# THE BROOKDALE HOSPITAL MEDICAL CENTER AND SUBSIDIARY

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

**KPMG LLP**
345 Park Avenue
New York, NY 10154-0102

# Independent Auditors' Report

The Board of Trustees
The Brookdale Hospital Medical Center and Subsidiary:

We have audited the accompanying consolidated financial statements of The Brookdale Hospital Medical Center and Subsidiary (the Medical Center), which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of operations and changes in net deficit, and cash flows for the year 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 responsibility 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 auditors consider 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 opinion.

## *Opinion*

In our opinion, the 2012 consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Brookdale Hospital Medical Center and Subsidiary as of December 31, 2012, and the results of their operations and their cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.

***Emphasis of Matter***

The accompanying consolidated financial statements have been prepared assuming The Brookdale Hospital Medical Center and Subsidiary will continue as a going concern. As discussed in note 3 to the consolidated financial statements, the Medical Center has suffered recurring losses from operations and has a working capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

As discussed in note 2(u) to the consolidated financial statements, the Medical Center adopted the provisions of Financial Accounting Standards Board Accounting Standards Update No. 2011-07, *Health Care Entities (Topics 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 Matter***

The accompanying consolidated financial statements of The Brookdale Hospital Medical Center and Subsidiary as of and for the year ended December 31, 2011 were audited by other auditors whose report thereon dated August 30, 2012, expressed an unmodified opinion on those consolidated financial statements.

KPMG LLP

June 30, 2013

**THE BROOKDALE HOSPITAL MEDICAL CENTER AND SUBSIDIARY**

Consolidated Balance Sheets

December 31, 2012 and 2011

(In thousands of dollars)

| Assets | | 2012 | 2011 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 4,683 | 282 |
| Patient accounts receivable (net of allowance for doubtful accounts of $33,986 in 2012 and $33,919 in 2011) | | 32,764 | 42,033 |
| Other receivables from capitation contracts | | 18,118 | 14,475 |
| Supplies | | 3,433 | 3,202 |
| Due from affiliates | | 1,988 | — |
| Assets limited as to use | | 14,187 | 174 |
| Due from third-party payors | | 14,595 | 4,969 |
| Other current assets | | 9,609 | 9,848 |
| Insurance receivable | | 2,047 | 2,749 |
| Total current assets | | 101,424 | 77,732 |
| Assets limited as to use, less current portion | | 17,736 | 29,581 |
| Due from third-party payors, less current portion | | 467 | 8,329 |
| Deferred financing costs, net | | 276 | 857 |
| Property, plant, and equipment, net | | 38,395 | 44,383 |
| Insurance receivable, less current portion | | 19,843 | 26,646 |
| Other assets, less current portion | | 8,384 | 6,911 |
| Total assets | $ | 186,525 | 194,439 |
| **Liabilities and Net Deficit** | | | |
| Current liabilities: | | | |
| Cash overdraft | $ | — | 3,400 |
| Current portion of long-term debt | | 136,069 | 89,386 |
| Accounts payable and accrued expenses | | 53,548 | 55,047 |
| Accrued salaries and related liabilities | | 80,998 | 66,560 |
| Accrued workers' compensation | | 4,240 | 3,780 |
| Due to affiliates | | — | 37,167 |
| Estimated professional liabilities | | 19,291 | 18,721 |
| Due to third-party payors | | 13,510 | 12,652 |
| Other current liabilities | | — | 500 |
| Total current liabilities | | 307,656 | 287,213 |
| Long-term debt, less current portion | | 5,005 | 14,366 |
| Accrued workers' compensation, less current portion | | 21,062 | 19,388 |
| Estimated professional liabilities, less current portion | | 173,621 | 168,492 |
| Due to third-party payors, less current portion | | 11,841 | 12,171 |
| Accrued pension liability, less current portion | | 59,846 | 52,557 |
| Total liabilities | | 579,031 | 554,187 |
| Net deficit: | | | |
| Unrestricted deficit | | (392,506) | (359,748) |
| Total net deficit | | (392,506) | (359,748) |
| Total liabilities and net deficit | $ | 186,525 | 194,439 |

See accompanying notes to consolidated financial statements.

**THE BROOKDALE HOSPITAL MEDICAL CENTER AND SUBSIDIARY**

Consolidated Statements of Operations and Changes in Net Deficit

Years ended December 31, 2012 and 2011

(In thousands of dollars)

| | 2012 | 2011 |
|---|---|---|
| Unrestricted revenues and other support: | | |
| Net patient service revenue (net of contractual allowances and discounts) | $ 302,803 | 338,121 |
| Provision for bad debts, net | (21,101) | (24,721) |
| Net patient service revenue less provision for bad debts | 281,702 | 313,400 |
| Capitation revenue | 114,984 | 90,815 |
| Contributions | 292 | 417 |
| Other revenue | 83,337 | 88,767 |
| Total revenues and other support | 480,315 | 493,399 |
| Expenses: | | |
| Salaries and wages | 202,315 | 208,029 |
| Employee benefits | 96,535 | 87,784 |
| Out-of-network cost related to capitation revenue | 84,390 | 63,968 |
| Insurance | 22,857 | 18,959 |
| Supplies and other | 123,013 | 118,435 |
| Interest | 4,117 | 6,316 |
| Depreciation and amortization | 10,019 | 10,835 |
| Provision for uncollectible amounts due from related parties, net | 13,870 | 21,453 |
| Impairment of fixed asset | — | 8,535 |
| Total expenses | 557,116 | 544,314 |
| Loss from operations before gain on discontinued operations | (76,801) | (50,915) |
| Gain on discontinued operations, net (note 17) | 13,886 | 581 |
| Excess of expenses over revenues and other support | (62,915) | (50,334) |
| Other changes in unrestricted net deficit: | | |
| Pension-related changes other than net periodic pension cost | (5,089) | (25,124) |
| Transfer of pension obligation from affiliate | (2,730) | — |
| Settlement of net due to affiliates | 37,976 | — |
| Grant for capital | — | 240 |
| Increase in unrestricted net deficit | (32,758) | (75,218) |
| Net deficit at beginning of year | (359,748) | (284,530) |
| Net deficit at end of year | $ (392,506) | (359,748) |

See accompanying notes to consolidated financial statements.

**THE BROOKDALE HOSPITAL MEDICAL CENTER**
**AND SUBSIDIARY**

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

(In thousands of dollars)

| | 2012 | 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Increase in net deficit | $ (32,758) | (75,218) |
| Adjustments to reconcile increase in net deficit to net cash (used in) provided by operating activities: | | |
| Grant for capital purposes | — | (240) |
| Provision for bad debts, net | 21,101 | 24,721 |
| Depreciation and amortization | 9,953 | 11,034 |
| Amortization of deferred financing costs | 66 | 87 |
| Settlement of net due to affiliates | (37,976) | — |
| Provision for uncollectible amounts from related parties | 13,870 | 21,453 |
| Impairment on fixed assets | — | 8,535 |
| Pension-related changes other than net periodic pension cost | 5,089 | 25,124 |
| Transfer of pension obligation from affiliate | 2,730 | — |
| Gain on sale of assets, net | (13,321) | — |
| Changes in assets and liabilities: | | |
| Patient accounts receivable | (11,832) | (18,420) |
| Insurance recoveries receivable | 7,505 | (29,395) |
| Accounts payable and accrued expenses | (1,499) | 5,272 |
| Accrued salaries and related liabilities | 14,438 | 16,373 |
| Due to/from third-party payors | (1,236) | (4,256) |
| Due to/from affiliates, net | (15,049) | (1,960) |
| Estimated professional liabilities and accrued workers' compensation | 7,833 | 35,321 |
| Pension liability | (530) | (2,852) |
| Other assets and liabilities | (5,093) | (2,346) |
| Net cash (used in) provided by operating activities | (36,709) | 13,233 |
| Cash flows from investing activities: | | |
| Purchases of property, plant, and equipment | (2,638) | (9,469) |
| Net change in assets limited as to use and investments | (2,168) | 6,187 |
| Proceeds from sale of assets, net | 16,370 | — |
| Net cash provided by (used in) investing activities | 11,564 | (3,282) |
| Cash flows from financing activities: | | |
| Principal payments on long-term debt | (26,923) | (11,657) |
| Proceeds from new debt | 59,869 | |
| Bank overdraft | (3,400) | 1,322 |
| Grant for capital purposes | — | 240 |
| Net cash provided by (used in) financing activities | 29,546 | (10,095) |
| Net increase (decrease) in cash and cash equivalents | 4,401 | (144) |
| Cash and cash equivalents: | | |
| Beginning of year | 282 | 426 |
| End of year | $ 4,683 | 282 |
| Supplemental disclosures: | | |
| Cash paid for interest | $ 6,904 | 4,582 |
| Capital lease obligations incurred | 4,376 | 3,874 |

See accompanying notes to consolidated financial statements.

## (1) Organization

The Brookdale Hospital Medical Center (Brookdale) is a not-for-profit membership corporation having as its sole member, Brookdale Health Systems, Inc. a corporation organized under the New York State not-for-profit corporation law. Brookdale Health Systems, Inc. was formed on June 27, 2012 to support and benefit other healthcare organizations and to assist such organizations in the furtherance of their corporate purposes by providing them with planning and consulting services and by improving the coordination of services across the continuum of care.

