

Audited Consolidated Financial Statements

Berkshire Health Systems, Inc. and Affiliates and Supplementary Financial Information

Years ended September 30, 2016 and 2015

Berkshire Health Systems, Inc. and Affiliates

Audited Consolidated Financial Statements
and Supplementary Financial Information

Years ended September 30, 2016 and 2015

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Report of Independent Certified Public Accountants

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We have audited the accompanying consolidated financial statements of Berkshire Health Systems, Inc. (the “Health System”), which comprise the consolidated balance sheet as of September 30, 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management’s responsibility for the consolidated financial statements

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

Auditors’ responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Health System’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 Health System’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the 2016 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Berkshire Health Systems, Inc. as of September 30, 2016 and the results of its operations, changes in its net assets, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary information

Our audit was performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating information is presented for the purpose of additional analysis, rather than to present the financial position, results of operations and changes in net assets, and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and certain additional procedures. These additional procedures include comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other matter

The consolidated financial statements of Berkshire Health Systems, Inc. as of and for the year ended September 30, 2015 were audited by other auditors. Those auditors expressed an unmodified opinion on those 2015 consolidated financial statements in their report dated February 11, 2016.

A handwritten signature in cursive script that reads "Grant Thornton LLP".

Iselin, New Jersey
December 23, 2016

Berkshire Health Systems, Inc. and Affiliates

Consolidated Balance Sheets

	September 30			September 30	
	2016	2015		2016	2015
Assets			Liabilities and net assets		
Current assets:			Current liabilities:		
Cash and cash equivalents	\$ 44,388,102	\$ 49,780,253	Accounts payable	\$ 17,353,717	\$ 19,062,616
Patient accounts receivable, less allowance for uncollectable amounts of \$20,063,000 in 2016 and \$18,757,000 in 2015	55,595,006	56,054,437	Accrued salaries and related withholdings	26,119,604	28,491,029
Note and other receivables	6,589,023	4,336,042	Accrued expenses	13,843,662	14,250,036
Inventories	10,830,077	9,780,990	Deferred revenue	1,540,425	1,228,441
Funds held by trustees	8,991,686	8,908,114	Due to third-party payors	24,052,858	29,585,967
Due from third-party payors	1,546,222	2,083,578	Current portion of long-term obligations	6,640,000	6,365,000
Due from managed entities	1,313,054	1,244,390	Total current liabilities	89,550,266	98,983,089
Prepaid expenses and other current assets	3,754,873	3,299,428	Deferred compensation	9,854,695	8,632,947
Total current assets	133,008,043	135,487,232	Other liabilities	14,812,123	15,198,451
Assets whose use is limited:			Long-term obligations, less current portion	92,428,644	99,709,662
Funds designated by Boards	206,197,849	188,518,294	Total liabilities	206,645,728	222,524,149
Funds held by trustees	5,130,631	5,018,976	Net assets:		
Funds held as endowments	7,006,159	7,006,159	Unrestricted	376,610,927	336,553,449
Funds held for donor-restricted purposes	16,405,672	14,877,729	Temporarily restricted	21,842,102	19,939,747
Deferred compensation	9,854,695	8,632,947	Permanently restricted	7,006,159	7,006,159
Total assets whose use is limited	244,595,006	224,054,105	Total net assets	405,459,188	363,499,355
Property and equipment, net	228,163,504	220,430,263	Total liabilities and net assets	\$ 612,104,916	\$ 586,023,504
Other assets	6,338,363	6,051,904			
Total assets	\$ 612,104,916	\$ 586,023,504			

See accompanying notes.

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Operations and Changes in Net Assets

	Years ended September 30	
	2016	2015
Patient service revenue (net of contractual allowances and discounts)	\$ 537,697,202	\$ 507,325,927
Less: provision for bad debts	10,483,023	10,281,556
Patient service revenue, net	527,214,179	497,044,371
Other revenue	49,708,005	36,369,816
Total revenues	576,922,184	533,414,187
Expenses:		
Salaries and wages	290,024,692	271,759,628
Fringe benefits	73,930,378	69,895,282
Supplies and other	154,397,649	136,718,785
Health Safety Net assessment	2,144,095	1,757,196
Depreciation and amortization	32,065,281	29,916,390
Interest	3,874,963	4,124,391
Total expenses	556,437,058	514,171,672
Gain from operations	20,485,126	19,242,515
Nonoperating gains:		
Investment gains net	11,332,679	15,224,021
Other, net	115,818	789,137
Total nonoperating gains	11,448,497	16,013,158
Excess of revenues over expenses	31,933,623	35,255,673

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Operations and Changes in Net Assets
(continued)

	Years ended September 30	
	2016	2015
Unrestricted net assets:		
Excess of revenues over expenses	\$ 31,933,623	\$ 35,255,673
Net unrealized gains (losses) on investments	7,506,175	(15,985,399)
Grant funds used for property and equipment	127,829	347,969
Net assets released from restrictions used for purchase of property and equipment	489,851	656,896
Increase in unrestricted net assets	40,057,478	20,275,139
Temporarily restricted net assets:		
Restricted contributions	1,137,724	1,194,348
Realized gains on investments	682,339	1,296,561
Net unrealized gains (losses) on investments	890,525	(1,777,227)
Net assets released from restrictions for operating purposes	(318,382)	(277,618)
Net assets released from restrictions for purchase of property and equipment	(489,851)	(656,896)
Increase (decrease) in temporarily restricted net assets	1,902,355	(220,832)
Increase in net assets	41,959,833	20,054,307
Net assets, beginning of year	363,499,355	343,445,048
Net assets, end of year	\$ 405,459,188	\$ 363,499,355

See accompanying notes.

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Cash Flows

	Years ended September 30	
	2016	2015
Operating activities and net gains		
Increase in net assets	\$ 41,959,833	\$ 20,054,307
Adjustments to reconcile increase in net assets to net cash provided by operating activities and net gains:		
Net unrealized (gains) losses on unrestricted investments	(7,506,175)	15,985,399
Realized and unrealized (gains) losses on restricted investments	(1,572,864)	480,666
Amortization of debt discount/premium	(799,756)	(843,628)
Depreciation and amortization	32,065,281	29,916,390
Equity income in Yankee Alliance, LLC	(633,744)	(806,419)
Restricted contributions	(1,137,724)	(1,194,348)
Effects of changes in operating assets and liabilities:		
Accounts receivable, net	459,431	(1,753,404)
Note and other receivables, inventories, prepaid expenses and other current assets	(3,757,513)	1,258,042
Accounts payable	(1,708,899)	2,982,518
Accrued salaries and related withholdings, accrued expenses, and deferred revenue	(2,465,815)	5,766,508
Due to third-party payors, net	(4,995,753)	(3,110,272)
Other liabilities	(386,328)	(160,699)
Net cash provided by operating activities and net gains	49,519,974	68,575,060
Investing activities		
Additions to property and equipment, net	(39,639,785)	(38,618,525)
Increase in funds held by trustees	(195,227)	(164,849)
Increase in funds designated by Boards	(10,173,380)	(15,646,778)
Decrease in funds held for donor-restricted purposes	44,921	44,024
Receipts on BHCS promissory note	240,195	234,687
Increase in other ongoing management fees and purchased services	(68,663)	(69,444)
Decrease in other assets	107,090	196,896
Net cash used in investing activities	(49,684,849)	(54,023,989)

