Partners HealthCare System, Inc. and Affiliates

Consolidated Financial Statements

September 30, 2017 and 2016

Partners HealthCare System, Inc. and Affiliates
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September 30, 2017 and 2016

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Report of Independent Auditors

To the Board of Directors of
Partners HealthCare System, Inc. and Affiliates

We have audited the accompanying consolidated financial statements of Partners HealthCare System, Inc. and Affiliates (Partners HealthCare), which comprise the consolidated balance sheets as of September 30, 2017 and 2016 and the related consolidated statements of operations, changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the consolidated financial statements based on our audits. We conducted our audits 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 our 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, we consider internal control relevant to Partners HealthCare'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 Partners HealthCare's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Partners HealthCare System, Inc. and Affiliates at September 30, 2017 and 2016, and the results of their operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

December 8, 2017

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Partners HealthCare System, Inc. and Affiliates
Consolidated Balance Sheets
September 30, 2017 and 2016

(in thousands of dollars)	**2017**	**2016**
Assets		
Current assets		
Cash and equivalents	$ 739,117	$ 827,683
Investments	1,506,524	1,069,006
Current portion of investments limited as to use	1,367,172	1,588,787
Patient accounts receivable, net of allowance for bad debts (2017 - $114,680; 2016 - $121,652)	977,294	881,993
Research grants receivable	127,868	129,243
Other current assets	436,037	449,440
Receivable for settlements with third-party payers	90,611	55,238
Total current assets	5,244,623	5,001,390
Investments limited as to use, less current portion	3,320,230	3,069,175
Long-term investments	1,266,697	1,136,528
Pledges receivable, net and contributions receivable from trusts, less current portion	199,730	194,684
Property and equipment, net	6,226,382	5,881,927
Other assets	614,096	599,775
Total assets	$ 16,871,758	$ 15,883,479
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term obligations	$ 615,151	$ 441,018
Accounts payable and accrued expenses	716,040	732,187
Accrued medical claims and related expenses	196,037	289,866
Accrued compensation and benefits	805,624	731,674
Current portion of accrual for settlements with third-party payers	52,348	63,195
Unexpended funds on research grants	265,253	247,423
Total current liabilities	2,650,453	2,505,363
Accrual for settlements with third-party payers, less current portion	20,231	7,443
Accrued professional liability	476,083	487,705
Accrued employee benefits	1,294,357	2,163,540
Interest rate swaps liability	367,830	510,172
Accrued other	156,909	156,178
Long-term obligations, less current portion	4,441,786	4,578,721
Total liabilities	9,407,649	10,409,122
Commitments and contingencies		
Net assets		
Unrestricted	5,889,170	4,060,285
Temporarily restricted	887,531	790,886
Permanently restricted	687,408	623,186
Total net assets	7,464,109	5,474,357
Total liabilities and net assets	$ 16,871,758	$ 15,883,479

The accompanying notes are an integral part of these consolidated financial statements.

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Operations
Years Ended September 30, 2017 and 2016

(in thousands of dollars)	2017	2016
Operating revenue		
Net patient service revenue, net of provision for bad debts (2017 - $139,554; 2016 - $127,798)	$ 8,382,683	$ 7,629,304
Premium revenue	2,487,100	2,508,924
Direct academic and research revenue	1,438,226	1,363,580
Indirect academic and research revenue	389,831	368,192
Other revenue	673,223	647,887
Total operating revenue	13,371,063	12,517,887
Operating expenses		
Employee compensation and benefit expenses	6,391,589	5,987,168
Supplies and other expenses	2,789,579	2,566,386
Medical claims and related expenses	1,890,368	2,017,773
Direct academic and research expenses	1,438,226	1,363,580
Depreciation and amortization expenses	626,383	555,814
Interest expense	182,348	135,045
Total operating expenses	13,318,493	12,625,766
Income (loss) from operations	52,570	(107,879)
Nonoperating gains (expenses)		
Income from investments	223,363	61,102
Change in fair value of interest rate swaps	144,860	(106,110)
Gifts and other, net of fundraising and other expenses	(108,353)	(37,293)
Academic and research gifts, net of expenses	25,268	(58,831)
Contribution income - affiliates	321,389	-
Total nonoperating gains (expenses), net	606,527	(141,132)
Excess (deficit) of revenues over expenses	659,097	(249,011)
Other changes in net assets		
Change in net unrealized appreciation on marketable investments	209,260	200,042
Funds utilized for property and equipment	44,384	49,162
Change in funded status of defined benefit plans	915,409	(647,180)
Other	735	(390)
Increase (decrease) in unrestricted net assets	$ 1,828,885	$ (647,377)

The accompanying notes are an integral part of these consolidated financial statements.

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2017 and 2016

(in thousands of dollars)	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Net assets at September 30, 2015	$ 4,707,662	$ 765,562	$ 579,578	$ 6,052,802
Increases (decreases)				
Loss from operations	(107,879)	-	-	(107,879)
Income (loss) from investments	61,102	(21,616)	37	39,523
Change in fair value of interest rate swaps	(106,110)	-	-	(106,110)
Gifts and other	(37,293)	39,875	44,093	46,675
Academic and research gifts, net of expenses	(58,831)	-	-	(58,831)
Change in net unrealized appreciation on marketable investments	200,042	30,170	(340)	229,872
Funds utilized for property and equipment	49,162	(23,105)	-	26,057
Change in funded status of defined benefit plans	(647,180)	-	-	(647,180)
Other	(390)	-	(182)	(572)
Change in net assets	(647,377)	25,324	43,608	(578,445)
Net assets at September 30, 2016	4,060,285	790,886	623,186	5,474,357
Increases (decreases)				
Income from operations	52,570	-	-	52,570
Income from investments	223,363	20,245	39	243,647
Change in fair value of interest rate swaps	144,860	-	-	144,860
Gifts and other	(108,353)	31,539	60,496	(16,318)
Academic and research gifts, net of expenses	25,268	-	-	25,268
Contribution income - affiliates	321,389	2,120	2,399	325,908
Change in net unrealized appreciation on marketable investments	209,260	59,522	322	269,104
Funds utilized for property and equipment	44,384	(16,781)	-	27,603
Change in funded status of defined benefit plans	915,409	-	-	915,409
Other	735	-	966	1,701
Change in net assets	1,828,885	96,645	64,222	1,989,752
Net assets at September 30, 2017	$ 5,889,170	$ 887,531	$ 687,408	$ 7,464,109

The accompanying notes are an integral part of these consolidated financial statements.

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended September 30, 2017 and 2016

(in thousands of dollars)	2017	2016
Cash flows from operating activities		
Change in net assets	$ 1,989,752	$ (578,445)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Contribution income - affiliates	(325,908)	-
Change in funded status of defined benefit plans	(915,409)	647,180
Gain on refunding of debt	-	(3,556)
Change in fair value of interest rate swaps	(144,860)	106,110
Depreciation and amortization	626,383	555,814
Provision for bad debts	139,554	127,798
Amortization of bond discount, premium and issuance costs	(4,349)	1,728
(Gain) loss on disposal of property	(3,865)	53
Net realized and change in unrealized appreciation on investments	(641,801)	(344,727)
Restricted contributions and investment income	(132,714)	(129,649)
Cash premium upon issuance of bonds	-	67,636
Increases (decreases) in cash resulting from a change in		
Patient accounts receivable	(200,945)	(131,758)
Research grants receivable	1,375	(7,468)
Pledges receivable and contributions receivable from trusts	2,511	1,329
Other assets	16,168	(40,167)
Accounts payable and accrued expenses	(54,229)	85,832
Accrued medical claims and related expenses	(93,829)	57,598
Accrued compensation and benefits	48,992	16,516
Settlements with third-party payers	(52,525)	(30,561)
Unexpended funds on research grants	17,830	45,286
Accrued employee benefits and other	30,646	(176,520)
Net cash provided by operating activities	302,777	270,029
Cash flows from investing activities		
Purchases of property and equipment	(754,105)	(1,102,846)
Proceeds from sale of property	7,104	566
Purchase of investments	(2,418,133)	(2,758,608)
Proceeds from sales of investments	2,669,588	3,078,598
Cash acquired through affiliations	39,244	-
Net cash used for investing activities	(456,302)	(782,290)
Cash flows from financing activities		
Borrowings under line of credit	-	74,969
Repayments under line of credit	-	(74,969)
Payments on long-term obligations	(67,755)	(70,499)
Proceeds from long-term obligations, net of financing costs	-	745,258
Deposits into refunding trusts	-	(86,032)
Restricted contributions and investment income	132,714	129,649
Net cash provided by financing activities	64,959	718,376
Net (decrease) increase in cash and equivalents	(88,566)	206,115
Cash and equivalents		
Beginning of year	827,683	621,568
End of year	$ 739,117	$ 827,683

The accompanying notes are an integral part of these consolidated financial statements.

(in thousands of dollars)

1. Organization and Community Benefit Commitments

Partners HealthCare System, Inc. (PHS) is the sole member of The Massachusetts General Hospital (MGH), Brigham Health, Inc. (formerly named Brigham and Women's Health Care, Inc.) (BH), NSMC HealthCare, Inc. (NSMC), Newton-Wellesley Health Care System, Inc. (NWHCS), Partners Continuing Care, Inc. (PCC), Partners HealthCare International, LLC (PHI) and Neighborhood Health Plan, Incorporated (NHP). The two physicians who serve as the President and Chief Executive Officer of PHS (PHS CEO) and the Chief Clinical Officer of PHS are the members of Partners Community Physicians Organization, Inc. (PCPO). The individual serving as the PHS CEO is the sole member of Partners Medical International, Inc. (PMI). PHS, together with all of its affiliates, is referred to as "Partners HealthCare."

Partners HealthCare currently operates two tertiary and eight community acute care hospitals, one facility providing inpatient and outpatient mental health services and three facilities providing inpatient and outpatient services in rehabilitation medicine and long-term care. Partners HealthCare also operates physician organizations and practices, a home health agency, nursing homes and a graduate level program for health professions. Partners HealthCare provides services to patients primarily from the Greater Boston area as well as New England and beyond. In addition, Partners HealthCare is a nonuniversity-based non-profit private medical research enterprise and is a principal teaching affiliate of the medical and dental schools of Harvard University. Partners HealthCare also operates a licensed, not-for-profit managed care organization that provides health insurance products to the Massachusetts Medicaid program (MassHealth), ConnectorCare (a state subsidized program for adults who meet income and immigration guidelines) and commercial populations.

PHS and substantially all of its affiliates are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC). NHP is a tax-exempt organization under Section 501(c)(4) of the IRC. Accordingly, no provision for income taxes related to these tax-exempt entities has been made. The Internal Revenue Service approved Harbor Medical Associate's application to become a tax-exempt organization under Section 501(c)(3) of the IRC effective October 1, 2016.

Community Benefit

Partners HealthCare's community benefit programs include working with communities to address a number of public health issues including racial disparities, alcohol and substance abuse among young people, infant mortality, domestic violence and cancer. Partners HealthCare provides economic opportunity for low income Boston residents by helping people advance into nursing and other healthcare careers through its public school partnerships and workforce development programs. In addition, twenty community health centers are licensed by or affiliated with Partners HealthCare entities and provide high quality, culturally competent primary care and access to Partners HealthCare's hospitals. Partners HealthCare invests in these health centers' infrastructure, programming and operation and also helps with relocation, renovation and other capital requirements.

