



MHS PRIMARY CARE, INC.

Financial Statements

September 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

MHS PRIMARY CARE, INC.

Financial Statements

September 30, 2011 and 2010

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KPMG LLP
One Financial Plaza
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Independent Auditors' Report

The Board of Directors
MHS Primary Care, Inc.:

We have audited the accompanying balance sheets of MHS Primary Care, Inc., a taxable Connecticut, nonstock corporation, (the Company) as of September 30, 2011 and 2010, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company'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 Company'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 financial position of MHS Primary Care, Inc., as of September 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

January 23, 2012

MHS PRIMARY CARE, INC.

Balance Sheets

September 30, 2011 and 2010

Assets	2011	2010
Current assets:		
Cash	\$ 653,985	473,104
Accounts receivable, less allowances of \$76,000 in 2011 and \$62,000 in 2010	869,939	863,310
Prepaid expenses and other receivables	101,874	93,371
Total current assets	1,625,798	1,429,785
Property and equipment, net of accumulated depreciation (note 4)	2,181,541	2,430,558
Total assets	\$ 3,807,339	3,860,343
Liabilities and Net Assets		
Current liabilities:		
Current portion – related party notes payable (note 6)	\$ 18,932	18,932
Current portion – notes payable (note 5)	229,558	39,559
Accounts payable and accrued expenses	1,293,823	1,289,108
Due to affiliates	58,046	898,778
Total current liabilities	1,600,359	2,246,377
Long-term liabilities:		
Related party notes payable (note 6)	28,820	47,753
Notes payable (note 5)	29,774	259,331
Capital lease obligation (note 5)	807,121	835,200
Retention compensation (note 6)	119,529	91,034
Total liabilities	2,585,603	3,479,695
Commitments and contingencies (note 6)		
Unrestricted net assets	1,221,736	380,648
Total liabilities and net assets	\$ 3,807,339	3,860,343

See accompanying notes to financial statements.

MHS PRIMARY CARE, INC.

Statements of Operations and Changes in Net Assets

Years ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenues:		
Net patient service revenue	\$ 10,354,602	9,788,212
Other revenue	253,020	194,373
Total revenues	<u>10,607,622</u>	<u>9,982,585</u>
Expenses:		
Salaries and wages	8,287,053	8,192,749
Fringe benefits	1,607,993	1,720,788
Medical supplies and drugs	574,207	443,428
Depreciation and amortization	324,689	328,189
Provision for bad debts	149,097	36,608
Professional fees	142,450	25,997
Interest	64,400	31,297
Rent	756,662	708,244
Purchased services	447,794	293,064
Insurance	305,320	311,852
Other	505,122	804,622
Total expenses	<u>13,164,787</u>	<u>12,896,838</u>
Operating loss	(2,557,165)	(2,914,253)
Contributed capital from Middlesex Health System, Inc.	<u>3,398,253</u>	<u>2,466,000</u>
Change in net assets	841,088	(448,253)
Unrestricted net assets, beginning of year	<u>380,648</u>	<u>828,901</u>
Unrestricted net assets, end of year	<u>\$ 1,221,736</u>	<u>380,648</u>

See accompanying notes to financial statements.

MHS PRIMARY CARE, INC.