Brookdale is the sole member of The Brookdale Hospital Center Hegeman Avenue Housing Company, Inc. (the Housing Company), a not-for-profit membership corporation that provides housing and related parking facilities to current and former staff members and employees of Brookdale. The Housing Company charges rent to employees for housing on a month-to-month basis. During 2012, the Housing Company was sold (note 17).

Brookdale and its subsidiary are hereinafter referred to collectively as the "Medical Center." The consolidated financial statements of the Medical Center include the accounts of Brookdale and the Housing Company.

Prior to Withdrawal and Settlement Agreement dated August 29, 2012, the Medical Center had as its sole member, MediSys Health Network, Inc. (MediSys), a corporation organized under the New York State not-for-profit corporation law. MediSys is also the sole voting member (directly or indirectly) of Flushing Hospital Center (Flushing), Jamaica Hospital Medical Center (Jamaica), and Peninsula Hospital and Peninsula Nursing Home other related entities.

On March 22, 2012, the board of trustees voted to appoint a Chief Restructuring Officer to effect a withdrawal of MediSys as sole member of the Medical Center. On April 26, 2012, the Board accepted the resignations of the former President and Chief Executive Officer and the former Executive Vice President and Chief Financial Officer, and appointed restructuring advisory firms, who are performing the roles within the management team consisting of a President/Chief Executive Officer/Chief Restructuring Officer, Chief Operating Officer, and Chief Financial Officer.

On August 29, 2012, MediSys entered into a Withdrawal and Settlement Agreement with the Medical Center and certain affiliates. Under this agreement, MediSys withdrew as sole member of the Medical Center effective September 27, 2012. The Withdrawal and Settlement Agreement also provided that MediSys, the Medical Center, and their affiliates will discharge all intercompany accounts receivable balances as of April 16, 2012.

On August 29, 2012, MediSys and the Medical Center also entered into a Transition Services Agreement. Under this agreement, MediSys and the Medical Center will continue to provide certain services to each other.

During 2000, MediSys, at the request of the New York State Department of Health and the Dormitory Authority of the State of New York (DASNY), entered into a management agreement with Brookdale, whereby MediSys would manage the operations of Brookdale. Under the agreement, Brookdale was required to pay a management fee of $6 million per year to MediSys. Also in 2000, MediSys became the



(Continued)

sole corporate member of Linroc Community Service Corporation (Linroc), the former sole member of Brookdale, and each of its related organizations: Amboy Properties Corporation (Amboy); BHMC Enterprises; LCSC Holding, Inc. (LCSC); The Brookdale Residence Housing Development Corporation (Residence); Brookdale Family Care Centers, Inc. (BFCC); Urban Strategies/Brookdale Family Care Center, Inc. (Urban); The Schulman and Schachne Institute for Rehabilitation Inc. (the Institute); Rockreal Corporation (Rockreal); and Linden Foundation, Inc. (Linden).

## (2) Summary of Significant Accounting Policies

### *(a) Basis of Accounting and Principles of Consolidation*

The consolidated financial statements of the Medical Center have been prepared in conformity with accounting principles generally accepted in the United States of America on the accrual basis of accounting. All significant intercompany transactions between Brookdale and the Housing Company have been eliminated in consolidation.

### *(b) Related-Party Transactions*

Transactions between the Medical Center and other related organizations, relating principally to the sharing of certain facilities, equipment, and personnel, are accounted for on the basis of allocated cost in the accompanying consolidated financial statements. Amounts due from or to related organizations are non-interest-bearing (note 12).

### *(c) Cash and Cash Equivalents*

Cash and cash equivalents include investments in highly liquid financial instruments with a maturity, when purchased, of three months or less, excluding assets whose use is limited. Substantially all of the Medical Center's cash and cash equivalents are deposited with three financial institutions at December 31, 2012 and 2011. The Medical Center generally limits the credit exposure to anyone financial institution; however, such deposits exceed federally insured limits.

### *(d) Capitation Receivable and Revenue*

The Medical Center has risk contracts with HealthFirst (a previously related party through one of Medysis' affiliated hospitals that has a partial ownership) and Neighborhood Health Providers (a related party that is owned by Linroc and Jamaica) to provide medical services to subscribing participants on a capitated basis. The HealthFirst contract renews every year on January 1, unless terminated with a 90-day notice by either party. The Neighborhood Health Providers contract renews every year on April 15, unless terminated with a 60-day notice by either party.

Under these agreements, the Medical Center receives monthly capitation payments based on the number of participants, regardless of services actually performed by the Medical Center and other providers. The Medical Center received capitation revenue from Neighborhood Health Providers and HealthFirst of $43.2 million and $71.8 million, respectively, during 2012 and $31.9 million and $58.9 million, respectively, during 2011, which is included in capitation revenue in the consolidated statements of operations and changes in net deficit. In addition, these health maintenance

organizations make fee for service payments to the Medical Center for certain covered services based upon discounted fee schedules.

In October 2011, Neighborhood Health Providers and HealthFirst included Medicaid Part – D pharmacy benefit coverage for all their members. As of December 31, 2012 and 2011, the Medical Center recognized $24.6 and $9.2 million in capitation revenue and expense, included in the revenue amount noted above and expense amount below, related to the new pharmacy benefit coverage.

The Medical Center's service agreement with HealthFirst provides that a portion of the premium revenue allocated to the Medical Center is retained by HealthFirst as additional capital contributions for the purpose of providing applicable statutory financial reserves and are disclosed as member equity by HealthFirst. As of December 31, 2012 and 2011, the Medical Center has recorded $8.4 and $6.9 million, respectively, in retained payments from HealthFirst, and are included in long-term other assets in the accompanying consolidated balance sheets.

### *(e) Healthcare Service Cost Recognition*

The cost of healthcare services provided or contracted under risk contracts is accrued in the period in which it is provided to a participant, based in part on estimates, including an accrual for medical services provided but not reported of approximately $12.3 million and $11.8 million at December 31, 2012 and 2011, respectively, which is included in accounts payable and accrued expenses. Costs related to capitation revenue incurred under the aforementioned risk contract for services rendered by out-of-network healthcare providers of approximately $84.4 million and $64.0 million for the years ended December 31, 2012 and 2011, respectively, are reflected as costs related to capitation revenue in the consolidated statements of operations and changes in net deficit.

### *(f) Charity Care and Uncompensated Services*

The Medical Center provides care to all patients regardless of their ability to pay. As a matter of policy, the Medical Center provides significant amounts of partially or totally uncompensated patient care. For accounting purposes, such uncompensated care is treated either as charity care or bad debt expense. The Medical Center has defined charity care for accounting purposes as the difference between its customary charges and the discounted rates given to patients in need of financial assistance. Since payment of this difference is not sought, charity care allowances are not reported as revenue. Uninsured patients who do not qualify for financial assistance are billed at the Medical Center's Medicaid rates. Uncollected balances for these patients are categorized as bad debts.

The estimated costs of providing charity services are based on a calculation, which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Medical Center's total expenses (less bad debt expense) divided by gross patient service revenue. Charity care costs related to the provision of charity care for all patient services approximated $14.2 million and $15.0 million for the years ended December 31, 2012 and 2011, respectively.

During fiscal year 2009, the Medical Center's financial assistance policy was amended to ensure that any patient that has been deemed to be uninsured through basic financial screening will be entitled to

a global charitable discount for emergent (NYS residents) and/or medically necessary services (resident in the Medical Center's primary service area). The global charitable discount will be based on the current applicable Medicaid or Medicare rate depending on the service provided. The global discounts for uninsured patients are based on the premise that the Medical Center serves a low income, under-insured population—as supported by public statistics—and that uninsured patients living in this community will generally not be able to pay their bill in its entirety. After the global charitable discount is applied, patients demonstrating additional financial need may be extended sliding scale discounts under the charity care policy. Additionally, for covered services there are no limits on financial assistance based on the medical condition of the applicant.

***(g) Assets Limited as to Use***

Assets limited as to use represent funds for specific purposes under internal designation or terms of agreements. Assets limited as to use consist of U.S. government, agency securities and commercial paper, guaranteed insurance contracts, and cash and cash equivalents. Deposits for malpractice reserves include an interest in an investment pool that is based on the net asset value of the units owned by the Medical Center.

A decline in the market value of assets limited as to use invested in available-for-sale securities that are below cost and are deemed to be other than temporary and not controlled by the Medical Center results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. At December 31, 2012 and 2011, the fair value of the Medical Center's securities was not below their cost value.

***(h) Property, Plant, and Equipment***

Property, plant, and equipment are carried at cost and those acquired by gifts and bequests are carried at fair value established as of the date of contribution. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years. In accordance with the Medical Center's policy, one-half year's depreciation is recorded in the year of asset acquisition, and a half year's depreciation is recorded in the final year of the asset's useful life. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized, net of any interest earned, as a component of the cost of acquiring those assets.

Equipment acquired through capital leases is recorded at the present value of the minimum lease payments at the inception of the leases and are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. The amortization of assets recorded under capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations and changes in net deficit. When assets retired or otherwise disposed of, the cost and the related depreciation is reversed from the accounts, and any gain or loss is reflected in current operations (note 7). Repair and maintenance expenditures are expensed as incurred.

