



ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

**Consolidated Financial Statements and Supplementary
Information on Federal Awards Programs**

December 31, 2012

**(With Independent Auditors' Report and
Reports on Internal Control and Compliance Thereon)**

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

December 31, 2012

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Independent Auditors' Report

The Board of Trustees
St. John's Riverside Hospital and Subsidiaries:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of St. John's Riverside Hospital and Subsidiaries (the Hospital), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net (deficit) assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of St. John's Riverside Hospital and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

As discussed in note 2(s) to the consolidated financial statements, the Hospital adopted Accounting Standards Update 2011-07, *Healthcare Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* in 2012. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2013 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

KPMG LLP

May 8, 2013

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 13,427,144	15,429,609
Investments	13,493,323	10,502,310
Patients' accounts receivable, net of allowance for doubtful accounts of \$11,760,000 in 2012 and \$12,202,000 in 2011	20,603,825	18,991,367
Assets limited or restricted as to use	7,423,542	7,429,031
Due from affiliates	2,947,675	2,804,707
Due from third-party payors	3,723,495	1,843,635
Other current assets	<u>9,547,222</u>	<u>10,293,997</u>
Total current assets	71,166,226	67,294,656
Due from affiliates, net of current portion	5,010,380	5,302,030
Assets limited or restricted as to use, net of current portion	10,828,655	10,313,495
Pledges receivable, net	1,058,832	1,358,536
Property, plant, and equipment, net	55,241,499	51,949,560
Other noncurrent assets, net	<u>5,428,413</u>	<u>3,703,277</u>
Total assets	<u>\$ 148,734,005</u>	<u>139,921,554</u>
Liabilities and Net (Deficit) Assets		
Current liabilities:		
Current portion of long-term debt	\$ 2,599,943	2,462,258
Accounts payable and accrued expenses	21,759,890	20,253,945
Accrued salaries and wages payable	10,980,316	10,022,270
Accrued benefit costs	600,224	617,525
Due to affiliate – Captive	183	521,682
Due to third-party payors	5,923,166	6,092,551
Current portion of other long-term liabilities	4,694,862	4,553,357
Refundable advance	<u>6,424,963</u>	<u>6,408,665</u>
Total current liabilities	52,983,547	50,932,253
Long-term debt, net of current portion	26,095,990	28,380,766
Accrued benefit costs, net of current portion	81,751,748	64,421,250
Other long-term liabilities, net of current portion	<u>16,094,076</u>	<u>14,519,285</u>
Total liabilities	<u>176,925,361</u>	<u>158,253,554</u>
Commitments and contingencies		
Net (deficit) assets:		
Unrestricted	(34,028,826)	(24,377,925)
Temporarily restricted	3,707,833	3,916,288
Permanently restricted	<u>2,129,637</u>	<u>2,129,637</u>
Total net deficit	<u>(28,191,356)</u>	<u>(18,332,000)</u>
Total liabilities and net deficit	<u>\$ 148,734,005</u>	<u>139,921,554</u>

See accompanying notes to consolidated financial statements.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Consolidated Statements of Operations
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted revenues, gains, and other support:		
Net patient service revenue (net of contractual allowances and discounts)	\$ 237,929,123	244,091,014
Provision for bad debts	<u>(15,608,781)</u>	<u>(17,826,847)</u>
Net patient service revenue less provision for bad debts	222,320,342	226,264,167
Other revenue	16,495,349	13,066,483
Investment income (loss)	1,387,550	(77,078)
Net assets released from restrictions for operations	<u>444,995</u>	<u>631,405</u>
Total revenues, gains, and other support	<u>240,648,236</u>	<u>239,884,977</u>
Expenses:		
Salaries and wages	110,061,582	105,333,584
Employee benefits	45,269,814	39,970,470
Supplies and other expenses	69,978,660	66,706,528
Interest	2,569,722	2,690,661
Depreciation and amortization	<u>8,746,969</u>	<u>8,258,408</u>
Total expenses	<u>236,626,747</u>	<u>222,959,651</u>
Gain from operations	4,021,489	16,925,326
Other changes in unrestricted net deficit:		
Net assets released from restrictions used for purchases of property, plant, and equipment	812,054	930,376
Pension-related changes other than net periodic benefit cost	(16,207,850)	(15,405,259)
Grant for purchases of property, plant, and equipment	2,552,956	772,044
Transfer to affiliate	<u>(829,550)</u>	<u>(1,004,136)</u>
Change in unrestricted net deficit	<u>\$ (9,650,901)</u>	<u>2,218,351</u>

See accompanying notes to consolidated financial statements.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Consolidated Statements of Changes in Net (Deficit) Assets

Years ended December 31, 2012 and 2011

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Balances at December 31, 2010	\$ (26,596,276)	4,100,397	2,129,637	(20,366,242)
Gain from operations	16,925,326	—	—	16,925,326
Gifts, grants, bequests, and contributions	—	1,377,672	—	1,377,672
Net assets released from restrictions used for operations	—	(631,405)	—	(631,405)
Net assets released from restrictions used for purchases of property, plant, and equipment	930,376	(930,376)	—	—
Pension-related changes other than net periodic benefit cost	(15,405,259)	—	—	(15,405,259)
Grant for purchases of property, plant, and equipment	772,044	—	—	772,044
Transfer to affiliate	(1,004,136)	—	—	(1,004,136)
Total changes in net (deficit) assets	2,218,351	(184,109)	—	2,034,242
Balances at December 31, 2011	(24,377,925)	3,916,288	2,129,637	(18,332,000)
Gain from operations	4,021,489	—	—	4,021,489
Gifts, grants, bequests, and contributions	—	1,048,594	—	1,048,594
Net assets released from restrictions used for operations	—	(444,995)	—	(444,995)
Net assets released from restrictions used for purchases of property, plant, and equipment	812,054	(812,054)	—	—
Pension-related changes other than net periodic benefit cost	(16,207,850)	—	—	(16,207,850)
Grant for purchases of property, plant, and equipment	2,552,956	—	—	2,552,956
Transfer to affiliate	(829,550)	—	—	(829,550)
Total changes in net (deficit) assets	(9,650,901)	(208,455)	—	(9,859,356)
Balances at December 31, 2012	\$ (34,028,826)	3,707,833	2,129,637	(28,191,356)

See accompanying notes to consolidated financial statements.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Consolidated Statements of Cash Flows
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Change in net (deficit) assets	\$ (9,859,356)	2,034,242
Adjustments to reconcile change in net (deficit) assets to net cash provided by operating activities:		
Provision for bad debts, net	15,608,781	17,826,847
Depreciation and amortization	8,746,969	8,258,408
Amortization of deferred financing cost	39,839	40,710
Accretion of assets retirement obligation	35,000	(29,000)
Net realized and unrealized (gains) losses on investments	(1,000,565)	424,904
Pension-related changes other than net periodic benefit cost	16,207,850	15,405,259
Grant received for capital expenditure	(2,552,956)	(772,044)
Transfer to affiliate	829,550	1,004,136
Restricted contributions for capital expenditures	(454,864)	(554,813)
Pledge receivable write-off	14,423	32,521
Changes in assets and liabilities:		
Patients' accounts receivable	(17,221,239)	(19,491,841)
Other current and noncurrent assets, net	(1,018,200)	(2,726,291)
Accounts payable and accrued expenses	1,505,945	2,041,624
Accrued salaries, wages payable, and accrued benefit costs	2,063,393	(1,847,345)
Due to third-party payors, net	(2,049,245)	2,168,463
Other current and noncurrent liabilities, net	1,681,296	2,181,865
Net cash provided by operating activities	<u>12,576,621</u>	<u>25,997,645</u>
Cash flows from investing activities:		
Acquisitions of property, plant, and equipment, net	(11,651,908)	(10,338,012)
Purchases of assets limited or restricted as to use and investments	(9,235,747)	(12,942,461)
Sales of assets limited or restricted as to use and investments	6,735,628	8,581,147
Increase in refundable advance	16,298	33,912
Net cash used in investing activities	<u>(14,135,729)</u>	<u>(14,665,414)</u>
Cash flows from financing activities:		
Pledge receivable, net	285,281	354,911
Due from affiliates	148,682	(74,559)
Due to affiliate – Captive	(521,499)	(953,941)
Proceeds from restricted contributions for capital expenditures	454,864	554,813
Proceeds from new debt	—	600,000
Repayment of long-term debt	(2,534,091)	(3,537,606)
Grant received for capital expenditures	2,552,956	772,044
Transfer to affiliate	(829,550)	(1,004,136)
Net cash used in financing activities	<u>(443,357)</u>	<u>(3,288,474)</u>
Net (decrease) increase in cash and cash equivalents	(2,002,465)	8,043,757
Cash and cash equivalents at beginning of year	<u>15,429,609</u>	<u>7,385,852</u>
Cash and cash equivalents at end of year	<u>\$ 13,427,144</u>	<u>15,429,609</u>
Supplemental information:		
Interest paid	\$ 2,441,548	2,612,971
Capital lease obligations incurred	387,000	3,000,000

See accompanying notes to consolidated financial statements.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(1) Organization

St. John's Riverside Hospital (the Hospital), located in Yonkers, New York, is a membership corporation organized under the not-for-profit corporation laws of the State of New York. The sole member of the Hospital is Riverside Health Care System, Inc. (RHCS), a State of New York not-for-profit corporation. The Hospital operates three campuses: Andrus Pavilion, which provides general acute care with a full range of inpatient and outpatient services; Dobbs Ferry Pavilion, which operates an emergency room, twelve inpatient beds, five operating rooms and breast cancer center services; and ParkCare Pavilion, which serves an inner-city population providing alcohol and substance abuse services.

