



AUDITED FINANCIAL STATEMENTS AND  
OTHER FINANCIAL INFORMATION

Danbury Office of Physician Services, P.C.  
Years Ended September 30, 2010 and 2009  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Danbury Office of Physician Services, P.C.

Audited Financial Statements  
and Other Financial Information

Years Ended September 30, 2010 and 2009

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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, 2010 and 2009, 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, 2010 and 2009, 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*

March 3, 2011

Danbury Office of Physician Services, P.C.

Balance Sheets

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,588,773	\$ 7,310,222
Accounts receivable, less allowance for uncollectible accounts of \$2,462,000 in 2010 and \$938,000 in 2009	10,614,681	8,675,380
Due from The Danbury Hospital	–	1,210,513
Prepaid expenses and other current assets	195,077	297,001
Inventory	186,591	231,144
Total current assets	14,585,122	17,724,260
Property and equipment:		
Equipment	8,053,802	5,689,461
Building and leasehold improvements	4,685,607	4,501,243
	12,739,409	10,190,704
Accumulated depreciation and amortization	(6,484,980)	(5,717,651)
	6,254,429	4,473,053
Other assets	3,402,919	3,301,579
Total assets	\$ 24,242,470	\$ 25,498,892
<b>Liabilities and members' equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 912,867	\$ 187,091
Payroll and related accruals	7,923,405	7,604,801
Deferred grant revenue	763,426	268,657
Current portion of loan payable	109,568	103,460
Total current liabilities	9,709,266	8,164,009
Note payable to the Danbury Hospital, less current portion	807,442	917,010
Due to The Danbury Hospital	15,058,366	12,947,737
Members' equity (accumulated deficit):		
Membership stock, no par value; 5,000 shares authorized, issued and outstanding	1,000	1,000
(Accumulated deficit) retained earnings	(1,333,604)	3,469,136
	(1,332,604)	3,470,136
Total liabilities and members' equity	\$ 24,242,470	\$ 25,498,892

*See accompanying notes.*

Danbury Office of Physician Services, P.C.

Statements of Operations and Retained Earnings

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Operating revenues:		
Net patient service revenue	<b>\$ 95,201,166</b>	\$ 86,638,586
Physician revenue	<b>34,906,237</b>	32,944,779
Other operating revenue	<b>1,639,474</b>	1,968,898
Total operating revenues	<b>131,746,877</b>	121,552,263
Operating expenses:		
Salaries and wages	<b>91,881,172</b>	83,916,948
Employee benefits	<b>17,352,383</b>	15,232,342
Purchased services	<b>5,604,641</b>	3,757,280
Medical and surgical supplies	<b>1,554,132</b>	1,522,321
Administrative fees paid to affiliates	<b>132,000</b>	132,000
Physician fees	<b>920,053</b>	1,359,463
Insurance	<b>2,932,128</b>	3,063,448
Dues, continuing education, licenses and subscriptions	<b>1,122,793</b>	944,367
Provision for uncollectible accounts	<b>5,431,473</b>	2,708,093
Depreciation and amortization	<b>880,195</b>	654,893
Rent	<b>5,005,663</b>	4,750,973
Professional services	<b>283,537</b>	193,983
Office supplies	<b>708,070</b>	721,378
Other	<b>2,759,354</b>	2,589,729
Total operating expenses	<b>136,567,594</b>	121,547,218
Operating (loss) income	<b>(4,820,717)</b>	5,045
Non-operating income	<b>17,977</b>	70,363
Net (loss) income	<b>(4,802,740)</b>	75,408
Retained earnings at beginning of year	<b>3,469,136</b>	3,393,728
(Accumulated deficit) retained earnings at end of year	<b>\$ (1,333,604)</b>	\$ 3,469,136

*See accompanying notes.*

Danbury Office of Physician Services, P.C.

Statements of Cash Flows

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Net (loss) income	\$ (4,802,740)	\$ 75,408
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash items:		
Provision for uncollectible accounts	5,431,473	2,708,093
Depreciation and amortization	880,195	654,893
Effects of changes in assets and liabilities:		
Accounts receivable, net	(7,370,774)	(2,178,284)
Due from The Danbury Hospital	1,210,513	(1,209,013)
Prepaid expenses and other current assets	101,924	39,223
Inventory	44,553	(103,552)
Other assets	(101,340)	(143,082)
Accounts payable and accrued expenses	725,776	16,285
Payroll and related accruals	318,604	2,244,596
Deferred grant revenue	494,769	226,921
Due to The Danbury Hospital	2,110,629	(1,974,704)
Net cash (used in) provided by operating activities	(956,418)	356,784
<b>Investing activity</b>		
Additions to property and equipment, net	(2,661,571)	(807,561)
Net cash used in investing activity	(2,661,571)	(807,561)
<b>Financing activity</b>		
Payments on long-term debt	(103,460)	(173,550)
Net cash used in financing activity	(103,460)	(173,550)
Net decrease in cash and cash equivalents	(3,721,449)	(624,327)
Cash and cash equivalents at beginning of year	7,310,222	7,934,549
Cash and cash equivalents at end of year	\$ 3,588,773	\$ 7,310,222

*See accompanying notes.*

# Danbury Office of Physician Services, P.C.

## Notes to Financial Statements

September 30, 2010

### **1. Organization**

Danbury Office of Physician Services, P.C. (the Corporation) is organized as an affiliated nonprofit corporation of Western Connecticut Healthcare, Inc. 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 Western Connecticut Healthcare, Inc. 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.