(in thousands of dollars)

The Massachusetts Attorney General's Community Benefits Guidelines direct non-profit acute care hospitals and health maintenance organizations to prepare annual reports documenting the status and level of their community benefit programs and initiatives. These annual reports serve the important purpose of providing the public with access to useful information about these programs and initiatives. Partners HealthCare files its report annually with the Massachusetts Attorney General. The report summarizes community benefit activities on a system-wide basis. In addition, each of the acute care hospitals within Partners HealthCare has a community benefit planning and service delivery structure and files separate community benefit reports. NHP also files a community benefit report annually.

Uncompensated Care
Partners HealthCare provides care to all patients regardless of their ability to pay. The cost of providing that care is reflected in the statements of operations. The cost related to those patients for which Partners HealthCare receives either partial or no reimbursement for healthcare services provided is summarized as follows:

State Programs
Massachusetts
Massachusetts acute care hospitals are partially reimbursed for charity care services through the statewide Health Safety Net Trust Fund (HSN) established under Massachusetts law. A portion of the funding for the HSN is paid by an assessment on acute care hospitals charges for private sector payers. The statewide assessment was $165,308 and $165,200 in 2017 and 2016, respectively, and the assessment on Partners HealthCare's acute care hospitals was $59,242 and $57,756 in 2017 and 2016, respectively, and was recorded as an expense.

Acute care hospitals are reimbursed for charity care based on claims for eligible patients and eligible services that are submitted to and adjudicated by the HSN. Payments are based on Medicare rates and payment policies. The HSN was under-funded by approximately $23,004 and $110,627 in 2017 and 2016, respectively. This shortfall is allocated to hospitals based on their share of total statewide patient care costs with approximately $5,695 and $39,571 in 2017 and 2016, respectively, allocated to Partners HealthCare's acute care hospitals. Each hospital's share of the overall state shortfall cannot exceed its total charity care reimbursement. Hospitals with a high proportion of charity care and government funding receive more favorable reimbursement, including limiting their shortfall allocation to no more than 15% of their payments for charity care. In aggregate, Partners HealthCare's acute care hospitals received uncompensated care funding covering 79% and 38% of the estimated cost of charity care provided in 2017 and 2016, respectively.

In 2016 the Legislature adopted an additional assessment on hospitals that will be redistributed to the hospitals based on certain pay-for-reporting (in 2017) and pay-for-performance (in 2018 and beyond) criteria. In 2017 the total assessment was $257,500, of which Partners HealthCare's hospitals paid $92,172, and the total amount redistributed to hospitals was $265,000, of which Partners HealthCare's hospitals received $60,720.

New Hampshire
The State of New Hampshire (New Hampshire) imposes a Medicaid Enhancement Tax (MET) on hospital net patient service revenue. For New Hampshire's fiscal years ending June 30, 2017 and 2016, the MET imposed was 5.40% and 5.45%, respectively. The amount of MET incurred by Wentworth-Douglass Hospital in 2017 was $11,683.

(in thousands of dollars)

New Hampshire acute care hospitals received disproportionate share payments based on a portion of their uncompensated care relative to other acute care hospitals. Wentworth-Douglass Hospital received $10,963 in 2017.

Medicaid

Medicaid is a health insurance program jointly funded by the states and the federal government. Each state administers its own program and sets rules for eligibility, benefits and provider payments within broad federal guidelines and in some cases, including Massachusetts, within a Waiver Agreement between the state and the federal government. The program provides health care coverage to low-income adults and children. Eligibility is determined by a variety of factors, which may include income relative to the federal poverty line, age, immigrant status and assets.

Medicaid payments to Partners HealthCare providers do not cover the full cost of services provided. In aggregate, reimbursement from Medicaid covered 65% and 60% of the estimated cost of services provided in 2017 and 2016, respectively. In addition, Medicaid premium revenue paid to NHP for the care of Medicaid patients enrolled in NHP did not cover the medical expense and administrative costs of care for these enrollees. In aggregate, the premium revenue paid to NHP by Medicaid, excluding the impact of premium deficiency reserves, was $380, or 0.02%, less than the cost of care in 2017, and $72,542, or 3.9%, less than the cost of care in 2016.

Federal Program

Medicare

Medicare is a federally sponsored health insurance program for people age 65 or older, under age 65 with certain disabilities and any age with End-Stage Renal Disease. For many years, Medicare payments have not kept pace with increases in the cost of care provided at many hospitals. Additionally, payments to physicians have seen little or no increases over the past several years. Compounding this shortfall in payments is the continued shift of care from higher paying inpatient services to lower paying outpatient services.

Consequently, Medicare payments to Partners HealthCare providers do not cover the full cost of services provided. In aggregate, reimbursement from Medicare covered approximately 70% and 73% of the estimated cost of services provided in 2017 and 2016, respectively.

(in thousands of dollars)

Summary

For charity care, Medicaid and Medicare, the estimated cost of services provided is either obtained directly from a costing system or based on an entity specific ratio of cost to gross charges. In the latter case, cost is derived by applying this ratio to gross charges associated with providing care to charity care, Medicaid and Medicare patients. The following summarizes, by program, the cost of services provided, net reimbursement and cost of services in excess of reimbursement for each year:

	Years Ended September 30, 2017	2016
Cost of services provided		
Charity care	$ 63,327	$ 81,222
Medicaid	1,165,800	1,077,629
Medicare	3,362,075	2,982,128
	$ 4,591,202	$ 4,140,979
Net reimbursement		
Charity care	$ 40,726	$ 23,293
Medicaid	754,043	651,022
Medicare	2,348,122	2,168,664
	$ 3,142,891	$ 2,842,979
Cost of services in excess of reimbursement		
Charity care	$ 22,601	$ 57,929
Medicaid	411,757	426,607
Medicare	1,013,953	813,464
	$ 1,448,311	$ 1,298,000

Bad Debts

In addition to charity care and inadequate funding from the Medicaid and Medicare programs, there are significant losses related to self-pay patients who fail to make payment for services rendered or insured patients who fail to remit co-payments and deductibles as required under the applicable health insurance arrangement. The provision for bad debts represents charges for services provided that are deemed to be uncollectible and was $139,554 and $127,798 in 2017 and 2016, respectively. The estimated cost of providing these services was approximately $49,501 and $44,959 for 2017 and 2016, respectively.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of PHS and its affiliates. Significant interaffiliate accounts and transactions have been eliminated.

(in thousands of dollars)

Use of Estimates
The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, research grants receivable, investments, receivables and accruals for settlements with third-party payers, accrued medical claims and related expenses, accrued professional liability, accrued compensation and employee benefits, interest rate swaps and accrued other.

Fair Value of Financial Instruments
The fair value of financial instruments approximates the carrying amount reported in the consolidated balance sheets for cash and equivalents, certain investments and investments limited as to use, patient accounts receivable, research grants receivable, accounts payable and accrued expenses and interest rate swaps. More information can be found in Note 6, Fair Value Measurements.

Cash and Equivalents
Cash and equivalents represent cash, registered money market funds and highly liquid debt instruments with a maturity at the date of purchase of three months or less. Partners HealthCare's banking cash and equivalents are maintained with several national banks and from time to time cash deposits exceed federal insurance limits. It is Partners HealthCare's policy to monitor these banks' financial strength on an ongoing basis and no losses have been experienced to date.

Investments
Investments in equity securities with readily determinable fair values and all investments in debt securities (marketable investments) are measured at fair value based on quoted market prices. The change in net unrealized appreciation on these marketable investments is excluded from excess of revenues over expenses.

Alternative investments, including hedge funds and private equities, do not have readily ascertainable market values. Investments in securities sold short or traded on a national securities exchange are valued based on quoted market prices. Investments in securities that are not traded and restricted securities of public companies are valued based on amounts reported by the fund manager and evaluated by management. The reported value of these investments represents the amount Partners HealthCare would expect to receive if it liquidated its investments at the balance sheet date on a nondistressed basis. Investments in hedge funds, private equity, private debt and other private partnerships (collectively, private partnerships) for which Partners HealthCare owns more than 5% of the overall investment are generally recorded as equity method investments. The change in value of equity method investments is included in excess of revenues over expenses as a component of income from investments. All other investments, including alternative investments, are recorded at cost.

Income from investments (including realized gains and losses, change in value of equity method investments, interest, dividends and endowment income distributions) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Income from investments is reported net of investment-related expenses.

(in thousands of dollars)

Investments whose cost exceeds fair value are reviewed each quarter to determine whether these investments are other-than-temporarily impaired. Externally managed marketable investments with fair value below cost are considered to be other-than-temporarily impaired and, accordingly, the unrealized depreciation is recognized as realized losses through a write-down in the cost basis of these investments. All other investments are subject to a further review, which considers factors including the anticipated holding period for the investment and the extent and duration of below cost valuation. A similar write-down is recorded when the impairment on these investments has been judged to be other-than-temporary.

Depending on any donor-imposed restrictions on the underlying investments, the amount of the write-down is reported as a realized loss in either temporarily restricted net assets or in excess of revenues over expenses as a component of income from investments, with no adjustment in the cost basis for subsequent recoveries.

Partners HealthCare has an endowment spending policy for pooled endowment funds. A fixed distribution rate for spending is determined each year which will come from either income and/or net accumulated appreciation.

Investments Limited as to Use
Investments limited as to use primarily includes assets whose use is contractually limited by external parties as well as assets set aside by the boards (or management) for identified purposes and over which the boards (or management) retain control such that the boards (or management) may, at their discretion, subsequently use such assets for other purposes. Certain investments corresponding to deferred compensation are accounted for such that all income and appreciation (depreciation) is recorded as a direct addition (reduction) to the asset and corresponding liability.

Derivative Instruments
Derivatives are recognized on the balance sheet at fair value with changes in the fair value recorded in excess of revenue over expenses.

Patient Accounts Receivable
Partners HealthCare receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), managed care payers, commercial insurance companies and patients. Patient accounts receivable are reported net of contractual allowances and reserves for denials, uncompensated care and doubtful accounts. The level of reserves is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental and private employer health care coverage and other collection indicators.

Research Grants Receivable
Partners HealthCare receives research funding from departments and agencies of the U.S. Government, industry and other foundation sponsors. Research grants receivable include amounts due from these sponsors of externally funded research. These amounts have been billed or are billable to the sponsor, or in limited circumstances, represent accelerated spending in anticipation of future funding. Research grants receivable are reported net of reserves for uncollectible accounts.

(in thousands of dollars)

Other Current Assets
Other current assets include prepaids, nonpatient receivables, current portion of pledges receivable, premiums receivable and reinsurance recoveries.

Property and Equipment
Property and equipment is reported on the basis of cost less accumulated depreciation. Donated items are recorded at fair value at the date of contribution. All research grants received for capital are recorded in the year of expenditure as a change in unrestricted net assets. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. Depreciation of property and equipment is calculated by use of the straight-line method at rates intended to depreciate the cost of assets over their estimated useful lives, which generally range from three to fifty years. 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.

