (9,052,745)</u>
Accrued pension liability	<u>\$ (10,832,970)</u>	<u>\$ (9,052,745)</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

Components of net periodic pension cost

Service cost	\$ 1,212,075	\$ 1,150,693
Interest cost	1,740,830	1,830,619
Expected return on plan assets	(2,674,199)	(2,661,262)
Amortization of actuarial loss	431,281	129,140
Amortization of prior service cost	<u>35,527</u>	<u>35,527</u>
Net periodic pension cost	<u>\$ 745,514</u>	<u>\$ 484,717</u>
Accumulated benefit obligation	<u>\$ 35,847,835</u>	<u>\$ 36,479,923</u>

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

	<u>2011</u>	<u>2010</u>
Unrecognized prior service cost	\$ (227,513)	\$ (263,040)
Unrecognized actuarial losses	<u>(15,972,081)</u>	<u>(14,120,108)</u>
Benefit obligation, end of year	<u>\$ (16,199,594)</u>	<u>\$ (14,383,148)</u>

Changes in benefit obligations recognized in unrestricted net assets include:

	<u>2011</u>	<u>2010</u>
Current year actuarial losses	\$ (2,283,254)	\$ (1,884,618)
Amortization of prior service cost	35,527	35,527
Amortization of net loss	<u>431,281</u>	<u>129,140</u>
	<u>\$ (1,816,446)</u>	<u>\$ (1,719,951)</u>

The prior service cost and actuarial losses included in unrestricted net assets and expected to be recognized in net periodic cost during the year ending September 30, 2012 are \$35,527 and \$623,737, respectively.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

ASSUMPTIONS

The weighted-average assumptions used to determine benefit obligations at September 30 are as follows:

	2011	2010
Discount rate	5.07%	4.83%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	2% for 5 year select period, 3% ultimate	2% for 5 year select period, 3% ultimate

The weighted-average assumptions used to determine net periodic benefit cost for years ended September 30 are as follows:

	2011	2010
Discount rate	4.83%	5.50%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	2.00% for 5 year select period, 3.00% ultimate	3.00%

EXPECTED LONG-TERM RETURN ON PLAN ASSETS

To develop the expected long-term rate of return on assets assumptions, the Hospital considered the historical returns and the future expectations of returns for each asset class, as well as target asset allocations of the pension portfolio. This resulted in the selection of the 8.0% long-term rate of return.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

INVESTMENT POLICY

The Plan's weighted-average asset allocation at September 30, 2011 and 2010, by asset category are as follows:

Asset Category	Plan Assets at September 30		Asset Allocation Policy	
	2011	2010	Target	Range
Equity securities	40%	71%	45%	40% -50%
Debt securities	36%	25%	35%	25% -45%
Multi-strategy hedge fund of funds	21%	0%	20%	15% -25%
Cash and cash equivalents	3%	4%		

The Pension Committee of the Board of Directors (the Committee) is responsible for employee benefit program policies with respect to plan assets and the retention of qualified managers, consultants and trustee/custodians. The purpose of the Committee is to ensure the Plan assets accumulate monies required to meet the anticipated benefit payments of the Plan; contributions are made by the Hospital on a basis determined by the Plan's actuary to be adequate to fund the benefits. The investment objective of the Committee is to maximize total return after inflation within the limits of prudent risk taking by diversifying across asset classes and multiple managers. The Committee has established an asset allocation policy that sets a target and range for each asset class, as shown in the table above.

CONTRIBUTIONS

The Hospital expects to make \$1,500,000 in contributions to the Plan in 2012.

ESTIMATED FUTURE BENEFIT PAYMENTS

The following benefit payments which reflect expected future service are expected to be paid as follows:

2012	\$ 3,843,417
2013	2,794,086
2014	2,978,445
2015	3,002,848
2016	3,336,941
2017-2021	<u>17,271,448</u>
	<u>\$ 33,227,185</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