##### **Subsequent Events**

The Corporation evaluates subsequent events, which are 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. For the year ended September 30, 2010, the Corporation evaluated subsequent events through March 3, 2011, which is the date the financial statements were available to be issued. No events occurred that require disclosure or adjustment to the financial statements.

##### **New Accounting Standards**

In January 2010, the Financial Accounting Standards Board issued Accounting Standards Update 2010-06, *Improving Disclosures about Fair Value Measurements*, (ASU 2010-06). ASU 2010-06 amended ASC 820 to clarify certain existing fair value disclosures and require a number of additional disclosures. The guidance in ASU 2010-06 clarified that disclosures should be presented separately for each "class" of assets and liabilities measured at fair value and provided guidance on how to determine the appropriate classes of assets and liabilities to be presented. ASU 2010-06 also clarified the requirement for entities to disclose information about both the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. In addition, ASU 2010-06 introduced new requirements to disclose the amounts (on a gross basis) and reasons for any significant transfers between Levels 1, 2 and 3 of the fair value hierarchy and present information regarding the purchases, sales, issuances and settlements of Level 3 assets and liabilities on a gross basis. With the exception of the requirement to present changes in Level 3 measurements on a gross basis, which is delayed until 2011, the guidance in ASU 2010-06 becomes effective for reporting periods beginning after December 15, 2009. Management is currently evaluating the effect that the provisions of ASU 2010-06 will have on the financial statements.

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

**3. Net Patient Service Revenue**

The following summarizes net patient service revenue:

	<b>Year Ended September 30</b>	
	<b>2010</b>	<b>2009</b>
Gross patient service revenue	<b>\$ 202,734,293</b>	\$ 201,083,748
Deductions:		
Contractual allowances	<b>(106,553,471)</b>	(113,321,119)
Provision for charity care	<b>(979,656)</b>	(1,124,043)
	<b>(107,533,127)</b>	(114,445,162)
	<b>\$ 95,201,166</b>	\$ 86,638,586

Revenues from the Medicare and Medicaid programs accounted for approximately 37% and 21%, respectively, of the Corporation's net patient service revenue for the year ended September 30, 2010 and 2009. 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:

	<b>September 30</b>	
	<b>2010</b>	<b>2009</b>
Medicare	<b>27%</b>	28%
Medicaid	<b>5</b>	5
HMO/PPO	<b>47</b>	48
Patients	<b>11</b>	10
Other	<b>10</b>	9
	<b>100%</b>	100%

#### 4. Related-Party Transactions

The Corporation has material related-party transactions with the Hospital, Danbury Health Care Affiliates (DHCA), Western Connecticut Healthcare, Inc. 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 \$1,721,375 and \$1,928,066 for the years ended September 30, 2010 and 2009, 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 \$15,058,366 and \$12,947,737 at September 30, 2010 and 2009, respectively. The Hospital also provides information technology services to the Corporation. Total costs related to information technology services were \$1,244,057 and \$579,851 for the years ended September 30, 2010 and 2009, 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>2010</u>	<u>2009</u>
Note payable to the Hospital, payable in monthly installments of \$13,287, including interest at 5.75%, due September 2017	\$ 917,010	\$ 1,020,470
Less current portion	<u>109,568</u>	<u>103,460</u>
Long-term debt	<u>\$ 807,442</u>	<u>\$ 917,010</u>

Scheduled installments on notes payable are as follows:

	<u>Long-Term Debt</u>
2011	\$ 109,568
2012	116,037
2013	122,883
2014	132,023
2015	137,827
Thereafter	<u>189,104</u>
	<u>\$ 807,442</u>

Interest expense (and paid) related to notes payable was \$55,979 and \$64,130 for the years ended September 30, 2010 and 2009, 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 \$2,949,303 and \$2,533,521 for the years ended September 30, 2010 and 2009, respectively. Minimum future lease commitments under noncancelable leases are as follows:

2011	\$ 3,049,284
2012	3,043,235
2013	3,043,235
2014	3,043,235
2015	3,067,639
Thereafter	<u>9,229,548</u>
	<u>\$ 24,476,177</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, 2010 and 2009. 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 Western Connecticut Healthcare, Inc., 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 \$5,036,832 and \$2,571,605 for the years ended September 30, 2010 and 2009, respectively.

Western Connecticut Healthcare, Inc.'s defined benefit pension plan had estimated projected benefit obligations of \$420,464,422 and \$362,762,642 at September 30, 2010 and 2009, respectively. The fair value of plan assets was \$297,328,592 and \$251,961,341 at September 30, 2010 and 2009, respectively.

## Danbury Office of Physician Services, P.C.

### Notes to Financial Statements (continued)

#### 9. Fair Value of Financial Instruments

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, 2010 are classified in the table below in one of the three categories described above:

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and cash equivalents	\$ 3,588,773	\$ –	\$ –	\$ 3,588,773
Other assets:				
Marketable securities	–	2,202,830	–	2,202,830

Danbury Office of Physician Services, P.C.

Notes to Financial Statements (continued)

**9. Fair Value of Financial Instruments (continued)**

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:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets</b>				
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.

**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>2010</u>	<u>2009</u>
Physician services	\$ 124,425,337	\$ 110,318,032
General and administrative	<u>12,142,257</u>	<u>11,229,186</u>
	<u>\$ 136,567,594</u>	<u>\$ 121,547,218</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*

March 3, 2011

Danbury Office of Physician Services, P.C.

Schedule of Net Cost of Providing Community Benefit Programs

Year Ended September 30, 2010

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

Traditional charity care provided	\$ 979,656
Unpaid cost of public programs	<u>18,286,157</u>
Community benefit programs	<u><u>\$ 19,265,813</u></u>

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