

# **UMass Memorial Health Care, Inc. and Affiliates**

**Consolidated Financial Statements with  
Supplemental Consolidating Information  
(Obligated Group)  
September 30, 2015 and 2014**

# UMass Memorial Health Care, Inc. and Affiliates

## Index

September 30, 2015 and 2014

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|   | Page(s)    |
|---|------------|
| <b>Independent Auditor's Report .....</b>                               | <b>1-2</b> |
| <b>Financial Statements</b>   |            |
| Consolidated Balance Sheets .....                                       | 3          |
| Consolidated Statements of Operations .....                             | 4          |
| Consolidated Statements of Changes in Net Assets .....                  | 5          |
| Consolidated Statements of Cash Flows .....                             | 6          |
| Notes to Consolidated Financial Statements .....                        | 7-53       |
| <b>Supplemental Consolidating Information</b>                           |            |
| <b>Consolidating Balance Sheet Information</b>                          |            |
| UMass Memorial Health Care, Inc. and Affiliates - Obligated Group ..... | 54-55      |
| <b>Consolidating Statement of Operations Information</b>                |            |
| UMass Memorial Health Care, Inc. and Affiliates - Obligated Group ..... | 56-57      |
| Notes to Supplemental Schedules .....                                   | 58         |



## **Independent Auditor's Report**

To the Board of Trustees of  
UMass Memorial Health Care, Inc.

We have audited the accompanying consolidated financial statements of UMass Memorial Health Care, Inc. and Affiliates (the "System"), which comprise the consolidated balance sheets as of September 30, 2015 and 2014, and the related consolidated statements of operations, changes in net assets, and 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's 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 the System's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of UMass Memorial Health Care, Inc. and Affiliates at September 30, 2015 and 2014, and the results of their operations, changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Other Matter***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplemental consolidating information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The supplemental consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual entities and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position and results of operations of the individual entities.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

December 17, 2015

**UMass Memorial Health Care, Inc. and Affiliates**  
**Consolidated Balance Sheets**  
**September 30, 2015 and 2014**

(in thousands of dollars)

|  | 2015                | 2014                |
|--|---------------------|---------------------|
| <b>Assets</b>  |                     |                     |
| Current assets   |                     |                     |
| Cash and cash equivalents  | \$ 162,456          | \$ 121,684          |
| Short-term investments   | 31,792              | 36,926              |
| Current portion of assets whose use is limited   | 8,700               | 6,705               |
| Patient accounts receivable, net of allowance for doubtful accounts of \$55,445 in 2015 and \$58,323 in 2014 | 237,658             | 241,148             |
| Inventories  | 29,135              | 24,763              |
| Prepaid expenses and other current assets  | 30,488              | 44,682              |
| Estimated settlements receivable from third-party payors   | 353,793             | 212,262             |
| Total current assets   | <u>854,022</u>      | <u>688,170</u>      |
| Assets whose use is limited  |                     |                     |
| Funds held in escrow under bond indenture agreements, net of current portion                                 | 12,103              | 12,009              |
| Restricted investments   | 88,195              | 81,889              |
| Captive insurance company investments  | 164,440             | 172,258             |
| Total assets whose use is limited  | <u>264,738</u>      | <u>266,156</u>      |
| Long-term investments  | 404,945             | 431,473             |
| Property and equipment, net  | 594,222             | 628,373             |
| Beneficial interest in trusts  | 7,991               | 15,675              |
| Other assets   | 77,748              | 49,076              |
| Total assets   | <u>\$ 2,203,666</u> | <u>\$ 2,078,923</u> |
| <b>Liabilities and Net Assets</b>  |                     |                     |
| Current liabilities  |                     |                     |
| Accounts payable and accrued expenses  | \$ 145,288          | \$ 142,275          |
| Accrued compensation   | 142,335             | 138,477             |
| Estimated settlements payable to third-party payors  | 21,593              | 16,477              |
| Debt, current  | 87,698              | 27,772              |
| Due to the University of Massachusetts   | 166,220             | 67,033              |
| Total current liabilities  | <u>563,134</u>      | <u>392,034</u>      |
| Estimated settlements payable to third-party payors, net of current portion                                  | 39,845              | 39,232              |
| Other noncurrent liabilities   | 23,429              | 25,192              |
| Accrued pension and postretirement benefit obligations   | 205,127             | 207,794             |
| Estimated self-insurance costs   | 165,372             | 171,955             |
| Debt, net of current portion   | 339,049             | 363,932             |
| Total liabilities  | <u>1,335,956</u>    | <u>1,200,139</u>    |
| Commitments and contingencies  |                     |                     |
| Net assets   |                     |                     |
| Unrestricted   | 770,804             | 778,744             |
| Temporarily restricted   | 42,537              | 47,906              |
| Permanently restricted   | 54,369              | 52,134              |
| Total net assets   | <u>867,710</u>      | <u>878,784</u>      |
| Total liabilities and net assets   | <u>\$ 2,203,666</u> | <u>\$ 2,078,923</u> |