The following tables set forth by level within the fair value hierarchy the investment assets and investment liabilities at fair value, as of September 30, 2011. As required by ASC 820, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Level 1	Level 2	Level 3	Total
Equities	\$ 1,222,719	\$ --	\$ --	\$ 1,222,719
Commingled funds and private equity	--	--	17,038,042	17,038,042
U.S. Government obligations	367,376	3,439,683	--	3,807,059
Corporate bonds	--	3,804,741	--	3,804,741
Distribution receivable	610,079	--	--	610,079
Interest and dividends	<u>57,873</u>	<u>--</u>	<u>--</u>	<u>57,873</u>
	<u>\$ 2,258,047</u>	<u>\$ 7,244,424</u>	<u>\$17,038,042</u>	<u>\$26,540,513</u>

The following is a reconciliation of Level 3 assets, collective investments and common trust funds, for which significant unobservable inputs were used to determine fair value:

Balance as of September 30, 2010	\$ 12,956,286
Change in unrealized depreciation	(1,081,776)
Purchases	18,117,388
Sales	<u>(12,953,856)</u>
Balance as of September 30, 2011	<u>\$ 17,038,042</u>

OTHER BENEFIT PLANS

The Hospital also makes contributions for substantially all union employees to pension plans sponsored by the union. Contributions are based on a percentage of each participant's total salary. Total pension expense charged to operations during the years ended September 30, 2011 and 2010 was \$3,917,189 and \$3,865,343, respectively.

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 9 – EMPLOYEE BENEFIT PLANS (CONTINUED)

In addition, the Hospital has a supplemental employee retirement plan for certain executives. The plan provides for a total benefit and is partially funded. As of September 30, 2011 and 2010, liabilities of \$76,031 and \$1,211,615, respectively, have been reflected in the consolidated balance sheets.

NOTE 10 – SELF-INSURANCE CLAIMS

There have been medical malpractice and workers' compensation claims that fall within the Hospital's partially self-insured program, which have been asserted against the Hospital. In addition, there are known incidents that have occurred through September 30, 2011 that may result in the assertion of claims. Hospital management has accrued its best estimate of these contingent losses. Other claims may be asserted arising from services provided to patients or workers' compensation incidents in the past. Hospital management has provided reserves for these contingent liabilities.

NOTE 11 – CONTINGENCIES

The Hospital is a party to various lawsuits incidental to its business. Management believes that the lawsuits will not have a material adverse effect on its financial position.

NOTE 12 – DUE FROM (TO) AFFILIATES

The amounts due from affiliates of \$3,848,949 and \$5,516,490 at September 30, 2011 and 2010, respectively, represent receivables from and (payables) to affiliates that do not eliminate in consolidation. These balances are comprised of the following:

	2011	2010
Greater Waterbury Health Network, Inc.	\$ 4,020,125	\$ 5,695,627
Alliance Medical Group of Greater Waterbury, P.C.	(9,983)	(10,409)
Greater Waterbury Management Resources, Inc.	(162,693)	(168,728)
GI Co-Management Company	1,500	--
	<u>\$ 3,848,949</u>	<u>\$ 5,516,490</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

NOTE 13 – FUNCTIONAL EXPENSES

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

	<u>2011</u>	<u>2010</u>
Health care services	\$ 210,118,153	\$ 200,583,835
General and administrative	76,707,776	69,679,789
Fundraising	<u>326,755</u>	<u>340,295</u>
	<u>\$ 287,152,684</u>	<u>\$ 270,603,919</u>

**INDEPENDENT AUDITORS' REPORT
ON OTHER FINANCIAL INFORMATION**

Board of Trustees
The Waterbury Hospital

Our report on our audits of the basic consolidated financial statements of The Waterbury Hospital as of and for the years ended September 30, 2011 and 2010 appears on page 1. Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The following consolidating information is presented for purposes of additional analysis and is not a required part of the basic 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 financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Marcum LLP