The Hospital and RHCS are exempt from federal, state, and local income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code).

SJR Medical P.C. is a for-profit organization that provides medical services. SJR Medical P.C. is controlled by the Hospital and, therefore, is included in the consolidated financial statements.

RHCS is the sole member of the Michael Malotz Skilled Nursing Pavilion (Nursing Home). The Nursing Home is not controlled by the Hospital and, therefore, is not included in the consolidated financial statements. The Nursing Home is exempt from federal, state, and local income taxes under Section 501(c)(3) of the Code.

RHCS is the sole member of River Management Co., Inc. (RMC), which is the sole shareholder of Riverside Management Services Organization, Inc. (RMSO). RMSO is not controlled by the Hospital and, therefore, is not included in the consolidated financial statements. These entities were incorporated under the New York Corporation Laws.

RHCS is the sole member of RHCS Bermuda Ltd. (the Captive), an affiliated captive insurance company incorporated under the laws of Bermuda. The Captive is not controlled by the Hospital and, therefore, is not included in the consolidated financial statements.

(2) Summary of Significant Accounting Policies**(a) Principles of Consolidation**

The consolidated financial statements include the financial statements of the Hospital and SJR Medical P.C., which have been prepared on the accrual basis and are in conformity with U.S. generally accepted accounting principles. All significant intercompany balances and transactions have been eliminated in preparation of the consolidated financial statements.

(b) Use of Estimates

The preparation of consolidated 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 consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(c) Cash and Cash Equivalents

Cash and cash equivalents include certain liquid investments with original maturities of three months or less (note 16).

(d) Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities classified as trading are measured at fair value in the accompanying consolidated balance sheets (note 4).

(e) Inventories

Inventories are stated at the lower of cost, determined on a first-in, first-out (FIFO) basis, or market, and are included in other current assets.

(f) Investment Income (Loss)

Investment income or loss (including net realized gains and losses, dividends, and interest income and net unrealized gains and losses on investments) is reflected within the caption "investment income (loss)" in the accompanying consolidated statements of operations unless the income or loss is restricted by donor or law.

(g) Assets Limited or Restricted as to Use

Assets limited or restricted as to use consist of funds externally restricted under mortgage agreements and letters of credit, funds whose use has been limited by donors to a specific period or purpose, or donor stipulations that assets be maintained in perpetuity, and funds temporarily transferred to the Hospital (notes 4 and 18).

(h) Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost (or, if acquired by gift, at fair market value at the date of the gift), net of accumulated depreciation. Depreciation of plant and equipment is computed under the straight-line method over each class of depreciable assets' estimated useful service lives (ranging from 3 to 40 years). Equipment under capital leases is amortized utilizing the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment.

Leases are classified as capital leases or operating leases, in accordance with the terms of the underlying lease agreements. Equipment under capital leases is recorded as assets and the related obligations as liabilities at the lower of fair market value or present value of future minimum lease payments. Lease payments under operating leases are charged departmentally to rental expense.

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Interest earned on the investment of related tax-exempt borrowings is offset against the interest costs capitalized.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(i) Contributions

Contributions, which include unconditional promises to give (pledges), are recognized as revenue in the period received. Unconditional promises to give that are expected to be collected within one year are reported at face value. Unconditional promises to give that are expected to be collected in future years are recorded at the net present value of their estimated cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are expected to be received. Amortization of the discounts is included in temporarily restricted net assets.

(j) Patients' Accounts Receivable

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	December 31	
	2012	2011
Medicare	26%	27%
Medicaid	27	24
Managed care and other insurers	25	26
Uninsured patients	20	19
Other	2	4
	100%	100%

The Hospital has agreements with third-party payors that provide for payment at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Management regularly reviews accounts and contracts and provides appropriate contractual allowances and discounts that are netted against patient accounts receivable in the consolidated balance sheets. Patient accounts receivable are further reduced by an allowance for doubtful accounts.

The Hospital analyzes its past collection history and identifies trends by each of its major payor sources of patient service revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about the major payor sources of patient service revenue in evaluating the adequacy of the allowance for doubtful accounts. The Hospital analyzes contractual amounts due from patients who have third-party coverage and provides an allowance for doubtful accounts and a provision for bad debts. For patient accounts receivable associated with self-pay patients, which includes those patients without insurance coverage and patients with deductibles and copayment balances for which third-party coverage exists for a portion of the bill, the Hospital records a significant provision for bad debts for patients that are unable or unwilling to pay for the portion of the bill representing their financial responsibility. Account balances are charged off against the allowance for doubtful accounts after all means of collection has been exhausted and the potential recovery is considered remote.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

The following table sets forth the components of the change in the allowance for doubtful accounts for the years ended December 31:

Year	Balance at beginning of year	Provision for bad debts	Write-offs, net of recoveries	Balance at end of year
2012	\$ 12,202,000	15,608,781	(16,050,781)	11,760,000
2011	13,899,000	17,826,847	(19,523,847)	12,202,000

(k) Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payment at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated settlements under payment agreements with third-party payors. Settlements with third-party payors are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined.

The estimated percentages of patient service revenue by inpatient and outpatient services for the years ended December 31 are as follows:

	2012	2011
Inpatient services	68%	69%
Outpatient services	32	31

The following table reflects the estimated percentages of patient service revenue, net of provision for bad debts, for the years ended December 31:

	2012	2011
Medicare	39%	38%
Medicaid	27	28
Managed care and other insurers	31	31
Uninsured patients	2	2
Other	1	1
	<u>100%</u>	<u>100%</u>

(l) Charity Care and Uncompensated Care

The Hospital, in keeping with its mission and philosophy to extend quality care and compassionate service, recognizes that some patients are unable to compensate the Hospital for their treatment through either third-party coverage or their own resources. Accordingly, the Hospital extends charity

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

or free care to those patients who do not have the ability to meet their obligations. The Hospital provides free care or sliding-fee scales based on federal poverty income guidelines or when it is determined that the patients are unable to fulfill their obligations to the Hospital. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amount of uncompensated care, at estimated cost, provided to the indigent and broader community for the years ended December 31 is as follows:

	<u>2012</u>	<u>2011</u>
Cost of charity care and uncompensated care:		
Cost of charity care provided	\$ 1,501,549	1,408,049
Provision for bad debts at estimated cost	5,186,776	6,198,234

New York State regulations provide for the distribution of funds from an indigent care pool, which is intended to partially offset the cost of services provided to the uninsured. The funds are distributed to the Hospital based on their level of bad debt, charity care, and uninsured units of service in relation to all other New York State hospitals. For the years ended December 31, 2012 and 2011, the Hospital received distributions of \$5,785,535 and \$6,422,546, respectively, from the indigent care pool while contributing \$2,922,124 in 2012 and \$2,979,858 in 2011.

The Hospital utilizes a cost to charge ratio methodology to convert charity care to estimated cost. The cost to charge ratio is calculated utilizing the methodology employed on the Medicare cost report.

(m) Classification of Net Assets

The net assets of the Hospital and changes therein are classified as follows:

Unrestricted net deficit – All funds not restricted by a donor or grantor and assets limited as to use through contractual or regulatory control of a third-party payor or under debt agreements are classified as unrestricted.

Temporarily restricted and permanently restricted net assets – Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific period or purpose. Permanently restricted net asset have been restricted by donors to be maintained by the Hospital in perpetuity. Contributions with donor-imposed restrictions that are met in the same year as received are reported as other revenue in the accompanying consolidated financial statements.

(n) Consolidated Statements of Operations

The consolidated statements of operations include the gain from operations, which represents the net gain attributed to all transactions deemed by management to be ongoing, major, or central to the provision of healthcare services. Changes in unrestricted net deficit, which are excluded from the gain from operations, consistent with industry practice, includes a transfer of funds to an affiliate, pension-related changes other than net periodic benefit cost and grant for purchase of property, plant,

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

and equipment and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purpose of acquiring such assets).

(o) Impairment of Long-Lived Assets

Management reviews long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

(p) Deferred Financing Costs

Deferred financing costs of approximately \$966,000, reported as other noncurrent assets, net in the accompanying consolidated balance sheets, represent costs incurred in connection with the issuance of long-term debt and are amortized on the interest method, over the term of the related obligations. Accumulated amortization of deferred financing costs amounted to \$497,578 and \$457,739 at December 31, 2012 and 2011, respectively.

(q) Conditional Asset Retirement Obligation

The Hospital recognizes a liability when a legal obligation exists to perform an asset retirement obligation (ARO) in which the timing or method of settlement are conditional on a future event that may or may not be under the control of the entity. The New York State Department of Labor Industrial Code Rule 56 requires the controlled removal or encapsulation of asbestos by a licensed contractor in commercial and public buildings including renovation and partial or complete demolition activities, such legislation being applicable to the Hospital.