Continued on next page

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Cash Flows
(continued)

	Years ended September 30	
	2016	2015
Financing activities		
Repayment of long-term obligations	\$ (6,365,000)	\$ (6,145,000)
Restricted contributions	<u>1,137,724</u>	<u>1,194,348</u>
Net cash used in financing activities	<u>(5,227,276)</u>	<u>(4,950,652)</u>
Net (decrease) increase in cash and cash equivalents	(5,392,151)	9,600,419
Cash and cash equivalents at beginning of year	<u>49,780,253</u>	<u>40,179,834</u>
Cash and cash equivalents at end of year	<u>\$ 44,388,102</u>	<u>\$ 49,780,253</u>
Supplemental disclosure of cash flow information for interest paid	<u>\$ 4,021,613</u>	<u>\$ 4,238,716</u>

See accompanying notes.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

1. Organization

The consolidated financial statements include the accounts of Berkshire Health Systems, Inc. and its controlled affiliates (collectively, the “Health System”). The following is a summary of controlled affiliated organizations included in the consolidated financial statements:

Organization	Nature and Purpose
Parent	
Berkshire Health Systems, Inc. (BHS)	The parent corporation which provides support for its controlled affiliates.
Hospitals	
Berkshire Medical Center, Inc. (the Medical Center) Fairview Hospital (the Hospital)	Not-for-profit hospital-operating corporations organized for the delivery of health care services.
Management Company	
BHS Management Services, Inc. (BMS)	A corporation that provides management services to controlled affiliates of BHS and Berkshire Healthcare Systems, Inc. and affiliates (the Managed Entities).
Others	
Berkshire Faculty Services, Inc.	A corporation that provides medical education, primary care, medical, surgical subspecialty and other physician services for the benefit of the Medical Center and the Hospital.
Tri-State Medical Management Corp.	A corporation that manages a physician office location for the benefit of the Hospital.
Williamstown Medical Associates, PC	A single shareholder corporation that provides primary care physician services.
Berkshire Indemnity Company SPC, LTD. – BHS Segregated Portfolio (BIC)	A 100% owned segregated portfolio organized in 2003, within Berkshire Indemnity Company SPC, LTD., a Cayman Islands Insurance Captive.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

1. Organization (continued)

BHS controls each of its affiliated entities through its status either as sole corporate member, as sole stockholder or under a management control agreement. BHS, the Medical Center and the Hospital are an obligated group for purposes of various debt financings.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements have been presented in conformity with accounting principles generally accepted in the United States (U.S. GAAP). The consolidated financial statements include the accounts of the above-named entities. All intercompany balances and transactions have been eliminated.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Health System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Health System in perpetuity. When a donor restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified for operations as a component of other revenue and as unrestricted net assets for property and equipment purchases, and are reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP 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 and the reported amounts of revenues and expenses during the reporting period. The significant management estimates and assumptions relate to the determination of allowance for doubtful accounts and contractual allowances for patient accounts receivable, estimated settlements with third-party payors, useful lives of property and equipment, self-insured professional, workers' compensation, and employee health liabilities, assets retirement obligations and the reported fair values of certain of the Health System's assets and liabilities. Actual results could differ from those estimates.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with maturities of 90 days or less from the date of purchase. Amounts whose use is limited or restricted are reported in accordance with their intended use, and are excluded from cash and cash equivalents. The carrying values reported in the consolidated balance sheets approximate fair value.

Inventories

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

Investments and Investment Income

Investments in equity and debt securities are measured at fair value in the consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, other than temporary impairments of investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses. The Health System reviews investments where the fair value is substantially below cost, and in cases where the decline is considered to be other than temporary, an adjustment is recorded to recognize the loss. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and unrestricted income of endowment funds are reported as other revenue. Investment income from all other general fund investments is reported as nonoperating gains.

The Medical Center accounts for its investment in Yankee Alliance, LLC on the equity method of accounting. The Medical Center's ownership in Yankee Alliance, LLC was 16.66% as of September 30, 2016 and 2015. The Medical Center's interest in the earnings of Yankee Alliance, LLC was \$633,744 and \$806,419 for the years ended September 30, 2016 and 2015, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment is recorded at cost or, if received by gift or bequest, at fair value when received. Depreciation is charged to operations using the straight-line method, based upon the estimated useful lives of the depreciable assets. Property and equipment under capital leases is amortized using the straight-line method over the shorter of the lease term or its estimated useful life. Such amortization is included with depreciation and amortization expense. Renovations and improvements which extend the useful lives of property and equipment are capitalized and recorded at cost.

Costs of Borrowing

Deferred financing costs and original issue premiums are amortized over the period that the related obligation is outstanding using the effective interest method.

Net Patient Service Revenue

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.

Allowance for Uncollectable Accounts

Accounts receivable are reduced by an allowance for uncollectable accounts. In evaluating the collectability of accounts receivable, the Health System analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectable accounts. For receivables associated with services provided to patients who have third-party coverage, the Health System analyzes contractually due amounts and provides for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid). For receivables associated with self-pay patients, the Health System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectable accounts.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

2. Summary of Significant Accounting Policies (continued)

The allowance for uncollectable amounts was approximately \$20,063,000 and \$18,757,000 as of September 30, 2016 and 2015, respectively. This balance as a percent of accounts receivable, net of contractual adjustments, was approximately 27% and 25% as of September 30, 2016 and 2015, respectively.

Gifts and Bequests

Unrestricted gifts and bequests are included in other revenue in the consolidated statements of operations and changes in net assets. Restricted gifts and bequests are credited directly to the applicable restricted net asset category.

Professional Liability Insurance

The Health System covers its primary hospital and physician professional liability and commercial general liability risk on a claims-made basis with tail coverage through a captive insurance company, BIC. The Health System establishes reserves for unpaid losses, with the assistance of consulting actuaries, based on a combination of industry and hospital-specific data. Management believes these reserves recorded in other liabilities on the accompanying consolidated balance sheets, which at September 30, 2016 and 2015, total \$11,227,000 and \$11,287,000, respectively, are adequate; however, no assurance can be given that the ultimate settlement of losses may not vary materially from the liability recorded. Future adjustments to the amounts recorded resulting from the continual review process, as well as differences between estimates and ultimate payments, will be reflected in the consolidated statements of operations and changes in net assets of future years when such adjustments, if any, become known.

Income Taxes

BHS and its affiliates, except those described below, are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code, as amended (the Code), and are generally exempt from income taxes pursuant to Section 501(a) of the Code.

Tri-State Medical Management, Inc. (Tri-State) and Williamstown Medical Associates, PC (WMA) are consolidated for-profit subsidiary corporations. An immaterial provision for income taxes incurred for both Tri-State and WMA has been made in these consolidated financial statements.