Hartford, CT
January 27, 2012

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2011

Assets	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Current Assets								
Cash and cash equivalents	\$ 10,101,423	\$ 2,261,550	\$ 1,381,166	\$ 150,640	\$ 1,266,286	\$ 249,604	\$ --	\$ 15,410,669
Short-term investments	--	--	401,931	--	--	--	--	401,931
Patient accounts receivable, net	30,992,121	877,050	1,699,666	134,089	2,888,957	403,439	(594,612)	36,400,710
Grants and other receivables	2,247,488	--	--	--	257,729	154,449	(192,833)	2,466,833
Inventories of supplies	705,790	--	--	--	148,972	--	--	858,762
Prepaid insurance and other expenses	1,449,521	--	56,694	4,550	115,906	120,487	--	1,747,158
Due to third-party reimbursement agencies	2,858,086	--	--	--	(1,771,409)	372,817	--	2,858,086
Due from affiliates	5,247,541	--	--	--	--	--	--	3,848,949
Total Current Assets	53,605,970	3,138,600	3,539,457	289,279	2,906,441	1,300,796	(787,445)	63,993,098
Other Assets								
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee:								
Construction fund	3,958,301	--	--	--	--	--	--	3,958,301
Funds held in trust by others								
Long-term investments	37,339,264	41,287	--	--	--	--	--	37,339,264
Board-designated endowment funds	8,719,340	--	--	--	--	--	--	8,760,627
Other receivables	2,615,009	--	--	--	--	--	--	2,615,009
Goodwill	3,240	--	--	--	--	--	--	3,240
CHEFA obligations issue expense, less amortization	200,500	--	--	--	--	1,613,067	--	1,813,567
	360,656	--	--	--	--	--	--	360,656
	49,238,009	41,287	--	--	--	1,613,067	--	50,892,363
Property, plant and equipment								
Land	287,549	--	--	--	--	--	--	287,549
Buildings and improvements	84,975,468	939,114	451,590	--	2,621,721	--	--	88,987,893
Equipment	168,608,541	8,318,347	676,462	1,134,076	1,793,693	329,419	--	180,860,538
Construction in progress	2,883,755	--	--	--	25,000	114,371	--	3,023,126
Accumulated depreciation	(214,304,472)	(6,691,757)	(638,404)	(1,088,107)	(783,562)	(36,147)	--	(223,582,449)
	42,450,841	2,565,704	489,648	45,969	3,656,852	407,643	--	49,616,657
Total Assets	\$ 149,253,121	\$ 5,745,591	\$ 4,029,105	\$ 335,248	\$ 6,563,293	\$ 3,321,506	\$ (787,445)	\$ 168,460,419

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2011

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Liabilities and Net Assets								
Current Liabilities								
Accounts payable and accrued expenses	\$ 26,681,066	\$ 350,041	\$ 462,510	\$ 92,375	\$ 460,438	\$ 59,738	\$ (787,445)	\$ 27,318,723
Salaries, wages, payroll taxes and amounts withheld from employees	7,272,613	--	119,751	--	1,258,251	1,446,425	--	10,097,040
Current portion of CHEFA obligations	423,779	--	--	--	--	--	--	423,779
Current portion of notes payable	370,853	--	--	20,318	193,045	--	--	584,216
Due to affiliates	--	--	--	--	--	--	--	--
Total Current Liabilities	34,748,311	350,041	582,261	112,693	1,911,734	1,506,163	(787,445)	38,423,758
Other Noncurrent Liabilities	19,365,945	--	--	--	440,672	--	--	19,806,617
CHEFA Obligations - less current portion and discount	25,207,100	--	--	--	--	--	--	25,207,100
Notes Payable - less current portion	973,089	--	--	--	525,945	--	--	1,499,034
Net Assets								
Unrestricted	22,349,947	3,453,152	2,240,448	189,172	3,684,942	1,815,343	--	33,733,004
Temporarily restricted	6,477,454	--	--	--	--	--	--	6,477,454
Permanently restricted	40,131,275	--	--	--	--	--	--	40,131,275
Total Net Assets Excluding Noncontrolling Interests	68,958,676	3,453,152	2,240,448	189,172	3,684,942	1,815,343	--	80,341,733
Noncontrolling Interests	--	1,942,398	1,206,396	33,383	--	--	--	3,182,177
Total Net Assets	68,958,676	5,395,550	3,446,844	222,555	3,684,942	1,815,343	--	83,523,910
	\$ 149,253,121	\$ 5,745,591	\$ 4,029,105	\$ 335,248	\$ 6,563,293	\$ 3,321,506	\$ (787,445)	\$ 168,460,419