The ARO liability is accreted through periodic charges to depreciation expense. The initially capitalized ARO long-lived asset cost is depreciated over the useful life of the related long-lived asset (note 12).

(r) Accounting for Uncertainty in Income Taxes

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Code, and is exempt from federal and state income taxes pursuant to Section 501(a) of the Code. There are certain transactions that could be deemed "Unrelated Business Income" and would result in a tax liability. Management reviews transactions to estimate potential tax liabilities using a threshold of more likely than not of being sustained. It is management's estimation that there are no material tax liabilities that need to be recorded.

(Continued)

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(s) New Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, to require a number of additional disclosures regarding fair value measurement. Effective for annual reporting periods beginning after December 15, 2009, ASU 2010-06 requires the disclosure of the amounts of significant transfers in or out of Level 2 investments and disclosure of the policy for determining when transfers among levels are recognized. ASU 2010-06 also clarifies the requirement to disclose information about the valuation techniques and inputs used in estimating Level 2 and Level 3 measurements. Effective for annual reporting periods beginning after December 15, 2010, ASU 2010-06 also requires that information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances, and settlements be provided on a gross basis. The effect of adopting ASU 2010-06 was not material to the consolidated financial statements.

In August 2010, the FASB issued ASU 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*. ASU 2010-23 requires that cost be used as the measurement for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing charity care, and requires disclosure of the method used to identify or determine such costs. The ASU is effective for the Hospital on January 1, 2011 and does not change recognition of revenue as the Hospital does not recognize revenue for charity care provided. The additional disclosures required under this ASU are reflected in note 2(I).

In August 2010, the FASB issued ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*. This ASU clarifies that a health care entity should not net insurance recoveries against related claim liability. This ASU is effective for the Hospital on January 1, 2011. The adoption of this guidance resulted in the Hospital recording an additional accrual for medical malpractice claims and workers' compensation liabilities and an insurance recoveries receivable of \$6,285,751 and \$4,283,016 on the consolidated balance sheet at December 31, 2012 and 2011, respectively. Such amounts are included in other current assets and current portion of long-term liabilities of \$1,923,000 and \$1,749,000 and other noncurrent assets, net and other long-term liabilities, net of \$4,362,751 and \$2,534,016, respectively, at December 31, 2012 and 2011, respectively. The adoption of this guidance did not have an impact on the results of operations or cash flows of the Hospital.

In July 2011, FASB issued ASU 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The guidance is intended to provide financial statement users with greater transparency about a healthcare entity's net patient service revenue and related allowance for doubtful accounts. The guidance provides information to assist financial statement users in assessing an entity's sources of net patient service revenue and related changes in its allowance for doubtful accounts. The guidance requires certain healthcare entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those healthcare entities are required to provide enhanced disclosures about their policies for recognizing revenue and assessing bad debts.

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The guidance also requires disclosures of patient service revenue (net of contractual allowances and discounts), as well as qualitative information about changes in the allowance for doubtful accounts. The Hospital adopted the guidance of ASU 2011-07 on January 1, 2012. As such, the Hospital reclassified the provision for bad debt expense, net totaling \$15,608,781 and \$17,826,847 for the years ended December 31, 2012 and 2011, respectively, from operating expenses to a reduction of net patient service revenue in the consolidated statements of operations. In addition, the required disclosures related to the Hospital's sources of patient service revenue and changes in the allowance for doubtful accounts can be found at notes 2(j) and 2(k).

In September 2011, the FASB issued ASU 2011-09, *Disclosures about an Employer's Participation in a Multiemployer Plan*. The guidance is intended to provide financial statement users with greater transparency about an employer's participation in a multiemployer pension plan. The guidance requires additional qualitative and quantitative information disclosures to assist users of the financial statements in understanding the commitments and risks involved in participating in multiemployer pension plans, including the financial health of all the significant plans in which the employer participates. This ASU does not change the current recognition and measurement guidance for an employer's participation in a multiemployer pension plan. This ASU is effective for the Hospital for the year ended December 31, 2011. The additional disclosures required under this ASU are reflected in note 9(d).

(t) Reclassifications

Certain reclassifications have been made to the 2011 consolidated financial statements in order to conform to the 2012 presentation.

(3) Reimbursement Contingencies

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

(a) Medicare

Under the Medicare program, the Hospital receives reimbursement under a prospective payment system (PPS) for inpatient and outpatient services. Under the hospital inpatient PPS, fixed payment amounts per inpatient discharge are established based on the patient's assigned diagnosis related group (DRG). When the estimated cost of treatment for certain patients is higher than the average, providers typically will receive additional "outlier" payments. Under the outpatient PPS, services are paid based on service groups called ambulatory payment classifications (APCs).

(b) Medicaid and Other Third-Party Payors

The New York Health Care Reform Act of 1996 (the Act), as amended, governs payments to hospitals in New York State, and Medicaid, workers' compensation, and no-fault payors rates are promulgated by the New York State Department of Health. Reimbursement for services to Medicaid program beneficiaries includes prospectively determined rates per discharge and per visit amounts. All other third-party payors, principally, Blue Cross, other private insurance companies, Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs), and other managed

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care plans, negotiate payment rates directly with hospitals. Such arrangements vary from DRG-based payment systems, per diems, case rates, and percentage of billed charges. If such rates are not negotiated, then the payors are billed at the Hospital's established charges.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a possibility that recorded estimates could change by a material amount. The Hospital has established estimates based on information presently available of the amounts due to or from Medicare, Medicaid, workers' compensation, and no-fault payors, and amounts due from the indigent care pool for such adjustments. Net patient service revenue for the years ended December 31, 2012 and 2011 increased (decreased) by approximately \$0.8 million and (\$0.2 million), for settlements related to prior years and changes in estimates to reflect the most recent information available.

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the Health Care Reform Law), which was signed into law on March 23, 2010, will change how healthcare services are covered, delivered, and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, reductions in Medicare and Medicaid Disproportionate Share Hospital payments, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the Health Care Reform Law reforms certain aspects of health insurance, expands existing efforts to tie Medicare and Medicaid payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Because of the many variables involved with the Health Care Reform Law, management is unable to predict the net effect on the Hospital of the expected increases in insured individuals using the Hospital's facilities, the reductions in Medicare spending and reductions in Medicare and Medicaid DSH funding, and numerous other provisions in the law that may affect the Hospital.

On July 13, 2010, CMS issued rules to implement the Medicare and Medicaid electronic health record (EHR) incentive program established under the Health Information Technology for Economic and Clinical Health Act (HITECH). Certain hospitals and eligible healthcare professionals that demonstrate "meaningful use" of certified EHR technology can qualify for Medicare payments beginning in 2011. Medicaid requires that hospitals and eligible healthcare professionals "adopt, implement, or upgrade" certified EHR, which includes purchasing the technology, in order to receive incentive payments in 2012. During the year ended December 31, 2012, the Hospital recognized \$5,217,850 of revenue for HITECH incentives from the Medicare and Medicaid programs that is related to the Hospital meeting the requirements of the meaningful use incentive program. The Hospital elected to recognize the revenue associated with the EHR incentive payment under the cliff recognition model and included such amounts in other revenue in the accompanying consolidated statements of operations. The cliff recognition model recognizes the incentive at the conclusion of the measurement period.

The current Medicare, Medicaid, and other third-party payor programs are based upon extremely complex laws and regulations that are subject to interpretation including, without limitation, the federal Anti-Kickback statute and the federal Ethics in Patient Referral Act (so-called Stark Law), which apply to virtually all companies engaged in the healthcare services industry. The Anti-Kickback statute prohibits, among other things, the offer, payment, solicitation, or receipt of any form of remuneration in return for the referral of Medicare and Medicaid patients. The Stark Law prohibits, with limited exceptions, financial relationships between ancillary service providers and referring physicians. Noncompliance with such laws and regulations could result in fines, penalties, and exclusion from such programs.

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Revenue from Medicare and Medicaid programs accounted for approximately 66% of the Hospital's net patient service revenue in 2012 and 2011. Future changes in the Medicare and Medicaid programs, such as the Health Care Reform Law, and any reduction of funding could adversely impact the Hospital's operations. There can be no assurance that payments under governmental and private third-party payor programs will be timely, will remain at levels comparable to present levels or will, in the future, be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to such programs. The Hospital's financial condition and results of operations may be materially and adversely affected by the reimbursement process, which in the healthcare industry is complex and can involve lengthy delays between the time that revenue is recognized and the time that reimbursement amounts are settled. In addition, under the Medicare program, if the federal government makes a formal demand for repayment of an amount previously reimbursed, even related to contested items, payment must be made for those items before the provider is given opportunity to appeal and resolve the matter.