Berkshire Indemnity Company SPC, LTD (BIC) is a segregated portfolio organized within a Cayman Islands Insurance Captive and is not subject to income taxes within the United States.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

2. Summary of Significant Accounting Policies (continued)

The income tax consequences, if any, from BHS and its affiliates are reflected in the consolidated financial statements. The Health System is required to assess uncertain tax positions and has determined that there are no such positions, individually or in the aggregate, that are material to the financial statements.

Asset Retirement Obligation

Conditional asset retirement obligations for certain buildings and land improvements amounted to \$3,015,000 and \$3,315,000 as of September 30, 2016 and 2015, respectively. The change in amounts resulted from \$49,922 and \$91,233 of accretion expense, less \$349,588 and \$39,730 of abatement work for 2016 and 2015, respectively. The obligations are recorded within other liabilities in the accompanying consolidated balance sheets.

Reclassification

Certain reclassifications, including the reclassification of deferred issuance costs to long-term debt in accordance with Accounting Standards Update (ASU) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, were made to the 2015 consolidated financial statements to conform to the 2016 presentation. The reclassifications had no effect on the excess of revenues over expenses, or the increase in total net assets, or on total net assets as previously reported.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods and services. This standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

2. Summary of Significant Accounting Policies (continued)

An entity will apply the amendments in this update using either a full retrospective application, which applies the standard to each prior period presented, or under the modified retrospective application, in which an entity recognizes the cumulative effect of initially applying the new standard as an adjustment to the opening balance sheet of retained earnings at the date of initial application. Revenue in periods presented before that date will continue to be reported under guidance in effect before the change. Currently, the American Institute of Certified Public Accountants Healthcare Revenue Recognition Task Force is interpreting this standard and its effects on the health care industry.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires that most leased assets be recognized on the balance sheet as assets and liabilities for the rights and obligations created by these leases. This ASU is effective for fiscal years beginning after December 15, 2018. Early application is permitted. An entity is required to apply the amendments in the standard under the modified retrospective transition approach. This approach includes a number of optional practical expedients, which are described in the final standard. Under these practical expedients, an organization will continue to account for leases that commence before the effective date in accordance with current U.S. GAAP, unless the lease is modified. However, lessees are required to recognize on the balance sheet leased assets and liabilities for operating leases at each reporting date.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the currently required three classes, as well as the annual change in each of the two classes; (2) the removal of the requirement to present or disclose the indirect method (reconciliation) when using the direct method for the statement of cash flows; and (3) the requirement to provide various enhanced disclosures relating to various not-for-profit specific topics. The new standard is effective for annual financial statements beginning after December 15, 2017.

The Health System has not determined the impact of these new standards at this time.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

3. Third-Party Payment Arrangements

The Medical Center and the Hospital maintain agreements with the Social Security Administration under the Medicare Program and the Commonwealth of Massachusetts (Commonwealth) under the Medicaid Program and various other insurance companies. These agreements provide for payment to the Medical Center and the Hospital for services rendered to patients covered by these programs based on the applicable regulations or contracts as described below.

Medicare

The Medical Center is paid for Medicare patients under the Prospective Payment System (PPS), the national Medicare system in which hospitals are paid a standard amount for inpatients adjusted for the patient's diagnosis, and a majority of Medicare outpatient services are paid based upon ambulatory payment classifications (APCs). Certain services are excluded from APCs and are paid under fee schedules or other payment methodologies.

The Hospital received the Critical Access Hospital (CAH) designation from Medicare during 2003. CAHs are reimbursed on a reasonable-cost basis for inpatient and outpatient services.

Medicaid

The Commonwealth Executive Office of Health & Human Services utilizes a prospective payment methodology for acute hospital services provided to Medicaid beneficiaries. Medicaid pays hospitals a case mix adjusted fixed amount per discharge for inpatient services. Outpatient services are paid on a prospective payment methodology based upon a Payment Amount Per Episode (PAPE). The Hospital is reimbursed on a reasonable cost basis for inpatient and outpatient services. The Medical Center and the Hospital contract with various Medicaid HMO's. Payments are based on the Medicaid payment methodology for inpatient services and a percentage of charges for outpatient services.

Health Safety Net Program

The Health Safety Net (HSN) program reimburses hospitals for uncompensated care based on actual services provided at rates approximating the Medicare PPS. Reimbursement rates are subject to available funds. The HSN program is partially funded by acute hospitals through an assessment on gross charges billed to non-government payors. The Medical Center and the Hospital have recorded estimates of their final settlements with the HSN program. The Medical Center and the Hospital have recorded their gross obligations to the program as an expense in the consolidated statements of operations and changes in net assets. Reimbursement from the HSN program for uncompensated care is recorded as net patient service revenue.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

3. Third-Party Payment Arrangements (continued)

Commonwealth Care / Qualified Health Plans (QHP)

Until January 1, 2015, the Medical Center and the Hospital contracted with Boston Medical Center Healthnet Plan, Health New England, Celticare and Network Health for the Health Connector's health insurance program for uninsured adults who meet income and other eligibility requirements. Payment was based on a percentage of Medicaid rates. In order to comply with requirements of the Patient Protection and Affordable Care Act, the Commonwealth Care Plans were replaced on January 1, 2015 with Qualified Health Plans. The Hospital and Medical Center contracted with Health New England, Celticare and Network Health for these programs at discounted rates.

Non-governmental Payors

The Medical Center and the Hospital have entered into contracts with non-governmental payors whereby they are paid on a per case, per diem or percentage of charge basis.

Third-Party Settlements

Medicare and Medicaid agreements require the Medical Center and the Hospital to prepare and file settlement reports annually. Net revenue from the Medicare and Medicaid programs accounted for approximately 43% and 7%, and 45% and 10%, respectively, of the Health System's net patient service revenue for the years ended September 30, 2016 and 2015. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and noncompliance could result in significant regulatory action, including fines and penalties. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Health System believes that it is in compliance with applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subjected to future government review and interpretations as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid program. Settlement reports have been submitted for all prior years; final settlements have been made with Medicare through 2011 for the Medical Center and through 2014 for the Hospital. Provisions have been made in the consolidated financial statements for prior and current year estimated final settlements.

Adjustments to estimates of prior year settlements with third-party payors are reflected in current year net patient service revenue and increased net patient service revenue by \$5,292,000 and \$4,500,000 in 2016 and 2015, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

4. Charity Care

The Health System provides care to patients who meet charity care policy criteria without charge or at amounts less than established rates. Because Health System entities do not pursue collection of amounts qualifying as charity care, such amounts are not reported as revenue. The Health System's charity care policy is based on the poverty income guidelines established by the Massachusetts Center for Health Information and Analysis.

If a patient is ineligible for charity care or care at reduced rates because the patient's income exceeds the eligibility guidelines, services rendered are recorded at established rates and any unpaid account receivable balance is written off to bad debts after a reasonable collection effort has been made.