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

**UMass Memorial Health Care, Inc. and Affiliates**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2015 and 2014**

(in thousands of dollars)

|   | 2015         | 2014         |
|---|--------------|--------------|
| <b>Unrestricted revenues, gains and other support</b>                             |              |              |
| Net patient service revenue   | \$ 2,173,845 | \$ 2,152,087 |
| Less: Provision for bad debts   | (48,863)     | (43,989)     |
| Net patient service revenue less provision for bad debts                          | 2,124,982    | 2,108,098    |
| Net assets released from restrictions used for operations                         | 2,618        | 2,985        |
| Other revenue   | 114,110      | 141,125      |
| Total revenues, gains and other support   | 2,241,710    | 2,252,208    |
| <b>Expenses</b>   |              |              |
| Salaries, benefits and contracted labor   | 1,298,997    | 1,293,021    |
| Supplies and other expense  | 766,299      | 798,014      |
| Depreciation and amortization   | 104,230      | 92,905       |
| Interest  | 14,146       | 14,441       |
| Total expenses  | 2,183,672    | 2,198,381    |
| Income from operations before nonrecurring income and expenses                    | 58,038       | 53,827       |
| Gain (loss) on sale of business (Note 15)   | 13,295       | (9,155)      |
| Expense reductions associated with sale of business (Note 15)                     | 873          | 853          |
| Expenses associated with reduction in force (Note 16)                             | -            | (16,478)     |
| Income from operations after nonrecurring income and expenses                     | 72,206       | 29,047       |
| Nonoperating income (loss)  |              |              |
| Investment and other related income   | 5,608        | 5,490        |
| Net realized and unrealized (loss) gain on investments                            | (30,815)     | 26,115       |
| Actuarial change in the present value of annuities                                | (352)        | 190          |
| Total nonoperating (loss) income  | (25,559)     | 31,795       |
| Excess of revenues over expenses  | 46,647       | 60,842       |
| Other changes in net assets   |              |              |
| Gain on sale from discontinued operations (Note 17)                               | -            | 1,439        |
| Loss on transfer of membership interest (Note 17)                                 | -            | (11,187)     |
| Contributions for property and equipment  | 1,958        | -            |
| Net assets released from restrictions used for purchase of property and equipment | 773          | 2,560        |
| Pension-related changes other than net periodic cost                              | (57,318)     | (36,398)     |
| (Decrease) increase in unrestricted net assets                                    | (7,940)      | 17,256       |
| Unrestricted net assets, beginning of year  | 778,744      | 761,488      |
| Unrestricted net assets, end of year  | \$ 770,804   | \$ 778,744   |