THE WATERBURY HOSPITAL AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

SEPTEMBER 30, 2010

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Eliminations	Consolidated
Assets							
Current Assets							
Cash and cash equivalents	\$ 16,243,349	\$ 3,220,789	\$ 1,017,272	\$ 245,555	\$ 679,883	\$ --	\$ 21,406,848
Short-term investments	--	--	391,878	--	--	--	391,878
Other assets required for current liabilities	582,693	--	--	--	--	--	582,693
Patient accounts receivable, net	27,764,677	809,415	1,707,121	58,429	2,104,542	(598,746)	31,845,438
Grants and other receivables	1,773,357	--	--	--	210,027	(255,323)	1,728,061
Inventories of supplies	634,324	--	--	--	178,036	--	812,360
Prepaid insurance and other expenses	1,161,757	--	58,652	4,999	151,372	--	1,376,780
Total Current Assets	<u>48,160,157</u>	<u>4,030,204</u>	<u>3,174,923</u>	<u>308,983</u>	<u>3,323,860</u>	<u>(854,069)</u>	<u>58,144,058</u>
Funds held in escrow by agreement with the State of Connecticut Health and Educational Facilities Authority (CHEFA) and trustee:							
Debt service fund	582,693	--	--	--	--	--	582,693
Debt service reserve fund	2,020,082	--	--	--	--	--	2,020,082
	<u>2,602,775</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>2,602,775</u>
	<u>(582,693)</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>(582,693)</u>
Less assets that are required for current liabilities	<u>2,020,082</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>2,020,082</u>
Funds held in trust by others	39,561,090	--	--	--	--	--	39,561,090
Long-term investments	12,235,187	41,287	--	--	--	--	10,067,386
Board-designated endowment funds	2,787,502	--	--	--	--	(2,209,088)	2,787,502
Other receivables	136,573	--	--	--	--	--	136,573
Due from affiliates, less current portion	5,695,627	--	--	--	--	--	5,695,627
CHEFA obligations issue expense, less amortization	575,582	--	--	--	--	--	575,582
	<u>60,991,561</u>	<u>41,287</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>(2,209,088)</u>	<u>58,823,760</u>
Property, plant and equipment:							
Land	287,549	--	--	--	--	--	287,549
Buildings and improvements	83,784,947	789,888	380,170	4,022	1,782,548	--	86,741,575
Equipment	159,689,260	6,818,886	623,216	1,089,651	615,336	--	168,836,349
Construction in progress	1,070,830	--	--	--	617,756	--	1,688,586
Accumulated depreciation	<u>(206,294,646)</u>	<u>(6,249,246)</u>	<u>(536,917)</u>	<u>(962,623)</u>	<u>(220,232)</u>	<u>--</u>	<u>(214,263,664)</u>
	<u>38,537,940</u>	<u>1,359,528</u>	<u>466,469</u>	<u>131,050</u>	<u>2,795,408</u>	<u>--</u>	<u>43,290,395</u>
	<u>\$ 149,709,740</u>	<u>\$ 5,431,019</u>	<u>\$ 3,641,392</u>	<u>\$ 440,033</u>	<u>\$ 6,119,268</u>	<u>\$ (3,063,157)</u>	<u>\$ 162,278,295</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET (CONTINUED)