Asset Retirement Obligations
Asset retirement obligations, reported in accrued other, are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Partners HealthCare records changes in the liability resulting from the passage of time and revisions to either the timing or the amount of the original liability estimate. Partners HealthCare reduces these liabilities when the related obligations are settled.

Other Assets
Other assets consist of long-term receivables, intangible assets, prepaid ground rent, malpractice insurance receivables (Note 14), receivable for settlements with third-party payers, investments in healthcare related limited partnerships and benefit assets for over-funded defined benefit plans. Deferred financing costs are amortized over the terms of the related obligations. The carrying value of other assets is evaluated for impairment if the facts and circumstances suggest that the carrying value may not be recoverable.

Compensated Absences
In accordance with formal policies concerning vacation and other compensated absences, accruals of $291,243 and $273,042 were recorded as of September 30, 2017 and 2016, respectively.

Unexpended Funds on Research Grants
Research grants received in advance of corresponding grant expenditures are accounted for as a direct addition to investments limited as to use and unexpended funds on research grants.

Self-Insurance Reserves
Partners HealthCare is generally self-insured for employee healthcare, disability, workers' compensation and certain other employee benefits. These costs are accounted for on an accrual basis to include estimates of future payments for claims incurred prior to year end.

(in thousands of dollars)

Net Assets
Permanently restricted net assets include the historical dollar amounts of gifts and the income and gains on such gifts which are required by donors to be permanently retained. Temporarily restricted net assets include gifts and the income and gains on permanently restricted net assets which can be expended but for which restrictions have not yet been met. Such restrictions include purpose restrictions where donors have specified the purpose for which the net assets are to be spent, or time restrictions imposed by donors or implied by the nature of the gift (capital projects, pledges to be paid in the future, life income funds) or by interpretations of law (gains available for appropriation but not appropriated in the current period). Unrestricted net assets include all of the remaining net assets of Partners HealthCare. More information can be found in Note 16, Net Assets.

Realized gains and losses are classified as unrestricted net assets unless they are restricted by the donor or law. Unless permanently restricted by the donor, realized gains and net unrealized appreciation on permanently restricted gifts are classified as temporarily restricted until appropriated for spending by Partners HealthCare in accordance with policies established by Partners HealthCare and applicable Uniform Prudent Management of Institutional Funds Acts (UPMIFA). Net losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the fair value of these funds exceeds historical cost.

Gifts
Unconditional promises to give cash and other assets to Partners HealthCare are reported at fair value at the date the promise is received. Conditional promises to give are recognized when the conditions are substantially met. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted gifts in the accompanying financial statements.

Gifts of long-lived assets with explicit restrictions that specify use of assets and gifts of cash or other assets that must be used to acquire long-lived assets are reported as additions to temporarily restricted net assets if the assets are not placed in service during the year.

Grants
Grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. Partners HealthCare recognizes revenue associated with direct and indirect costs as direct costs are incurred. The recovery of indirect costs is based on predetermined rates for U.S. Government grants and contracts and negotiated rates for other grants and contracts.

Contributed Securities
Partners HealthCare's policy is to sell securities contributed by donors upon receipt, unless prevented from doing so by donor request. For the years ended September 30, 2017 and 2016, contributed securities of $52,361 and $48,160, respectively, were received and liquidated. Donors restricted the proceeds received from the sale of these contributed securities of $23,401 and $11,634 for long-term purpose for the years ended September 30, 2017 and 2016, respectively.

(in thousands of dollars)

Statement of Operations
All activities of Partners HealthCare deemed by management to be ongoing, major and central to the provision of healthcare services, teaching, research activities and health insurance are reported as operating revenue and expenses. Other activities are deemed to be nonoperating and include unrestricted gifts (net of fundraising expenses), external community benefit program support, net change in unexpended academic and research gifts, change in fair value of interest rate swaps, substantially all income (loss) from investments and interest on advanced borrowings. Academic and research gifts largely consist of donor contributions (and the related investment income including realized gains and losses) designated to support the clinical, teaching or research efforts of a physician or department as directed by the donor. These gifts are reported as unrestricted, net of related support expenses, when donor restrictions are of a general nature that are inherent in the normal activities of the organization.

Partners HealthCare recognizes changes in third-party payer settlements and other estimates in the year of the change in estimate. For the years ended September 30, 2017 and 2016, adjustments to prior year estimates resulted in an increase to income from operations of $34,995 and $12,536, respectively.

Effective October 1, 2007, the Centers for Medicare and Medicaid Services (CMS) adopted the MS-DRG patient classification system (MS-DRGs) for inpatient services to better recognize severity of illness in Medicare payment rates for acute care hospitals. The adoption of MS-DRGs resulted in the expansion of the number of diagnosis related groups (DRGs), a system of classifying patients for purposes of inpatient reimbursement. By increasing the number of DRGs and more fully taking into account patients' severity of illness in Medicare payment rates for acute care hospitals, the use of MS-DRGs encourages hospitals to improve their documentation and coding of patient diagnoses. CMS has determined that the adoption of the MS-DRGs has increased aggregate payments to hospitals due to additional documentation and coding without a corresponding increase in actual patient severity of illness.

CMS is required by its enabling statute to maintain budget neutrality by prospectively adjusting the Medicare payment rate to eliminate the effect of changes in DRG classification that do not reflect real changes in case-mix. CMS requires Congressional authority, however, to recoup any overpayments made in prior years. Under the American Taxpayer Relief Act of 2012, Congress granted CMS the authority to recoup overpayments made to hospitals in 2010 through 2012 through rate reductions in 2014 through 2017.

(in thousands of dollars)

In 2013, Partners HealthCare recorded the estimated overpayment amounts received in 2010 through 2012 of $79,020 as deferred revenue to be amortized into net patient service revenue in 2014 through 2017 to offset the rate reductions. Management believes this accounting treatment better reflects the financial impact of this rate methodology and more accurately presents the recognition of revenue. For the years ended September 30, 2017 and 2016, amortization of these overpayments amounted to $33,035 and $23,900, respectively. As of September 30, 2017, the total estimated overpayment of $79,020 has been amortized into net patient service revenue.

The statement of operations includes excess (deficit) of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include change in net unrealized appreciation on marketable investments, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for acquisition of such assets) and change in funded status of defined benefit plans.

Net Patient Service Revenue

Partners HealthCare maintains agreements with CMS of the United States Department of Health and Human Services under the Medicare program, the Commonwealth of Massachusetts (the Commonwealth) under the Medicaid program and various managed care payers that govern payment for services rendered to patients covered by these agreements. The agreements generally provide for per case or per diem rates or payments based on discounted charges for inpatient care and discounted charges or fee schedules for outpatient care. Certain contracts also provide for payments that are contingent upon meeting agreed upon quality and efficiency measures.

Partners HealthCare recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, Partners HealthCare recognizes revenue on the basis of its standard rates (subject to discounts) for services provided. On the basis of historical experience, a significant portion of Partners HealthCare's uninsured patients are unable or fail to pay for the services provided. Consequently, Partners HealthCare records a provision for bad debts related to uninsured patients in the period the services are provided. For the years ended September 30, 2017 and 2016, patient service revenue net of contractual allowances and discounts (before the provision for bad debts) is as follows:

	2017	2016
Patient service revenue (net of contractual allowances and discounts)		
Third-party payers	$ 8,050,424	$ 7,319,696
Uninsured patients	332,259	309,608
Total all payers	$ 8,382,683	$ 7,629,304

(in thousands of dollars)

Net patient service revenue includes estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations. Contracts, laws and regulations governing the Medicare, Medicaid and uncompensated care programs (Note 1) and managed care payer arrangements 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. A portion of the accrual for settlements with third-party payers has been classified as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year.

Partners HealthCare provides either full or partial uncompensated care to patients who cannot afford to pay for their medical services based on income and family size. Uncompensated care is generally available to qualifying patients for medically necessary services. Partners HealthCare reports certain bad debts related to emergency services as uncompensated care. Uncompensated care is reported at gross charges with an offsetting allowance, as there is no expectation of collection. Accordingly, there is no net patient service revenue related to uncompensated care.

Premium Revenue
Premiums are due monthly and recorded as earned during the period in which members are eligible to receive services. Premiums received prior to the first day of the coverage period are recorded as unearned premiums in accounts payable and accrued expenses.

Other Revenue
Other revenue includes institutional revenue (for example, billing for services provided to other healthcare providers), parking, nonpatient pharmacy, tuition revenue and commercialization of intellectual property.

Medical Claims and Related Expenses
NHP contracts with various community health centers, hospital-based primary care physician practices and other health care providers for the delivery of services to its members and compensates these providers on a capitated, fee-for-service or per diem basis.

The cost of contracted health care services is accrued in the period in which services are provided and include certain estimated amounts. The estimated liability for medical claims and related expenses is actuarially determined based on analysis of historical claims-paid experience, modified for changes in enrollment, inflation and benefit coverage. The liability for medical claims and related expenses represents the anticipated cost of claims incurred but unpaid at the balance sheet date. The estimates for claims expense may be more or less than the amounts ultimately paid when claims are settled. Such changes in estimates are reflected in the current period in the consolidated statements of operations.

(in thousands of dollars)

In the normal course of business, NHP identifies and recoups overpayments through reductions in future payments made to providers and hospitals. Such overpayments are the result of, among other things, coordination of benefits and provider claim audits. For the years ended September 30, 2017 and 2016, NHP identified approximately $62,932 and $62,433, respectively, of recoveries related to claim overpayments made for both current-year and prior-year paid claims, which are reflected as a reduction to medical claims and related expenses in the consolidated statements of operations. As of September 30, 2017 and 2016, NHP's accounts receivable include $1,774 and $1,718, respectively, related to such overpayments.

Reinsurance
Reinsurance premiums are reported in medical claims and related expenses and reinsurance recoveries are reported as reductions in medical claims and related expenses.

Settlements
NHP contracts with certain providers at negotiated rates based on historical and anticipated experience. These methods of reimbursement result in settlements based on actual versus anticipated experience which could result in either payments due from (to) these providers. Settlements receivable of $10,559 and $7,704 were recorded as of September 30, 2017 and 2016, respectively. Settlements payable of $2,058 and $5,201 were recorded as of September 30, 2017 and 2016, respectively. The settlements are intended to include both reported and unreported incurred claims as of September 30, 2017 and 2016.

In 2014, the Affordable Care Act introduced new settlements related to a risk adjustment program, a risk corridor program and a reinsurance program designed to mitigate the transitional impact on insurers for new members. The risk corridor program and reinsurance program ended on December 31, 2016 in accordance with the provision of the Affordable Care Act. NHP's estimated net receivable due from the federal government for these programs was $7,784 and $36,801 at September 30, 2017 and 2016, respectively. Similar to the federal program, EOHHS has a risk corridor program and NHP's estimated net receivable due from EOHHS is $46,312 and $39,260 at September 30, 2017 and 2016, respectively.

Premium Deficiency Reserve
Premium deficiency reserves are assessed and recognized on a product line basis based upon expected premium revenue, medical expense and administrative expense levels, and remaining contractual obligations using historical experience. As of September 30, 2016, a premium deficiency reserve totaling approximately $51,735 is included in accrued medical claims and related expenses in the accompanying consolidated financial statements. There is no premium deficiency reserve as of September 30, 2017.