***(i) Impairment of Long-Lived Assets***

Management routinely evaluates the carrying value of its long-lived assets for impairment or whenever events or changes in circumstances indicate that the carrying amount of assets, or related group of assets, may not be recoverable from estimated undiscounted cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds the estimated recoverability, an asset impairment charge is recognized. Estimated fair value is determine through an evaluation of recent and projected financial performance of the facility using standard industry valuation techniques. During 2011, there was an impairment charge for long-lived assets of approximately $8.5 million (note 7). No impairment charge was recorded during the year ended December 31, 2012.

Gifts of long-lived assets such as property, plant, and equipment are recorded at the fair value at the date of the gift and reported as an increase to unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

***(j) Deferred Financing Costs***

Deferred financing costs represent costs incurred to obtain financing. Amortization of these costs is provided on the effective-interest method over the term of the applicable indebtedness.

***(k) Supplies***

The Medical Center values its supplies at the lower of cost using the FIFO (first-in, first-out) method or market.

***(l) Use of Estimates***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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. The Medical Center's most significant estimates are its patient accounts receivable allowances, amounts related to third-party payor settlements, malpractice liabilities, accrual for medical services provided but not reported, and employee benefit costs. Actual results could differ from those estimates. The net adjustment included within the consolidated statements of operations and changes in net deficit relating to changes in prior year estimates increased net patient service revenue by $7.1 million and $18.2 million for the years ended December 31, 2012 and 2011, respectively.

***(m) Investment Gains, Losses, and Income***

All dividends, interest income, and net realized gains and losses not restricted by donor or law are reflected within the other revenue in the accompanying consolidated statements of operations and

changes in net deficit. These amounts include investment income and realized gains and losses earned on temporarily restricted net assets upon which restrictions have been placed by donors, unless the restriction is not satisfied in the year that the income is earned. If the restriction is not met within the current year, any investment income and realized gains and losses are included in the changes in temporarily restricted net assets.

### *(n) Other Revenue*

Other revenue, recorded by the Medical Center, is derived from healthcare services and other nonhealthcare services (note 16).

### *(o) Performance Indicator*

The consolidated statements of operations and changes in net deficit include a performance indicator, which is the excess of expenses over revenues and other support. Other changes in unrestricted net deficit, which are excluded from excess of expenses over revenues and other support, consistent with industry practice, include pension-related changes other than net periodic pension cost, transfer of pension obligation from affiliate, settlement of net due to affiliates, and grants for capital (including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets).

### *(p) Employee Medical and Dental Benefits*

The Medical Center has been self-insured for all of the nonunion employee medical and dental benefits. As of May 29, 2011, the Medical Center added all union employees to its self-insured medical and dental benefits plan (note 10(d)). The provisions for estimated medical and dental claims include estimates for both reported claims and estimates of the ultimate cost of claims incurred but not reported.

### *(q) Grants*

The Medical Center is the recipient of funds under several federal, state, and local grant programs. These funds are generally designated to cover current operating costs and/or capital acquisitions for specific programs. Revenue is recognized as expenditures are incurred. For the years ended December 31, 2012 and 2011, grant revenue recognized by the Medical Center was approximately $4.7 million and $4.8 million, respectively, which is included in other revenue in the consolidated statements of operations and changes in net deficit.

On June 18, 2012, the New York State Department of Health awarded the Medical Center $20 million under the Heath Care Efficiency and Affordability Law for New Yorkers (HEAL-NY) Restructuring Initiatives in Medicaid Redesign. The original purpose of the grant proceeds was to repay the 2012 loans obtained by the Medical Center from the New York State Health Facility Restructuring Program (note 8). During January 2013, the Medical Center received the grant funds and deposited them into an account controlled by DASNY to be held as collateral security for repayment of restructuring loans. Through June 2013, the Medical Center received approval from DASNY to use $16.0 million of the grant funds to fund operations. The Medical Center recorded the grant revenue during 2013 when funds were used.

***(r) Tax-Exempt Status***

The Medical Center is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Housing Company is exempt from federal income taxes under Section 501(c)(2) of the Internal Revenue Code.

***(s) Discontinued Operations***

The Medical Center accounts for discontinued operations under ASC Topic 360, *Property, Plant, and Equipment (ASC 360)*. ASC 360 requires that a component of an entity that has been disposed of or is classified as held-for-sale and has operations and cash flows that can be clearly distinguished from the rest of the entity be reported as discontinued operations. In the period that a component of an entity has been disposed of or classified as held-for-sale, the results of operations are reclassified to discontinued operations in the accompanying consolidated statements of operations and changes in net deficit.

***(t) Reclassifications***

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

***(u) Recent Accounting Pronouncements***

In July 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 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*. ASU 2011-07 includes amendments to FASB's ASC Topic 954, *Health Care Entities*. The objective of the update is to provide financial statement users with greater transparency about a healthcare entity's net patient service revenue and the related allowance for doubtful accounts. The amendments require healthcare entities that recognize significant amounts of patient service revenue at the time services are rendered, even though they do not immediately assess the patients' ability to pay, to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their statement of operations. The Medical Center has adopted the presentation and included in the additional disclosures within notes 4 and 5.

In September 2011, the FASB issued ASU No. 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. The guidance requires additional qualitative and quantitative information disclosures to assist the user of the financial statements in understanding the commitments and risks involved in participating in multiemployer pension plans, including the financial health of all 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. The Medical Center adopted the provisions of ASU 2011-09 for the year ended December 31, 2011. Adoption of this guidance did not have an impact on the consolidated financial statements of the Medical Center. ASU 2011-09

requires additional disclosures about the Medical Center's participation in multiemployer pension plans (note 10).

## (3) Going Concern

The Medical Center incurred excess of expenses over revenue, and other support of $62.9 million and $50.3 million, a working capital deficiency of $206.2 million and $209.5 million and an unrestricted net deficit of $392.5 million and $359.7 million as of December 31, 2012 and 2011, respectively.

The Medical Center's recurring working capital deficiencies, net deficit, and consolidated financial condition raise substantial doubt about the Medical Center's ability to continue as a going concern. Management is implementing an operational and financial restructuring to address the Medical Center's debt and operating shortfalls. These initiatives include identification of cost reductions and revenue cycle improvement, as well as the evaluation of various inpatient and outpatient service lines to generate additional working capital. Additionally, Management has engaged financial advisors to review the strategic plans for the Medical Center and its related entities to determine additional areas of operational improvements to ensure the sustainability of business operations into the future. However, there can be no assurance that Management's plans will be sufficient or timely enough to generate sufficient cash to meet its operating needs and achieve financial stability for the Medical Center. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

## (4) Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates (i.e., gross charges). Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments.

Billings relating to services rendered are recorded as net patient service revenue in the period in which the service is performed, net of contractual and other allowances, which represent differences between gross charges and the estimated receipts under such programs. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Patient accounts receivable is also reduced for allowances for uncollectible accounts.

The process for estimating the ultimate collection of receivables involves significant assumptions and judgment. Account balances are written off against the allowance when management determines it is probable the receivable will not be recovered. The use of historical collection and payor reimbursement experience is an integral part of the estimation of reserves for uncollectible accounts. Revisions in reserve for uncollectible account estimates are recorded as an adjustment to the provision for bad debts.

A summary of the payment arrangements with major third-party payors is as follows:

- *Medicare*: Inpatient acute care services, certain nonacute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain inpatient nonacute services and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. The Medical Center has been audited and received final settlements on their Medicare cost reports through 2009.
- *Non-Medicare Payments*: The New York Health Care Reform Act of 1996, as updated, governs payments to hospitals in New York State. Under this system, a rate equivalent to Medicare payors, except Medicaid, workers' compensation and no-fault insurance programs, negotiate hospital payment rates. If negotiated rates are not established, payors are billed at hospitals' established charges. Medicaid, workers' compensation, and no-fault payors pay hospital rates promulgated by the New York State Department of Health on a prospective basis. Adjustments to current and prior years' rates for these payors will continue to be made in the future.

There are various proposals at the federal and state levels that could, among other things, reduce payment rates and increase Managed Care penetration, including Medicaid. The ultimate outcome of these proposals and other market changes cannot presently be determined.

Revenue from the Medicare and Medicaid programs accounted for approximately 82% and 86% of the Medical Center's net patient service revenue for the years ended December 31, 2012 and 2011, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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 Medical Center based on each hospital's level of bad debt and charity care in relation to all other hospitals. For the years ended December 31, 2012 and 2011, the Medical Center recognized revenue of approximately $23.3 million and $21.2 million, respectively, from the indigent care pool, which is included in net patient service revenue.

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 Medical Center has implemented a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future government review and interpretation exists. The ultimate outcome of any such reviews, which may be initiated by regulatory agencies, cannot be 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 | 82% | 87% |
| Outpatient services | 18 | 13 |

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

| | 2012 | 2011 |
|---|---|---|
| Medicare (including Medicare Manage Care) | 34% | 38% |
| Medicaid (including Medicaid Managed Care) | 48 | 48 |
| Commercial and managed care | 13 | 9 |
| Self-pay | 3 | 3 |
| Other (no fault and worker's compensation) | 2 | 2 |
| | 100% | 100% |

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 Reduction (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 Medical Center Nonphysician Medicare payments will be reduced by the mandatory 2% reduction beginning on April 1, 2013.

It is not currently possible to determine the impact that the reduction to Medicare spending during the Sequestration, as well as 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 Medical Center.