The Budget Control Act of 2011 (the Budget Control Act) mandated significant reductions and spending caps on the federal budget for fiscal years 2012 through 2021. The Budget Control Act also created a Joint Select Committee on Deficit Reductions (the Super Committee) to develop a plan to further reduce the federal deficit by \$1.5 trillion on or before November 23, 2011. Since the Super Committee failed to act before the mandated deadline, a 2% reduction in Medicare spending, among other reductions, was to take effect beginning January 1, 2013 in a process known as Sequestration. The Budget Control Act also required a 26.5% reduction in the sustainable growth rate formula regarding physician reimbursement under Medicare to be effective January 1, 2013.

On January 2, 2013, President Obama signed into law the American Taxpayers Relief Act, which delayed Sequestration until March 1, 2013 and is now in effect as of March 1, 2013 and will continue until Congress takes further action. Further, the American Taxpayers Relief Act delays the implementation of the reduction to the sustainable growth rate formula regarding physician reimbursement under Medicare through the end of 2013. As such, the Hospital Medicare payments for inpatient and outpatient services will be reduced by the mandatory 2% reduction beginning on April 1, 2013.

It is not currently possible to determine the impact that any further spending reductions to Medicare, Medicaid, and other federal government healthcare spending, including any budget reduction actions taken by Congress to reduce the federal deficit in order to end Sequestration, will have on the revenue of the Hospital.

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid antifraud and abuse legislation. Recent federal initiatives have prompted a national review of federally funded healthcare programs. The Hospital has a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future government review and interpretation exists. The Hospital believes that it is in compliance, in all material respects, with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation. Noncompliance with such laws and regulations could result in repayments of amounts improperly reimbursed, substantial monetary fines, civil and criminal penalties, and exclusion from the Medicare and Medicaid programs.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

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(4) Investments and Assets Limited or Restricted as to Use

The composition of investments and assets limited or restricted as to use consists of the following at December 31:

	<u>2012</u>	<u>2011</u>
By type of investments:		
Money market funds	\$ 9,666,343	9,114,336
Corporate bonds	5,550,784	5,813,436
U.S. government and agencies securities	1,028,537	1,258,415
Equity securities	10,688,079	9,068,445
Fixed income commingled funds	3,448,626	983,547
Certificate of deposit	1,336,310	1,336,112
Mortgage- and asset-backed securities	26,841	670,545
	<u>\$ 31,745,520</u>	<u>28,244,836</u>
By type of limitation or restriction:		
Unrestricted	\$ 13,493,323	10,502,310
Limited as to use by debt agreements	6,339,598	6,412,972
Other restricted investments (note 18)	6,424,963	6,408,665
Board-designated	1,711,184	1,235,686
Temporarily restricted	1,646,815	1,555,566
Permanently restricted	2,129,637	2,129,637
	<u>\$ 31,745,520</u>	<u>28,244,836</u>

Investment income and gains from investments, assets limited or restricted as to use, cash equivalents, and other investments included in investment income (loss) comprise the following for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Investment income:		
Interest and dividend income	\$ 386,985	347,827
Realized gains on sales of securities	225,607	115,833
Unrealized gains (losses) on trading investments	774,958	(540,738)
	<u>\$ 1,387,550</u>	<u>(77,078)</u>

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Maturities of U.S. government and corporate bonds and notes are classified as follows at December 31, 2012:

	<u>Amortized cost</u>	<u>Fair value</u>
Due in less than five years	\$ 5,947,834	6,005,148
Due after five years	549,804	574,173
	<u>\$ 6,497,638</u>	<u>6,579,321</u>

Maturities of U.S. government and corporate bonds and notes are classified as follows at December 31, 2011:

	<u>Amortized cost</u>	<u>Fair value</u>
Due in less than five years	\$ 6,213,445	6,259,610
Due after five years	780,023	812,241
	<u>\$ 6,993,468</u>	<u>7,071,851</u>

The fair value of the financial instrument represents the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Hospital's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Hospital based on the best information available in the circumstances, including expected cash flows and appropriately risk-adjusted discount rates, and available observable and unobservable inputs.

FASB established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. 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 measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Hospital has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

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The following table presents the Hospital's fair value hierarchy for assets measured at fair value on a recurring basis as of December 31, 2012. At December 31, 2012, there were no Level 3 assets in the Hospital's investment portfolio.

	Fair value	Fair value measurements using	
		Level 1	Level 2
By type of investment:			
Money market funds	\$ 9,666,343	9,666,343	—
Corporate bonds	5,550,784	—	5,550,784
U.S. government and agencies securities	1,028,537	932,774	95,763
Equity securities - Domestic	10,688,079	10,688,079	—
Fixed income commingled funds	3,448,626	3,448,626	—
Certificate of deposit	1,336,310	1,336,310	—
Mortgage- and asset-backed securities	26,841	—	26,841
Total	\$ 31,745,520	26,072,132	5,673,388

The following table presents the Hospital's fair value hierarchy for assets measured at fair value on a recurring basis as of December 31, 2011. At December 31, 2011, there were no Level 3 assets in the Hospital's investment portfolio.

	Fair value	Fair value measurements using	
		Level 1	Level 2
By type of investment:			
Money market funds	\$ 9,114,336	9,114,336	—
Corporate bonds	5,813,436	—	5,813,436
U.S. government and agencies securities	1,258,415	1,194,870	63,545
Equity securities - Domestic	9,068,445	9,068,445	—
Fixed income commingled funds	983,547	983,547	—
Certificate of deposit	1,336,112	1,336,112	—
Mortgage- and asset-backed securities	670,545	—	670,545
Total	\$ 28,244,836	21,697,310	6,547,526

There were no significant transfers between Level 1 and Level 2 and no Level 3 transactions during the years ended December 31, 2012 and 2011.

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(5) Property, Plant, and Equipment

A summary of property, plant, and equipment and accumulated depreciation and amortization at December 31 is as follows:

	<u>2012</u>	<u>2011</u>	<u>Useful lives</u>
Land and leasehold improvements	\$ 8,306,698	7,582,301	Life of the lease
Building and building improvements	102,695,144	96,329,662	10 – 40 years
Fixed equipment	27,444,149	26,391,380	3 – 15 years
Moveable equipment	97,862,987	93,186,203	3 – 15 years
	<u>236,308,978</u>	<u>223,489,546</u>	
Accumulated depreciation and amortization	<u>(182,716,764)</u>	<u>(174,701,531)</u>	
	53,592,214	48,788,015	
Construction in progress	<u>1,649,285</u>	<u>3,161,545</u>	
Property, plant, and equipment, net	<u>\$ 55,241,499</u>	<u>51,949,560</u>	

Construction in progress consists of various renovations and upgrades being performed throughout the Hospital with estimated cost to complete of approximately \$2.4 million. During 2012 and 2011, the Hospital disposed of approximately \$0.7 million and \$0.8 million, respectively, of fully depreciated property, plant, and equipment.

Equipment under capitalized lease obligations as of December 31 is as follows:

	<u>2012</u>	<u>2011</u>
Equipment	\$ 14,184,453	13,797,453
Less accumulated depreciation	<u>(8,483,626)</u>	<u>(7,393,518)</u>
	<u>\$ 5,700,827</u>	<u>6,403,935</u>

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

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(6) Pledges Receivable, Net

The composition of the Hospital's unconditional promises to give, included in pledges receivable, is stated at face value (due in less than one year) and net present value (expected to be collected in future years) at a discount rate based on the year the pledge was received. The discount rate was 3.7% and 4.4% at December 31, 2012 and 2011, respectively. Pledges receivable, net consist of the following at December 31:

	<u>2012</u>	<u>2011</u>
Pledges due in less than one year	\$ 271,429	372,080
Pledges due in one to ten years	<u>828,961</u>	<u>1,049,262</u>
Total pledges receivable	1,100,390	1,421,342
Discount on pledges receivable	<u>(41,558)</u>	<u>(62,806)</u>
Total pledges receivable, net	<u>\$ 1,058,832</u>	<u>1,358,536</u>

During 2012 and 2011, the Hospital wrote off \$14,423 and \$32,521, respectively, of pledges receivable.