During 2016 and 2015, the Health System provided \$5,436,974 and \$5,981,524 in charity care, respectively, based on established rates. The net cost of charity includes the direct and indirect cost of providing charity care services, offset by revenues received from financial assistance donations. The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity care. The cost of charity care provided during the years ended September 30, 2016 and 2015, was \$2,265,093 and \$2,614,364, respectively. Donations received to offset charity services provided totaled \$58,981 and \$109,271 for the years ended September 30, 2016 and 2015, respectively. During 2016 and 2015, the Medical Center and the Hospital received \$1,618,404 and \$1,548,437, respectively, from the HSN program for reimbursement of charity care. During 2016 and 2015, the Medical Center and the Hospital paid an assessment into the HSN program of \$2,144,095 and \$1,757,196, respectively.

5. Related-Party Transactions

As of September 30, 2016 and 2015, BHS had \$1,313,053 and \$1,244,390, respectively, due from nursing homes and other entities (collectively, the Managed Entities) owned and operated by Berkshire Healthcare Systems, Inc. (BHCS) and managed by BMS for ongoing management fees and purchased services. The management fee revenue recorded by BMS related to services provided to BHCS was \$15,114,976 and \$13,890,605 for 2016 and 2015, respectively.

On August 31, 2009, BHCS issued a promissory note to BHS related to the transfer of Pittsfield Management Systems, Inc. The note bears interest at 2.75% with monthly installments of \$25,308 through September 1, 2024. As of September 30, 2016 and 2015, the note had a balance of \$2,178,693 and \$2,418,888, respectively, of which \$246,884 and \$240,195 is included in note and other receivables, and \$1,931,809 and \$2,178,693 is included in other assets in 2016 and 2015, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments

Assets Limited as to Use

The composition and classification of investments at September 30, 2016 and 2015, is set forth in the following table. Investments are stated at fair value.

	2016	2015
Cash and cash equivalents	\$ 44,388,102	\$ 49,780,253
Funds held by trustees – current	8,991,686	8,908,114
Assets whose use is limited:		
Funds designated by Boards	206,197,849	188,518,294
Funds held by trustees	5,130,631	5,018,976
Funds held as endowments	7,006,159	7,006,159
Funds held for donor-restricted purposes	16,405,672	14,877,729
Deferred compensation	9,854,695	8,632,947
	<u>\$ 297,974,794</u>	<u>\$ 282,742,472</u>

The following is a summary of the composition of cash, investments, and assets whose use is limited as of September 30:

	2016	2015
Cash and cash equivalents	\$ 54,636,652	\$ 58,430,200
Equity securities:		
Consumer discretionary and staples	26,925,021	22,264,853
Energy and utilities	9,271,073	6,938,121
Financials	16,977,549	17,039,723
Health care	14,161,891	13,051,877
Industrials and materials	16,306,291	16,875,768
Information technologies	21,311,002	18,044,965
Telecommunication services	4,964,521	3,414,742
Total U.S. equities	109,917,348	97,630,049
Non-U.S. equities	26,731,460	22,901,222
U.S. Treasury and U.S. Government Agency debt	8,014,843	7,258,500
Other government debt issues	26,329,847	17,397,877
Corporate debt securities	31,557,894	51,154,545
REITs and mortgage-backed securities	25,291,160	16,802,788
Mutual funds	15,495,590	11,167,291
	<u>\$ 297,974,794</u>	<u>\$ 282,742,472</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments (continued)

Investment income and realized and unrealized gains on investments consisted of the following for the years ended September 30:

	2016	2015
Income:		
Other revenue – interest income	\$ 455,980	\$ 454,171
Nonoperating gains:		
Interest income, net	\$ 5,111,691	\$ 5,929,370
Realized gains on sale of investments	6,220,988	9,294,651
Total investment gains	\$ 11,332,679	\$ 15,224,021
Other changes in net assets:		
Net unrealized gains (losses) – unrestricted net assets	\$ 7,506,175	\$ (15,985,399)
Net realized gains – restricted net assets	682,339	1,296,561
Net unrealized gains (losses) – restricted net assets	890,525	(1,777,227)

Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other than temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors, and the length of time and extent to which the market value has been less than cost. During the years ended September 30, 2016 and 2015, the Health System recorded losses of \$588,152 and \$389,122 for other than temporary declines in the fair value of investments within investment gains on the accompanying consolidated statements of operations and changes in net assets.

At September 30, 2016, investments with a fair value of \$74,740,242 have unrealized losses of \$1,435,117, of which \$759,898 had been unrealized for over one year. At September 30, 2015, investments with a fair value of \$78,702,233 had unrealized losses of \$3,021,119, of which \$178,474 had been unrealized for over one year. The Health System has the intent and ability to hold these investments until recovery.

Investment management fees were \$159,641 and \$175,520 for the years ended September 30, 2016 and 2015, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments (continued)

Fair Value of Financial Instruments

As of September 30, 2016, the Health System held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents, investments and assets whose use is limited. The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs. Investments classified in this level generally include exchange-traded equity securities.

Level 2: Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Investments classified in this level generally include fixed-income securities, including asset-backed securities.

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

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Health System uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, and considers non-performance risk in its assessment of fair value.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments (continued)

Financial instruments carried at fair value, are classified in the tables below in one of the three categories described above as of September 30:

2016	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 54,481,506	\$ 155,146	\$ -	\$ 54,636,652
Equity securities:				
Consumer discretionary	17,588,180	8,669,341	667,500	26,925,021
Energy and utilities	6,480,724	2,790,349	-	9,271,073
Financials	12,530,133	4,447,416	-	16,977,549
Health care	14,102,509	59,382	-	14,161,891
Industrials and materials	13,084,304	3,221,987	-	16,306,291
Information technologies	17,550,404	3,760,598	-	21,311,002
Telecommunication services	1,480,460	3,484,061	-	4,964,521
Non-U.S. equities	26,731,460	-	-	26,731,460
U.S. Treasury and U.S.				
Government Agency debt	6,798,712	1,216,131	-	8,014,843
Other government debt issues	26,329,847	-	-	26,329,847
Corporate debt securities	25,774,517	5,783,377	-	31,557,894
REITs and mortgage-backed securities	23,399,401	1,891,759	-	25,291,160
Mutual funds	14,354,767	1,140,823	-	15,495,590
	<u>\$ 260,686,924</u>	<u>\$ 36,620,370</u>	<u>\$ 667,500</u>	<u>\$ 297,974,794</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments (continued)

2015	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 58,275,329	\$ 154,871	\$ -	\$ 58,430,200
Equity securities:				
Consumer discretionary	13,861,141	7,821,212	582,500	22,264,853
Energy and utilities	4,633,087	2,305,034	-	6,938,121
Financials	13,150,648	3,889,075	-	17,039,723
Health care	13,004,094	47,783	-	13,051,877
Industrials and materials	14,096,506	2,779,262	-	16,875,768
Information technologies	14,783,884	3,261,081	-	18,044,965
Telecommunication services	678,603	2,736,139	-	3,414,742
Non-U.S. equities	22,901,222	-	-	22,901,222
U.S. Treasury and U.S. Government Agency debt	6,079,260	1,179,240	-	7,258,500
Other government debt issues	17,397,877	-	-	17,397,877
Corporate debt securities	28,552,503	22,602,042	-	51,154,545
REITs and mortgage-backed securities	14,968,415	1,834,373	-	16,802,788
Mutual funds	10,135,229	1,032,062	-	11,167,291
	<u>\$ 232,517,798</u>	<u>\$ 49,642,174</u>	<u>\$ 582,500</u>	<u>\$ 282,742,472</u>