Claims Adjustment Expenses
Claims adjustment expenses (CAE) are those costs expected to be incurred in connection with the adjustment and recording of health claims. NHP has recorded an estimate of unpaid CAE associated with incurred but unpaid claims, which is included in medical claims and related expenses in the accompanying consolidated statements of operations. Management believes the amount of the liability for unpaid CAE as of September 30, 2017, is adequate to cover NHP's cost for the adjustment and recording of unpaid claims; however, actual expenses may differ from those established estimates. Adjustments to the estimates for unpaid CAE are reflected in operating results in the period in which the change in estimate is identified (Note 9).

(in thousands of dollars)

Recent Accounting Guidance
In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The ASU is effective for Partners HealthCare in 2019. Partners HealthCare is evaluating the impact this standard will have on the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall: Recognition and Measurement *of Financial Assets and Financial Liabilities*. ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values. Partners HealthCare will adopt the new guidance in 2019. Partners HealthCare is evaluating the impact of the new standard on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842),* which, requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The guidance also expands the required quantitative and qualitative disclosures surrounding leases. The ASU is effective for Partners HealthCare in 2020. Partners HealthCare is evaluating the impact of the new standard on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities,* which makes targeted changes to the not-for-profit financial reporting model. Under the new ASU, net asset reporting will be streamlined and clarified. The guidance also requires new disclosures about information useful for assessing liquidity and availability of resources. The ASU is effective for Partners HealthCare in 2019. Partners HealthCare is evaluating the impact of the new standard on the consolidated financial statements.

Adoption of New Accounting Guidance
In April 2015, the Financial Accounting Standards Board issued Accounting Standards Update No. 2015-03 *“Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs” (*ASU *2015-3).* Under the new guidance Partners reclassified debt issuance costs from other assets to a reduction in long-term obligations in the consolidated balance sheet as well as the amortization of debt issuance costs was reclassified from amortization expense to interest expense. The standard was adopted retroactively and accordingly, certain amounts in the 2016 financial statements have been reclassed to conform with the 2017 presentation. These standards did not have a material impact on the consolidated financial statements.

(in thousands of dollars)

Reclassification

Certain amounts in the 2016 financial statements have been reclassified to conform with the 2017 presentation. In addition to the adoption of ASU 2015-3, the acute care hospital HSN assessment previously presented as a deduction to net patient service revenue was reclassed to an operating expense which resulted in a $57,756 increase to both net patient service revenue and supplies and other expenses.

3. Acquisitions

Wentworth-Douglass Health System (Wentworth-Douglass) contributed their net assets to MGH on January 1, 2017. As a result, Partners HealthCare recorded contribution income of $325,908 reflecting the fair value of the contributed net assets of Wentworth-Douglass on the transaction date. Of this amount, $321,389 represents unrestricted net assets and is included as a nonoperating gain in the accompanying consolidated statements of operations and changes in net assets. Restricted contribution income of $2,120 and $2,399 was recorded within temporarily restricted net assets and permanently restricted net assets, respectively, in the accompanying consolidated statement of changes in net assets.

Assets, liabilities, and net assets assumed as of the acquisition dates are as follows:

Assets	
Cash and cash equivalents	$ 39,244
Investments and investments limited as to use	206,781
Patient accounts receivable, net	33,910
Property and equipment, net	214,261
Other assets	29,921
Total assets acquired	$ 524,117
Liabilities	
Long-term obligations	$ 109,302
Accounts payable and accrued expenses	38,082
Accrued compensation and benefits	30,904
Accrual for settlements with third-party payers	17,405
Other liabilities	2,516
Total liabilities assumed	198,209
Net assets	
Unrestricted	321,389
Temporarily restricted	2,120
Permanently restricted	2,399
Total net assets	325,908
Total liabilities and net assets	$ 524,117

(in thousands of dollars)

A summary of the financial results of Wentworth-Douglass from January 1, 2017 through September 30, 2017 is included in the 2017 consolidated statements of operations and changes in net assets is as follows:

Total operating revenue	$ 272,451
Total operating expenses	266,213
Income from operations	6,238
Nonoperating gains (expenses), net	17,349
Excess of revenues over expenses	23,587
Other changes	321,389
Increase in unrestricted net assets	$ 344,976

A summary of the consolidated financial results of Partners HealthCare for the year ended September 30, 2017 and 2016, as if the transactions had occurred on October 1, 2015 is as follows (unaudited):

	2017	2016
Total operating revenue	$ 13,466,398	$ 12,862,845
Total operating expenses	13,407,375	12,947,217
Income (loss) from operations	59,023	(84,372)
Nonoperating gains (expenses), net	602,856	(126,968)
Excess (deficit) of revenues over expenses	661,879	(211,340)
Pension related changes	915,409	(647,180)
Other changes	254,379	248,814
Increase (decrease) in unrestricted net assets	$ 1,831,667	$ (609,706)

4. Levels of Capital and Surplus

Risk-based capital (RBC) is a methodology adopted by the National Association of Insurance Commissioners (NAIC) for determining the minimum level of capital and surplus deemed necessary for an insurer based upon the types of assets held and business written. Pursuant to a guaranty entered into by PHS when it acquired NHP in 2012 (the RBC Guaranty), PHS has committed to maintain NHP's capital and surplus at a specified minimum level, measured quarterly in accordance with an RBC methodology permitted by the Massachusetts Division of Insurance (DOI). The RBC Guaranty may be enforced by the DOI. PHS provided capital to NHP of $57,200 and $123,800 in 2017 and 2016, respectively.

NHP's current contract with EOHHS requires NHP to maintain a minimum net worth and/or financial insolvency insurance in an amount equal to the Minimum Net Worth calculation as defined in Massachusetts General Law 176G, Section 25. At December 31, 2016 and 2015 (NHP's fiscal and statutory year end), the minimum net worth requirement, as determined in accordance with EOHHS guidelines, was $150,000 and $139,400, respectively. NHP's statutory net worth was $192,400 and $186,900 at December 31, 2016 and 2015, respectively, and thus exceeded the EOHHS requirements by $42,400 and $47,500, respectively.

(in thousands of dollars)

5. Investments and Investments Limited as to Use

Investments are either separately invested or included in pooled investment funds within the Partners HealthCare System Pooled Investment Accounts (Partnership). The Partnership is structured as a single general partnership composed of three investment pools, with PHS and substantially all of its affiliates participating in the pools as partners. Each partner's interest in the Partnership is based on its underlying investments in one or more of the three separate pools. Amounts included in the investment pools are accounted for using the fair value method, whereby each partner's ownership percentage is tracked and updated monthly. Each partner is allocated income from investments on a monthly basis, to include realized gains and losses, based on their individual ownership ratio of the total pool.

Among other investments, the Partnership invests in private partnerships whose assets include equity, fixed income and other investments. As of September 30, 2017, the Partnership has unfunded commitments of approximately $777,926 which will be drawn down by the various general partners over the next several years. The maximum annual drawdown is expected to be less than 2% of investments and investments limited as to use.

Investments and investments limited as to use are recorded in the balance sheet as follows:

	September 30, 2017	September 30, 2016
Current assets		
Investments	$ 1,506,524	$ 1,069,006
Current portion of investments limited as to use	1,367,172	1,588,787
	2,873,696	2,657,793
Long-term assets		
Investments limited as to use, less current portion	3,320,230	3,069,175
Long-term investments	1,266,697	1,136,528
	$ 7,460,623	$ 6,863,496

(in thousands of dollars)

Investments limited as to use consist of the following:

	September 30, 2017		September 30, 2016	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Internally designated funds				
Reserved for capital expenditures	$ 852,813	$ -	$ 706,374	$ -
Unexpended academic and research gifts	-	2,660,599	-	2,456,587
Deferred compensation	-	306,940	-	259,152
Other	129,697	315,730	410,749	318,772
	982,510	3,283,269	1,117,123	3,034,511
Externally limited funds				
Unexpended funds on research	265,253	-	247,423	-
Contributions held for others	1,379	-	1,073	-
Professional liability trust fund	-	36,961	-	34,664
Held by trustees under debt and other	-	-	-	-
agreements	118,030	-	223,168	-
	384,662	36,961	471,664	34,664
	$ 1,367,172	$ 3,320,230	$ 1,588,787	$ 3,069,175

Investments and investments limited as to use are reported at either fair value or on the equity or cost methods of accounting. The composition of these investments, segregated between pooled investments and those that are separately invested, is as follows:

	September 30, 2017			
	At Fair Value	On Equity Method	On Cost Method	Total
Pooled investments				
Invested cash equivalents	$ 46,459	$ -	$ -	$ 46,459
Separately managed investments	1,502,489	-	-	1,502,489
Mutual funds	137,942	-	-	137,942
Commingled funds	1,227,012	-	-	1,227,012
Private partnerships	-	1,391,784	2,337,517	3,729,301
	2,913,902	1,391,784	2,337,517	6,643,203
Separately invested				
Invested cash equivalents	111,237	-	18	111,255
Equities	5,783	-	47,934	53,717
U.S. Government and domestic				
fixed income securities	26,059	-	-	26,059
Mutual funds	501,152	-	1	501,153
Other	26,980	22,306	75,950	125,236
	671,211	22,306	123,903	817,420
	$ 3,585,113	$ 1,414,090	$ 2,461,420	$ 7,460,623

(in thousands of dollars)

Separately managed investments include cash and equivalents of $172,055, equities of $669,466 and fixed income securities of $660,968 as of September 30, 2017.

	September 30, 2016			
	At Fair Value	**On Equity Method**	**On Cost Method**	**Total**
Pooled investments				
Invested cash equivalents	$ 102,646	$ -	$ -	$ 102,646
Separately managed investments	1,470,531	-	-	1,470,531
Mutual funds	116,568	-	-	116,568
Commingled funds	1,133,006	-	-	1,133,006
Private partnerships	-	1,155,879	2,060,638	3,216,517
	2,822,751	1,155,879	2,060,638	6,039,268
Separately invested				
Invested cash equivalents	205,719	-	15	205,734
Equities	5,527	-	42,714	48,241
U.S. Government and domestic fixed income securities	26,330	-	-	26,330
Mutual funds	442,244	-	-	442,244
Other	25,084	-	76,595	101,679
	704,904	-	119,324	824,228
	$ 3,527,655	$ 1,155,879	$ 2,179,962	$ 6,863,496

Separately managed investments include cash and equivalents of $235,172, equities of $604,855 and fixed income securities of $630,504 as of September 30, 2016.

For the private partnerships reflected in the balance sheet at cost, the difference (unrecorded net unrealized appreciation) between the value reported by the investment managers and the cost for these investments was $1,127,814 and $928,510 as of September 30, 2017 and 2016, respectively.

(in thousands of dollars)

The fair value and gross unrealized depreciation of investments and investments limited as to use, with a fair value less than cost, that are not deemed to be other-than-temporarily impaired as of September 30, 2017 are as follows:

	Less than 12 Months		12 Months or Greater	
	Fair Value	**Gross Unrealized Depreciation**	**Fair Value**	**Gross Unrealized Depreciation**
Pooled investments				
Separately managed investments	$ 516	$ (1)	$ -	$ -
Mutual funds	430	(2,187)	-	-
	946	(2,188)	-	-
Separately invested				
Equities	-	-	12	(3)
Fixed income securities	18,697	(53)	5,231	(42)
Mutual funds	9,327	(1)	-	-
	28,024	(54)	5,243	(45)
	$ 28,970	$ (2,242)	$ 5,243	$ (45)

In addition, for certain private partnerships recorded at cost, gross unrealized depreciation amounted to $34,586 as of September 30, 2017, with $25,675 of that amount unrealized for 12 months or greater.