(7) Long-Term Debt

A summary of long-term debt and capital lease obligations at December 31 is as follows:

	<u>2012</u>	<u>2011</u>
6.80% mortgage loan – IDA Series 2001 A and 2001 B Bonds, monthly principal installments varying in amounts from from \$45,833 in 2012 to \$165,833 in 2031, maturing July 31, 2031 (a)	\$ 21,865,000	22,415,000
7.25% mortgage loan, monthly installments of \$23,096 including interest, beginning March 27, 2008 until February 27, 2018 collateralized by certain of the Hospital's property and plant (b)	3,156,310	3,202,786
Revolving line of credit beginning October 2005 until June 30, 2013 (the Maturity Date) (c)	—	—
6.52% business loan, monthly installments of \$20,485, including interest, until February 2012, collateralized by acquired equipment (d)	—	40,628
6.89% Primary Care Development Corporation loan, monthly installments of \$10,314, including interest, until March 2012 (e)	—	20,451
7.00% mortgage loan, monthly installments of \$3,156 including interest, until November 29, 2021, collateralized by property (f)	253,231	272,334
4.75% term loan, monthly installments of \$13,769, including interest, until August 2015, collateralized by equipment (g)	412,739	554,308

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	<u>2012</u>	<u>2011</u>
Capital lease obligations, interest rates varying from 5.43% to 7.89%	\$ 3,008,653	4,337,517
	28,695,933	30,843,024
Less current portion	<u>2,599,943</u>	<u>2,462,258</u>
	<u>\$ 26,095,990</u>	<u>28,380,766</u>

- (a) During 2001, the City of Yonkers Industrial Development Agency Civic Facility Revenue Bonds, Series 2001 A and Series 2001 B (St. John's Riverside Hospital Project) (Series 2001) were issued to raise moneys necessary to refund the outstanding obligation of the FHA Mortgage and fund certain other obligations and costs. The original principal amount of the Series 2001 bonds was \$26,295,000. The bonds are secured by a mortgage on the Hospital's property and plant, as well as the gross receipts of the Hospital. Among other requirements, the mortgage agreement requires the Hospital to make deposits to escrow accounts to meet interest and amortization payments. Such escrow accounts contain certain withdrawal restrictions. In connection with the mortgage agreement, the Hospital is required to maintain a specified long-term debt service coverage ratio. At December 31, 2012 and 2011, the Hospital was in compliance with debt covenant requirements.
- (b) In March 2008, the Hospital entered into a commercial mortgage loan with Hudson Valley Bank in the amount of \$3,350,000 to be used to refinance its existing first mortgage loan and fund expenses incurred in connection with closing this loan. This 10-year loan with an option to renew for one additional 5-year period shall consist of principal and interest payments payable in equal monthly installments calculated on a 30-year amortization schedule from the date of issuance until the maturity date on February 27, 2018. This mortgage loan is secured by the Hospital's Park Care Pavilion site property and plant.
- (c) In October 2005, Hudson Valley Bank issued an unsecured revolving line of credit to the Hospital to be used for working capital. The loan had a maximum principal amount of \$2,400,000, and in October 2006, the maximum principal amount was increased to \$3,000,000. The outstanding balance on the loan as of December 31, 2012 and 2011 was \$0. As of February 2008, the terms of this credit line were modified to include security up to \$1.5 million of the maximum principal amount of \$3.0 million through a second security position on the Hospital's Park Care Pavilion site property and plant. In June 2009, the maximum principal balance was reduced to a \$1.0 million level. In April 2010, the existing \$1.0 million credit line was increased to \$2.0 million. The maturity date of the revolving line of credit is June 30, 2013. The line of credit bears interest of 3.25%.
- (d) In February 2006, Hudson Valley Bank issued a business loan to the Hospital to be used to purchase capital equipment. The original principal amount was \$1,215,000 and was paid in full on February 1, 2012.
- (e) In March 2006, Primary Care Development Corporation (PCDC), a New York not-for-profit corporation, issued a loan to Valentine Lane for the expansion of Valentine Lane's primary care center. The original principal amount was \$600,000 and was paid in full on March 24, 2012.

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- (f) On November 29, 2006, the Hospital obtained a \$350,000 loan from a bank to be used for the purchase of property. As collateral, the bank holds the first mortgage on the property.
- (g) In August 2011, the Hospital obtained a \$600,000 loan from Hudson Valley Bank to be used for the purchase of equipment. As collateral, the bank holds the first priority interest in the equipment.
- (h) Scheduled principal payments on long-term debt, including capital leases, are as follows:

Year ending December 31:		
2013	\$	2,599,943
2014		1,917,846
2015		1,006,314
2016		802,444
2017		853,995
Thereafter		<u>21,515,391</u>
	\$	<u><u>28,695,933</u></u>

(8) Leases

Future minimum payments, in the aggregate, under capitalized leases and noncancelable operating leases with initial or remaining terms in excess of one year, are as follows:

	<u>Capitalized leases</u>	<u>Operating leases</u>
Year ending December 31:		
2013	\$ 1,918,705	2,025,074
2014	1,099,820	1,164,079
2015	152,735	865,736
2016	—	695,055
2017	—	387,150
Thereafter	—	<u>138,525</u>
	<u>3,171,260</u>	5,275,619
Less amount representing interest	<u>162,607</u>	—
	<u><u>\$ 3,008,653</u></u>	<u><u>5,275,619</u></u>

Total rental expense charged to operations for the years ended December 31, 2012 and 2011 was approximately \$2.1 million and is reported in supplies and other expenses in the consolidated statements of operations.

(9) Benefit Plans

- (a) The Andrus Pavilion has a noncontributory defined benefit pension plan covering a majority of its employees. Benefits are based on employees' compensation during all their years of credited service.

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It is the Hospital's policy to fund pension costs throughout the plan year based on regulatory requirements.

During 2000, the Andrus Pavilion curtailed the noncontributory defined benefit plan and the postretirement benefits plan discussed below to, in effect, freeze defined plan benefits for those participants who, in October 2000, joined a bargaining unit. Effective July 1, 2007, no new employee shall become an active participant of the noncontributory defined benefit plan, and no inactive participant or former participant shall again become an active participant of this plan.

- (b) The Andrus Pavilion provides postretirement healthcare benefits through age 65 to all retired employees who have met the minimum requirements of achieving age 60 and 20 years of service. Thereafter, benefits are only provided to the extent not covered by Medicare. Participants are subject to an annual contribution. Attribution of postretirement benefits commences at age 35. It is the Hospital's policy to fund postretirement costs on a pay-as-you-go basis.

During 2003, the Andrus Pavilion amended the postretirement benefits plan as to the eligibility requirement. Effective December 31, 2003, the minimum age requirements changed from 58 and 20 years of service to 60 and 20 years of service.

Effective January 1, 2011, the Andrus Pavilion postretirement healthcare benefit was amended to offer the choice of a Health Retirement Account (HRA) or a Blue Cross Medicare Advantage Program (MAP) for current and future Medicare retirees. The annual maximum HRA reimbursement is \$3,100 multiplied by a percentage based on years of service of retirement. These plan changes resulted in a reduction in benefit obligation and are amortized on a straight-line basis over the average remaining service of full eligibility for active employees expected to service benefits under the plan.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) became law in the United States. The Act introduces a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to the Medicare benefit. This estimated subsidy reduced the December 31, 2009 accumulated postretirement benefit obligation by \$4,500,000. With the change in the postretirement healthcare benefit effective January 1, 2011, the federal subsidy is no longer assumed to be received for 2012 or later years.

- (c) Effective October 1, 1996, all employees of the Andrus Pavilion are eligible to participate in a defined contribution retirement plan, whereby contributions are made on a quarterly basis up to 2% of employees' qualifying salary. Effective July 1, 2007, all new employees participate in a defined contribution plan, whereby contributions are made on an annual basis equal to 2% of the employee's qualifying salary plus the Hospital matches 100% of an employee's contribution up to 4%. Five-year vesting is a requirement for this defined contribution plan. The Hospital recorded pension expense of \$1,134,497 and \$1,000,059 for the years ended December 31, 2012 and 2011, respectively, in relation to this plan.

Effective July 1, 1994, certain employees at the ParkCare Pavilion have participated in a defined contribution retirement plan, whereby contributions are made on an annual basis equal to 2% of the employees' qualifying salary. In addition, certain employees of the ParkCare Pavilion participate in a

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defined contribution plan, whereby the ParkCare Pavilion matches 100% of an employee's contributions up to 3%. Effective July 1, 2007, the employer match was changed to 100% of an employee's contribution up to 4%. Five year vesting is a requirement for these defined contribution plans. The Hospital recorded pension expense related to these plans of \$462,034 and \$451,300 for the years ended December 31, 2012 and 2011, respectively.

For the years ended December 31, 2012 and 2011, the Hospital recorded pension expense of \$357,025 and \$344,712, respectively, for the various defined contribution plans in place for Dobbs Ferry Pavilion employees.

- (d) The Hospital participates in a multiemployer union pension plan, covering substantially all employees not eligible for the Hospital's plans. The Employer Identification Number is 13-3604862 and the three-digit Pension Plan number is 001. The most recent Pension Protection Act (PPA) zone status is green at both December 31, 2012 and 2011, which is for the plan years ended December 31, 2011 and 2010, respectively. The zone status is based on information that the Hospital received from the plan sponsor and, as required by the PPA, is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded.

The financial improvement plan (FIP) or a rehabilitation plan (RP), as required by PPA, has been implemented by the plan's sponsor. The expiration date of the collective-bargaining agreement requiring contributions to the plan is April 30, 2015. The contributions by the Hospital to the union pension fund were \$3,118,953 and \$2,761,891 for the years ended December 31, 2012 and 2011, respectively. There have been no significant changes that affect the comparability of 2012 and 2011 contributions. At the date the consolidated financial statements were issued, Form 5500 was not available for the plan year ended December 31, 2012.

- (e) The Hospital recognizes the funded status (the difference between the fair value of plan assets and projected benefit obligations for its defined benefit plan and difference between the fair value of plan assets and accumulated postretirement benefit obligation for its postretirement plan) of its defined benefit pension plan and postretirement plan as an asset or liability in its consolidated balance sheet and also recognizes changes in the funded status in the year in which the changes occur through changes in unrestricted net assets.

The measurement date used to determine pension and other postretirement benefit measures for the pension plan and the postretirement benefit plan is December 31.