The following table is a rollforward of the consolidated statements of operations and changes in net assets amounts for financial instruments classified by the Health System in Level 3 of the valuation hierarchy defined above:

	Year Ended September 30	
	2016	2015
Balance, beginning of year	\$ 582,500	\$ 575,000
Net change in fair value	<u>85,000</u>	<u>7,500</u>
Balance, end of year	<u>\$ 667,500</u>	<u>\$ 582,500</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

6. Investments (continued)

The fair value and carrying values of the Health System's financial instruments that are not required to be carried at fair value are as follows as of:

	<u>September 30, 2016</u>		<u>September 30, 2015</u>	
	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>
Long-term debt	\$105,429,600	\$ 99,068,644	\$113,062,700	\$107,136,339

The fair value of the Health System's long-term debt is based on quoted market prices for similar bonds and is classified by the Health System in Level 2 of the valuation hierarchy.

Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 assets is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Health System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Level 3 assets consist of donated stock in a closely held corporation. The corporation annually provides an independently compiled analysis of the corporate stock value which utilizes the income approach and market approach. This value is applied to the total quantity of the corporate stock held.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

7. Property and Equipment

Property and equipment consisted of the following at September 30:

	2016	2015
Land and improvements	\$ 16,408,108	\$ 15,559,802
Buildings and building improvements	249,067,103	225,232,277
Fixed equipment	98,596,164	97,814,769
Major movable equipment	181,777,653	174,279,713
	545,849,028	512,886,561
Less accumulated depreciation and amortization	(349,344,673)	(318,623,849)
	196,504,355	194,262,712
Construction in progress	31,659,149	26,167,551
	\$ 228,163,504	\$ 220,430,263

The estimated cost to complete construction in progress at September 30, 2016 and 2015, was approximately \$3,537,000 and \$5,377,000, respectively.

8. Long-Term Obligations

Long-term obligations consisted of the following at September 30:

	2016	2015
Obligated Group:		
Massachusetts Development Finance Agency (MDFA), formerly MHEFA, Revenue Bonds, Berkshire Health Systems, Inc. Issues:		
2012 Series G, net of unamortized premium and debt issuance costs of \$5,185,211 in 2016 and \$5,770,054 in 2015	\$ 79,730,211	\$ 82,810,054
2005 Series F, net of unamortized premium and debt issuance costs of \$98,433 in 2016 and \$154,608 in 2015	19,338,433	23,264,608
	99,068,644	106,074,662
Less portion classified as current	(6,640,000)	(6,365,000)
Total long-term obligations	\$ 92,428,644	\$ 99,709,662

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

8. Long-Term Obligations (continued)

Obligated Group

On May 23, 2012, MDFA issued Revenue Bonds, Series G, with a face value of \$84,490,000, which were used to refund debt and finance additions to property and equipment. The Series G bonds are fixed rate bonds and bear interest at rates ranging from 3.0% to 5.0% per annum and with principal payment ranging from \$2,410,000 to \$7,020,000 maturing in 2031. The Series G bonds are redeemable prior to maturity without premiums after October 1, 2021.

On July 15, 2005, MHEFA issued Revenue Bonds, Series F, with a face value of \$50,190,000, which were used to refund debt and finance additions to property and equipment. The Series F bonds are fixed rate bonds and bear interest at rates ranging from 3.875% to 5.0% per annum and with principal payment ranging from \$1,645,000 to \$4,775,000 maturing in 2020. The Series F bonds are redeemable prior to maturity without premiums after October 1, 2015. The Series F bonds were redeemed through the issuance of the Series H Bonds on November 18, 2016 (Note 18).

Under a Master Trust Indenture (MTI), Berkshire Medical Center, Fairview Hospital and Berkshire Health Systems (the Obligated Group) granted MDFA a lien on its revenues, excluding revenues related to endowment funds whose principal and income are restricted and not available to be pledged. The Obligated Group also purchased bond insurance as additional security for the payment of principal and interest.

The MTI provides for, among other requirements, the maintenance by the Obligated Group of a minimum debt service ratio and restrictions on incurring additional debt and the sale or disposition of assets, and requires the Obligated Group to comply with various financial and other reporting requirements. The Obligated Group is in compliance with those requirements at September 30, 2016 and 2015.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

8. Long-Term Obligations (continued)

Maturities

Aggregate maturities of the Health System subsequent to September 30, 2016, are as follows:

Year ending September 30,	
2017	\$ 6,640,000
2018	7,035,000
2019	7,355,000
2020	7,790,000
2021	4,055,000
2022 and thereafter	<u>60,910,000</u>
Total face maturities	93,785,000
Unamortized bond premiums and debt issuance costs	<u>5,283,644</u>
	<u><u>\$ 99,068,644</u></u>

9. Funds Held by Trustees

Under the terms of the agreements with MDFA, certain funds are required to be maintained as follows at September 30:

	2016	2015
Escrow for long-term obligations:		
Debt service fund	\$ 8,991,686	\$ 8,908,114
Debt service reserve fund	5,130,631	5,018,976
	14,122,317	13,927,090
Less portion classified as current	(8,991,686)	(8,908,114)
	<u>\$ 5,130,631</u>	<u>\$ 5,018,976</u>

These funds are primarily invested in money market funds and United States Government securities and are carried at fair value. Income earned of \$182,277 and \$196,780 in 2016 and 2015, respectively, on certain debt-financed funds held in escrow has been reported as other revenue. Income of \$1,638 and \$217 in 2016 and 2015, respectively, has been reported as nonoperating gains since the related funds held in escrow have been contributed by the Obligated Group.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

10. Lease Commitments

Minimum rental commitments under noncancelable operating leases for buildings and equipment are as follows:

Year ending September 30,	Operating Leases
2017	\$ 636,526
2018	391,828
2019	<u>125,440</u>
Total minimum lease payments	<u>\$ 1,153,794</u>

Rent expense under noncancelable operating leases approximated \$830,097 for both years ended September 30, 2016 and 2015, and is included within supplies and other on the accompanying consolidated statements of operations and changes in net assets.

11. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	2016	2015
Health care services:		
Patient care	\$ 2,111,802	\$ 2,027,341
Education	1,259,102	1,259,393
Property and equipment	2,826,228	2,443,536
Scholarship	433,773	441,102
Undistributed appreciation on permanently restricted funds	<u>15,211,197</u>	<u>13,768,375</u>
	<u>\$ 21,842,102</u>	<u>\$ 19,939,747</u>

Permanently restricted net assets at September 30 are restricted to:

	2016	2015
Investments to be held in perpetuity, the income from which is restricted as to use	\$ 5,504,205	\$ 5,504,205
Investments to be held in perpetuity, the income from which is unrestricted	<u>1,501,954</u>	<u>1,501,954</u>
	<u>\$ 7,006,159</u>	<u>\$ 7,006,159</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

11. Temporarily and Permanently Restricted Net Assets (continued)

During 2016 and 2015, net assets of \$808,233 and \$934,514, respectively, were released from donor restrictions by incurring expenses satisfying the restricted purposes as noted above.