Statements of Cash Flows

Years ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Change in net assets	\$ 841,088	(448,253)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Contributed capital from Middlesex Health System, Inc.	(3,398,253)	(2,466,000)
Depreciation and amortization	324,689	328,189
Changes in assets and liabilities:		
Accounts receivable, net	(6,629)	(144,417)
Prepaid expenses and other receivables	(8,503)	58,625
Accounts payable and accrued expenses	4,715	108,076
Due from/to affiliate	(840,732)	906,936
Retention compensation	28,495	27,145
Net cash used in operating activities	<u>(3,055,130)</u>	<u>(1,629,699)</u>
Cash flows from investing activities:		
Purchases of property and equipment	<u>(75,672)</u>	<u>(428,919)</u>
Net cash used in investing activities	<u>(75,672)</u>	<u>(428,919)</u>
Cash flows from financing activities:		
Contributed capital from Middlesex Health System, Inc.	3,398,253	2,466,000
Payments for related party notes payable, note payable, and capital lease obligation	<u>(86,570)</u>	<u>(55,895)</u>
Net cash provided by financing activities	<u>3,311,683</u>	<u>2,410,105</u>
Net increase in cash	180,881	351,487
Cash, beginning of year	<u>473,104</u>	<u>121,617</u>
Cash, end of year	<u>\$ 653,985</u>	<u>473,104</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 33,103	13,286
Supplemental disclosure of noncash item:		
Assets acquired under capital lease	\$ —	835,200

See accompanying notes to financial statements.

MHS PRIMARY CARE, INC.

Notes to Financial Statements

September 30, 2011 and 2010

(1) Organization

MHS Primary Care, Inc. (the Company) is a taxable Connecticut, nonstock corporation, and wholly owned subsidiary of Middlesex Health System, Inc. (System). System is the sole member/shareholder of its other wholly owned subsidiaries as follows: Middlesex Hospital (the Hospital), Middlesex Health Resources, Inc. (Resources), and Middlesex Health Services, Inc. (Services). The Company's purpose is to operate a number of primary care physician offices. The System and its wholly owned subsidiaries have committed to financially support the Company through September 30, 2012.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles.

(b) Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are being provided using the straight-line method over five to fifteen years. Leasehold improvements are depreciated over the shorter of the lease term or the useful life of the asset.

(c) Net Patient Service Revenue

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.

Contractual allowances represent the differences between established billing rates for patient services and the amounts reimbursable by third-party payors.

Net patient service revenue for the years ended September 30, 2011 and 2010 is reported net of contractual allowances as follows:

	<u>2011</u>	<u>2010</u>
Gross patient service revenue	\$ 16,772,988	15,493,403
Less contractual allowances	<u>(6,418,386)</u>	<u>(5,705,191)</u>
Net patient service revenue	<u>\$ 10,354,602</u>	<u>9,788,212</u>

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(d) *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 contingent assets and liabilities 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.

(e) *Income Taxes*

Deferred tax assets and liabilities are recognized for the differences between the financial and income tax reporting basis of assets and liabilities.

As of September 30, 2011, the Company had net operating loss carryforwards available to reduce its future Federal taxable income of approximately \$24,509,604. The carryforward periods expire at various dates through 2030. The Company had net operating loss carryforwards available to reduce its future state taxable income of approximately \$13,604,497. The state carryforward periods expire at various dates through 2030. The deferred tax asset associated with the Company's loss carryforwards, compensation accruals, and fixed assets was offset by a corresponding valuation allowance, as realization of such loss carryforwards is not assured.

The Company follows FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, included in ASC Topic 740, *Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a threshold of more-likely-than-not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. The Company has not recorded any uncertain tax positions.

(3) **Health Care 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. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations of 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 Company is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. While no known regulatory inquiries are pending, 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.

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(4) Property and Equipment

Property and equipment consists of the following as of September 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Leasehold improvements	\$ 2,727,320	2,727,320
Buildings and improvements	835,200	835,200
Furniture and equipment	1,149,069	1,075,222
	<u>4,711,589</u>	<u>4,637,742</u>
Less accumulated depreciation	(2,530,048)	(2,207,184)
	<u>\$ 2,181,541</u>	<u>2,430,558</u>

In addition, the Company rents certain equipment under operating lease agreements. For the years ended September 30, 2011 and 2010, total rental and related expenses were \$52,495 and \$56,563, respectively.

Property under capital leases had a net book value of \$763,355 and \$817,239 at September 30, 2011 and 2010, respectively.