(Continued)

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

The following table sets forth the benefit obligations and fair value of plan assets at December 31:

	Defined benefit plan		Postretirement benefit plan	
	2012	2011	2012	2011
Reconciliation of the benefit obligation:				
Benefit obligation at beginning of year	\$ 129,677,220	112,779,997	19,055,735	14,768,421
Service cost	3,993,975	3,784,303	657,253	483,759
Interest cost	6,488,588	6,194,720	815,636	796,215
Actuarial loss	24,354,745	10,745,423	(899,275)	3,646,958
Benefits paid and administrative expenses	(4,081,477)	(3,827,223)	(553,559)	(639,618)
Projected benefit obligation at end of year	\$ 160,433,051	129,677,220	19,075,790	19,055,735
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 83,694,183	75,379,677	—	—
Actual return on plan assets	9,441,151	2,554,535	—	—
Employer contributions	8,103,012	9,587,194	553,559	639,618
Benefits paid and administrative expenses	(4,081,477)	(3,827,223)	(553,559)	(639,618)
Fair value of plan assets at end of year	\$ 97,156,869	83,694,183	—	—

The accumulated benefit obligation for the defined benefit pension plan was \$151,324,320 and \$122,414,622 at December 31, 2012 and 2011, respectively.

The funded status and amounts recognized in the consolidated balance sheets at December 31 are as follows:

	Defined benefit plan		Postretirement benefit plan	
	2012	2011	2012	2011
Funded status, end of year:				
Fair value of plan assets	\$ 97,156,869	83,694,183	—	—
Projected benefit obligation	(160,433,051)	(129,677,220)	(19,075,790)	(19,055,735)
Funded status	\$ (63,276,182)	(45,983,037)	(19,075,790)	(19,055,735)

(Continued)

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Amounts recognized in the consolidated balance sheets, end of year:		
Accrued benefit costs	\$ (82,351,972)	(65,038,772)
Included in other changes in unrestricted net deficit are the following amounts that have not yet been recognized in net periodic benefit cost:		
Net actuarial loss	\$ 80,198,510	66,159,448
Prior service benefit	<u>(15,438,918)</u>	<u>(17,607,706)</u>
	<u>\$ 64,759,592</u>	<u>48,551,742</u>

The estimated amounts that will be amortized from unrestricted net assets into net periodic pension cost in 2013 are as follows:

Net actuarial loss	\$ 6,911,155
Prior service benefit	<u>(2,168,788)</u>
	<u>\$ 4,742,367</u>

The components of net periodic pension cost for the years ended December 31 are as follows:

	<u>Defined benefit plan</u>		<u>Postretirement benefit plan</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Service cost	\$ 3,993,975	3,784,303	657,253	483,759
Interest cost	6,488,588	6,194,720	815,636	796,215
Expected return on assets	(5,322,998)	(5,363,157)	—	—
Amortization of prior service cost (benefit)	1,709	1,709	(2,170,497)	(2,170,497)
Recognized net actuarial loss	<u>3,904,865</u>	<u>2,751,639</u>	<u>1,393,390</u>	<u>1,212,893</u>
Net periodic benefit cost	<u>\$ 9,066,139</u>	<u>7,369,214</u>	<u>695,782</u>	<u>322,370</u>

(Continued)

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

	<u>Defined benefit plan</u>		<u>Postretirement benefit plan</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Weighted average assumptions used to determine benefit obligation:				
Discount rate	4.05%	5.10%	3.95%	4.35%
Rate of compensation increase	3.00	3.00	—	—
Weighted average assumptions used to determine net benefit cost:				
Discount rate	5.10%	5.60%	4.35%	5.50%
Expected long-term rate of return on plan assets	6.25	7.00	—	—
Rate of compensation increase	3.00	3.75	—	—

The expected long-term rate of return on plan assets is based on the portfolio as a whole and not the sum of the returns on the individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, the annual healthcare cost trend rates used for pre age and post age 65 begin at 8.5% and then decrease gradually to 4% in the year 2084 and thereafter.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plan. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects:

	<u>One- percentage- point increase</u>	<u>One- percentage- point decrease</u>
Effect on total of service and interest cost components	\$ 358,072	(269,738)
Effect on postretirement benefit obligation	3,595,614	(2,798,711)

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

Plan Assets

The fair value of the Hospital's pension plan assets at December 31, 2012 and 2011 by asset category is as follows:

	Fair value	Fair value measurements at December 31, 2012 using		
		Level 1	Level 2	Level 3
Asset category:				
Equity securities:				
U.S. large cap equity	\$ 19,139,375	—	19,139,375	—
U.S. small/mid cap equity	4,429,332	—	4,429,332	—
International equity	7,343,233	—	7,343,233	—
Fixed income securities:				
Fixed income commingled funds	60,759,418	—	60,759,418	—
U.S. real estate property commingled fund	5,485,511	—	—	5,485,511
Total	\$ 97,156,869	—	91,671,358	5,485,511
	Fair value	Fair value measurements at December 31, 2011 using		
		Level 1	Level 2	Level 3
Asset category:				
Equity securities:				
U.S. large cap equity	\$ 15,218,692	—	15,218,692	—
U.S. small/mid cap equity	3,532,710	—	3,532,710	—
International equity	5,547,448	—	5,547,448	—
Fixed income securities:				
Fixed income commingled funds	54,862,504	—	54,862,504	—
U.S. real estate property commingled fund	4,532,829	—	—	4,532,829
Total	\$ 83,694,183	—	79,161,354	4,532,829

There were no significant transfers between Levels 1, 2, and 3 during the years ended December 31, 2012 and 2011.

Fair values are determined based on valuation techniques categorized as follows: Level 1 means the use of quoted prices for identical instruments in active markets; Level 2 means the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable; and Level 3 means the use of unobservable inputs.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

The effect of fair value measurements using significant unobservable inputs (Level 3) on change in plan assets for the years ended December 31, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Beginning balance, January 1	\$ 4,532,829	2,269,688
Actual return on plan assets held	547,531	446,258
Purchases	405,151	1,816,883
Ending balance, December 31	\$ <u>5,485,511</u>	<u>4,532,829</u>

The weighted average asset allocation of the pension plan assets at December 31 was as follows:

	<u>2012</u>	<u>2011</u>
Equity securities	32%	29%
Fixed income	63	66
Other	5	5
	<u>100%</u>	<u>100%</u>

The Hospital's financial and investment objectives are to meet present and future obligations to beneficiaries while minimizing the Hospital's contributions over the long term, by earning an adequate return on assets with moderate volatility. The Hospital's plan assets consist of investments in pooled separate accounts. The weighted average asset allocations in the preceding table are representative of the target asset allocation for the Hospital's pension plan. The investment strategy is to build an efficient, well-diversified portfolio based on a long-term strategic outlook of the investment markets. The investment market outlook utilizes both historical-based and forward-looking return forecasts to establish future return expectations for various asset classes. These return expectations are used to develop a core asset allocation based on the needs of the plan. The core asset allocation utilizes investment portfolios of various asset classes and multiple investment managers in order to help maximize the plan's return while providing multiple layers of diversification to help minimize risk. The investment performance is reviewed and presented to an investment committee on a quarterly basis in total as well as by asset class and individual manager, relative to one or more benchmarks.

Cash Flows

The Hospital expects to contribute \$4,939,364 to its pension plan and \$600,224 to its postretirement benefit plan in 2013. On March 14, 2007, an application for a waiver of the minimum funding standard under Section 412(d) of the Code and Section 303 of the Employee Retirement Security Act of 1974 (ERISA) was submitted by the Hospital for the 2006 pension plan year in the amount of \$5,386,467. On February 22, 2008, the Hospital received the final ruling letter from the Internal Revenue Service approving this waiver request. Certain conditions were agreed to by the Hospital as part of the waiver request approval, which included a requirement that the Hospital reach agreement with the Pension Benefit Guarantee Corporation (PBGC) within 120 days of the final ruling letter on collateral acceptable for the full amount of the approved waiver amount. This requirement was met, and the Hospital signed a collateral security agreement with the PBGC effective September 29, 2008, whereby the Hospital granted to the

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

PBGC a second mortgage on specific hospital property in an amount not to exceed \$6 million. As of December 31, 2012, the Hospital's pension actuary has certified that the Hospital has satisfied all minimum contribution requirements associated with the waiver and steps are in progress by the Hospital to obtain from the PBGC a pension funding waiver lien release noting that this obligation has been satisfied.

The benefits expected to be paid for the pension plan in each year 2013–2017 are \$5,240,000, \$5,480,000, \$5,800,000, \$5,990,000, and \$6,440,000, respectively. The aggregate benefits expected to be paid in the five years from 2018 to 2022 are \$38,310,000. The expected benefits are based on the same assumptions used to measure the Hospital's benefit obligation at December 31 and include estimated future employee service.

The benefits expected to be paid for the postretirement plan in each year 2013–2017 are \$600,224, \$627,474, \$660,147, \$689,808, and \$700,302, respectively. The aggregate benefits expected to be paid in the five years from 2018 to 2022 are \$4,140,541. The expected benefits are based on the same assumptions used to measure the Hospital's benefit obligation at December 31 and include estimated future employee service.