Based on management's quantitative and qualitative assessment, investments whose cost exceeds fair value are not considered to be other-than-temporarily impaired as of September 30, 2017. Management believes these investments will recover their values and there is no intention to liquidate these positions.

(in thousands of dollars)

Investment income and gains (losses) from cash and equivalents, investments, investments limited as to use and beneficial interests in perpetual trusts comprise the following:

	Years Ended September 30, 2017	2016
Unrestricted		
Dividends, interest and other income	$ 35,521	$ 35,535
Endowment income distributions, net of reinvested gains	42,458	43,359
Net realized gains (losses) on investments		
Realized gains	205,263	87,259
Other-than-temporary impairment	(34,813)	(80,553)
Change in value of equity method investments	121,336	76,644
Recovery (losses) on endowment funds	7,025	4,133
Total investment activity included in excess of revenues over expenses	376,790	166,377
Change in net unrealized appreciation on marketable investments	209,260	200,042
Total unrestricted investment activity	586,050	366,419
Temporarily restricted		
Dividends and interest income	179	2,397
Endowment income distributions	(53,768)	(51,339)
Net realized gains (losses) on investments		
Realized gains	42,295	21,934
Other-than-temporary impairment	(5,643)	(17,604)
	(16,937)	(44,612)
Change in value of equity method investments	37,182	22,996
Change in net unrealized appreciation on marketable investments	66,547	34,303
(Recovery) losses on endowment funds	(7,025)	(4,133)
	96,704	53,166
Total temporarily restricted investment activity	79,767	8,554
Permanently restricted		
Dividends and interest income	(13)	(9)
Net realized gains on investments	52	46
Change in net unrealized appreciation on marketable investments	322	(340)
Change in value of beneficial interests in perpetual trusts	966	(182)
Total permanently restricted investment activity	1,327	(485)
	$ 667,144	$ 374,488

(in thousands of dollars)

Investment income included in operating results and excess of revenues over expenses comprise the following:

	Years Ended September 30, 2017	2016
Investment income included in operations and reported in other revenue	$ 13,100	$ 12,282
Investment income included in nonoperating gains and reported in		
Income from investments	223,363	61,102
Academic and research gifts, net of expenses	140,327	92,993
Total investment activity included in excess of revenues over expenses	$ 376,790	$ 166,377

6. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as exit price). Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. In determining fair value, the use of various valuation approaches, including market, income and cost approaches, is permitted.

Fair Value Hierarchy

A fair value hierarchy has been established based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the reporting entity's assumptions about the inputs market participants would use. The fair value hierarchy requires the reporting entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. In addition, for hierarchy classification purposes, the reporting entity should not look through the form of an investment to the nature of the underlying securities held by an investee.

The hierarchy is described below.

Level 1 Valuations using quoted prices in active markets for identical assets or liabilities. Valuations of these products do not require a significant degree of judgment. Level 1 assets and liabilities primarily include debt and equity securities that are traded in an active exchange market.

Level 2 Valuations using observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; broker or dealer quotations; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities primarily include debt securities with quoted prices that are traded less frequently than exchange-traded instruments as well as debt securities and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

(in thousands of dollars)

Level 3 Valuations using unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes assets and liabilities whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the reporting entity's assumptions about the assumptions market participants would use as well as those requiring significant management judgment.

Valuation Techniques

Pooled investments (except for private partnerships, which are reported on either the equity or cost method of accounting), separately invested cash equivalents and debt and equity securities are classified within Level 1 or Level 2 of the fair value hierarchy as they are valued using quoted market prices, broker or dealer quotations, or other observable pricing sources. Certain types of investments are classified within Level 3 of the fair value hierarchy because they have little or no market activity and therefore have little or no observable inputs with which to measure fair value.

The valuation of interest rate swaps is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

The following tables summarize fair value measurements as of September 30, 2017 and 2016 for financial assets and liabilities measured at fair value on a recurring basis:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Fair Value at September 30, 2017**
Assets				
Pooled investments				
Invested cash equivalents	$ 32,800	$ 13,659	$ -	$ 46,459
Separately managed investments	1,330,419	172,070	-	1,502,489
Mutual funds	137,942	-	-	137,942
Commingled funds	-	1,227,012	-	1,227,012
	1,501,161	1,412,741	-	2,913,902
Separately invested				
Invested cash equivalents	111,237	-	-	111,237
Equities	5,783	-	-	5,783
U.S. Government and domestic fixed income securities	26,059	-	-	26,059
Mutual funds	501,152	-	-	501,152
Beneficial interests in perpetual assets	-	-	26,980	26,980
	644,231	-	26,980	671,211
	$ 2,145,392	$ 1,412,741	$ 26,980	$ 3,585,113
Liabilities				
Interest rate swaps		$ 367,830		$ 367,830

(in thousands of dollars)

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Fair Value at September 30, 2016**
Assets				
Pooled investments				
Invested cash equivalents	$ 102,646	$ -	$ -	$ 102,646
Separately managed investments	1,196,027	274,504	-	1,470,531
Mutual funds	116,568	-	-	116,568
Commingled funds	-	1,133,006	-	1,133,006
	1,415,241	1,407,510	-	2,822,751
Separately invested				
Invested cash equivalents	205,719	-	-	205,719
Equities	5,527	-	-	5,527
U.S. Government and domestic fixed income securities	26,330	-	-	26,330
Mutual funds	442,244	-	-	442,244
Beneficial interests in perpetual assets	-	-	25,084	25,084
	679,820	-	25,084	704,904
	$ 2,095,061	$ 1,407,510	$ 25,084	$ 3,527,655
Liabilities				
Interest rate swaps		$ 510,172		$ 510,172

(in thousands of dollars)

7. Pledges Receivable and Contributions Receivable From Trusts

Pledges receivable represent unconditional promises to give and are net of allowances for uncollectible amounts. Pledges are recorded at the present value of their estimated future cash flows. Pledges collectible within one year are classified as other current assets, net of allowances, and total $94,527 and $100,280 as of September 30, 2017 and 2016, respectively. Estimated cash flows due after one year are discounted using published treasury bond and note yields that are commensurate with estimated collection risks. The blended discount rate was 1.7% and 0.9% for 2017 and 2016, respectively. Pledges are expected to be collected as follows:

	September 30, 2017	September 30, 2016
Amounts due		
Within one year	$ 108,506	$ 109,111
In one to five years	134,782	126,786
In more than five years	46,878	49,693
Total pledges receivable	290,166	285,590
Less: Unamortized discount	9,882	5,540
	280,284	280,050
Less: Allowance for uncollectibles	17,607	12,359
Net pledges receivable	262,677	267,691
Contributions receivable from trusts	31,580	27,273
	$ 294,257	$ 294,964

8. Property and Equipment

Property and equipment consists of the following:

	September 30, 2017	September 30, 2016
Land and land improvements	$ 227,952	$ 180,156
Buildings and building improvements	7,507,549	6,471,440
Equipment	2,757,263	2,297,392
Construction in progress	377,225	1,062,074
	10,869,989	10,011,062
Accumulated depreciation	(4,643,607)	(4,129,135)
Property and equipment, net	$ 6,226,382	$ 5,881,927

Depreciation expense for the years ended September 30, 2017 and 2016 was $620,672 and $549,082, respectively. Interest costs, net of interest earned, aggregating $8,727 and $40,042 were capitalized in 2017 and 2016, respectively.

(in thousands of dollars)

For the years ended September 30, 2017 and 2016, fully depreciated assets with an original cost of $357,837 and $151,927, respectively, were written off.

9. Accrued Medical Claims and Related Expenses

Accrued medical claims and related expenses include estimates of expected trends in claims severity, frequency, and other factors, which could vary as the claims are ultimately settled and are based principally upon historical experience. For the years ended September 30, 2017 and 2016, changes in estimates resulted in a decrease of accrued medical claims and related expense of $49,440 and $43,872, respectively. Increases (decreases) of this nature occur as the result of claim settlements and recoveries during the current year and as additional information is received regarding individual claims, causing changes from the original estimates of the cost of these claims. Ongoing analysis of the recent loss development trends is also taken into account in evaluating the overall adequacy of the reserves.

Changes in accrued medical claims and related expenses are as follows:

	2017	2016
Balance at beginning of year	$ 289,866	$ 232,268
Less:		
Premium deficiency reserve	(51,735)	(32,636)
Accrual for claims adjustment expenses	(6,192)	(4,877)
Accrued medical payables - other	(14,577)	(14,477)
Claim recoveries	-	(8,300)
Plus: Settlements payable, net	16,652	13,058
Net balance at beginning of year	234,014	185,036
Incurred related to		
Current year	2,393,818	2,470,782
Prior years	(49,440)	(43,872)
Total incurred	2,344,378	2,426,910
Paid related to		
Current year	2,187,269	2,219,247
Prior years	187,520	158,685
Total paid	2,374,789	2,377,932
Net balance at end of year	203,603	234,014
Plus:		
Premium deficiency reserve	-	51,735
Accrual for claims adjustment expenses	3,523	6,192
Accrued medical payables - other	7,197	14,577
Less: Settlements payable, net	(18,286)	(16,652)
Balance at end of year	$ 196,037	$ 289,866

(in thousands of dollars)

Medical claims and related expenses in the accompanying consolidated statements of operations include these amounts along with other nonclaims related costs. These nonclaims related expenses were for directly delivered services and medical cost risk sharing and incentives, totaling approximately $45,719 and $23,545 for the years ended September 30, 2017 and 2016, respectively.