Interpretation of Relevant Law

The Commonwealth requires the preservation of the fair value of the original gift as of the date of the donor-restricted endowment, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Medical Center and the Hospital classify as permanently restricted net assets: (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment funds that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure. The Medical Center and the Hospital consider the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund, (2) the purpose of the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, and (6) the investment policies of the Health System.

The following represents the net asset classifications of the Health System endowment funds, as well as the changes in endowments, for the year ended September 30, 2016:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at			
October 1, 2015	\$ 15,380,787	\$ 7,006,159	\$ 22,386,946
Investment income	111,693	-	111,693
Realized gains on investments	570,645	-	570,645
Unrealized gains on investments	890,525	-	890,525
Endowment net assets at			
September 30, 2016	\$ 16,953,650	\$ 7,006,159	\$ 23,959,809

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

11. Temporarily and Permanently Restricted Net Assets (continued)

The following represents the net asset classifications of the Health System endowment funds, as well as the changes in endowments, for the year ended September 30, 2015:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at			
October 1, 2014	\$ 15,861,454	\$ 7,006,159	\$ 22,867,613
Investment income	109,810	-	109,810
Realized gains on investments	1,186,750	-	1,186,750
Unrealized losses on investments	(1,777,227)	-	(1,777,227)
Endowment net assets at			
September 30, 2015	<u>\$ 15,380,787</u>	<u>\$ 7,006,159</u>	<u>\$ 22,386,946</u>

12. Pension Plans

Pension benefits are available to eligible employees of the Health System through the defined contribution Berkshire Health Systems Partnership Tax Deferred Annuity Retirement Plan (the Plan) and the Berkshire Health Systems 457B Deferred Compensation Plan (the 457B Plan).

The Plan allows employees of the Health System, age 21 or older, who are regularly scheduled to work at least twenty hours per week, to participate in the Plan upon the completion of one year of service. Employees may contribute up to 21.5% of their base pay.

Each week, the Health System makes a minimum fixed contribution to the Plan from 2.5% to 3.5% of each participant's salary, and a matching contribution of 50% of employee voluntary contributions on the first 4% of a participant's salary for those employees who elect to contribute. Contributions made by the Health System to the Plan in years ended September 30, 2016 and 2015 were \$11,059,076 and \$9,729,414, respectively.

The 457B Plan is a non-qualified supplemental retirement plan available to certain executives of the Health System. The contribution limit for employees in 2016 was \$18,000. Contributions made by the Health System to the 457B plan in years ended September 30, 2016 and 2015 were \$322,134 and \$307,553, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

13. Commitments and Contingencies

The Health System, several affiliates and employees of those affiliates are defendants in various civil actions for alleged medical malpractice and other matters. The Health System maintains liability coverage for these actions either through commercial insurance carriers, the Health System's own self-insurance program or both. The Health System defendants are represented in those matters by experienced defense counsel selected by the Health System. Those defense counsel and Health System management are of the opinion that the available coverage for those claims is adequate and that an adverse result in those pending actions will not materially adversely affect the financial position of the Health System.

The Health System has obtained a \$4,430,000 surety bond from an insurance company as security for potential workers' compensation obligations as required by the Commonwealth.

At September 30, 2016, there was no amount outstanding under the Health System's \$5,000,000 secured demand line of credit from TD Bank. Interest is equal to LIBOR plus 1.5%, resulting in an interest rate of 2.03% at September 30, 2016. The line of credit expires on May 31, 2017.

14. Functional Expenses

The Health System provides general health care services to residents within its geographic region. Expenses related to providing these services at September 30 are as follows:

	<u>2016</u>	<u>2015</u>
Health care services	\$480,447,540	\$453,166,828
General and administrative	75,989,518	61,004,844
	<u>\$556,437,058</u>	<u>\$514,171,672</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

15. Concentration of Credit Risk

The Health System grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30 was as follows:

	2016	2015
Medicare	43%	41%
Medicaid and connector products	13	18
Commercial insurances	34	31
Patients	10	10
	<u>100%</u>	<u>100%</u>

Revenues from third-party payors, the uninsured, and other revenues, net of contractual allowances and discounts at September 30 was as follows:

	2016	%	2015	%
Medicare	\$237,364,042	44%	\$228,734,658	45%
Medicaid and connector products	38,307,701	7	51,619,771	10
Commercial insurances	253,671,142	47	218,586,575	43
Patients	8,354,317	2	8,384,923	2
	<u>\$537,697,202</u>	<u>100%</u>	<u>\$507,325,927</u>	<u>100%</u>
Patient service revenues				

16. Medicare and Medicaid Electronic Health Record (EHR) Program

Certain health care providers can earn up to four incentive payments between federal fiscal years 2011 and 2016 if certain specific program criteria are met. The providers are required to establish an EHR system and maintain its meaningful use status for a continuous 90-day period. In subsequent years, such meaningful use must be maintained for the entire 365-day federal fiscal year.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

16. Medicare and Medicaid Electronic Health Record (EHR) Program (continued)

The Health System records the revenue related to this program when management is reasonably assured that the Health System has complied with the terms of the program.

The Health System has included \$554,000 and \$942,000 in other revenue related to the program in years ended September 30, 2016 and 2015, respectively. The payments are based on submitted cost report data from the year 2015 and prior used to project the total incentive payments. Each subsequent payment will be adjusted for changes in the projected total incentive payment. The Health System's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

17. Other Operating Revenues

Other operating revenues consisted of the following:

	2016	2015
Meaningful use and incentives	\$ 861,466	\$ 1,364,573
Retail pharmacy	19,158,363	8,077,648
Unrestricted donations	160,440	243,735
Rent	1,386,585	1,437,488
Grants	5,916,024	3,898,560
Management services	15,114,976	13,890,605
Psychiatric and other services	4,529,181	4,659,937
Dietary food sales	1,481,466	1,519,887
Interest income	398,805	454,171
Miscellaneous	700,699	823,212
Total	\$ 49,708,005	\$ 36,369,816

18. Subsequent Event

The Health System evaluated its September 30, 2016 consolidated financial statements for subsequent events through December 23, 2016 the date the financial statements were available to be issued. The Health System is not aware of any subsequent events which would require recognition or disclosure in the consolidated financial statements other than the following:

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

September 30, 2016 and 2015

18. Subsequent Event (continued)

On November 18, 2016, BHS, the Medical Center, and the Hospital (collectively, the Obligated Group) entered into a 5-year, \$10,540,000 loan with MDFA (the Series H bonds). The proceeds from the loan and the Series F bonds debt service reserve fund of approximately \$5,131,000, were used to refund \$15,205,000 of Series F bonds, before scheduled maturity. The Series H bonds are fixed rate bonds and bear interest at 1.41% per annum and mature in various annual amounts through 2020. A gain of \$92,890 on the refinancing was recorded primarily representing the unamortized deferred debt issuance costs and bond premium.