(10) Insurance Arrangements**(a) Professional Liabilities**

Effective July 1989 and April 1995, the ParkCare Pavilion and the Andrus Pavilion, respectively, became self-insured for a portion of losses, which may arise from medical malpractice claims filed against them, including incidents that have occurred but have not been reported. A self-insurance program was established for medical malpractice coverage, augmented by an umbrella policy.

In April 1999, both the ParkCare Pavilion and the Andrus Pavilion discontinued the self-insured medical malpractice program and began purchasing medical malpractice coverage on a claims-made basis from the Captive. Accordingly, management recorded a liability for claims incurred but not reported (IBNR) that is recorded in other long-term liabilities current portion in the consolidated balance sheets, in the amounts of approximately \$1,128,000 and \$1,010,000, respectively, at December 31, 2012 and 2011. The Captive currently provides coverage for the Hospital of up to \$5,000,000 per each and every occurrence, which is augmented by an umbrella policy of \$10,000,000 per occurrence, and \$10,000,000 in aggregate. The Hospital pays as premiums to the Captive an estimate of the ultimate cost of losses payable by the Captive. Effective July 2001, the Captive provided loss portfolio transfer coverage for the Hospital, which retroactively transferred the liability of the Hospital for certain professional liability losses. The loss portfolio transfer period of coverage was for Andrus Pavilion for claims occurring prior to April 24, 1999 and for ParkCare Pavilion for claims occurring prior to July 1, 1999. The Captive has reported assets necessary to cover the outstanding losses of the Captive, which are determined by an independent actuary.

The Hospital has accrued medical malpractice claims liability incurred claims discounted at a rate of 2% and an insurance recoveries receivable of \$5.6 million and \$4.1 million on the consolidated balance sheet as of December 31, 2012 and 2011, respectively. Such amounts are included in other current assets and current portion of long-term liabilities of \$1.9 million and \$1.7 million and other noncurrent assets, net and other long-term liabilities, net of \$3.7 million and \$2.4 million, at December 31, 2012 and 2011, respectively.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

During 2009, certain medical malpractice litigation matters were settled. The Hospital structured these medical malpractice settlements with a long-term payment arrangement. The annual cash flow requirements for these settlements were \$481,750 for 2011 and are \$800,500 for 2012, \$800,500 for the years 2013–2020, \$736,750 for the year 2021, \$418,000 for the years 2022–2029, and \$237,332 for the year 2030. The net present value of the liability for these settled litigation matters has been recorded on the Hospital's consolidated balance sheet in the amount of approximately \$8.1 million and \$8.6 million for the years ended December 31, 2012 and 2011, respectively, included in other current and long-term liabilities.

There are known incidents that have occurred that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. The ultimate outcome of these cases cannot be predicted at this time. Management does not believe that the ultimate outcome of these matters will have a material adverse effect on the Hospital's consolidated financial position, results of operations, or liquidity.

(b) Workers' Compensation

The Hospital purchases workers' compensation and employer liability insurance from an unrelated insurance company. The program provided coverage with a \$350,000 deductible, and limits of \$1 million per accident, \$1 million by disease per employee, and \$1 million by disease in total.

From October 1, 1998 to December 31, 2006, the Hospital had also purchased a workers' compensation insurance deductible reimbursement policy from the Captive. This policy had been renewed annually. The policy had a limit of \$350,000 per occurrence and \$1.4 million in the aggregate.

In December 2006, the Hospital completed a loss portfolio transaction, which transferred the workers' compensation outstanding loss reserve and IBNR liability from the Captive to the Hospital in exchange for a reduction of premiums due to the Captive by the Hospital.

In connection with the loss portfolio transaction, the Hospital engaged an independent actuary to estimate the undiscounted liability for uninsured claims for all occurrences of workers' compensation after October 1, 1998 for both reported claims and claims IBNR. Included in current portion of other long-term liabilities at December 31, 2012 and 2011 is \$950,020 and \$856,495, respectively; included in other long-term liabilities is \$3,588,808 and \$3,243,167, respectively.

The Hospital has accrued undiscounted workers' compensation claims liability and an insurance recoveries receivable of \$0.7 million and \$0.2 million on the consolidated balance sheet at December 31 and 2011, respectively. Such amounts are included in other noncurrent assets, net and other long-term liabilities, net, respectively, at December 31, 2012 and 2011.

(11) Commitments and Contingencies

- (a) The Hospital is involved in general liability litigation and claims in the normal course of business. The ultimate outcome of these cases cannot be predicted at this time. Management does not believe that the ultimate outcome of these matters will have a material adverse effect on the Hospital's consolidated financial position, results of operations, or liquidity.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

- (b) Approximately 70% of the Hospital's employees are covered under a collective bargaining agreement with various unions.
- (c) During 2010, the Hospital entered into a Community Benefit Grant Agreement with Hudson River Healthcare, Inc. (HRH), a Federally Qualified Health Center (FQHC), whereby HRH assumed prospective responsibility for operating the Hospital's Prenatal Care Clinic in exchange for a grant award to be made by the Hospital to provide financial support to HRH in the amount of \$2,300,000 over the initial five-year term. The agreed-upon payments for the initial five-year period are \$460,000 per annum to cover the costs of HRH's anticipated uncompensated expenses in providing prenatal, postpartum, gynecological services, and programs to the residents of the communities served by the Clinic. The grant award will be expensed as paid. This agreement may be terminated at any time by mutual consent of the parties.

(12) Conditional Asset Retirement Obligation

In the normal course of operations, the Hospital performs maintenance and repairs on its buildings. The Hospital is also involved in ongoing construction projects. As part of these two activities, the Hospital has identified costs that will be incurred for asbestos removal in future periods. The estimated asbestos removal cost is approximately \$532,000 and \$567,000, respectively, as of December 31, 2012 and 2011, and is reported in other long-term liabilities, net in the consolidated balance sheets.

(13) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at December 31 are available for the following purposes:

	<u>2012</u>	<u>2011</u>
Restricted use property and equipment	\$ 1,002,186	1,002,186
Healthcare services	1,102,779	959,952
Health education	589,206	583,298
Capital campaign (restricted for property and equipment)	1,013,662	1,370,852
	<u>\$ 3,707,833</u>	<u>3,916,288</u>

During the years ended December 31, 2012 and 2011, net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes of patient care, health education, and capital in the amounts of \$1,257,049 and \$1,561,781, respectively.

The Hospital has adopted investment and spending policies for endowment or permanently restricted assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. The Hospital's endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

Permanently restricted net assets at December 31 are as follows:

	<u>2012</u>	<u>2011</u>
Investments to be held in perpetuity, the income from which is expendable to support healthcare services (reported as investment income)	\$ 2,129,637	2,129,637

(14) Related-Party Transactions

The components of due from affiliates at December 31 are as follows:

	<u>2012</u>		
	<u>Total</u>	<u>Current</u>	<u>Long term</u>
Noninterest bearing:			
RMSO (a)	\$ 643,661	643,661	—
Nursing Home (b)	<u>2,019,930</u>	<u>2,019,930</u>	<u>—</u>
Due from affiliates, noninterest bearing, net	<u>2,663,591</u>	<u>2,663,591</u>	<u>—</u>
Interest bearing:			
RMSO (a)	57,023	57,023	—
Nursing Home (b)	<u>5,237,441</u>	<u>227,061</u>	<u>5,010,380</u>
Due from affiliates, interest bearing	<u>5,294,464</u>	<u>284,084</u>	<u>5,010,380</u>
Total due from affiliates, net	<u>\$ 7,958,055</u>	<u>2,947,675</u>	<u>5,010,380</u>
		<u>2011</u>	
		<u>Total</u>	<u>Current</u>
		<u>Long term</u>	
Noninterest bearing:			
RMSO (a)	\$ 621,642	621,642	—
Nursing Home (b)	<u>1,893,751</u>	<u>1,893,751</u>	<u>—</u>
Due from affiliates, noninterest bearing, net	<u>2,515,393</u>	<u>2,515,393</u>	<u>—</u>
Interest bearing:			
RMSO (a)	131,645	67,056	64,589
Nursing Home (b)	<u>5,459,699</u>	<u>222,258</u>	<u>5,237,441</u>
Due from affiliates, interest bearing	<u>5,591,344</u>	<u>289,314</u>	<u>5,302,030</u>
Total due from affiliates, net	<u>\$ 8,106,737</u>	<u>2,804,707</u>	<u>5,302,030</u>

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

The Hospital owes the Captive, an affiliated captive insurance company, \$183 and \$521,682 for the years ended December 31, 2012 and 2011, respectively. Premiums for professional and general insurance coverage amounted to approximately \$1,885,275 and \$1,758,075 for the years ended December 31, 2012 and 2011, respectively, and are reported in supplies and other expenses in the consolidated statements of operations. The Hospital contributed capital in the amount of \$829,550 and \$1,004,136 during the years ended December 31, 2012 and 2011, respectively, to the Captive, an affiliate of the Hospital, to maintain compliance with the Bermuda Monetary Authority Liquidity and Solvency Ratio Requirements. The Hospital may be directed by its parent (RHCS) to commit to provide additional capital to the Captive during 2013, if needed.