10. Long-Term Obligations

Long-term obligations issued by PHS and its affiliates consist of the following:

	September 30, 2017	September 30, 2016
Massachusetts Health and Educational Facilities Authority (Authority) Revenue Bonds		
Series D*, variable interest rate of 0.78%, final maturity in 2017	$ -	$ 1,010
Series F*, variable interest rate of 1.01% and 0.80%, final maturity in 2040	235,150	237,350
Series G*, average fixed interest rate of 4.93%, variable interest rate of 0.87% and 0.90%, final maturity in 2047	283,250	303,240
Series H*, variable interest rate of 0.78% and 0.59%, final maturity in 2042	170,510	170,915
Series I*, average fixed interest rate of 4.84%, variable interest rate of 0.93% and 0.84%, final maturity in 2044	148,130	157,175
Series J*, average fixed interest rate of 5.01%, final maturity in 2039	403,650	415,010
Series P*, variable interest rate of 0.92% and 0.78%, final maturity in 2027	150,000	150,000
Massachusetts Development Finance Agency (Agency) Revenue Bonds		
Series K*, average fixed interest rate of 5.09%, variable interest rate of 0.93% and 0.87%, final maturity in 2046	234,760	244,760
Series L, average fixed interest rate of 4.95%, final maturity in 2041	307,505	311,735
Series M*, average fixed interest rate of 4.96%, variable interest rate of 1.26% and 1.18%, final maturity in 2048	491,920	493,100
Series N*, variable interest rate of 1.35% and 0.87%, final maturity in 2044	135,150	137,350
Series O*, average fixed interest rate of 4.60%, variable interest rate of 1.42% and 1.32%, final maturity in 2050	314,870	317,615
Series Q*, average fixed interest rate of 4.79%, final maturity in 2047	423,600	423,990
Series R*, variable interest rate of 1.40% and 0.92%, final maturity in 2052	100,000	100,000
New Hampshire Health and Education Facilities Authority Revenue Bonds		
Series 2011A, average fixed interest rate of 6.47%, final maturity in 2041	87,065	-
Series 2016A, variable interest rate of 1.55%, final maturity in 2031	15,180	-
Series 2016B, variable interest rate of 1.46%, final maturity in 2026	5,500	-
PHS Taxable Debt		
Series 2007 taxable bonds, fixed interest rate of 6.26%, final maturity in 2037	100,000	100,000
Series 2011 taxable bonds, fixed interest rate of 3.44%, final maturity in 2021	250,000	250,000
2012 Taxable Senior Notes, fixed interest rate of 4.11%, final maturity in 2052	400,000	400,000
2014 Taxable Senior Notes, fixed interest rate of 4.73%, final maturity in 2044	150,000	150,000
Series 2015 taxable bonds, fixed interest rate of 4.12%, final maturity in 2055	300,000	300,000
2016 Taxable Senior Notes, fixed interest rate of 3.89%, final maturity in 2046	225,000	225,000
Other obligations	5,312	5,712
Capital lease obligations	432	796
Total long-term obligations, par value	4,936,984	4,894,758
Unamortized discounts and premiums, net	148,277	154,374
Deferred financing costs	(28,324)	(29,393)
Total long-term obligations, net	5,056,937	5,019,739
Less: Current portion	615,151	441,018
	$ 4,441,786	$ 4,578,721

* Denotes series is issued in multiple subseries.
Variable interest rates are presented at September 30, 2017 and 2016, respectively.

(in thousands of dollars)

Aggregate maturities and payments of long-term obligations during the next five years and thereafter, and other amounts classified as current liabilities, are as follows:

	Scheduled Maturities	Bonds Supported by Partners HealthCare Liquidity	Bonds Supported by Bank Facilities	Total
2018	$ 73,636	$ 435,265	$ 106,250	$ 615,151
2019	75,238	-	-	75,238
2020	77,938	-	-	77,938
2021	83,203	-	-	83,203
2022	330,622	-	-	330,622
Thereafter	3,874,785	-	-	3,874,785
	$ 4,515,422	$ 435,265	$ 106,250	$ 5,056,937

The scheduled maturities represent annual payments as required under debt repayment schedules. The current portion of long-term obligations includes the payments scheduled to be made in 2018, bonds supported by Partners HealthCare liquidity that can be tendered prior to September 30, 2018, and bonds supported by bank facilities with financial institutions (standby bond purchase agreements or letters of credit) that expire prior to September 30, 2018. The bonds supported by Partners HealthCare liquidity provide the bondholder with an option to tender the bonds to Partners HealthCare. Accordingly, these bonds are classified as a current liability. The bonds supported by bank facilities provide the bondholder with an option to tender the bonds to the liquidity provider. Generally accepted accounting principles require bonds backed by bank facilities expiring within one year of the balance sheet date as well as potential principal amortization under bank facilities' term out provisions due within one year of the balance sheet date to be classified as a current liability.

Interest expense paid during the years ended September 30, 2017 and 2016 was $212,428 and $185,358, respectively.

In September 2016, PHS issued $225,000 of Partners HealthCare System Taxable Senior Notes. Proceeds from the notes were used to make a voluntary contribution to Partners HealthCare's defined benefit pension plans.

In March 2016, PHS issued $100,000 of Partners HealthCare System Series R Revenue Bonds. Proceeds from the bonds were used to finance certain capital projects.

In January 2016, PHS issued $423,990 of Partners HealthCare System Series Q Revenue Bonds, plus bond premium of $67,636. The bond proceeds, net of issuance costs of $3,732 were used to refund portions of Series F Bonds ($2,873), Series G Bonds ($8,068) and Series K bonds ($75,091) and to finance certain capital projects ($401,862).

Partners HealthCare bonds are general obligations of PHS supported by guarantees from BH, The Brigham and Women's Hospital, Inc. (BWH), MGH and The General Hospital Corporation (the General) which may be suspended under certain conditions.

(in thousands of dollars)

PHS and affiliate debt agreements contain certain covenants, including a minimum debt service coverage ratio and limitations on additional indebtedness and asset transfers.

Credit Agreement

Partners HealthCare maintains a $150,000 Credit Agreement (the Agreement) that provides access to same day funds. Advances under the Agreement bear a variable rate of interest based on the London Interbank Offered Rate (LIBOR). As of September 30, 2017, there were no amounts outstanding under the Agreement. The Agreement expires in June 2020.

11. Derivatives

Interest Rate Swaps

Partners HealthCare utilizes swap contracts to manage fluctuations in cash flows resulting from interest rate risk on certain of its variable rate bonds. These bonds expose Partners HealthCare to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, Partners HealthCare entered into various swap contracts involving the exchange of fixed rate payments by Partners HealthCare for variable rate payments from several counterparties based on a percentage of LIBOR.

By using swap contracts to manage the risk of changes in interest rates, Partners HealthCare exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the swap contracts. When the fair value of a swap contract is positive, the counterparty has a liability to Partners HealthCare, which creates credit risk. Partners HealthCare minimizes its credit risk by entering into swap contracts with several counterparties and requiring the counterparty to post collateral for the benefit of Partners HealthCare based on the credit rating of the counterparty and the fair value of the swap contract. Conversely, when the fair value of a swap contract is negative, Partners HealthCare has a liability to the counterparty and, therefore, it does not possess credit risk. Under certain circumstances, Partners HealthCare may be required to post collateral for the benefit of the counterparty. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

(in thousands of dollars)

The following is a summary of the outstanding positions under these swap contracts as of September 30, 2017:

Effective Date	Notional Amount	Maturity	Rate Paid	Rate Received
5/1/03	$ 150,000	7/1/35	4.40 %	67% 1-month LIBOR
10/15/03	9,945	1/1/31	3.85 %	70% 1-month LIBOR
7/1/05	150,000	7/1/40	3.63 %	67% 1-month LIBOR
7/1/05	30,100	7/1/25	5.11 %	67% 6-month LIBOR
9/1/05	5,060	1/1/23	3.26 %	70% 1-month LIBOR
7/1/07	150,000	7/1/42	3.46 %	67% 1-month LIBOR
7/1/09	100,000	7/1/44	3.71 %	67% 1-month LIBOR
7/1/11	100,000	7/1/46	3.74 %	67% 1-month LIBOR
7/1/13	100,000	7/1/48	3.80 %	67% 1-month LIBOR
7/1/15	50,000	7/1/50	3.80 %	67% 1-month LIBOR
4/1/16	50,000	7/1/50	3.93 %	67% 1-month LIBOR
4/1/16	50,000	7/1/52	3.59 %	67% 1-month LIBOR
7/1/17	50,000	7/1/52	3.74 %	67% 1-month LIBOR
7/1/19	50,000	7/1/49	1.85 %	67% 1-month LIBOR
7/1/21	50,000	7/1/51	1.84 %	67% 1-month LIBOR
7/1/23	50,000	7/1/53	1.82 %	67% 1-month LIBOR
7/1/24	100,000	7/1/54	1.81 %	67% 1-month LIBOR
7/1/25	50,000	7/1/55	1.77 %	67% 1-month LIBOR
7/1/26	100,000	7/1/56	1.78 %	67% 1-month LIBOR
7/1/27	100,000	7/1/57	1.78 %	67% 1-month LIBOR
Total	$ 1,495,105			

Partners HealthCare's swap contracts contain provisions that require collateral to be posted if the fair value of the swap exceeds certain thresholds. The collateral thresholds reflect the current credit ratings issued by major credit rating agencies on Partners HealthCare's and the counterparty's debt. Declines in Partners HealthCare's or the counterparty's credit ratings would result in lower collateral thresholds and, consequently, the potential for additional collateral postings by Partners HealthCare or the counterparty. As of September 30, 2017 and 2016, Partners HealthCare had posted collateral of $117,715 and $222,926, respectively. Partners HealthCare has established procedures to ensure that liquidity and securities are available to meet collateral posting requirements.

Upon the occurrence of certain events of default or termination events identified in the swap contracts, either Partners HealthCare or the counterparty could terminate the contracts in accordance with their terms. Termination results in the payment of a termination amount by one party that attempts to compensate the other party for its economic losses. If interest rates at the time of termination are lower than those specified in the swap contract, Partners HealthCare would make a payment to the counterparty. Conversely, if interest rates at such time are higher, the counterparty would make a payment to Partners HealthCare.

(in thousands of dollars)

Derivatives - Other
Partners HealthCare also enters into options and futures primarily as hedges on securities and indices primarily related to foreign currency. Forward contracts are used as currency hedges. These agreements are limited in use and generally do not exceed one year.

12. Commitments

Leases
Partners HealthCare has capital and noncancelable operating leases for certain buildings and equipment. Minimum future lease commitments under noncancelable leases for the next five years and thereafter are as follows:

	Capital Leases	Operating Leases
2018	$ 418	$ 169,170
2019	22	138,751
2020	4	124,266
2021	-	110,166
2022	-	87,585
Thereafter	-	364,199
Total lease payments	444	$ 994,137
Less: Amount representing interest	12	
Capital lease obligations at September 30, 2017	$ 432	

Rental expense under operating leases approximated $178,252 and $238,081 in 2017 and 2016, respectively.

Construction Projects
North Shore Medical Center, Inc. is constructing a new building and renovating the former Spaulding North Shore building to enable consolidation of services provided at the Union Hospital (Lynn) campus to the Salem Hospital location. The new building includes a new 65 bay emergency department, a fully outfitted 24 bed medical and surgical floor and a second floor shelled out for future medical and surgical demand. The former Spaulding North Shore building is being converted to a 90 bed psychiatric unit. As of September 30, 2017, accumulated costs incurred related to this campus consolidation project are approximately $40,900 with approximately $114,400 in outstanding commitments. The total cost of the project is expected to be approximately $207,000 with occupancy scheduled for Fall 2019.

(in thousands of dollars)

13. Pension and Postretirement Healthcare Benefit Plans

Substantially all employees of Partners HealthCare are covered under various noncontributory defined benefit pension plans and various defined contribution pension plans. In addition, certain affiliates provide subsidized healthcare benefits for retired employees on a self-insured basis, with the benefit obligation being partially funded. These retiree healthcare benefits are administered through an insurance company and are accounted for on the accrual basis, which includes an estimate of future payments for claims incurred.

In 2017, a Voluntary Retirement program was offered to a sub-set of BH employees who met specific criteria. For those employees who accepted the voluntary retirement package, the benefits of this program were conveyed as increased contributions to the defined benefit pension plan and the postretirement health plan. The total cost of this program was approximately $88,384, of which approximately $80,915 was for the defined benefit plan and $7,469 was for the postretirement plan. In September 2017, approximately $80,200 was funded into the defined benefit plan related to this program.

