



MIDDLESEX HEALTH SERVICES, INC.

Financial Statements

September 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

MIDDLESEX HEALTH SERVICES, INC.

Financial Statements

September 30, 2011 and 2010

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KPMG LLP
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Independent Auditors' Report

The Board of Directors
Middlesex Health Services, Inc.:

We have audited the accompanying balance sheets of Middlesex Health Services, Inc., a not-for-profit Connecticut corporation, (Services) 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 Services' 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 Services' 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 Middlesex Health Services, 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

MIDDLESEX HEALTH SERVICES, INC.

Balance Sheets

September 30, 2011 and 2010

Assets	2011	2010
Current assets:		
Cash and cash equivalents	\$ 1,118,888	1,088,218
Accounts receivable	7,383	58,956
Prepaid expenses and other current assets	2,604	2,899
Current portion of investments limited as to use (note 4)	105,939	143,976
Total current assets	1,234,814	1,294,049
Investments limited as to use, net of current portion (note 4)	44,130	629,413
Property and equipment, net (note 3)	4,888,918	5,044,452
Deferred financing costs, net of accumulated amortization of \$621 in 2011 and \$136,454 in 2010, respectively	77,125	109,217
Total assets	\$ 6,244,987	7,077,131
Liabilities and Net Assets		
Current liabilities:		
Current portion – long-term debt (note 5)	\$ 270,000	245,000
Accounts payable and accrued expenses	165,604	192,709
Due to related parties	32,692	5,993
Estimated self-insurance liability (note 7)	19,391	74,445
Accrued interest payable	40,725	81,651
Deferred revenue	58,881	97,314
Total current liabilities	587,293	697,112
Long-term debt, net of current portion (note 5)	5,366,000	6,017,597
Total liabilities	5,953,293	6,714,709
Commitments and contingencies (note 7)		
Net assets:		
Unrestricted	247,564	306,635
Temporarily restricted (note 8)	44,130	55,787
Total net assets	291,694	362,422
Total liabilities and net assets	\$ 6,244,987	7,077,131

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Statements of Operations and Changes in Net Assets

Years ended September 30, 2011 and 2010

	2011	2010
Revenues:		
Resident revenues	\$ 2,912,098	2,839,598
Ancillary revenues	65,087	50,259
Other revenues	3,600	3,600
Total revenues	2,980,785	2,893,457
Expenses:		
Salaries and wages	1,244,203	1,201,044
Payroll taxes and employee benefits	261,226	275,405
Purchased services	203,387	180,533
Maintenance	235,074	280,964
Professional fees	26,090	25,575
Advertising	33,959	31,519
Food and beverage	174,986	162,449
Depreciation and amortization	226,324	235,745
Interest, net	302,600	324,496
Other	112,339	108,801
Total expenses	2,820,188	2,826,531
Income from operations	160,597	66,926
Loss from conversion of debt (note 5)	(219,668)	—
(Deficiency) excess of revenues over expenses and (decrease) increase in unrestricted net assets	(59,071)	66,926
Temporarily restricted net assets:		
Temporarily restricted contributions	1,906	55,787
Temporarily restricted interest income	226	—
Expenditures for intended purposes	(13,789)	—
(Decrease) increase in temporarily restricted net assets	(11,657)	55,787
(Decrease) increase in net assets	(70,728)	122,713
Net assets, beginning of year	362,422	239,709
Net assets, end of year	\$ 291,694	362,422

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Statements of Cash Flows

Years ended September 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Change in net assets	\$ (70,728)	122,713
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation and amortization	226,324	235,745
Loss from conversion of debt	219,668	—
Temporarily restricted contributions net of expenditures	11,657	(55,787)
Changes in operating assets and liabilities:		
Accounts receivable, net	51,573	(4,451)
Prepaid expenses and other assets	91,780	(197)
Accounts payable and accrued expenses and accrued interest payable	(68,031)	51,788
Estimated self-insurance liability	(55,054)	(44,129)
Due to related parties	26,699	746
Deferred revenue	(38,433)	(36,396)
Net cash provided by operating activities	395,455	270,032
Cash flows from investing activities:		
Purchases of property and equipment	(55,849)	(101,215)
Investments limited as to use, net	623,320	(41,037)
Net cash provided by (used in) investing activities	567,471	(142,252)
Cash flows from financing activities:		
Proceeds from revenue bonds	5,637,382	—
Repayment of long-term debt	(6,466,496)	(235,000)
Deferred financing costs	(91,485)	—
Temporarily restricted contributions net of expenditures	(11,657)	55,787
Net cash used in financing activities	(932,256)	(179,213)
Net increase (decrease) in cash	30,670	(51,433)
Cash and cash equivalents, beginning of year	1,088,218	1,139,651
Cash and cash equivalents, end of year	\$ 1,118,888	1,088,218
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 245,788	319,985