## (5) Patient Accounts Receivable

The Medical Center provides healthcare services through its inpatient and outpatient care facilities located in Brooklyn, New York, and various surrounding boroughs of New York City. The Medical Center grants credit to patients, substantially all of whom are local residents. The Medical Center generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, HMOs, and commercial insurance policies).

The Medical Center 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, if any. Management regularly reviews data about the major payor sources of patient service revenue in evaluating the adequacy of the allowance for doubtful accounts. The Medical Center analyzes contractual amounts due from patients who have third-party coverage and provides an allowance for doubtful accounts and a provision for bad debts, if any. 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 Medical Center 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.

The following table sets forth the components of the change in the allowance for doubtful accounts for the year ended December 31, 2012:

| Primary payor | Balance at the beginning of the period | Provision for bad debts | Write-offs, net of recoveries | Balance at the end of the period |
|---|---|---|---|---|
| Medicare (including Medicare Manage Care) | $ 1,388 | 940 | (937) | 1,391 |
| Medicaid (including Medicaid Managed Care) | 15,769 | 10,376 | (10,345) | 15,800 |
| Commercial and managed care | 4,081 | 1,267 | (1,259) | 4,089 |
| Self-pay | 11,140 | 7,487 | (7,465) | 11,162 |
| Other (no fault and worker's compensation) | 1,541 | 1,031 | (1,028) | 1,544 |
| Grand total | $ 33,919 | 21,101 | (21,034) | 33,986 |



(Continued)

Significant concentrations of gross accounts receivable for services to patients include the following at December 31:

| | 2012 | 2011 |
|---|---|---|
| Medicare (including Medicare Manage Care) | 22% | 21% |
| Medicaid (including Medicaid Managed Care) | 42 | 44 |
| Commercial and managed care | 17 | 20 |
| Self-pay | 16 | 12 |
| Other (no fault and worker's compensation) | 3 | 3 |
| | 100% | 100% |

## (6) Assets Limited as to Use

The Medical Center follows ASC Topic 820, *Fair Value Measurement*. The guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement data.

This fair value guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Medical Center for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the whole term of the assets or liabilities.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- Market approach – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- Cost approach – Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- Income approach – Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing models, and lattice models).

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions the market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics, and other factors.

The fair value of assets limited as to use that is measured at fair value on a recurring basis as follows as of December 31 (in thousands of dollars):

| | | 2012 | 2011 |
|---|---|---|---|
| Assets limited as to use by type of investment: | | | |
| Cash and cash equivalents | $ | 19,344 | 17,073 |
| U.S. government, agency securities, and commercial paper | | 400 | 400 |
| Guaranteed insurance contract | | 12,142 | 12,142 |
| Interest in CCC investment trust | | 37 | 140 |
| | | 31,923 | 29,755 |
| Less current portion related to assets limited or restricted as to use: | | | |
| Assets limited or restricted as to use | | 14,187 | 174 |
| | $ | 17,736 | 29,581 |
| Assets limited as to use by type of restriction: | | | |
| Funds held for capital acquisition (note 8) | $ | 400 | 400 |
| Escrow agreement (note 17) | | 1,397 | 784 |
| Funds held for debt service reserve (note 8) | | 12,542 | 12,402 |
| Self-insurance professional liabilities trust (note 11) | | 8 | 8 |
| Workers' compensation collateral | | 17,539 | 16,021 |
| Deposit for malpractice | | 37 | 140 |
| | $ | 31,923 | 29,755 |

Assets limited as to use classified as current at December 31, 2012 comprise $1.4 million of operating escrow, malpractice funds of $0.04 million, and $12.5 million of debt service reserves consisting of $4.2 million released from restriction by DASNY in February 2013 to fund part of the debt service



(Continued)

payment on February 15, 2013 and $8.4 million of the remaining debt service reserves funds as a result of debt in default (note 8(a)). Assets limited as to use classified as current at December 31, 2011 comprise $0.03 million of operating escrow, malpractice funds of $0.14 million and $0.3 million of debt service reserves anticipated to be used in 2012.

At December 31, 2012 and 2011, respectively, in accordance with the Medical Center's workers' compensation self-insurance program, $17.5 million and $16.0 million of assets were on deposit with the New York State Workers' Compensation Board. At December 31, 2012, these amounts were invested in cash and cash equivalents. At December 31, 2011, these amounts comprising a $1.7 million letter of credit, which is fully collateralized by an investment in a government agency security, and $14.3 million in cash and cash equivalents. These funds are held by the New York State Workers' Compensation Board to guarantee payment of workers' compensation claims and disability benefits to employees.

Investment income and realized gains (losses), reported as other revenue, comprise the following for the years ended December 31 (in thousands):

| | | 2012 | 2011 |
|---|---|---|---|
| Interest income | $ | 720 | 743 |

The classification by level of the Medical Center's assets that are measured on a recurring basis at December 31, 2012 and 2011 is as follows (in thousands):

| | | | Based on | | |
|---|---|---|---|---|---|
| | | Fair value at December 31, 2012 | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Cash and cash equivalents | $ | 19,344 | 19,344 | — | — |
| Guaranteed Insurance Contract | | 12,142 | — | 12,142 | — |
| U.S. government securities treasury bills | | 400 | 400 | — | — |
| Interest in CCC investment pool | | 37 | — | — | 37 |
| | $ | 31,923 | 19,744 | 12,142 | 37 |



(Continued)

| | | Based on | | | |
|---|---|---|---|---|---|
| | Fair value at December 31, 2011 | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Cash and cash equivalents | $ 17,073 | 17,073 | — | — |
| Guaranteed Insurance Contract | 12,142 | — | 12,142 | — |
| U.S. government securities treasury bills | 400 | 400 | — | — |
| Interest in CCC investment pool | 140 | — | — | 140 |
| | $ 29,755 | 17,473 | 12,142 | 140 |

The following methods and assumptions were used to estimate the fair value of each class of investments within assets limited as to use and the pension plan (note 10):

*Marketable Equity Securities and Mutual Funds* – Fair value estimates for publicly traded equity securities are based on quoted market prices and are classified as Level 1.

*Mortgage-Backed Securities* – Fair value estimates for mortgage-backed securities are based other market data for the same or comparable instruments and transactions in establishing the prices and are classified as Level 2.

*Corporate and Government Bonds and U.S. Government Securities* – The estimated fair values of debt securities are based on market data for the same or comparable instruments and transactions in establishing the prices and are classified as Level 2.

*Guaranteed Insurance Contract* – Fair value is based on the value of the underlying assets owned by the fund, minus its liabilities, and then divided by number of shares outstanding and are classified as Level 2.

*Interest in CCC Investment Pool* – Fair value of interest in the CCC investment pool is based on unobservable inputs that cannot be corroborated by observable market data and, therefore, classified as Level 3.

## (7) Property, Plant, and Equipment

A summary of property, plant, and equipment is as follows at December 31 (in thousands):

| | 2012 | 2011 | Useful lives |
|---|---|---|---|
| Land | $ 1,069 | 1,393 | |
| Buildings and improvements | 79,163 | 89,393 | 5 – 40 years |
| Furniture and equipment | 178,198 | 182,342 | 3 – 25 years |
| Leased equipment (note 9) | 34,497 | 30,121 | Lease term |
| | 292,927 | 303,249 | |
| Accumulated depreciation and amortization | (256,510) | (260,742) | |
| | 36,417 | 42,507 | |
| Construction in progress | 1,978 | 1,876 | |
| | $ 38,395 | 44,383 | |

Substantially all property, plant, and equipment serve as collateral under various loan agreements.

Effective April 9, 2010, MediSys entered into an agreement with Epic to implement an integrated, patient centered electronic health record system (EHR) across all hospitals and all clinical areas within MediSys. Due to the Medical Center's restructuring, management decided to discontinue the EHR project. As a result, the Medical Center recorded an impairment of long-lived assets at December 31, 2011 of $8.5 million, which represents the entire investment in the project.

On November 1, 2012, the Housing Company sold its four residential apartment buildings and all their related assets. See note 17.

Construction in progress is for other various renovation projects at the Medical Center. The total estimated additional cost to complete the projects is $6.7 million and the expected date of completion for all projects is 2015.

