

AUDITED FINANCIAL STATEMENTS AND
OTHER FINANCIAL INFORMATION

Danbury Office of Physician Services, P.C.
Years Ended September 30, 2009 and 2008
With Report of Independent Auditors

Danbury Office of Physician Services, P.C.

Audited Financial Statements
and Other Financial Information

Years Ended September 30, 2009 and 2008

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Report of Independent Auditors

Board of Directors
Danbury Office of Physician Services, P.C.

We have audited the accompanying balance sheets of Danbury Office of Physician Services, P.C. (the Corporation) as of September 30, 2009 and 2008, and the related statements of operations and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audits included 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 Corporation'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, and 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 Danbury Office of Physician Services, P.C. at September 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

February 17, 2010

Danbury Office of Physician Services, P.C.

Balance Sheets

	September 30	
	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,310,222	\$ 7,934,549
Accounts receivable, less allowance for uncollectible accounts of \$938,000 in 2009 and \$1,582,000 in 2008	8,675,380	9,205,189
Due from The Danbury Hospital	1,210,513	1,500
Prepaid expenses and other current assets	297,001	336,224
Inventory	231,144	127,592
Total current assets	17,724,260	17,605,054
Property and equipment:		
Equipment	5,689,461	5,125,717
Building and leasehold improvements	4,501,243	4,298,526
	10,190,704	9,424,243
Accumulated depreciation and amortization	(5,717,651)	(5,103,858)
	4,473,053	4,320,385
Other assets	3,301,579	3,158,497
Total assets	\$ 25,498,892	\$ 25,083,936
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 187,091	\$ 170,806
Payroll and related accruals	7,604,801	5,360,205
Deferred grant revenue	268,657	41,736
Current portion of loan payable	103,460	173,550
Total current liabilities	8,164,009	5,746,297
Note payable to the Danbury Hospital, less current portion	917,010	1,020,470
Due to The Danbury Hospital	12,947,737	14,922,441
Members' equity:		
Membership stock, no par value; 5,000 shares authorized, issued and outstanding	1,000	1,000
Retained earnings	3,469,136	3,393,728
	3,470,136	3,394,728
Total liabilities and members' equity	\$ 25,498,892	\$ 25,083,936

See accompanying notes.

Danbury Office of Physician Services, P.C.

Statements of Operations and Retained Earnings

	Year Ended September 30	
	2009	2008
Operating revenues:		
Net patient service revenue	\$ 86,638,586	\$ 84,132,691
Physician revenue	32,944,779	30,631,505
Other operating revenue	1,968,898	2,185,960
Total operating revenues	121,552,263	116,950,156
Operating expenses:		
Salaries and wages	83,916,948	75,829,132
Employee benefits	15,232,342	13,090,037
Purchased services	3,757,280	3,893,187
Medical and surgical supplies	1,522,321	5,922,508
Administrative fees paid to affiliates	132,000	132,924
Physician fees	1,359,463	1,647,826
Insurance	3,063,448	3,271,897
Dues, continuing education, licenses and subscriptions	944,367	942,429
Provision for uncollectible accounts	2,708,093	3,686,194
Depreciation and amortization	654,893	675,308
Rent	4,750,973	4,210,074
Professional services	193,983	413,036
Office supplies	721,378	726,048
Other	2,589,729	2,357,171
Total operating expenses	121,547,218	116,797,771
Operating (loss) income	5,045	152,385
Non-operating income	70,363	134,755
Net income	75,408	287,140
Retained earnings at beginning of year	3,393,728	3,106,588
Retained earnings at end of year	\$ 3,469,136	\$ 3,393,728

See accompanying notes.

Danbury Office of Physician Services, P.C.