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Notes to Financial Statements
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(1) Organization

Middlesex Health Services, Inc. (Services), is a wholly owned subsidiary of Middlesex Health System, Inc. (System). In addition to Services, System's subsidiaries include: Middlesex Hospital (the Hospital), Middlesex Health Resources, Inc. (Resources), and MHS Primary Care, Inc. (MHSPC).

Services operates a licensed assisted living facility, One MacDonough Place, located in Middletown, Connecticut. The facility has 70 residential units comprised of studios, one-bedroom, and two-bedroom apartments. Services provides assistance with activities of daily living, nursing services, client assessment, and supervision of and assistance with medication administration. Residents receive individualized assistance, designed to meet their needs 24 hours a day. Resident contracts are generally a year long and renewable, though there are some contracts for short-term respite care.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The 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 is being provided using the straight-line method over the estimated useful lives of the related assets.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

<u>Classifications</u>	<u>Life</u>
Building and improvements	5-35 years
Furniture and equipment	3-10 years

(c) Deferred Financing Costs

Deferred financing costs are amortized over the life of the related debt.

(d) Resident and Ancillary Revenues

Resident and ancillary revenues are recorded when earned for rental use and when services are performed, respectively. Rents received in advance are deferred until earned.

(e) Income Taxes

Services is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is generally exempt from Federal income taxes pursuant to Section 501(a) of the Internal Revenue Code. Effective October 1, 2009, Services adopted 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

MIDDLESEX HEALTH SERVICES, INC.

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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 adoption of this standard did not have a material impact on Services' financial statements.

(f) *Investments Limited as to Use*

Services is required to maintain certain deposits with a trustee relating to its outstanding bonds (see notes 4 and 5). Such deposits are included in investments limited as to use in the accompanying balance sheets and consist of \$573,626 in the debt service reserve fund at September 30, 2010 and \$105,939 and \$143,976 in the debt service fund as of September 30, 2011 and 2010, respectively. The debt service reserve fund was liquidated with the conversion of the Series I bonds to Series N bonds. Services received donations whose uses were restricted by the donors and recorded as temporarily restricted with a balance of \$44,130 and \$55,787 as of September 30, 2011 and 2010, respectively.

(g) *Cash equivalents*

Services consider all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

(h) *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.

(i) *Estimated Self-Insurance Liability*

Effective February 1, 2004, Services adopted a policy of self-insuring a portion of its workers' compensation insurance coverage through System's self-insurance program. The annual self-insured retention limit for the fiscal year was \$400,000 per occurrence (see note 7).

(j) *Fair value measurements*

FASB ASC 820, Fair Value Measurements and Disclosures, establishes a formal hierarchy and framework for measuring fair value, and expanded disclosure about fair value measurements and the reliability of valuation inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

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

Level 2 – Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;

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- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

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

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

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

(k) Net Asset Categories

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

Unrestricted

Unrestricted net assets represent available resources other than donor restricted contributions. Included in unrestricted net assets are assets set aside by the board of directors for future unspecified uses over which the board retains control and may, at its discretion, subsequently use for other purposes.

Temporarily Restricted

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

MIDDLESEX HEALTH SERVICES, INC.