The future maturities of the Series H bonds are as follows:

Year ending September 30,	
2017	\$ 3,200,000
2018	3,210,000
2019	3,315,000
2020	<u>815,000</u>
Total face maturities	<u><u>\$ 10,540,000</u></u>

SUPPLEMENTARY INFORMATION

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet

September 30, 2016

Assets	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Williamstown Medical Associates, Inc.	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Current assets:							
Cash and cash equivalents	\$ 44,388,102	\$ -	\$ -	\$ 10,748	\$ 146,839	\$ -	\$ 13,728,650
Accounts receivable, less allowance for uncollectable amounts of \$20,063,000	55,595,006	-	-	2,465,133	252,039	-	-
Note and other receivables	6,589,023	-	1,163,815	91,556	58,875	-	-
Inventories	10,830,077	-	-	-	-	-	-
Funds held by trustees	8,991,686	-	-	-	-	-	-
Due from third-party payors	1,546,222	-	-	-	-	-	-
Due from managed entities	1,313,054	-	-	-	-	-	-
Prepaid expenses and other current assets	3,754,873	(1,279,954)	1,823,001	25,601	-	-	-
Due from affiliates	-	(4,354,281)	3,019,898	1,334,383	-	-	-
Total current assets	133,008,043	(5,634,235)	6,006,714	3,927,421	457,753	-	13,728,650
Due from affiliates	-	(105,644)	-	-	-	-	-
Assets whose use is limited:							
Funds designated by Boards	206,197,849	-	-	-	-	-	-
Funds held by trustees	5,130,631	-	-	-	-	-	-
Funds held as endowments	7,006,159	-	-	-	-	-	-
Funds held for donor-restricted purposes	16,405,672	-	-	-	-	-	-
Deferred compensation	9,854,695	-	3,190,647	2,369,713	-	-	-
Total assets whose use is limited	244,595,006	-	3,190,647	2,369,713	-	-	-
Property and equipment, net	228,163,504	-	19,326	-	-	114,162	-
Deferred financing costs, net	-	-	-	-	-	-	-
Other assets	6,338,363	-	-	-	-	-	-
Investments in subsidiaries	-	(100)	-	-	-	-	-
Total assets	\$ 612,104,916	\$ (5,739,979)	\$ 9,216,687	\$ 6,297,134	\$ 457,753	\$ 114,162	\$ 13,728,650

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2016

Assets	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Current assets:					
Cash and cash equivalents	\$ 30,501,865	\$ -	\$ 30,216,235	\$ 280,614	\$ 5,016
Accounts receivable, less allowance for uncollectable amounts of \$19,407,000	52,877,834	-	47,377,390	5,500,444	-
Note and other receivables	5,274,777	-	4,948,661	75,701	250,415
Inventories	10,830,077	-	10,237,244	592,833	-
Funds held by trustees	8,991,686	-	8,551,036	440,650	-
Due from third-party payors	1,546,222	-	1,546,222	-	-
Due from managed entities	1,313,054	-	-	-	1,313,054
Prepaid expenses and other current assets	3,186,225	-	3,170,597	15,628	-
Due from affiliates	-	(9,745,297)	-	303,410	9,441,887
Total current assets	114,521,740	(9,745,297)	106,047,385	7,209,280	11,010,372
Due from affiliates	105,644	(7,053,575)	7,053,575	105,644	-
Assets whose use is limited:					
Funds designated by Boards	206,197,849	-	186,094,352	20,103,497	-
Funds held by trustees	5,130,631	-	4,874,099	256,532	-
Funds held as endowments	7,006,159	-	6,747,917	258,242	-
Funds held for donor-restricted purposes	16,405,672	-	15,210,242	1,195,430	-
Deferred compensation	4,294,335	-	4,143,588	150,747	-
Total assets whose use is limited	239,034,646	-	217,070,198	21,964,448	-
Property and equipment, net	228,030,016	-	216,124,129	11,905,887	-
Deferred financing costs, net	-	-	-	-	-
Other assets	6,338,363	-	4,334,797	11,757	1,991,809
Investments in subsidiaries	100	-	-	-	100
Total assets	\$ 588,030,509	\$ (16,798,872)	\$ 550,630,084	\$ 41,197,016	\$ 13,002,281

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2016

Liabilities and Net Assets	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Williamstown Medical Associates, Inc.	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Current liabilities:							
Accounts payable	\$ 17,353,717	\$ (1,279,954)	\$ 1,516,817	\$ 340,698	\$ 17,263	\$ 1,963	\$ 1,333,015
Accrued salaries and related withholdings	26,119,604	-	4,005,420	3,301,831	-	-	-
Accrued expenses	13,843,662	-	467,803	284,892	651,253	6,555	-
Deferred revenue	1,540,425	-	36,000	-	-	-	-
Due to third-party payors	24,052,858	-	-	-	-	-	-
Current portion of long-term obligations	6,640,000	-	-	-	-	-	-
Due to affiliates	-	(4,354,281)	-	-	-	-	-
Total current liabilities	89,550,266	(5,634,235)	6,026,040	3,927,421	668,516	8,518	1,333,015
Due to affiliates	-	(105,644)	-	-	-	105,644	-
Deferred compensation	9,854,695	-	3,190,647	2,369,713	-	-	-
Other liabilities	14,812,123	-	-	-	-	-	11,237,013
Long-term obligations, less current portion	92,428,644	-	-	-	-	-	-
Total liabilities	206,645,728	(5,739,879)	9,216,687	6,297,134	668,516	114,162	12,570,028
Net assets:							
Unrestricted	376,610,927	(100)	-	-	(210,763)	-	1,158,622
Temporarily restricted	21,842,102	-	-	-	-	-	-
Permanently restricted	7,006,159	-	-	-	-	-	-
Total net assets	405,459,188	(100)	-	-	(210,763)	-	1,158,622
Total liabilities and net assets	\$ 612,104,916	\$ (5,739,979)	\$ 9,216,687	\$ 6,297,134	\$ 457,753	\$ 114,162	\$ 13,728,650

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2016

Liabilities and Net Assets	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Current liabilities:					
Accounts payable	\$ 15,423,915	\$ -	\$ 14,555,497	\$ 866,818	\$ 1,600
Accrued salaries and related withholdings	18,812,353	-	16,950,349	1,862,004	-
Accrued expenses	12,433,159	-	11,755,322	677,712	125
Deferred revenue	1,504,425	-	1,403,166	101,259	-
Due to third-party payors	24,052,858	-	21,754,829	2,298,029	-
Current portion of long-term obligations	6,640,000	-	6,313,210	326,790	-
Due to affiliates	4,354,281	(9,745,297)	14,099,578	-	-
Total current liabilities	83,220,991	(9,745,297)	86,831,951	6,132,612	1,725
Due to affiliates	-	(7,053,575)	-	-	7,053,575
Deferred compensation	4,294,335	-	4,143,588	150,747	-
Other liabilities	3,575,110	-	2,813,641	761,469	-
Long-term obligations, less current portion	92,428,644	-	87,959,494	4,469,150	-
Total liabilities	183,519,080	(16,798,872)	181,748,674	11,513,978	7,055,300
Net assets:					
Unrestricted	375,663,168	-	343,863,659	25,852,528	5,946,981
Temporarily restricted	21,842,102	-	18,269,834	3,572,268	-
Permanently restricted	7,006,159	-	6,747,917	258,242	-
Total net assets	404,511,429	-	368,881,410	29,683,038	5,946,981
Total liabilities and net assets	\$ 588,030,509	\$ (16,798,872)	\$ 550,630,084	\$ 41,197,016	\$ 13,002,281