(5) Notes Payable and Capital Leases

Repayment of a note payable of \$300,000 began on April 1, 2007 at \$1,667 per month plus interest with a final balloon payment of \$200,000 due March 1, 2012. The interest rate is the LIBOR Market Index Rate (0.24% and 0.26% at September 30, 2011 and 2010, respectively) plus 0.90%. The outstanding balance of this note as of September 30, 2011 and 2010 was \$210,000 and \$229,999, respectively.

Repayment of a five (5) year note of \$100,000 began on January 1, 2009 with the final payment due December 1, 2013. The interest rate on this note is 7% and the outstanding balance of this note as of September 30, 2011 and 2010 was \$49,332 and \$68,891, respectively.

In 2010, the Company entered into a 15-year capital lease in the amount of \$835,200 with an interest rate of 6.5% for a building. The outstanding balance on this capital lease at September 30, 2011 and 2010 was \$807,121 and \$835,200, respectively.

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Aggregate scheduled repayments on long-term debt and capital lease payments are as follows:

	<u>Notes payable</u>	<u>Capital lease</u>
2012	\$ 230,972	80,000
2013	22,490	90,000
2014	5,870	90,000
2015	—	90,000
2016	—	90,000
Thereafter	—	825,000
	<u>259,332</u>	<u>1,265,000</u>
Less interest	—	(457,879)
	<u>\$ 259,332</u>	<u>807,121</u>

(6) Related Party Transactions and Notes Payable

For the fiscal years 2011 and 2010, the Company received \$3,398,253 and \$2,466,000 in capital contributions from System, respectively.

The Company purchases general and administrative supplies and services from the Hospital. These totaled \$201,342 and \$104,494 for the years ended September 30, 2011 and 2010, respectively. The balance due to the Hospital from the Company as of September 30, 2011 and 2010 was \$58,046 and \$898,778, respectively.

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The Company has two unsecured promissory notes payable to the Hospital for lines of credit to finance leasehold improvements at two sites. Repayment of the notes in 120 monthly installments of \$1,917 including interest began upon completion of the renovations in 2004. The outstanding balance on the notes as of September 30, 2011 and 2010 was \$47,752 and \$66,685, respectively. The interest rate on the notes is 7%. The Company paid the Hospital interest in the amount of \$4,068 and \$5,344 for the years ended September 30, 2011 and 2010, respectively. The Company leases ten of its facilities under noncancelable operating lease agreements (collectively, the leases). Of these leases, two facilities are leased from Resources and one was owned by Middletown Professional Park Limited Partnership I, an affiliate of Resources until November 2010. Rental expense for the years ended September 30, 2011 and 2010 to related parties was \$69,623 and \$153,411, respectively. Under the terms of the lease agreements, the Company is responsible for common area maintenance costs. Estimated future payments under the leases are as follows:

Year ending September 30:	
2012	\$ 678,103
2013	645,648
2014	630,497
2015	642,698
2016	655,315
Thereafter	<u>1,459,259</u>
	<u>\$ 4,711,520</u>

The Company also has employment contracts and various compensation arrangements with certain physicians. Under the terms of the contracts, the Company is obligated to pay the employees certain salaries and other negotiated amounts. During 2008, the Company implemented a retention program under which certain physicians would receive a retention bonus after completing 5 years of service. The amount accrued under this arrangement was \$119,529 and \$91,034 as of September 30, 2011 and 2010, respectively.

(7) Employee Profit Sharing Plan

The Company sponsors a defined contribution profit sharing plan (the Plan) for its eligible employees. Participants may elect to defer amounts as allowed under the Plan and Internal Revenue Code. The employer match equals 100% of the first 3% of participant elective deferrals plus 50% of the next 2% of participant elective deferrals. In addition, the Company may make discretionary contributions as determined by the board of directors of the Company. For the years ended September 30, 2011 and 2010, the Company made matching contributions in the amount of \$283,068 and \$254,364, respectively.

(8) Subsequent Events

The Company has evaluated events through January 23, 2012, which represents the date the financial statements were available to be issued and noted no subsequent events that would have impacted the Company's financial statements.