## (8) Long-Term Debt

A summary of long-term debt at December 31 follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Series 1998 J Secured Hospital Revenue Refunding Bonds, varying rates ranging from 5.0% to 5.3%, due through 2017 (a) | $ 50,407 | 59,482 |
| Mortgage payable to GMAC Commercial Mortgage Corp., 7.01% interest rate, due monthly through 2036 (b) | — | 10,091 |
| Note payable to New York State Health Facility Restructuring Pool (c) | 24,500 | 24,500 |
| Note payable to New York State Health Facility Restructuring Pool (c) | 3,000 | 3,000 |
| Note payable to Siemens Financial Services, Inc., 10.86% interest rate, due monthly through 2012 (d) | — | 52 |
| Note payable to the Dormitory Authority of the State of New York (e) | 11,823 | — |
| Note payable to New York State Health Facility Restructuring Program, 1.0% interest rate, due 2014 (f) | 18,500 | — |
| Note payable to New York State Health Facility Restructuring Program, 1.0% interest rate, due 2014 (f) | 17,000 | — |
| Note payable to New York State Health Facility Restructuring Program, 1.0% interest rate, due 2014 (f) | 7,545 | — |
| Note payable to Nouveau Elevator, Inc., 1.5% interest rate, due monthly through 2013 (g) | 112 | 223 |
| Capital leases, at varying rates of interest from 4.5% to 11.5% (note 8) | 8,187 | 6,404 |
| | 141,074 | 103,752 |
| Less current portion | 136,069 | 89,386 |
| | $ 5,005 | 14,366 |

The Medical Center is currently in violation of certain debt covenants, which constitutes a default under certain of its debt agreements. As a result of the defaults, in the absence of waivers, the lender may declare the debt immediately payable. Therefore, the Medical Center's debt in default (see (a) and (g) below) has been classified as currently due. The Medical Center's various debt agreements are as follows:

a. The Medical Center, through participation with DASNY, issued Secured Hospital Revenue Refunding Bonds, Series 1998 J. Additional credit enhancement for the bonds is provided under a service contract between DASNY and the State of New York acting through the Director of Budget. Under the terms of the service contract, the Director of Budget will determine, annually, the next fiscal year's debt service, subject to legislative approval. The bonds are collateralized by a first mortgage lien on the Medical Center's property, plant, equipment, and substantially all other assets.



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Pursuant to the bond documents and loan-related mortgage agreements, the Medical Center is, among other things, required to maintain a Capital Reserve Fund (debt service fund) and other funds whose use is limited to debt repayments, capital asset acquisition, and related items. Annual payments of principal and interest that the Medical Center is required to pay into the debt service fund are approximately $12.1 million. The funds consist principally of fixed income securities and are included in assets limited as to use (note 6). In addition, the Medical Center is also required to maintain a debt service coverage ratio and other financial and nonfinancial covenants. At December 31, 2012, the Medical Center failed to deposit $30.1 million of the required payments to the debt service fund for the bonds within the specified time frame per the debt agreements and did not meet the required debt service coverage ratio. Accordingly, the bonds are classified as current in the accompanying consolidated balance sheets as of December 31, 2012 and 2011.

b. In May 2006, the Housing Company entered into a $10.8 million loan agreement with GMAC at an interest rate of 7.01%. The loan is payable in monthly installments of principal and interest approximating $72,000 through June 2036. The four buildings of the Housing Company collateralize the GMAC loan. In November 2012, the Housing Company sold the four buildings that collateralized the GMAC loan and paid off the remaining $9.9 million principal balance of the GMAC debt (note 17).

c. In 1999, the Medical Center entered into a reimbursement agreement (the Restructuring Pool Loan) with DASNY, which provided non-interest-bearing loans to the Medical Center. The source of the funds was the New York State Health Facility Restructuring Pool. During 1999, DASNY advanced $9.5 million. Additionally, in February 2000, DASNY provided the Medical Center an additional $15 million from available moneys on deposit in the Restructuring Pool.

   The Restructuring Pool Loan has no specified repayment terms, other than under certain circumstances as stated in the agreement. The Medical Center has not been required to make any repayments of the Restructuring Pool Loan. Under the terms of the Restructuring Pool Loan, an event of default of the mortgage loan agreement related to the bonds (note 8(a)) constitutes an event of default of the Restructuring Pool Loan. At December 31, 2012 and 2011, the Medical Center did not meet its debt covenant, as discussed in (a), above. Accordingly, the Restructuring Pool Loan has been classified as current in the accompanying consolidated balance sheets as of December 31, 2012 and 2011.

   During 2000, the Medical Center entered into a non-interest-bearing loan agreement with DASNY, whereby DASNY agreed to pay directly to MediSys $3.0 million of the management fee payable during the first twelve months of the management agreement from the Restructuring Pool Loan program. The remainder of the management fee was payable to MediSys by the Medical Center.

d. In December 2007, the Medical Center entered into a $0.2 million loan agreement with Siemens Financial Services, Inc. with an interest rate of 10.86% to finance the construction needed for the installation of a new magnetic radiology imaging machine. The loan was payable in monthly installments of principal and interest approximating $4,600 for the period from January 2008 through December 2012. The equipment was held as collateral. In December 2012, the Medical Center made their last principal and interest payment to pay off the remaining balance of the debt.

e. As of December 31, 2012, the Medical Center failed to deposit a cumulative $30.1 million of the required payments to the debt service fund for the Secured Hospital Revenue Refunding Bonds, Series 1998 J within the specified time frame per the debt agreements. As a result, the Medical Center had insufficient funds in the debt service fund to meet the scheduled interest and principal payments at August 15, 2011, February 15, 2012, and August 15, 2012. DASNY deposited a total of $11.8 million into the debt service fund to satisfy the scheduled interest and principal payments when they came due. The moneys are currently due to DASNY with an effective interest rate of 5.19%.

f. On May 3, 2012, the Medical Center acquired a loan in the amount of $5.0 million from the New York State Health Facility Restructuring Program at an interest rate of 1.0%. Interest is payable on a quarterly basis beginning July 1, 2012. The entire outstanding principal balance was payable on April 1, 2014. The entire balance was paid off on May 25, 2012.

On May 25, 2012, the Medical Center acquired a loan in the amount of $18.5 million from the New York State Health Facility Restructuring Program at an interest rate of 1.0%. Interest is payable on a quarterly basis beginning July 1, 2012. The entire outstanding principal balance is payable on April 1, 2014. $5.0 million of the proceeds were used to pay off the May 3, 2012 loan from the New York State Health Facility Restructuring Program.

On August 30, 2012, the Medical Center acquired a loan in the amount of $17.0 million from the New York State Health Facility Restructuring Program at an interest rate of 1.0%. Interest is payable on a quarterly basis beginning October 1, 2012. The entire outstanding principal balance is payable on October 1, 2014.

The Medical Center shall use the proceeds of the loans in furtherance of the Medical Center's corporate purposes, including, in particular, to fund the working capital needs and to enable the Medical Center to meet its immediate financial obligations.

On October 24, 2012, the Medical Center acquired a loan in the amount of $11.2 million from the New York State Health Facility Restructuring Program at an interest rate of 1.0%. Interest is payable on a quarterly basis beginning July 1, 2013. The entire outstanding principal balance is payable on October 1, 2014. The proceeds of the loan are to be used solely to pay amounts owed to the Internal Revenue Service for unpaid payroll taxes. In October 2012, the Medical Center drew down $7.5 million of the $11.2 million loan to repay the Internal Revenue Service for outstanding payroll taxes related to 2011 and the first quarter of 2012, respectively.

The loans are collateralized by a first mortgage lien on the Medical Center's property, plant, equipment, and substantially all other assets. The 2012 DASNY loans have various nonfinancial debt covenants.

g. In March 2010, the Housing Company entered into a $0.4 million loan agreement with Nouveau Elevator, Inc. with an interest rate of 1.5% to finance the construction and installation of new elevators at one of the residential apartment buildings. The loan is payable in monthly installments of principal and interest of $0.01 million for the period from April 2010 through March 2013. Construction was completed in 2011. As of December 31, 2012, the Housing Company failed to

make several scheduled payments on the debt. They are currently in negotiations with Nouveau Elevator, Inc. to settle the loan and other outstanding invoices.

Scheduled payments and payments in default on long-term debt are as follows (in thousands):

| | Scheduled payments | Reclassification of debt in default | Total |
|---|---|---|---|
| Year ending December 31: | | | |
| 2013 | $ 24,655 | 111,414 | 136,069 |
| 2014 | 55,514 | (52,995) | 2,519 |
| 2015 | 11,287 | (9,986) | 1,301 |
| 2016 | 11,145 | (10,131) | 1,014 |
| 2017 | 10,973 | (10,802) | 171 |
| Thereafter | 27,500 | (27,500) | — |
| Total long-term debt | $ 141,074 | — | 141,074 |

## (9) Leases

The Medical Center is obligated under capital leases covering certain equipment that expire at various dates during the next five years. At December 31, 2012 and 2011, the gross amount of equipment and related accumulated amortization recorded under capital leases were as follows (in thousands):

| | 2012 | 2011 |
|---|---|---|
| Equipment | $ 34,497 | 30,121 |
| Less accumulated amortization | (26,786) | (24,048) |
| | $ 7,711 | 6,073 |

Amortization of assets held under capital leases is included within depreciation and amortization expense.



(Continued)

Future minimum payments in the aggregate, under capitalized leases and noncancelable operating leases (predominantly for equipment rental) with initial or remaining terms of one year or longer are as follows (in thousands):

| | Capitalized leases | Operating leases |
|---|---|---|
| Year ending December 31: | | |
| 2013 | $ 3,697 | 1,074 |
| 2014 | 2,823 | 745 |
| 2015 | 1,460 | 442 |
| 2016 | 1,073 | 143 |
| 2017 | 176 | — |
| Thereafter | — | — |
| | 9,229 | 2,404 |
| Less amounts representing interest range from 4.5% to 11.5% | 1,042 | |
| Present value of minimum lease payments | $ 8,187 | |

Total rental expense charged to operations for the years ended December 31, 2012 and 2011 amounted to approximately $3.4 million and $3.5 million, respectively.