SEPTEMBER 30, 2010

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Eliminations	Consolidated
Liabilities and Net Assets							
Current Liabilities							
Accounts payable and accrued expenses	\$ 18,516,046	\$ 370,949	\$ 434,840	\$ 57,787	\$ 438,367	\$ (854,069)	\$ 18,963,920
Salaries, wages, payroll taxes and amounts withheld from employees	7,688,690	--	95,025	--	1,421,227	--	9,204,942
Due to third-party reimbursement agencies	230,310	--	--	--	--	--	230,310
Current portion of CHEFA obligations	865,000	--	--	--	--	--	865,000
Current portion of notes payable	64,625	--	--	232,641	175,609	--	472,875
Due to affiliates	(752,190)	--	--	--	931,327	--	179,137
Total Current Liabilities	<u>26,612,481</u>	<u>370,949</u>	<u>529,865</u>	<u>290,428</u>	<u>2,966,530</u>	<u>(854,069)</u>	<u>29,916,184</u>
Other Noncurrent Liabilities	<u>14,200,723</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>466,698</u>	<u>--</u>	<u>14,667,421</u>
CHEFA Obligations - less current portion and discount	<u>18,142,716</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>18,142,716</u>
Notes Payable - less current portion	<u>--</u>	<u>--</u>	<u>--</u>	<u>20,318</u>	<u>716,567</u>	<u>--</u>	<u>736,885</u>
Net Assets							
Unrestricted	40,084,846	3,238,444	2,022,493	109,894	1,969,473	(2,209,088)	45,216,062
Temporarily restricted	8,315,873	--	--	--	--	--	8,315,873
Permanently restricted	42,353,101	--	--	--	--	--	42,353,101
Total Net Assets Excluding Noncontrolling Interests	<u>90,753,820</u>	<u>3,238,444</u>	<u>2,022,493</u>	<u>109,894</u>	<u>1,969,473</u>	<u>(2,209,088)</u>	<u>95,885,036</u>
Noncontrolling Interests	<u>--</u>	<u>1,821,626</u>	<u>1,089,034</u>	<u>19,393</u>	<u>--</u>	<u>--</u>	<u>2,930,053</u>
Total Net Assets	<u>90,753,820</u>	<u>5,060,070</u>	<u>3,111,527</u>	<u>129,287</u>	<u>1,969,473</u>	<u>(2,209,088)</u>	<u>98,815,089</u>
	<u>\$ 149,709,740</u>	<u>\$ 5,431,019</u>	<u>\$ 3,641,392</u>	<u>\$ 440,033</u>	<u>\$ 6,119,268</u>	<u>\$ (3,063,157)</u>	<u>\$ 162,278,295</u>

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc	Cardiology Associates of Greater Waterbury, LLC	Eliminations	Consolidated
Unrestricted Revenues								
Net revenues from services to patients	\$ 227,759,506	\$ 5,372,114	\$ 9,841,590	\$ 617,265	\$ 20,731,882	\$ 4,009,213	\$ (2,468,710)	\$ 265,862,860
Other operating revenues	2,698,433	3,145	1,536	25,231	4,603,080	944,669	(398,619)	7,877,475
Net assets released from restrictions	5,919,545	--	--	--	--	--	--	5,919,545
	<u>236,377,484</u>	<u>5,375,259</u>	<u>9,843,126</u>	<u>642,496</u>	<u>25,334,962</u>	<u>4,953,882</u>	<u>(2,867,329)</u>	<u>279,659,880</u>
Operating Expenses								
Salaries	99,160,311	660,064	5,416,451	--	23,808,078	5,227,616	--	134,272,520
Employee benefits	30,355,478	110,377	1,136,223	--	3,122,358	656,685	--	35,381,121
Supplies and other	85,881,091	1,984,823	2,198,699	406,796	6,617,697	817,385	(2,867,329)	95,039,162
Bad debts	10,912,386	(28,740)	132,860	--	435,004	206,657	--	11,658,167
Depreciation	7,993,796	442,510	103,212	129,283	607,768	36,744	--	9,313,313
Operations improvement	285,998	--	--	--	--	--	--	285,998
Interest and amortization	1,113,937	--	--	12,949	75,517	--	--	1,202,403
	<u>235,702,997</u>	<u>3,169,034</u>	<u>8,987,445</u>	<u>549,028</u>	<u>34,666,422</u>	<u>6,945,087</u>	<u>(2,867,329)</u>	<u>287,152,684</u>
Income (Loss) from Operations	<u>674,487</u>	<u>2,206,225</u>	<u>855,681</u>	<u>93,468</u>	<u>(9,331,460)</u>	<u>(1,991,205)</u>	<u>--</u>	<u>(7,492,804)</u>
Nonoperating Gains (Losses)								
Unreimbursed start-up costs	(202,579)	--	--	--	--	--	--	(202,579)
Unrestricted gifts and bequests	276,737	--	--	--	--	--	--	276,737
Investment income	1,670,892	--	11,162	--	--	--	--	1,682,054
Loss on extinguishment of debt	(1,082,212)	--	--	--	--	--	--	(1,082,212)
	<u>662,838</u>	<u>--</u>	<u>11,162</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>674,000</u>
Excess (Deficiency) of Revenues Over Expenses Before Changes in								
Net Unrealized Losses on Investments	1,337,325	2,206,225	866,843	93,468	(9,331,460)	(1,991,205)	--	(6,818,804)
Changes in Net Unrealized Losses on Investments	(528,650)	--	(1,108)	--	--	--	--	(529,758)
Excess (Deficiency) of Revenues Over Expenses	<u>808,695</u>	<u>2,206,225</u>	<u>865,735</u>	<u>93,468</u>	<u>(9,331,460)</u>	<u>(1,991,205)</u>	<u>--</u>	<u>(7,348,542)</u>
Less Excess of Revenue over Expenses Attributable to Noncontrolling Interests	--	--	--	--	--	--	(1,111,268)	(1,111,268)
Excess (Deficiency) of Revenues Over Expenses								
Attributable to Controlling Interest	\$ 808,695	\$ 2,206,225	\$ 865,735	\$ 93,468	\$ (9,331,460)	\$ (1,991,205)	\$ (1,111,268)	\$ (8,459,810)