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2016

	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Williamstown Medical Associates, Inc.	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Net patient service revenue	\$ 537,697,202	\$ -	\$ -	\$ 32,936,144	\$ 4,610,531	\$ -	\$ -
Less: provision for bad debts	10,483,023	-	-	921,642	(368)	-	-
Patient service revenue, net	527,214,179	-	-	32,014,502	4,610,899	-	-
Other revenue	49,708,005	(46,483,256)	57,998,448	2,640,897	75,397	77,916	1,857,322
Total revenues	576,922,184	(46,483,256)	57,998,448	34,655,399	4,686,296	77,916	1,857,322
Expenses:							
Salaries and wages	290,024,692	-	27,802,417	35,026,520	3,683,424	-	-
Fringe benefits	73,930,378	-	8,104,074	5,088,638	797,683	-	-
Supplies and other	154,397,649	(46,483,256)	21,978,688	11,971,864	1,325,645	44,834	1,857,322
Health Safety Net assessment	2,144,095	-	-	-	-	-	-
Depreciation and amortization	32,065,281	-	113,269	-	-	39,159	-
Interest	3,874,963	-	-	-	-	-	-
Total expenses	556,437,058	(46,483,256)	57,998,448	52,087,022	5,806,752	83,993	1,857,322
Gain (loss) from operations	20,485,126	-	-	(17,431,623)	(1,120,456)	(6,077)	-
Nonoperating gains:							
Investment gains	11,332,679	-	-	10,476	-	-	-
Other, net	115,818	-	-	-	-	-	-
Loss on investments in subsidiary	-	6,077	-	-	-	-	-
Total nonoperating gains	11,448,497	6,077	-	10,476	-	-	-
Excess of (deficiency in) revenues over expenses	31,933,623	6,077	-	(17,421,147)	(1,120,456)	(6,077)	-

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2016

	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Williamstown Medical Associates, Inc.	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Unrestricted net assets:							
Excess of (deficiency in) revenues over expenses	\$ 31,933,623	\$ 6,077	\$ -	\$ (17,421,147)	\$ (1,120,456)	\$ (6,077)	\$ -
Net unrealized gains on investments	7,506,175	-	-	-	-	-	605,669
Grant funds used for property and equipment	127,829	-	-	-	-	-	-
Net assets released from restrictions used for purchase of property and equipment	489,851	-	-	-	-	-	-
Equity transfer	-	-	-	17,421,147	753,000	-	-
Investment from Parent	-	(6,077)	-	-	-	6,077	-
Increase (decrease) in unrestricted net assets	40,057,478	-	-	-	(367,456)	-	605,669
Temporarily restricted net assets:							
Restricted contributions	1,137,724	-	-	-	-	-	-
Realized gains on investments	682,339	-	-	-	-	-	-
Net unrealized gains on investments	890,525	-	-	-	-	-	-
Net assets released from restrictions for operating purposes	(318,382)	-	-	-	-	-	-
Net assets released from restrictions for purchase of property and equipment	(489,851)	-	-	-	-	-	-
Increase in temporarily restricted net assets	1,902,355	-	-	-	-	-	-
Increase (decrease) in net assets	41,959,833	-	-	-	(367,456)	-	605,669
Net assets, beginning of year	363,499,355	(100)	-	-	156,693	-	552,953
Net assets, end of year	\$ 405,459,188	\$ (100)	\$ -	\$ -	\$ (210,763)	\$ -	\$ 1,158,622

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2016

	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Net patient service revenue	\$ 500,150,527	\$ -	\$ 450,301,567	\$ 49,848,960	\$ -
Less: provision for bad debts	9,561,749	-	8,285,381	1,276,368	-
Patient service revenue, net	490,588,778	-	442,016,186	48,572,592	-
Other revenue	33,541,281	(2,164,150)	34,537,430	1,167,831	170
Total revenues	524,130,059	(2,164,150)	476,553,616	49,740,423	170
Expenses:					
Salaries and wages	223,512,331	-	200,079,976	23,432,355	-
Fringe benefits	59,939,983	-	54,074,753	5,865,230	-
Supplies and other	163,702,552	(2,164,150)	149,865,102	15,999,767	1,833
Health Safety Net assessment	2,144,095	-	1,973,143	170,952	-
Depreciation and amortization	31,912,853	-	29,904,264	2,008,589	-
Interest	3,874,963	-	3,687,315	187,648	-
Total expenses	485,086,777	(2,164,150)	439,584,553	47,664,541	1,833
Gain (loss) from operations	39,043,282	-	36,969,063	2,075,882	(1,663)
Nonoperating gains and (losses):					
Investment gains	11,322,203	-	10,274,127	1,048,076	-
Other, net	115,818	-	(46,689)	99,000	63,507
Loss on investments in subsidiary	(6,077)	-	-	(6,077)	-
Total nonoperating gains (losses)	11,431,944	-	10,227,438	1,140,999	63,507
Excess of revenues over expenses	50,475,226	-	47,196,501	3,216,881	61,844

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2016

	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Unrestricted net assets:					
Excess of revenues over expenses	\$ 50,475,226	\$ -	\$ 47,196,501	\$ 3,216,881	\$ 61,844
Net unrealized gains on investments	6,900,506	-	6,252,313	648,193	-
Grant funds used for property and equipment	127,829	-	127,829	-	-
Net assets released from restrictions used for purchase of property and equipment	489,851	-	263,787	226,064	-
Equity transfer	(18,174,147)	-	(16,558,244)	(1,615,903)	-
Increase in unrestricted net assets	39,819,265	-	37,282,186	2,475,235	61,844
Temporarily restricted net assets:					
Restricted contributions	1,137,724	-	315,952	821,772	-
Realized gains on investments	682,339	-	663,581	18,758	-
Net unrealized (losses) gains on investments	890,525	-	823,848	66,677	-
Net assets released from restrictions for operating purposes	(318,382)	-	(187,934)	(130,448)	-
Net assets released from restrictions for purchase of property and equipment	(489,851)	-	(263,787)	(226,064)	-
Increase in temporarily restricted net assets	1,902,355	-	1,351,660	550,695	-
Increase in net assets	41,721,620	-	38,633,846	3,025,930	61,844
Net assets, beginning of year	362,789,809	-	330,247,564	26,657,108	5,885,137
Net assets, end of year	\$ 404,511,429	\$ -	\$ 368,881,410	\$ 29,683,038	\$ 5,946,981