## (10) Retirement and Similar Benefits

### *(a) Defined-Benefit Plan*

The Medical Center had a noncontributory defined-benefit pension plan (the DB Plan) covering substantially all of its employees not represented by a collective bargaining agreement. Effective June 30, 1993, the Medical Center discontinued the accrual of benefits for future services of participants in the DB Plan as this plan was frozen at this date. Benefits were based upon years of service and salaries earned during those years of service. Effective January 1, 1999, the Medical Center amended the plan to resume accruing for active participants under an updated benefit formula. All participants' frozen benefit amounts were added to the benefits earned for services accrued effective January 1, 1999. The defined-benefit plan was frozen as of May 31, 2010. The Medical Center's funding policy is to contribute an amount at least equal to the minimum required contribution under the Employee Retirement Income Security Act of 1974 (ERISA). Although management reserves the right to terminate the plan at any time, it is obligated to fund the recommended contribution level determined by the plan's actuaries as long as the plan remains in effect.

The DB Plan was not offered to employees hired after December 31, 2005. For all new nonunion employees hired after January 1, 2006, who are over 21, completed one year of service and who worked over 1,000 hours per annum, the Medical Center offered a defined-contribution plan (the DC Plan). The Medical Center contributed 4% of the employees' annual salary to the DC Plan. Employees became 100% vested upon completing five years of service.



(Continued)

The following table sets forth the benefit obligations and fair value of plan assets at December 31, 2012 and 2011 (in thousands) for the original DB Plan:

| | | 2012 | 2011 |
|---|---|---|---|
| Reconciliation of the benefit obligation: | | | |
| Benefit obligation at beginning of year | $ | 126,382 | 106,990 |
| Interest cost | | 5,160 | 5,584 |
| Actuarial loss | | 9,393 | 17,692 |
| Benefits paid | | (4,373) | (3,884) |
| Projected benefit obligation at end of year | $ | 136,562 | 126,382 |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | $ | 73,825 | 76,704 |
| Actual return on plan assets | | 7,603 | (2,891) |
| Employer contributions | | 2,652 | 3,896 |
| Benefits paid | | (4,373) | (3,884) |
| Fair value of plan assets at end of year | $ | 79,707 | 73,825 |

The accumulated benefit obligation for the defined-benefit pension plan was $136.6 million and $126.4 million at December 31, 2012 and 2011, respectively. The funded status and amounts recognized in the consolidated balance sheets at December 31, 2012 and 2011, pursuant to pension accounting, are as follows (in thousands):

| | | 2012 | 2011 |
|---|---|---|---|
| Funded status, December 31: | | | |
| Fair value of plan assets | $ | 79,707 | 73,825 |
| Projected benefit obligation | | (136,562) | (126,382) |
| Funded status | $ | (56,855) | (52,557) |
| Amounts recognized in the consolidated balance sheets, end of year: | | | |
| Accrued pension obligation | $ | (56,855) | (52,557) |
| Unrestricted net deficit: | | | |
| Net actuarial loss | $ | 57,655 | 52,566 |

The estimated amount that will be amortized from unrestricted net deficit into net periodic pension cost in 2013 is a net actuarial loss of $1.8 million.



(Continued)

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

| | | 2012 | 2011 |
|---|---|---|---|
| Interest cost | $ | 5,160 | 5,584 |
| Expected return on assets | | (5,012) | (5,300) |
| Recognized net actuarial loss | | 1,713 | 760 |
| Net periodic benefit cost | $ | 1,861 | 1,044 |
| Other changes in plan assets and benefit obligation recognized in unrestricted net deficit: | | | |
| Net actuarial loss | $ | (6,802) | (25,884) |
| Less amortization of actuarial loss | | 1,713 | 760 |
| Total recognized in other changes in unrestricted net deficit | $ | (5,089) | (25,124) |

Weighted average assumptions used to determine benefit obligations for 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Discount rate | 3.64% | 4.15% |
| Rate of compensation increase | — | — |

Weighted average assumptions used to determine net benefit cost are as follows:

| | 2012 | 2011 |
|---|---|---|
| Discount rate | 4.15% | 5.26% |
| Expected long-term rate of return on plan assets | 7.00 | 7.00 |
| Rate of compensation increase | — | — |

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 on expected risk premiums by class and applies this to the plan's allocation to determine a range of long-term expected returns.



(Continued)

***Plan Assets***

The weighted average asset allocation of the Medical Center's pension portfolio was as follows:

| | Plan assets at December 31 | |
|---|---|---|
| | **2012** | **2011** |
| Asset category: | | |
| Cash and cash equivalents | 4% | —% |
| Equity securities | 78 | 78 |
| Fixed income | 18 | 22 |
| | 100% | 100% |

The Medical Center's investment policy for the plan assets identifies target allocations and ranges for individual asset categories as follows:

| | **Target allocation** | **Allocation range** |
|---|---|---|
| Equity securities | 50% | 40% – 60% |
| Debt | 50 | 40 – 60 |

If the asset allocation of the defined-benefit pension plan portfolio is in violation of the asset allocation range for six months, assets will be redistributed to achieve the target allocation within a reasonable period of time.

The Medical Center's primary investment goal to achieve an expected long-term rate of return on plan assets in 2012 and 2011 of 7% is to maximize total return, comprising income and net realized and unrealized gains and losses. This objective is accomplished by assuming a prudent level of risk in the investment of the plan assets. The Medical Center's policy permits investments in U.S. and international common stocks and bonds, convertible securities, and cash equivalents. The Medical Center regularly reviews and approves methods and assumptions used to determine the contributions required to provide adequate funding to the plan. As the level of inflation can be expected to vary over time, the long-range funding requirements are periodically examined in light of investment returns after deducting inflation as measured by the Consumer Price Index.



(Continued)

The classification by level of the Medical Center's DB Plan at December 31 (in thousands):

| | 2012 | | | |
|---|---|---|---|---|
| | **Quoted prices in active markets for identical assets (Level 1)** | **Significant other observable inputs (Level 2)** | **Significant unobservable inputs (Level 3)** | **Fair value** |
| Cash and cash equivalents | $ 2,893 | — | — | 2,893 |
| Marketable equity securities: | | | | |
| Common stock – domestic | 42,948 | — | — | 42,948 |
| Common stock – international | 10,816 | — | — | 10,816 |
| Mutual funds | 8,182 | — | — | 8,182 |
| U.S. government securities: | | | | |
| Government bonds and notes | — | 5,555 | — | 5,555 |
| Municipal bonds | — | 2,003 | — | 2,003 |
| Mortgage-backed securities | — | 1,422 | — | 1,422 |
| Corporate bonds | — | 5,888 | — | 5,888 |
| | $ 64,839 | 14,868 | — | 79,707 |



(Continued)

| | 2011 | | | |
|---|---|---|---|---|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Fair value |
| Cash and cash equivalents | $ 44 | — | — | 44 |
| Marketable equity securities: | | | | |
| Common stock – domestic | 39,162 | — | — | 39,162 |
| Common stock – international | 7,496 | — | — | 7,496 |
| Mutual funds | 11,161 | — | — | 11,161 |
| U.S. government securities: | | | | |
| Government bonds and notes | — | 8,154 | — | 8,154 |
| Municipal bonds | — | 2,003 | — | 2,003 |
| Mortgage-backed securities | — | 2,325 | — | 2,325 |
| Corporate bonds | — | 3,480 | — | 3,480 |
| | $ 57,863 | 15,962 | — | 73,825 |

The methods and assumptions used to estimate the fair value of each class of the plan's financial instruments is described in note 6.

***Cash Flows***

The Medical Center expects to contribute $9.4 million to the plan in 2013.

The benefits expected to be paid in each year from 2013 through 2017 are $6.6 million, $6.8 million, $7.0 million, $7.2 million, and $7.2 million, respectively. The aggregate benefits expected to be paid in the five years from 2018 through 2022 are $37.7 million. The expected benefits are based on the same assumptions used to measure the Medical Center's benefit obligation at December 31, 2012.

***(b) Cash Balance Defined-Benefit Plan***

Effective January 1, 2010, a new cash balance defined-benefit plan was established by MediSys for most of the affiliate entities including the Medical Center. This plan covers all nonleased or per diem employees who are at least 21 years old and not covered by a collective bargaining agreement of the Medical Center. Upon termination of employment, and after satisfying the plan's vesting requirements, employees are eligible to receive the sum of the allocations made since January 1, 2010. In addition, all benefits earned through May 31, 2010 are payable under the terms of the DB Plan prior to the amendment. Effective June 1, 2010, all employees previously covered by the DC Plan will continue to receive certain allocations into that plan going forward, which for the Medical Center, that percentage has remained consistent at 4% of an employee's salary, with the same conditions as the original DC Plan. The Medical Center accounted for its participation in the new



(Continued)

defined-benefit plan under the guidance for multiemployer plans. The Medical Center and the other participants in the cash balance plan were joint and severally liable. The allocations to the Medical Center for the cash balance plan were based on actual service costs for the employees at the Medical Center, plus a pro rata portion of the remaining pension expense items based on projected benefit obligation for the employees at the Medical Center. Pension expense was allocated to the Medical Center from MediSys for the years ended December 31, 2012 and 2011 was $5.1 million and $6.0 million, respectively

Effective August 2, 2012, the MediSys Cash Balance Retirement Plan spunoff a portion of its assets and obligations to a new plan, The Brookdale Hospital Medical Center Cash Balance Plan (CB Plan). The benefits under the new cash balance defined-benefit plan were also frozen as of December 31, 2012.