In 2017, MGH changed the guaranteed minimum interest credit given to its employees to 5.0% from 6.5% to comply with new regulations.

Total expense for these plans consists of the following:

	Years Ended September 30, 2017	2016
Defined benefit plans	$ 386,170	$ 287,156
Defined contribution plans	157,721	159,974
Postretirement healthcare benefit plans	5,733	6,754
	$ 549,624	$ 453,884

Information regarding benefit obligations, plan assets, funded status, expected cash flows and net periodic benefit cost follows within this footnote.

(in thousands of dollars)

Benefit Obligations

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	**2016**	**2017**	**2016**
Change in benefit obligations				
Benefit obligations at beginning of year	$ 6,855,889	$ 5,678,875	$ 151,875	$ 156,875
Service cost	337,981	295,014	3,502	5,060
Interest cost	261,797	262,977	4,087	5,725
Plan amendments (gain) loss	(267,820)	(85,804)	-	(34,797)
Actuarial (gain) loss	(171,081)	856,616	(7,762)	16,615
Special termination benefits	80,915	-	7,469	-
Benefits paid	(164,243)	(134,790)	(6,354)	(5,971)
Expenses paid	(17,359)	(17,174)	-	-
Employee contributions	157	175	8,283	8,368
Benefit obligations at end of year	$ 6,916,236	$ 6,855,889	$ 161,100	$ 151,875

The accumulated benefit obligation for all defined benefit pension plans at the end of 2017 and 2016 was $6,595,493 and $6,485,483, respectively.

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	**2016**	**2017**	**2016**
Weighted-average assumptions used to determine end of year benefit obligation				
Discount rate	3.90%	3.70%	2.85% - 3.85%	2.40% - 3.50%
Rate of compensation increase				
Professional staff	3.45% - 4.45%	4.45%	N/A	N/A
Other than professional staff	3.00%	3.00% - 3.50%	N/A	N/A
Healthcare cost trend rate for next year	N/A	N/A	5.00% - 6.00%	6.50%
Rate to which the cost trend rate is to decline	N/A	N/A	5.00%	5.00%
Year that rate reaches the ultimate trend rate	N/A	N/A	2020	2020

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

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on postretirement benefit obligation	$ 745	$ (735)

(in thousands of dollars)

Plan Assets

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	**2016**	**2017**	**2016**
Change in plan assets				
Fair value of plan assets at beginning of year	$ 5,069,057	$ 4,332,095	$ 85,426	$ 73,205
Actual return on plan assets	762,731	376,198	9,553	4,120
Employer contributions	388,894	512,553	6,354	5,704
Employee contributions	157	175	8,283	8,368
Benefits paid	(164,243)	(134,790)	(6,354)	(5,971)
Expenses paid	(17,359)	(17,174)	-	-
Fair value of plan assets at end of year	$ 6,039,237	$ 5,069,057	$ 103,262	$ 85,426

The assets of the defined benefit pension plans are aggregated in a single master trust (Master Trust) and managed as one asset pool. The investment objective for the Master Trust is to achieve the highest reasonable total return after considering (i) plan liabilities, (ii) funding status and projected cash flows, (iii) projected market returns, valuations and correlations for various asset classes and (iv) Partners HealthCare's ability and willingness to incur market risk.

Oversight of the management of Partners HealthCare's investable assets, including the Master Trust, is provided by the Investment Committee of the PHS Board of Directors which seeks to achieve incremental returns by manager selection and asset allocation (increasing/decreasing allocations within allowable ranges based on current and projected valuations). The Committee is supported by a professional staff, an outside investment consultant and a pension actuarial consultant.

Partners HealthCare utilizes a target allocation policy that balances projected returns, correlations and volatility of various asset classes within the overall risk tolerance. Asset allocations are managed based on relative valuations among and within asset classes and the perceived ability of managers to outperform passive benchmarks. Exposure by asset class is the sum of the net exposures reported by each manager. Asset allocation can and will deviate from target exposures and is regularly monitored for rebalancing opportunities.

The following table presents the capital allocations, reported exposures of the allocations and policy benchmarks by manager mandate within the Master Trust. Some managers, particularly real assets and less market sensitive managers, invest allocated capital among multiple policy benchmark asset classes.

	September 30, 2017			September 30, 2016		
	Dollars	**Reported Exposures**	**Policy Benchmark**	**Dollars**	**Reported Exposures**	**Policy Benchmark**
Global equity	$ 674,691	11 %	11 %	$ 411,834	8 %	10 %
Traditional U.S. equity	787,491	13	13	502,439	10	13
Traditional foreign developed equity	708,281	12	12	605,920	12	11
Traditional emerging markets equity	814,762	13	13	561,745	11	11
Private equity	474,426	8	8	424,014	8	9
Real assets	173,313	3	3	306,147	6	3
Less Market Sensitive managers	2,126,629	35	35	1,821,446	36	36
Fixed income managers	279,644	5	5	435,512	9	7
	$ 6,039,237	100 %	100 %	$ 5,069,057	100 %	100 %

(in thousands of dollars)

Within the Master Trust, assets are allocated to managers with investment mandates that may range from a single sub-asset class to very broad mandates; with restrictions that range from long-only to unconstrained; and with management structures ranging from separately managed funds to mutual/commingled funds to private partnerships. Less market sensitive managers employ absolute return, long/short equity and diversified strategies, which in the aggregate are expected to generate positive returns on a consistent basis. Other exposures include currency and volatility based strategies. Inflation defensive strategies include investments in real estate assets, commodities, timber and inflation protection bonds. Investment risks (concentration, correlation, valuation, liquidity, leverage, mandate compliance, etc.) are measured at the manager level as well as the pool level.

The postretirement healthcare benefit plans assets are invested in commingled funds with the objective of achieving returns to satisfy plan obligations and with a level of volatility commensurate with Partners HealthCare's overall financial profile.

The following table presents plan assets, by form of ownership, as of September 30, 2017 and 2016 measured at fair value on a recurring basis using the fair value hierarchy defined in Note 6:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Investments Valued Using NAV as a Practical Expedient**	**Fair Value at September 30, 2017**
Defined benefit pension plans				
Invested cash equivalents	$ 21,217	$ -	$ -	$ 21,217
Separately managed investments	693,171	328,558	-	1,021,729
Registered investments	118,902	-	-	118,902
Commingled funds	-	1,530,156	-	1,530,156
Private partnerships	-	-	3,347,233	3,347,233
	833,290	1,858,714	3,347,233	6,039,237
Postretirement healthcare benefit plans				
Commingled funds	11,717	82,452	9,093	103,262
Total plan assets	$ 845,007	$ 1,941,166	$ 3,356,326	$ 6,142,499

(in thousands of dollars)

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Investments Valued Using NAV as a Practical Expedient**	**Fair Value at September 30, 2016**
Defined benefit pension plans				
Invested cash equivalents	$ 187,184	$ -	$ -	$ 187,184
Separately managed investments	589,274	229,128	-	818,402
Registered investments	100,478	-	-	100,478
Commingled funds	-	1,132,414	-	1,132,414
Private partnerships	-	-	2,830,579	2,830,579
	876,936	1,361,542	2,830,579	5,069,057
Postretirement healthcare benefit plans				
Commingled funds	7,235	78,191	-	85,426
Total plan assets	$ 884,171	$ 1,439,733	$ 2,830,579	$ 5,154,483

In evaluating the Level at which Partners HealthCare's private partnerships have been classified within the fair value hierarchy, management has assessed factors including, but not limited to price transparency, the ability to redeem these investments at net asset value at the measurement date, and the existence or absence of certain restrictions at the measurement date. Investments in private partnerships generally have limited redemption options for investors and, subsequent to final closing, may or may not permit subscriptions by new or existing investors. These entities may also have the ability to impose gates, lockups and other restrictions on an investor's ability to readily redeem out of their investment interest in the fund. As of September 30, 2017 and 2016, Partners HealthCare has excluded all assets from the fair value hierarchy for which fair value is measured at net asset value per share using the practical expedient.

(in thousands of dollars)

Funded Status

The funded status of the plans recognized in the balance sheet and the amounts recognized in unrestricted net assets follows:

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	2016	2017	2016
End of year				
Fair value of plan assets at measurement date	$ 6,039,237	$ 5,069,057	$ 103,262	$ 85,426
Benefit obligations at measurement date	(6,916,236)	(6,855,889)	(161,100)	(151,875)
Funded status	$ (876,999)	$ (1,786,832)	$ (57,838)	$ (66,449)
Amounts recognized in the balance sheet consist of				
Current liabilities	$ (1,914)	$ (6,493)	$ (1,309)	$ (3,437)
Long-term liabilities	(875,085)	(1,780,339)	(56,529)	(63,012)
	$ (876,999)	$ (1,786,832)	$ (57,838)	$ (66,449)
Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets consist of				
Actuarial net loss (gain)	$ 1,940,521	$ 2,604,947	$ 14,975	$ 28,258
Prior service cost (credit)	(322,508)	(79,519)	(29,508)	(34,797)
	$ 1,618,013	$ 2,525,428	$ (14,533)	$ (6,539)
Amounts recognized in unrestricted net assets consist of				
Current year actuarial (gain) loss	$ (526,545)	$ 844,931	$ (11,348)	$ 17,793
Amortization of actuarial gain (loss)	(137,883)	(90,109)	(1,935)	(1,267)
Current year prior service cost (credit)	(267,820)	(85,804)	-	(34,797)
Amortization of prior service (cost) credit	24,833	(3,567)	5,289	-
	$ (907,415)	$ 665,451	$ (7,994)	$ (18,271)

At the end of 2017 and 2016, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with an accumulated benefit obligation in excess of plan assets were as follows:

	2017	2016
Accumulated benefit obligation in excess of plan assets		
Projected benefit obligation	$ 6,916,236	$ 6,855,889
Accumulated benefit obligation	6,595,493	6,485,483
Fair value of plan assets	6,039,237	5,069,057

(in thousands of dollars)

Expected Cash Flows

Information about the expected cash flows for the defined benefit and postretirement healthcare benefit plans is as follows:

	Defined Benefit Pension Plans	Postretirement Healthcare Benefit Plans	Medicare Subsidy
Expected employer contributions			
2018	$ 272,754	$ 6,421	
Expected benefit payments (receipts)			
2018	$ 315,956	$ 6,439	$ (18)
2019	315,363	7,936	(16)
2020	336,832	9,400	(14)
2021	355,749	10,792	(12)
2022	368,906	12,268	(11)
2023-2027	2,064,325	82,100	(36)

Net Periodic Benefit Cost

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	**2016**	**2017**	**2016**
Service cost	$ 337,981	$ 295,014	$ 3,502	$ 5,060
Interest cost	261,797	262,977	4,087	5,725
Expected return on plan assets	(407,573)	(364,511)	(5,971)	(5,298)
Special termination benefits	80,915	-	7,469	-
Amortization of				
Prior service cost (credit)	(24,833)	3,567	(5,289)	-
Actuarial net (gain) loss	137,883	90,109	1,935	1,267
Net periodic benefit cost	$ 386,170	$ 287,156	$ 5,733	$ 6,754

Amounts expected to be amortized from unrestricted net assets into net periodic benefit cost during the year ending September 30, 2018 are as follows:

	Defined Benefit Pension Plans	Postretirement Healthcare Benefit Plans
Actuarial net loss (gain)	$ 133,111	$ 847
Prior service cost (credit)	(32,338)	(5,289)

(in thousands of dollars)

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2017	**2016**	**2017**	**2016**
Weighted-average assumptions used to determine net periodic pension and postretirement cost				
Discount rate	3.70% - 4.20%	4.50 %	2.40 %	3.00 % - 4.55 %
Expected return on plan assets	7.50 %	7.75 %	7.00 %	7.50 %
Rate of compensation increase				
Professional staff	4.45 %	4.45 %	N/A	N/A
Other than professional staff	3.00% - 3.50%	3.00 % - 3.50 %	N/A	N/A
Healthcare cost trend rate for this year	N/A	N/A	5.00% - 6.50%	7.00 %
Rate to which the cost trend rate is to decline	N/A	N/A	5.00%	5.00 %
Year that rate reaches the ultimate trend rate	N/A	N/A	2020	2021

Partners HealthCare uses a long-term return assumption which is validated annually by obtaining long-term asset return, volatility and correlation projections for relevant asset class indexes; modifying volatility and correlations to reflect the actual historical experience of the active managers; calculating the expected return using benchmark weights and indexes; and comparing the return assumption to the sum of the expected return and the historical outperformance of the actual return versus the benchmark. Partners HealthCare regularly monitors the active risk of the Master Trust by a statistical regression of the return series of the actual portfolio to that of the policy benchmark.

