



MIDDLESEX HEALTH SERVICES, INC.

Financial Statements

September 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

MIDDLESEX HEALTH SERVICES, INC.

Financial Statements

September 30, 2010 and 2009

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KPMG LLP
One Financial Plaza
755 Main Street
Hartford, CT 06103

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, 2010 and 2009, 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 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, 2010 and 2009, 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

December 23, 2010

MIDDLESEX HEALTH SERVICES, INC.

Balance Sheets

September 30, 2010 and 2009

Assets	2010	2009
Current assets:		
Cash and cash equivalents	\$ 1,088,218	1,139,651
Accounts receivable	58,956	54,505
Prepaid expenses and other current assets	2,899	2,702
Current portion of investments limited as to use (note 4)	143,976	158,424
Total current assets	1,294,049	1,355,282
Investments limited as to use, net of current portion (note 4)	629,413	573,928
Property and equipment, net (note 3)	5,044,452	5,160,184
Deferred financing costs, net of accumulated amortization of \$136,454 in 2010 and \$127,629 in 2009	109,217	118,042
Total assets	\$ 7,077,131	7,207,436
Liabilities and Net Assets		
Current liabilities:		
Current portion – long-term debt (note 5)	\$ 245,000	235,000
Accounts payable and accrued expenses	192,709	137,983
Due to related parties	5,993	5,247
Estimated self-insurance liability	74,445	118,574
Accrued interest payable	81,651	84,589
Deferred revenue	97,314	133,710
Total current liabilities	697,112	715,103
Long-term debt, net of current portion (note 5)	6,017,597	6,252,624
Total liabilities	6,714,709	6,967,727
Commitments and contingencies (note 7)		
Net assets:		
Unrestricted	306,635	239,709
Temporarily restricted	55,787	—
Total net assets	362,422	239,709
Total liabilities and net assets	\$ 7,077,131	7,207,436

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Statements of Operations and Changes in Net Assets

Years ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Revenues:		
Resident revenues	\$ 2,839,598	2,882,316
Ancillary revenues	50,259	37,294
Other revenues	3,600	3,600
Total revenues	<u>2,893,457</u>	<u>2,923,210</u>
Expenses:		
Salaries and wages	1,201,044	1,137,112
Payroll taxes and employee benefits	275,405	297,964
Purchased services	180,533	171,140
Maintenance	280,964	197,620
Management and professional fees	25,575	112,631
Advertising	31,519	28,265
Food and beverage	162,449	161,965
Depreciation and amortization	235,745	238,276
Interest, net	324,496	316,307
Other	108,801	115,650
Total expenses	<u>2,826,531</u>	<u>2,776,930</u>
Excess of revenues over expenses	<u>66,926</u>	<u>146,280</u>
Temporarily restricted net assets:		
Temporarily restricted contributions	<u>55,787</u>	—
Increase in temporarily restricted net assets	<u>55,787</u>	—
Increase in net assets	122,713	146,280
Net assets, beginning of year	<u>239,709</u>	<u>93,429</u>
Net assets, end of year	<u>\$ 362,422</u>	<u>239,709</u>

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Statements of Cash Flows

Years ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Increase in net assets	\$ 122,713	146,280
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation and amortization	235,745	238,276
Changes in operating assets and liabilities:		
Accounts receivable, net	(4,451)	(30,170)
Prepaid expenses and other current assets	(197)	1,566
Accounts payable and accrued expenses and accrued interest payable	51,788	(39,070)
Estimated self-insurance liability	(44,129)	15,454
Due to related parties	746	(2,431)
Deferred revenue	(36,396)	72,856
Net cash provided by operating activities	<u>325,819</u>	<u>402,761</u>
Cash flows from investing activities:		
Purchases of property and equipment	(101,215)	(12,409)
Investments limited as to use, net	(41,037)	14,692
Net cash (used in) provided by investing activities	<u>(142,252)</u>	<u>2,283</u>
Cash flows from financing activities:		
Repayment of long-term debt	(235,000)	(220,000)
Net cash used in financing activities	<u>(235,000)</u>	<u>(220,000)</u>
Net (decrease) increase in cash	(51,433)	185,044
Cash and cash equivalents, beginning of year	<u>1,139,651</u>	<u>954,607</u>
Cash and cash equivalents, end of year	<u>\$ 1,088,218</u>	<u>1,139,651</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 319,985	349,137

See accompanying notes to financial statements.