The Medical Center recorded the accrued pension obligation in the amount of $3.0 million on the consolidated balance sheet as of December 31, 2012. The Medical Center recorded the transfer of the pension obligation from affiliate in other changes in unrestricted net deficit on the consolidated statement of operations and changes in net deficit during the year ended December 31, 2012 in the amount of $2.7 million. The plan assets in the amount of $8.6 million are Level 1 mutual funds.

### *(c) Multiemployer Pension Plans*

The Medical Center also contributes to the pension, welfare, and dental benefit plans for its union employees. The Medical Center had been delinquent in remitting certain required contributions to union benefit plans. The risks of participating in these multiemployer plans are different from a single-employer plan in the following aspects: (1) assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers, (2) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers, and (3) if the Medical Center chooses to stop participating in some of its multiemployer plans, it may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability. The Medical Center has made cash contributions in 2012 and 2011 for the multiemployer plans noted in the table below:

| | Contributions | |
|---|---|---|
| | 2012 | 2011 |
| 1199 SEIU Health Care Employees Pension Fund | $ 10,053 | 12,584 |

| | EIN/Pension plan number | Pension protection act zone status (b) 2012 | Pension protection act zone status (b) 2011 | FIP/RP (c) Status pending | Surcharge imposed | Expiration date of collective bargaining agreement |
|---|---|---|---|---|---|---|
| 1199 SEIU Health Care Employees Pension Fund (a) | 13-3604862/001 (1199) | Green | Green | No | No | 4/30/2015 |



(Continued)

(a) Represents less than 5% of total plan contributions.

(b) A zone status rating of green indicates the plan is at least 80% funded, yellow indicates between 65% and 80% funded, and red indicates less than 65% funded.

(c) Funding improvement plan or rehabilitation plan.

***(d) Union Plan Contributions***

During 2007, the Medical Center was delinquent in remitting certain required contributions to union pension and benefit plans. The delinquent amounts outstanding aggregated approximately $11.0 million through October 2007. In October 2007, the Medical Center entered into an agreement (the 2007 Agreement) with the union regarding these outstanding balances. Under the Agreement, the Medical Center agreed to a total principal balance of approximately $11.5 million, which includes accrued interest of approximately $0.5 million, with the union agreeing to accept monthly principal payments of $0.6 million over a period of 18 months. As consideration for the modified agreement, the Medical Center agreed on January 27, 2009 to give the union liens on two properties, located in Brooklyn, New York, in the amount of $4.8 million. Additional interest was accrued on the principal balance at a rate of 1.5% per month and became due with the final scheduled principal payment on December 31, 2009.

During 2012 and 2011, the Medical Center was delinquent in remitting certain required contributions to union pension and benefit plans, as well as accrued interest of $1.7 million on the 2007 agreement. The delinquent amounts outstanding on the required contributions aggregated approximately $17.9 million through May 2010. In June 2010, the Medical Center entered into an agreement (the 2010 Agreement) with the union regarding these outstanding balances. Under the 2010 Agreement, the Medical Center agreed to a total principal balance of approximately $24.8 million, which includes accrued interest of approximately $6.8 million (of which $1.7 million relates to the modified 2007 agreement). The union agreed to accept monthly principal payments of approximately $1.2 million over a period of 24 months. Additional interest of approximately $4.0 million will accrue on the principal balance at a rate of 1.5% per month and is included in the monthly payments.

The outstanding balance (the 2010 Agreement discussed above) of approximately $5.3 million and $15.1 million, which represents unpaid accrued interest, is included in accrued salaries and related liabilities in the accompanying consolidated balance sheets as of December 31, 2012 and 2011, respectively. The Medical Center is not current on its payments, and pursuant to the agreement, this constitutes an event of default. As such, the outstanding balance has been classified as current as of December 31, 2012.

As a result of the Medical Center's continued delinquent payments, the union terminated all medical and dental benefits to its members effective May 29, 2011. The Medical Center immediately enrolled the union employees into its self-insured medical and dental benefits plan. The cost of the enrolled union members for the years ended December 31, 2012 and 2011 was $18.9 and $8.5 million, respectively.

## (11) Insurance Arrangements

Effective July 1, 1983, the Medical Center, together with several other not-for-profit institutions, obtained primary and excess professional liability insurance coverage from third-party insurance providers. Effective July 1, 1985, the Medical Center with the same other not-for-profit institutions formed Combined Coordinating Council program, a captive insurance company (the Company) to provide professional liability and insurance coverage. The Company is organized under the laws of Bermuda, and the Medical Center's voting control represents a 16% ownership interest. Coverage provided by the Company was on an occurrence basis through June 30, 2000. Effective July 1, 2000, the Medical Center changed to a claims-made coverage policy. Subsequently, the Medical Center changed back to a modified occurrence basis policy, retrospective to July 1, 2000, and accrued the additional costs associated with this conversion.

Should claim payments under the insurance program exceed current estimates or if investment interest rate assumptions are not achieved, the Company can, under the terms of the policies issued, make further premium assessments on the shareholders. Correspondingly, if claim payments are less than current estimates or if investment interest rate assumptions are favorable, the Medical Center may be entitled to a dividend. The policies also provide that the insured are jointly and severally liable for such assessment through June 30, 2004. There were no amounts outstanding at December 31, 2012 and 2011.

In 2012 and 2011, the Medical Center was entitled to a dividend from the Company of approximately $7.9 million and $12.3 million, which is included in other revenue. In 2011, the Company applied $5.8 million of these amounts against the outstanding balance of the retrospective premiums. In 2012, the Company did not apply any amounts against the outstanding balance of retrospective premiums.

Effective July 1, 2004, the Medical Center and Jamaica Hospital (a former affiliate of the Medical Center) collectively participate in a captive cell malpractice insurance program through the Company. This program provides insurance coverage up to the amount that the participating members have funded in their respective segregated cells. In connection with the program, the Medical Center had on deposit approximately $0.04 million in 2012 and $0.14 million in 2011 with the Company. The Medical Center is assessed premiums based on actuarial estimates and these premiums are applied to the Medical Center's segregated cell. On an annual basis, an independent actuary performs an analysis to set the funding requirements for each participating hospital's segregated cell for the upcoming year. The Medical Center is covered by an excess insurance policy after the limits of $7.5 million per claim and $25.0 million in the aggregate are reached. As of December 31, 2012 and 2011, the Medical Center had recorded an estimated undiscounted malpractice liability of approximately $192.9 million and $187.2 million, respectively, based on an independent actuarial calculation.

The Medical Center is also self-insured for workers' compensation and annually charges to operations amounts representing the estimated liability related to claims resulting from incidents that occur each year. The liability of approximately $25.3 million and $23.2 million related to workers' compensation claims is actuarially determined as of December 31, 2012 and 2011, respectively, based on a discount rate of 4%.

Under current accounting guidance, it is the Medical Center's policy to accrue an estimate of the ultimate cost of claims under all insurance policies whether the policy is fully insured or a self-insurance policy. In addition, any insurance recoverable under such policies is recorded as a receivable.



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Amounts recognized as anticipated insurance recoveries related to the malpractice claims approximate $19.2 million and $26.9 million at December 31, 2012 and 2011, respectively. Amounts recognized as anticipated insurance recoveries related to workers' compensation claims approximate $2.7 million and $2.5 million at December 31, 2012 and 2011, respectively. Insurance recoveries are measured on the same basis as the liability subject to the need for valuation allowance for any uncollectible amounts.

## (12) Related-Party Transactions

The balances due from (to) the Medical Center's related organizations at December 31 are as follows (in thousands):

| | | 2012 | 2011 |
|---|---|---|---|
| Institute (a) | $ | 100,155 | 85,795 |
| Amboy (b) | | 4,513 | 3,664 |
| Residence (c) | | 222 | 272 |
| Urban (d) | | 5,184 | 4,889 |
| BFCC (d) | | 5,751 | 8,233 |
| Linroc (e) | | — | — |
| BHMC Enterprise (e) | | 1,205 | 1,205 |
| Brookdale Rx., Inc. (g) | | 1,988 | — |
| MediSys and affiliate (f) | | — | 7,306 |
| | | 119,018 | 111,364 |
| Reserve on due from affiliates (g) | | 117,030 | 111,364 |
| Due from affiliates, net | $ | 1,988 | — |
| Rockreal (c) | $ | — | (1,624) |
| MediSys and affiliates (f) | | — | (35,543) |
| Due to affiliates | $ | — | (37,167) |



(Continued)

The Medical Center provides related organizations with certain general, administrative, plant, and ancillary department services on a cost basis for operations. These amounts are included in other revenue in the accompanying consolidated statements of operations and changes in net deficit and were as follows for the years ended December 31 (in thousands):

| | | 2012 | 2011 |
|---|---|---|---|
| Institute (a) | $ | 27,829 | 34,570 |
| Amboy (b) | | 273 | 278 |
| Urban (d) | | 747 | 854 |
| BFCC (d) | | 2,715 | 3,246 |
| Residence (c) | | 286 | 286 |
| Brookdale Rx (g) | | 161 | — |
| MediSys and affiliate (f) | | 1,163 | 2,130 |
| Total support provided | $ | 33,174 | 41,364 |

Details of the services provided and received are listed below:

(a) The Medical Center and the Institute have agreed to a cost allocation methodology based upon the Medical Center's Medicaid cost report to allocate management, administrative, and ancillary services.