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(3) Property and Equipment

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

	2011	2010
Land	\$ 894,611	894,611
Building and improvements	6,478,898	6,445,331
Furniture and equipment	304,349	282,067
	7,677,858	7,622,009
Less accumulated depreciation	(2,788,940)	(2,577,557)
Property and equipment, net	\$ 4,888,918	5,044,452

(4) Investments Limited as to Use

Cost and market values for investments included in investments limited as to use as of September 30, 2011 and 2010 are summarized as follows:

	2011		2010	
	Total		Total	
	Market	Cost	Market	Cost
Cash	\$ 44,130	44,130	55,782	55,782
Money market fund	16,205	16,205	717,607	717,607
U.S. treasury bills	64,340	64,340	—	—
U.S. treasury notes	25,394	25,394	—	—
Total investments limited to use	\$ 150,069	150,069	773,389	773,389

The table below segregates all financial assets that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at September 30, 2011 and 2010.

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	Total carrying value at September 30, 2011	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Cash	\$ 44,130	44,130	—	—
Money market fund	16,205	16,205	—	—
U.S. treasury bills	64,340	—	64,340	—
U.S. treasury notes	25,394	—	25,394	—
Total investments limited as to use	\$ 150,069	60,335	89,734	—

	Total carrying value at September 30, 2010	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Cash	\$ 55,782	55,782	—	—
Money market fund	717,607	717,607	—	—
Total investments limited as to use	\$ 773,389	773,389	—	—

(5) Long-Term Debt

In October 1997, the Connecticut Health and Educational Facilities Authority (CHEFA) issued \$8,450,000 of Revenue Bonds, Middlesex Health Services Issue, Series I for the construction of One MacDonough Place (the Project). Services is obligated to provide amounts, which will be sufficient to enable CHEFA to pay the principal and interest on the bonds. The proceeds of the bonds, together with certain investment income and an equity contribution by Services, were used to finance the land acquisition, construction, and equipment as well as to pay for certain start-up expenses, to pay a portion of the interest on the bonds through January 1, 2000, to fund the debt service reserve fund and to pay certain costs related to the issuances of the bonds. The Hospital issued a guaranty note to secure Services Series I debt service. In July 2011 the remaining Series I bonds were converted to the Series N Note (Middlesex Health Services Loan), as Services' allocable share of the Revenue Bonds, Middlesex Hospital Issue, Series N. During 2011, Services recognized a loss on the conversion of debt of \$219,668 primarily due to the writeoff of remaining unamortized Series I bond discount and deferred financing costs.

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Services' share of Series N bonds mature from July 1, 2012 through July 1, 2027 and incur interest at rates between 3.000% and 5.000%. With the conversion to Series N, Services became a member of the obligated group with System and the Hospital.

The fair value of Services' CHEFA bonds, based on market prices, was approximately \$5,777,000 and \$6,385,000 at September 30, 2011 and 2010, respectively.

Aggregate scheduled principal repayments on long-term debt are as follows:

	Long-term debt
Year ending September 30:	
2012	\$ 270,000
2013	255,000
2014	265,000
2015	275,000
2016	285,000
Thereafter	<u>4,080,000</u>
	5,430,000
Plus bond premium	206,000
Less current portion	<u>(270,000)</u>
	<u>\$ 5,366,000</u>

(6) Retirement Savings Plan

Services sponsors a 403(b) retirement savings plan (the Plan) for its employees. The Plan allows participants to contribute up to 10% of their annual compensation, not to exceed certain IRS limitations. There is no matching contribution from Services.

(7) Estimated Self-Insurance Liability for Workers' Compensation Insurance

The costs of certain workers' compensation claims falling within Services' retention limits have been estimated by management and reflected in the accompanying financial statements. These estimates are subject to change, however, in the opinion of Services' management, the ultimate resolution of these claims will not have a material impact on Services' results of operations or financial position.

(8) Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by Services has been limited by the donors for a specific purpose. Temporarily restricted assets in the amount of \$44,130 and \$55,787 as of September 30, 2011 and 2010, respectively, are available for use to provide recreational programs to Services' residents.

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(9) Related Party Transactions

Services purchases certain general and administrative services and health benefits from the Hospital totaling for 2011 and 2010, \$425,431 and \$384,116, respectively. At September 30, 2011 and 2010 Services had payables to the Hospital of \$32,692 and \$5,993, respectively.

(10) Subsequent Event

Services has evaluated subsequent 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 Services' financial statements.