- (a) The Hospital has advanced RMSO funds for working capital, start-up costs, renovations, and daily operations.
- (b) The Hospital has advanced funds for certain costs associated with the building of the Nursing Home. The balance represents amounts for the funding of start-up and certain operating costs for the Nursing Home. During 2012 and 2011, respectively, the Hospital charged the Nursing Home approximately \$2.0 million and \$2.2 million, at the Hospital's cost, for various services. These amounts have been offset by payments received from the Nursing Home of approximately \$2.1 million and \$1.9 million during years ended December 31, 2012 and 2011, respectively.

Since inception on each of the advances, interest rates charged on interest bearing amounts due from the RMSO and the Nursing Home are at a fixed rate of 2.14%.

(15) Functional Expenses

The Hospital provides general healthcare services to residents within its geographic location, including general acute care with a full range of inpatient and outpatient services. Program expenses for the years ended December 31, 2012 and 2011 related to providing these services are as follows:

	<u>2012</u>	<u>2011</u>
Healthcare services	\$ 217,696,607	205,122,879
Administrative and general	18,930,140	17,836,772
	<u>\$ 236,626,747</u>	<u>222,959,651</u>

(16) Concentration of Credit Risk

At December 31, 2012 and 2011, the Hospital had cash balances in a financial institution that exceeded federal depository insurance limits.

The Hospital routinely invests its surplus operating funds in money market funds. These funds generally invest in highly liquid U.S. government and agency obligations. Investments in money market funds are not insured or guaranteed by the U.S. government.

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ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(17) Fair Value of Financial Instruments

Fair value of financial instruments is defined as the amount at which the instruments could be exchanged in a current transaction between willing parties. See note 4, for disclosures on the fair value of the Hospital's marketable investment securities. The Hospital's mortgage loans approximate their fair value based upon their respective rates of interest. The Hospital's IDA Bonds have a fair value of \$21,873,941 and \$22,527,075 as of December 31, 2012 and 2011, respectively, based on quoted market prices. The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, accounts payable and accrued expenses, and due to and from third-party payors approximates their fair value based on the short-term nature of these assets and liabilities.

(18) Smithers Fund

On February 12, 2008, funds in the amount of \$6,230,668 were temporarily transferred to the Hospital by the Christopher D. Smithers Foundation to be held and managed by the Hospital in accordance with the investment guidelines and the designated use of the funds as defined in the agreement between the parties. The Certificate of Incorporation for the new Smithers Foundation (Foundation) was issued by the State of New York on March 24, 2010, and upon approval as a tax-exempt organization under Section 501(c)(3) these funds will be transferred to the Foundation. The sole member of the Foundation will be RHCS, which is the sole member of the Hospital. At December 31, 2012 and 2011, the market value of the funds held by the Hospital for the Foundation was \$6,424,963 and \$6,408,665, respectively, and the Hospital has accounted for these funds as current assets limited or restricted as to use and as a refundable advance in the consolidated balance sheet as of December 31, 2012.

(19) Subsequent Events

Management evaluated all events and transactions that occurred after December 31, 2012 and through May 8, 2013. Other than described below, the Hospital did not have any material recognizable subsequent events during this period.

During the first quarter of 2013, the Hospital contributed capital to the Captive, an affiliate, in the amount of \$1,000,000 to maintain compliance with the Bermuda Monetary Authority Solvency Ratio requirements.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Consolidated Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

Federal grants/program title	CFDA number	Federal expenditures
U.S. Department of Justice:		
Pass through from Westchester County Department of Community Mental Health:		
Family Based Offender Grant	16.812	\$ <u>65,382</u>
Total U.S. Department of Justice		<u>65,382</u>
U.S. Department of Health and Human Services:		
Yonkers Drug Abuse and HIV Services for Minority Families (SAMHSA)	93.243	<u>472,975</u>
Outpatient Early Intervention Services with Respect to HIV Disease	93.918	<u>389,380</u>
Pass through from Health Research, Inc.:		
Ryan White Title II HIV Healthcare and Supportive Service	93.917	282,372
Westchester Medical Center HIV Treatment Adherence	93.917	<u>50,632</u>
Subtotal		<u>333,004</u>
National Bioterrorism Hospital Preparedness	93.889	<u>76,000</u>
Community Based HIV Primary Care and Prevention Services	93.940	<u>45,981</u>
Subtotal pass through from Health Research, Inc.		<u>454,985</u>
Pass through from NYS Office of Alcoholism & Substance Abuse Services:		
Methadone Maintenance Program	93.558	<u>198,919</u>
HIV Emergency Relief Project Grants:		
Pass through from Westchester County Department of Health:		
Ryan White Title I Outreach/Access to Primary Care	93.914	23,295
Ryan White Title I Maintenance in Primary Care	93.914	<u>180,251</u>
Subtotal HIV Emergency Relief Project Grants		<u>203,546</u>
Total U.S. Department of Health and Human Services		<u>1,719,805</u>
U.S. Department of Education:		
Student Financial Assistance Cluster:		
Federal Pell Grant Program	84.063	122,543
Federal Direct Student Loans Program (note 2)	84.268	<u>745,832</u>
Subtotal Student Financial Assistance Cluster		<u>868,375</u>
Total U.S. Department of Education		<u>868,375</u>
Total expenditures of federal awards		<u>\$ <u>2,653,562</u></u>

See accompanying notes to consolidated schedule of expenditures of federal awards.

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES
Notes to Consolidated Schedule of Expenditures of Federal Awards
Year ended December 31, 2012

(1) Basis of Presentation

The accompanying consolidated schedule of expenditures of federal awards includes the federal grant activity of St. John's Riverside Hospital and Subsidiaries (the Hospital) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the Hospital's consolidated financial statements.

(2) Federal Direct Student Loans Program

With respect to the Federal Direct Student Loans Program, the Hospital is only responsible for the performance of certain administrative duties; therefore, the transactions and the balances of loans outstanding related to this program are not included in the Hospital's financial statements. The consolidated schedule of expenditures of federal awards includes the amounts loaned to students during the year ended December 31, 2012. It is not practical to estimate the outstanding balance of loans under this program.



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New York, NY 10154

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**Independent Auditors' Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards***

The Board of Trustees
St. John's Riverside Hospital and Subsidiaries:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of St. John's Riverside Hospital and Subsidiaries (the Hospital), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in net (deficit) assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated May 8, 2013, which included an explanatory paragraph regarding the Hospital's adoption of Accounting Standards Update 2011-07, *Healthcare Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* in 2012. Our opinion was not modified with respect to this matter.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Hospital's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

May 8, 2013



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Independent Auditors' Report on Compliance for Each Major Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

The Board of Trustees
St. John's Riverside Hospital and Subsidiaries:

Report on Compliance for Each Major Federal Program

We have audited St. John's Riverside Hospital and Subsidiaries' (the Hospital) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Hospital's major federal programs for the year ended December 31, 2012. The Hospital's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the Hospital's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Hospital's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Hospital's compliance.

Opinion on Each Major Federal Program

In our opinion, St. John's Riverside Hospital and Subsidiaries complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of the Hospital is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Hospital's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the



auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the consolidated financial statements of St. John's Riverside Hospital and Subsidiaries as of and for the years ended December 31, 2012 and 2011, and have issued our report thereon dated May 8, 2013, which contained an unmodified opinion on those financial statements. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidated schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidated schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

KPMG LLP

September 24, 2013

ST. JOHN'S RIVERSIDE HOSPITAL AND SUBSIDIARIES

Schedule of Findings and Questioned Costs

Year ended December 31, 2012

(1) Summary of Auditors' Results

- (a) An unmodified opinion was issued on the consolidated financial statements of St. John's Riverside Hospital and Subsidiaries (the Hospital) as of and for the year ended December 31, 2012.
- (b) Significant deficiencies in internal control disclosed by the audit of the consolidated financial statements: None reported. Material weaknesses: None reported.
- (c) Noncompliance that is material to the consolidated financial statements: None reported.
- (d) Significant deficiencies in internal control over the major program: None reported. Material weaknesses: None reported.
- (e) An unmodified opinion was issued on the Hospital's compliance with its major federal program for the year ended December 31, 2012.
- (f) There were no audit findings that were required to be reported under Section 510(a) of federal OMB Circular A-133 for the year ended December 31, 2012.
- (g) The major federal program of the Hospital for the year ended December 31, 2012 was as follows:

<u>Agency</u>	<u>Program title</u>	<u>CFDA number</u>
U.S. Department of Education	Student Financial Assistance Cluster:	
	Federal Pell Grant Program	84.063
	Federal Direct Student Loans Program	84.268

- (h) The dollar threshold to distinguish between Type A and Type B programs, as described in Section 520(b) of OMB Circular A-133, was \$300,000.
- (i) The Hospital qualified as a low-risk auditee under Section 530 of OMB Circular A-133 for the year ended December 31, 2012.

(2) Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards*

No findings that are required to be reported.

(3) Findings and Questioned Costs Relating to Federal Awards

No findings or questioned costs that are required to be reported.