Statements of Cash Flows

	Year Ended September 30	
	2009	2008
Operating activities		
Net income	\$ 75,408	\$ 287,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash items:		
Provision for uncollectible accounts	2,708,093	3,686,194
Depreciation and amortization	654,893	675,308
Effects of changes in assets and liabilities:		
Accounts receivable, net	(2,178,284)	(3,874,009)
Due from The Danbury Hospital	(1,209,013)	(1,500)
Prepaid expenses and other current assets	39,223	(233,194)
Inventory	(103,552)	438,399
Other assets	(143,082)	(90,803)
Accounts payable and accrued expenses	16,285	71,980
Payroll and related accruals	2,244,596	243,594
Deferred grant revenue	226,921	983
Due to The Danbury Hospital	(1,974,704)	4,737,083
Net cash provided by operating activities	<u>356,784</u>	<u>5,941,175</u>
Investing activity		
Additions to property and equipment, net	(807,561)	(2,116,350)
Net cash used in investing activity	<u>(807,561)</u>	<u>(2,116,350)</u>
Financing activity		
Payments on long-term debt	(173,550)	(163,874)
Net cash used in financing activity	<u>(173,550)</u>	<u>(163,874)</u>
Net (decrease) increase in cash and cash equivalents	<u>(624,327)</u>	<u>3,660,951</u>
Cash and cash equivalents at beginning of year	<u>7,934,549</u>	<u>4,273,598</u>
Cash and cash equivalents at end of year	<u>\$ 7,310,222</u>	<u>\$ 7,934,549</u>

See accompanying notes.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements

September 30, 2009

1. Organization

Danbury Office of Physician Services, P.C. (the Corporation) is organized as an affiliated nonprofit corporation of Danbury Health Systems, Inc. (DHS). The Corporation, which is incorporated under the General Statutes of the State of Connecticut, provides physician services to patients primarily from Western Connecticut and Southeastern New York. The Corporation also provides physician support to various DHS affiliates.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and related footnotes. 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.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less at the date of purchase. Cash and cash equivalents are maintained with domestic financial institutions with deposits exceeding federally insured limits. It is the Corporation's policy to monitor the financial strength of these institutions.

Other Assets

Other assets represents the premiums paid related to split dollar life insurance for certain physicians for which the Corporation is the assignee and the asset portion of a 457(B) Plan for certain physicians. Upon termination or retirement of those physicians with a split dollar life insurance policy, the Corporation has the right to release its collateral assignment in the policy for no consideration. The asset portion of the 457(B) Plan primarily comprises mutual funds with readily determinable fair values based upon quoted market prices.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided for using the straight-line method at rates intended to depreciate the costs of the related assets over the shorter of their estimated useful lives or the terms of their respective leases.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Patient Accounts Receivable and Net Patient Service Revenue

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

The amount of the allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, payor agreements and trends in Medicare and Medicaid health care coverage and other collection indicators. See Note 3 for additional information relative to third party payor programs.

Patient accounts receivable and revenues are recorded when patient services are performed. Net patient service revenue is derived from public and private sources and is reported at the estimated net realizable amounts based on established rates. The Corporation has agreements with third-party payors that provide for payments to the Corporation at amounts different from its established rates. Services provided to publicly aided individuals are reimbursed on the basis of costs as determined by various federal and state agencies. Differences between third-party payments and established rates are recorded as contractual allowances.

Physician Revenue

As its affiliate, the Corporation provides physician services to the patients of The Danbury Hospital (the Hospital). The Corporation records physician revenue at cost and is subsequently paid by the Hospital for providing such services.

Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Corporation does not pursue collection of amounts determined to qualify as charity care, as such, they are not reported as revenue.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method) or market.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

The Corporation is a not-for-profit organization described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income.

Reclassifications

Certain reclassifications have been made to the year ended September 30, 2008 balances previously reported in the balance sheets and statement of operations and retained earnings to conform with the year ended September 30, 2009 presentation.

Adoption of New Accounting Standards

On October 1, 2008, the Corporation adopted the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) (FASB ASC), *Fair Value Measurements* (ASC 820-10), which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. The Corporation's adoption of ASC 820-10 did not significantly affect its financial statements (see Note 9).