THE WATERBURY HOSPITAL AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED SEPTEMBER 30, 2010

	The Waterbury Hospital	Greater Waterbury Imaging Center Limited Partnership	Access Rehab Centers, LLC	Imaging Partners, LLC	Alliance Medical Group, Inc.	Eliminations	Consolidated
Unrestricted Revenues							
Net revenues from services to patients	\$ 229,011,318	\$ 5,333,662	\$ 9,139,398	\$ 702,239	\$ 12,979,844	\$ (2,378,526)	\$ 254,787,935
Other operating revenues	2,460,675	7,648	(1,372)	5,419	4,806,872	(640,864)	6,638,378
Net assets released from restrictions	5,405,414	--	--	--	--	--	5,405,414
	<u>236,877,407</u>	<u>5,341,310</u>	<u>9,138,026</u>	<u>707,658</u>	<u>17,786,716</u>	<u>(3,019,390)</u>	<u>266,831,727</u>
Operating Expenses							
Salaries	98,804,093	667,632	5,025,637	--	16,006,728	--	120,504,090
Employee benefits	28,853,399	146,782	1,058,833	--	2,633,469	--	32,692,483
Supplies and other	81,766,375	2,057,812	2,184,667	439,329	4,182,428	(3,019,390)	87,611,221
Bad debts	14,985,815	(15,848)	62,621	--	667,000	--	15,699,588
Depreciation	8,705,929	357,192	96,073	207,688	230,644	--	9,597,526
Operations improvement	2,695,434	--	--	--	--	--	2,695,434
Interest and amortization	1,708,531	--	--	32,371	62,675	--	1,803,577
	<u>237,519,576</u>	<u>3,213,570</u>	<u>8,427,831</u>	<u>679,388</u>	<u>23,782,944</u>	<u>(3,019,390)</u>	<u>270,603,919</u>
(Loss) Income from Operations	<u>(642,169)</u>	<u>2,127,740</u>	<u>710,195</u>	<u>28,270</u>	<u>(5,996,228)</u>	<u>--</u>	<u>(3,772,192)</u>
Nonoperating Gains (Losses)							
Unreimbursed start-up costs	(946,925)	--	--	--	--	--	(946,925)
Unrestricted gifts and bequests	157,191	--	--	--	--	--	157,191
Investment income	1,631,835	--	9,968	--	--	--	1,641,803
Realized gains on sales of investments	--	--	4,056	--	--	--	4,056
	<u>842,101</u>	<u>--</u>	<u>14,024</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>856,125</u>
Excess (Deficiency) of Revenues Over Expenses Before Changes in							
Net Unrealized Gains on Investments	199,932	2,127,740	724,219	28,270	(5,996,228)	--	(2,916,067)
Change in Net Unrealized Gains on Investments	127,424	--	18,031	--	--	--	145,455
Excess (Deficiency) of Revenues Over Expenses	<u>327,356</u>	<u>2,127,740</u>	<u>742,250</u>	<u>28,270</u>	<u>(5,996,228)</u>	<u>--</u>	<u>(2,770,612)</u>
Less Excess of Revenue over Expenses Attributable to Noncontrolling Interests	--	--	--	--	--	(1,030,015)	(1,030,015)
Excess (Deficiency) of Revenues Over Expenses							
Attributable to Controlling Interest	\$ 327,356	\$ 2,127,740	\$ 742,250	\$ 28,270	\$ (5,996,228)	\$ (1,030,015)	\$ (3,800,627)