(b) Amboy provides parking facilities for employees of the Medical Center. Amboy purchases management services from the Medical Center.

(c) The Medical Center charges Rockreal and Residence a management fee for general and administrative operating services. As of December 31, 2012, the board of trustees of Rockreal forgave $1.7 million in advances provided by Rockreal to the Medical Center. Accordingly, the Medical Center has record $1.7 million in the accompanying consolidated statements of operations and changes in net deficit for the year ended December 31, 2012 as settlement of net due to affiliate.

(d) The Medical Center charges BFCC and Urban for general and administrative expenses.

(e) The Medical Center charges Linroc and BHMC Enterprises for general and administrative expenses. As of December 31, 2012, the board of trustees of Linroc forgave $3.3 million in advances provided by Linroc to the Medical Center. Accordingly, the Medical Center has record $3.3 million in the accompanying consolidated statements of operations and changes in net deficit for the year ended December 31, 2012 as settlement of net due to affiliates.

(f) In compliance with the Medisys Withdrawal and Settlement Agreement, (note 1), the Medical Center discharged all Medisys related intercompany payable and receivable balances as of April 16, 2012, in their entirety. As of December 31, 2012, the Medical Center wrote off approximately $33.0 million of net intercompany balance due to Medisys and their affiliated entities.



(Continued)

As of December 31, 2012, the Medical Center has recorded $38.0 million in the accompanying consolidated statements of operations and changes in net deficit as settlement of net due to affiliates relating to MediSys, Rockreal, and Linroc.

As of December 31, 2011, amounts due to MediSys and affiliates, net, represent amounts due to MediSys for management fees of approximately $6.0 million, respectively, for the year ended December 31, 2011. Also included are amounts due to Jamaica Hospital, Flushing Hospital, Peninsula Hospital, Peninsula Nursing Home (through August 22, 2011), MediSys Ambulance, and Brookdale, Rx, Inc., affiliated entities whose sole corporate member is MediSys, relating to medical and management services provided.

(g) All amounts due from affiliates except Brookdale Rx, Inc. have been fully reserved. These amounts were paid by Brookdale Rx. to the Medical Center in fiscal year 2013.

## (13) Functional Expenses

The Medical Center provides healthcare and related services primarily within its geographic location in Brooklyn, New York. Expenses related to providing such services included in the accompanying consolidated statements of operations and changes in net deficit are as follows for the years ended December 31 (in thousands):

| | | 2012 | 2011 |
|---|---|---|---|
| Healthcare services | $ | 493,066 | 473,553 |
| Administrative and general services | | 64,050 | 70,761 |
| | $ | 557,116 | 544,314 |

## (14) Commitments and Contingencies

### *(a) MediSys*

On March 10, 2011, the former Chief Executive Officer (CEO) of the Medical Center, was charged in a criminal complaint filed in the United States District Court for the Southern District of New York, with conspiracy to commit honest services mail fraud by paying or offering to pay bribes to former New York State elected officials in exchange for these legislators undertaking official action to benefit the Company as opportunities arose. The former CEO's employment was terminated on March 14, 2011.

The former CEO subsequently was indicted for mail fraud, wire fraud, conspiracy to violate, and conspiracy to commit honest services mail and wire fraud. All the charges arose out of the same facts and circumstances underlying the complaint against him. The former CEO was tried on the charges against him and found guilty on September 12, 2011. He was sentenced primarily to three years in prison on May 7, 2012.

Following the former CEO's termination, and prior to his indictment, the board of trustees of MediSys (the Board) retained the services of former United States Attorney and United States

magistrate judge, Zachary Carter, and his law firm, Dorsey & Whitney, to review and make recommendations to the Board regarding, among other things, MediSys' business standards, ethical practices and compliance policies, programs and procedures, including all internal controls and those of its constituent entities. Mr. Carter completed that process and in February 2012 reported his findings and recommendations to the Board. The Report concludes that written compliance policies of all of the MediSys entities express a commitment to providing care and services to patients in an ethical manner and in compliance with all applicable laws and that their policies and procedures, in both scope and content, compare favorably with effective compliance policies in place at similarly sized hospital systems. The Report also concludes that Mr. Carter and his team found no broader wrongdoing or complicity in any wrongdoing, nor evidence of systemic corruption or of a culture tolerant of corruption.

Future interpretations or enforcement of laws, rules and regulations governing the healthcare industry could subject the Medical Center's current business practices to allegations of impropriety or illegality or could require the Medical Center to make changes in our facilities, equipment, personnel, services and capital expenditure programs, increase our operating expenses and distract our management. If the Medical Center fails to comply with these extensive laws and government regulations, the Medical Center could become ineligible to receive government program payments (including exclusion from Medicare and Medicaid programs), suffer civil and criminal penalties, or be required to make significant changes to our operations. In addition, the Medical Center could be forced to expend considerable resources responding to an investigation or other enforcement action under these laws or regulations.

***(b) Litigation***

Various investigations, lawsuits, and claims arising in the normal course of operations are pending or on appeal against the Medical Center. While the ultimate effect of such actions cannot be determine at this time, it is the opinion of management, that the liabilities that may arise from such actions would not materially affect the consolidated financial position or results of the Medical Center.

***(c) Clinical Information System***

On January 18, 2013, Brookdale Hospital Medical Center entered into an agreement with numerous vendors to implement a clinical information system, including the development of an electronic health record. The scope of the work is staged over approximately seven years at a total cost of approximately $24.8 million.

***(d) Other***

The New York City Water Board has asserted a lien against the Medical Center's property which is senior to the DASNY liens. The liability in the amount of $6.8 million and $4.7 million and is recorded on the consolidated balance sheets in accounts payable and accrued expenses as of December 31, 2012 and 2011, respectively.

## (15) Fair Values of Financial Instruments

The following methods and assumptions were used by the Medical Center in estimating its fair value disclosures for financial instruments:

- The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, net, estimated amounts due to/from third-party payors, net other current assets, accounts payable, accrued expenses, and other current liabilities approximate fair value.
- *Long-term debt (Bonds)*: The fair value of the Medical Center's bonds is estimated based on quoted market prices.
- *Long-term debt (Other)*: The carrying values of the Medical Center's long-term debt approximate fair value.

The carrying amounts and fair values of the Medical Center's long-term debt at December 31, 2012 and 2011 are as follows (in thousands):

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Long-term debt | $ 50,407 | 50,413 | 59,482 | 59,588 |

## (16) Other Revenue

Other revenue consists of the following for the years ended December 31 (in thousands):

| | 2012 | 2011 |
|---|---|---|
| CCC dividend income (note 11) | $ 7,924 | 12,280 |
| Grant income | 4,701 | 4,842 |
| Investment income | 720 | 743 |
| Pharmacy | 14,241 | 7,815 |
| Physician billing | 13,181 | 12,568 |
| Rental income | 536 | 519 |
| Services provided to related organizations (note 12) | 33,174 | 41,364 |
| Other | 8,860 | 8,636 |
| | $ 83,337 | 88,767 |



(Continued)

## (17) Discontinued Operations

On November 1, 2012, the Housing Company sold its four residential apartment buildings and all their related assets located at 505 Rockaway Parkway, 525 Rockaway Parkway, 660 East 98th Street, and 7 Hegeman Avenue in Brooklyn, New York for approximately $22.0 million. The proceeds of the sale were used to pay off the remaining $9.9 million principal balance of the GMAC debt, prepayment penalty of $4.6 million, and closing costs of $1.1 million. The net book value of property, plant, and equipment sold was $3.0 million representing original cost of $17.5 million net of accumulated depreciation of $14.5 million. As a result of the transaction, the Housing Company recognized a gain on the sale of assets totaling $13.3 million, which is included in discontinued operations in the consolidated statement of operations and changes in net deficit for the year ended December 31, 2012.

At the time of the sale, the Housing Company had several outstanding liabilities to various third parties. As a result, the Housing Company was required to escrow $1.4 million of the proceeds, which are included in current portion of assets limited as to use in the accompanying consolidated balance sheet as of December 31, 2012.

In accordance with ASC 360, the sale of the four residential apartment buildings have been accounted for as discontinued operations. Accordingly, the results of operations on these facilities and the related gain on the sale have been classified as discontinued operations in the accompanying consolidated statements of operations and changes in net deficit for the years ended December 31, as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Rental income | $ | 2,962 | 3,635 |
| Gain on sale of assets, net | | 13,321 | — |
| Total revenue | | 16,283 | 3,635 |
| Expenses: | | | |
| Supplies and other | | 1,602 | 2,052 |
| Interest | | 602 | 737 |
| Depreciation | | 188 | 265 |
| Provisions for bad debts | | 5 | — |
| Total expenses | | 2,397 | 3,054 |
| Gain from discontinued operations | $ | 13,886 | 581 |

## (18) Subsequent Events

During 2013, Linroc and Jamaica sold their interest in Neighborhood Health Providers. Linroc has transferred approximately $10.0 million in cash support from the sale to the Medical Center in 2013.

The Medical Center has performed an evaluation of subsequent events through June 30, 2013, which is the date the consolidated financial statements were issued. The Medical Center did not have any recognition subsequent events during the period, except as previously disclosed.