MIDDLESEX HEALTH SERVICES, INC.

Notes to Financial Statements

September 30, 2010 and 2009

(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.

MIDDLESEX HEALTH SERVICES, INC.

Notes to Financial Statements

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(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 and \$573,928 in the debt service reserve fund and \$143,976 and \$158,424 in the debt service fund as of September 30, 2010 and 2009, respectively. Services received donations whose uses were restricted by the donors and recorded as temporarily restricted with a balance at September 30, 2010 of \$55,787.

(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 the Hospital has the ability to access.

Level 2 Inputs to the valuation methodology include:

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

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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.

(l) Prior Year Reclassification

Certain prior year balances have been reclassified in order to be consistent with the current year presentation.

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(3) Property and Equipment

Property and equipment as of September 30, 2010 and 2009 consist of the following:

	2010	2009
Land	\$ 894,611	894,611
Building and improvements	6,445,331	6,505,901
Furniture and equipment	282,067	186,948
	7,622,009	7,587,460
Less accumulated depreciation	(2,577,557)	(2,427,276)
Property and equipment, net	\$ 5,044,452	5,160,184

(4) Investments Limited as to Use

Cost and market values for investments included in investments limited as to use as of September 30, 2010 and 2009 are summarized as follows:

	2010		2009	
	Total		Total	
	Market	Cost	Market	Cost
Cash	\$ 55,782	55,782	10,909	10,909
Money market fund	717,607	717,607	563,389	563,389
U.S. treasury bills	—	—	99,970	99,985
U.S. treasury notes	—	—	58,084	58,138
Total investments	773,389	773,389	732,352	732,421
limited as to use	\$ 773,389	773,389	732,352	732,421

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, 2010 and 2009.

	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)
Money market fund	\$ 717,607	\$ 717,607	\$ —	\$ —

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	Total carrying value at September 30, 2009	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Money market fund	\$ 563,389	\$ 563,389	\$ —	\$ —
U.S. treasury bills	99,970	—	99,970	—
U.S. treasury notes	58,084	—	58,084	—
	\$ 721,443	\$ 563,389	\$ 158,054	\$ —

(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 bonds mature from July 1, 2007 through July 1, 2027 and incur interest at rates between 4.700% and 5.125%. The Hospital issued a guaranty note to secure the CHEFA obligations of Services.

The fair value of Services' CHEFA bonds, based on market prices, was approximately \$6,385,000 and \$6,331,000 at September 30, 2010 and 2009, respectively.

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

	Long-term debt
Year ending September 30:	
2011	\$ 245,000
2012	255,000
2013	270,000
2014	285,000
2015	300,000
Thereafter	5,030,000
	6,385,000
Less bond discount	122,403
Less current portion	245,000
	\$ 6,017,597

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(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) Management Contract

Services had a management contract with Genesis Health Ventures, Inc. (Genesis) to manage and provide oversight of the day-to-day operations of One MacDonough Place. In consideration for performing these services Genesis was paid a monthly management fee and an incentive fee as defined by the management contract. Total management fees for the year ended September 30, 2009 was \$87,696. The contract was terminated effective October 1, 2009.

(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 \$55,787 at September 30, 2010 are available for use to provide recreational programs to Services' residents.

(9) Related Party Transactions

Services purchases certain general and administrative services and health benefits from the Hospital totaling for 2010 and 2009 \$384,116 and \$297,773, respectively. At September 30, 2010 and 2009 Services had payables to the Hospital of \$5,993 and \$5,257, respectively.

(10) Subsequent Event

Services has evaluated subsequent events through December 23, 2010, which represents the date the financial statements were available to be issued and noted no subsequent events that would have impacted Services' financial statements.