On October 1, 2008, the Corporation adopted ASC 825-10, *The Fair Value Option for Financial Assets and Financial Liabilities* (ASC 825-10). ASC 825-10 permits companies to choose to measure certain financial instruments and other items at fair value that currently are not required to be measured at fair value under GAAP. The Corporation chose not to elect the fair value option for its financial assets and liabilities. Consequently, the adoption of ASC 825-10 did not have any impact on its financial statements.

During 2009, the Corporation adopted ASC 855-10, *Subsequent Events* (ASC 855-10). ASC 855-10 establishes general standards of accounting and disclosure requirements for subsequent events, events that occur after the balance sheet but before the financial statements are issued. In addition, certain events subsequent to the balance sheet date may require recognition in the financial statements as of the balance sheet date based upon the requirements of ASC 855-10. The Corporation adopted the provisions of ASC 855-10 as of September 30, 2009, and evaluated the impact of subsequent events through February 17, 2010, representing the date at which the financial statements were issued.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles*, which establishes the FASB ASC as the sole source of authoritative GAAP. Pursuant to the provisions of ASC 105, the Corporation has updated references to GAAP in its financial statements issued for the year ended September 30, 2009. The adoption of FASB ASC 105 did not impact the Corporation's financial position or results of operations.

3. Net Patient Service Revenue

The following summarizes net patient service revenue:

	Year Ended September 30	
	2009	2008
Gross patient service revenue	\$ 201,083,748	\$ 179,025,647
Deductions:		
Contractual allowances	(113,321,119)	(94,165,201)
Provision for charity care	(1,124,043)	(727,755)
	(114,445,162)	(94,892,956)
	\$ 86,638,586	\$ 84,132,691

Revenues from the Medicare and Medicaid programs accounted for approximately 21% and 23%, respectively, of the Corporation's net patient service revenue for the year ended September 30, 2009 and 2008. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term. The Corporation believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries are outstanding, 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. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the Corporation.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

3. Net Patient Service Revenue (continued)

The Corporation grants credit without collateral to its patients, some of whom are insured under third-party payor agreements. Percentages of accounts receivable from patients and third-party payors, exclusive of estimated settlements, included in the balance of accounts receivable, were as follows:

	September 30	
	2009	2008
Medicare	28%	28%
Medicaid	5	5
HMO/PPO	48	51
Patients	10	6
Other	9	10
	100%	100%

4. Related-Party Transactions

The Corporation has material related-party transactions with the Hospital, Danbury Health Care Affiliates (DHCA), DHS and The Danbury Hospital Development Fund, Inc. (the Development Fund).

The Hospital provides office space to the Corporation under an operating lease agreement. Total rent expense for office space provided by the Hospital amounted to \$1,928,066 and \$1,897,436 for the years ended September 30, 2009 and 2008, respectively, and was based on an allocation of related costs from the Hospital. In addition, the Corporation provides physician services (Note 2) to patients of the Hospital, and is reimbursed for these services by the Hospital. The Hospital also funds the operating and capital needs of the Corporation. Amounts due to the Hospital for working capital totaled \$12,947,737 and \$14,922,441 at September 30, 2009 and 2008, respectively. The Hospital also provides information technology services to the Corporation. Total costs related to information technology services were \$579,851 and \$194,419 for the years ended September 30, 2009 and 2008, respectively. During 2009, the Hospital forgave approximately \$979,000 related to certain amounts previously owed from the Corporation.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

5. Loans Payable

	<u>2009</u>	<u>2008</u>
Note payable to the Hospital, payable in monthly installments of \$13,287, including interest at 5.75%, due September 2017	\$ 1,020,470	\$ 1,194,020
Less current portion	103,460	173,550
Long-term debt	<u>\$ 917,010</u>	<u>\$ 1,020,470</u>

Scheduled installments on notes payable are as follows:

	<u>Long-Term Debt</u>
2010	\$ 103,460
2011	109,568
2012	116,037
2013	122,883
2014	132,023
Thereafter	333,039
	<u>\$ 917,010</u>

Interest expense (and paid) related to notes payable was \$64,130 and \$73,805 for the years ended September 30, 2009 and 2008, respectively.