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

	One-Percentage-Point	
	Increase	**Decrease**
Effect on service and interest cost	$ 90	$ (70)

14. Professional Liability Insurance

Partners HealthCare insures substantially all of its professional and general liability risk on a claims-made basis in cooperation with other healthcare organizations in the Greater Boston area through a captive insurance company, Controlled Risk Insurance Company Ltd. (CRICO). PHS owns 10% of CRICO. The investment is accounted for on the cost basis of accounting. The policies cover claims made during their respective terms, but not those occurrences for which claims may be made after expiration of the policy, except for certain tail liabilities which CRICO has assumed on an occurrence basis through December 31, 2017. Management intends to renew its coverage on a claims-made basis and has no reason to believe that it will be prevented from such renewal. In October 2017, CRICO announced it will pay a dividend to its members in December 2017. As a result, Partners HealthCare anticipates receiving $84,900.

(in thousands of dollars)

Partners HealthCare follows the accounting policy of establishing reserves to cover the ultimate costs of medical malpractice claims, which include costs associated with litigating or settling claims. The liability also includes an estimated tail liability, established to cover all malpractice claims incurred but not reported to the insurance company as of the end of the year. The total malpractice liability of $476,083 and $487,705 as of September 30, 2017 and 2016, respectively, is presented as an accrued professional liability in the consolidated balance sheets. These reserves have been recorded on a discounted basis using an interest rate of 3.5% and 3.0% as of September 30, 2017 and 2016, respectively.

Partners HealthCare also recognizes an insurance receivable from CRICO, at the same time that it recognizes the liability, measured on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts. The insurance receivable of $401,394 and $402,649 as of September 30, 2017 and 2016, respectively, is reported as a component of other assets in the consolidated balance sheets.

Management is not aware of any claims against Partners HealthCare or factors affecting CRICO that would cause the expense for professional liability risks to vary materially from the amount provided.

15. Concentration of Credit Risk

Financial instruments that potentially subject Partners HealthCare to concentration of credit risk consist of patient accounts receivable, research grants receivable, pledges receivable, premiums receivable, certain investments and interest rate swaps.

Partners HealthCare receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payers, including Medicare, Medicaid, Blue Cross and Blue Shield of Massachusetts, Harvard Pilgrim Health Care and Tufts Health Plan. Research funding is provided through many government and private sponsors. NHP receives a significant portion of its premium revenue from the Commonwealth. Pledges receivable are due from multiple donors. Partners HealthCare assesses the credit risk for pledges based on history and the financial wherewithal of donors, most of which are individuals or organizations well known to Partners HealthCare.

Investments, which include government and agency securities, stocks and corporate bonds, and private partnerships and other investments are not concentrated in any corporation or industry or with any single counterparty. Alternative investments are less liquid than Partners HealthCare's other investments. The reported values of the alternative investments may differ significantly from the values that would have been used had a ready market for those securities existed. These instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments and nondisclosure of portfolio composition.

Partners HealthCare minimizes the credit risk it is exposed to under interest rate swap agreements by utilizing several counterparties and requiring the counterparties to post collateral for the benefit of Partners HealthCare when the fair value of the swap is positive. Partners HealthCare minimizes its counterparty risk by contracting with nine counterparties, none of which accounts for more than 20% of the aggregate notional amount of the swap contracts.

(in thousands of dollars)

16. Net Assets

Restricted net assets are available for the following purposes:

	September 30, 2017	September 30, 2016
Temporarily restricted		
Charity care	$ 100,858	$ 90,525
Buildings and equipment	82,119	80,644
Clinical care, research and academic	704,554	619,717
	$ 887,531	$ 790,886
Permanently restricted		
Charity care	$ 21,772	$ 20,001
Buildings and equipment	2,433	2,433
Clinical care, research and academic	663,203	600,752
	$ 687,408	$ 623,186

Endowment
Partners HealthCare's endowment consists of numerous individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the boards to function as endowment.

Partners HealthCare has interpreted UPMIFA as requiring the preservation of the value of the original gift of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Partners HealthCare classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts donated 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 that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Partners HealthCare in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Partners HealthCare considers several factors in making a determination to appropriate or accumulate donor-restricted endowment funds. These factors include: the duration and preservation of the fund; the purposes of the organization and the donor-restricted endowment fund; general economic conditions; the possible effect of inflation and deflation; the expected total return from income and the appreciation of investments; other resources of the organization; and the investment policies of the organization.

Endowment Funds with Deficits
From time to time, the value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts. When such endowment deficits exist, they are classified as a reduction to unrestricted net assets. Deficits of this nature reported in unrestricted net assets were $135 and $7,159 as of September 30, 2017 and 2016, respectively. These deficits resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions or subsequent endowment additions.

(in thousands of dollars)

The following presents the endowment net asset composition by type of fund as of September 30, 2017 and 2016 and the changes in endowment assets for the years ended September 30, 2017 and 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net asset composition by type of fund as of September 30, 2017				
Donor-restricted endowment funds	$ (135)	$ 499,875	$ 665,718	$ 1,165,458
Board-designated endowment funds	1,193,620	-	-	1,193,620
Total funds	$ 1,193,485	$ 499,875	$ 665,718	$ 2,359,078

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Changes in endowment net assets				
Endowment net assets at September 30, 2016	$ 972,040	$ 419,900	$ 602,658	$ 1,994,598
Investment return				
Investment income	959	24	-	983
Net realized and unrealized appreciation (depreciation)	150,089	134,481	163	284,733
Total investment return	151,048	134,505	163	285,716
Contributions	5,437	(497)	60,498	65,438
Appropriation of endowment assets for expenditure	(45,683)	(53,464)	-	(99,147)
Other changes	110,643	(569)	2,399	112,473
Total changes	221,445	79,975	63,060	364,480
Endowment net assets at September 30, 2017	$ 1,193,485	$ 499,875	$ 665,718	$ 2,359,078

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net asset composition by type of fund as of September 30, 2016				
Donor-restricted endowment funds	$ (7,159)	$ 419,900	$ 602,658	$ 1,015,399
Board-designated endowment funds	979,199	-	-	979,199
Total funds	$ 972,040	$ 419,900	$ 602,658	$ 1,994,598

(in thousands of dollars)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Changes in endowment net assets				
Endowment net assets at October 1, 2015	$ 874,088	$ 410,816	$ 558,507	$ 1,843,411
Investment return				
Investment income	2,225	1,628	-	3,853
Net realized and unrealized appreciation (depreciation)	66,408	57,931	54	124,393
Total investment return	68,633	59,559	54	128,246
Contributions	7,138	(102)	44,097	51,133
Appropriation of endowment assets for expenditure	(42,464)	(50,373)	-	(92,837)
Other changes	64,645	-	-	64,645
Total changes	97,952	9,084	44,151	151,187
Endowment net assets at September 30, 2016	$ 972,040	$ 419,900	$ 602,658	$ 1,994,598

Conditional Pledge

During 2009, the General signed an agreement (Ragon Agreement) with The Massachusetts Institute of Technology (MIT), The President and Fellows of Harvard College (Harvard) and The Phillip T. and Susan M. Ragon Foundation (Ragon Foundation) to establish the Phillip T. and Susan M. Ragon Institute (Ragon Institute) as a joint research center of the General, MIT and Harvard with the purpose of harnessing the potential of the immune response to combat and conquer human diseases, integrating biomedical research with emerging engineering technologies (with the main initial focus being the development of an AIDS vaccine) and educating and training scientists. The Ragon Foundation committed to provide funding for the Ragon Institute of $100,000 over ten years through the General (as the administrative home for the Ragon Institute), beginning retroactively on January 1, 2008. The Ragon Foundation has the ability to slow, suspend or eliminate funding based on restrictions described in the Ragon Agreement. Additionally, any funding not paid by December 31, 2017 would no longer be due by the Ragon Foundation. In February 2014, an amendment was signed (Ragon Amendment) that noted that the current agreement would be completed by December 2018 and that an additional $50,000 of funding would be committed by the Ragon Foundation over five years beginning in 2019. Due to the conditions within the Ragon Agreement, funding is recognized when received, with no pledge receivable recorded for the balance of the amended commitment.

Through September 30, 2017, total funding of $111,213 was received (including $5,213 of endowment earnings distributed), with $13,161 received for the year ended September 30, 2017 (including $2,161 of endowment earnings distributed), and total net expenses of $88,484 were incurred, including $9,626 for the year ended September 30, 2017. As of September 30, 2017, unspent funding has been recorded as temporarily restricted net assets, to be released to unrestricted net assets after qualifying expenses have been incurred.

(in thousands of dollars)

17. Functional Expenses

Total operating expenses by function are as follows:

	Years Ended September 30,	
	2017	2016
Healthcare services	$ 8,403,658	$ 7,682,556
Research and academic	1,828,057	1,731,772
Medical claims and related expenses	1,890,368	2,017,773
General and administrative	1,196,410	1,193,665
	$ 13,318,493	$ 12,625,766

18. Contingencies

Partners HealthCare is subject to complaints, claims and litigation which arise in the normal course of business. In addition, Partners HealthCare is subject to reviews and investigations by various federal and state government agencies to assure compliance with applicable laws, some of which are subject to different interpretations. Governmental review of compliance by healthcare institutions, including Partners HealthCare, has increased.

19. Pending Transactions

Partners HealthCare has entered a definitive agreement to combine the operations of the Foundation of Massachusetts Eye and Ear Infirmary, Inc. into Partners HealthCare. This transaction is currently in regulatory review by various Commonwealth agencies.

20. Subsequent Events

Partners HealthCare has assessed the impact of subsequent events through December 8, 2017, the date the audited financial statements were issued. During this period, there were no subsequent events that require adjustment to the audited financial statements. Other than the CRICO dividend described in Note 14, there were no events that require disclosure in the notes of the audited financial statements.