6. Lease Commitments

The Corporation is obligated under operating leases for office space and equipment. Total rent expense, excluding office space and equipment provided by its affiliates (Note 4), amounted to \$2,533,521 and \$2,096,201 for the years ended September 30, 2009 and 2008, respectively. Minimum future lease commitments under noncancelable leases are as follows:

2010	\$ 2,480,268
2011	2,411,144
2012	2,433,599
2013	2,433,599
2014	2,433,599
Thereafter	9,832,010
	<u>\$ 22,024,219</u>

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

7. Professional Liability Self-Insurance

Effective October 1, 2004, coverage for professional liability insurance was purchased from Danbury Health Systems Insurance Company, Ltd., a captive insurance company, which is owned by the Hospital.

Coverage for malpractice is on a claims-made basis. The coverage limits are \$5,000,000 per claim and \$25,000,000 in the aggregate for the years ended September 30, 2009 and 2008. The excess indemnity coverage is \$15,000,000 per claim and \$15,000,000 in the aggregate. A liability for the Corporation's claims that have been incurred-but-not-reported has been recorded by the Hospital as the Hospital has agreed to pay these claims on behalf of the Corporation.

Professional liability claims have been asserted against the Corporation by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. In the opinion of counsel, the outcome of these actions will not have a significant effect on the financial position or the results of operations of the Corporation.

8. Pension Plan

The Corporation participates in a noncontributory defined benefit pension plan (the Plan) sponsored by DHS, covering substantially all employees. Contributions are made to the Plan in amounts sufficient to meet the Employee Retirement Income Security Act of 1974 (ERISA) minimum funding requirements. Net periodic pension expense allocated to the Corporation was \$2,571,605 and \$1,666,097 for 2009 and 2008, respectively.

DHS's defined benefit pension plan had estimated projected benefit obligations of \$362,762,642 and \$279,449,297 at September 30, 2009 and 2008, respectively. The fair value of plan assets was \$251,961,341 and \$252,705,819 at September 30, 2009 and 2008, respectively.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

9. Fair Value of Financial Instruments

As described in Note 1, on October 1, 2008, the Corporation adopted the methods of fair value as described in ASC 820-10 to value its financial assets and liabilities, where applicable. As defined in ASC 820-10, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase consistency and comparability in fair value measurements, ASC 820-10 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data are available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Corporation utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. In addition, the Corporation considers counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value as of September 30, 2009 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 7,310,222	\$ –	\$ –	\$ 7,310,222
Other assets:				
Marketable securities	–	1,796,372	–	1,796,372

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 as quoted market prices for such securities are not readily available.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

10. Functional Expenses

The Corporation provides general physician services to residents within its geographic region. Expenses related to these services are as follows for the years ended September 30:

	<u>2009</u>	<u>2008</u>
Physician services	\$ 110,318,032	\$ 109,920,352
General and administrative	11,229,186	6,877,419
	<u>\$ 121,547,218</u>	<u>\$ 116,797,771</u>

Other Financial Information

Report of Independent Auditors on Other Financial Information

Board of Directors
Danbury Office of Physician Services, P.C.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information and the Schedule of Net Cost of Providing Community Benefit Programs are presented for purposes of additional analysis of the basic consolidated financial statements, and are not required parts of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Ernst + Young LLP

February 17, 2010

Danbury Office of Physician Services, P.C.

Schedule of Net Cost of Providing Community Benefit Programs

Year Ended September 30, 2009

The net cost to the Corporation of providing community benefit programs is as follows:

Traditional charity care provided	\$ 1,124,043
Unpaid cost of public programs	<u>14,708,144</u>
Community benefit programs	<u>\$ 15,832,187</u>