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

**UMass Memorial Health Care, Inc. and Affiliates**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended September 30, 2015 and 2014**

| <i>(in thousands of dollars)</i>                        | <b>Unrestricted</b> | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>      |
|---|---------------------|-----------------------------------|-----------------------------------|-------------------|
| <b>Net assets - September 30, 2013</b>                  | \$ 761,488          | \$ 44,987                         | \$ 53,877                         | \$ 860,352        |
| Excess of revenues over expenses                        | 60,842              | -                                 | -                                 | 60,842            |
| Gain on sale from discontinued operations               | 1,439               | -                                 | -                                 | 1,439             |
| Loss on transfer of membership interest                 | (11,187)            | (1,038)                           | (2,195)                           | (14,420)          |
| Contributions   | -                   | 3,674                             | -                                 | 3,674             |
| Investment and other related income                     | -                   | 1,110                             | -                                 | 1,110             |
| Net assets released from restrictions                   |                     |                                   |                                   |                   |
| Used for purchase of property and equipment             | 2,560               | (2,560)                           | -                                 | -                 |
| Used for operations                                     | -                   | (2,985)                           | -                                 | (2,985)           |
| Net realized gain on sale of investments                | -                   | 5,609                             | -                                 | 5,609             |
| Change in unrealized gains and losses<br>on investments | -                   | (891)                             | -                                 | (891)             |
| Change in beneficial interest in trusts and other       | -                   | -                                 | 452                               | 452               |
| Pension-related changes other than net<br>periodic cost | (36,398)            | -                                 | -                                 | (36,398)          |
| Total increase (decrease) in net assets                 | 17,256              | 2,919                             | (1,743)                           | 18,432            |
| <b>Net assets - September 30, 2014</b>                  | 778,744             | 47,906                            | 52,134                            | 878,784           |
| Excess of revenues over expenses                        | 46,647              | -                                 | -                                 | 46,647            |
| Contributions   | -                   | 685                               | 2,879                             | 3,564             |
| Investment and other related income                     | -                   | 1,143                             | -                                 | 1,143             |
| Net assets released from restrictions                   |                     |                                   |                                   |                   |
| Used for purchase of property and equipment             | 773                 | (773)                             | -                                 | -                 |
| Used for operations                                     | -                   | (2,618)                           | -                                 | (2,618)           |
| Net realized gain on sale of investments                | -                   | 2,762                             | -                                 | 2,762             |
| Contributions for property and equipment                | 1,958               | -                                 | -                                 | 1,958             |
| Change in unrealized gains and losses<br>on investments | -                   | (6,568)                           | -                                 | (6,568)           |
| Change in beneficial interest in trusts and other       | -                   | -                                 | (644)                             | (644)             |
| Pension-related changes other than net<br>periodic cost | (57,318)            | -                                 | -                                 | (57,318)          |
| Total increase (decrease) in net assets                 | (7,940)             | (5,369)                           | 2,235                             | (11,074)          |
| <b>Net assets - September 30, 2015</b>                  | <u>\$ 770,804</u>   | <u>\$ 42,537</u>                  | <u>\$ 54,369</u>                  | <u>\$ 867,710</u> |

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

**UMass Memorial Health Care, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows**  
**Years Ended September 30, 2015 and 2014**

(in thousands of dollars)

|   | 2015              | 2014              |
|---|-------------------|-------------------|
| <b>Cash flows from operating activities</b>   |                   |                   |
| Change in net assets  | \$ (11,074)       | \$ 18,432         |
| Adjustments to reconcile change in net assets<br>to net cash provided by (used in) operating activities |                   |                   |
| Net unrealized loss on investments  | 51,221            | 504               |
| Depreciation and amortization   | 104,230           | 92,905            |
| Accretion on asset retirement obligation  | 510               | 575               |
| Provision for bad debts   | 48,241            | 44,830            |
| Net loss not yet recognized in net periodic pension cost  | 57,318            | 36,398            |
| Actuarial change in the present value of annuities  | 352               | (190)             |
| Net realized gain on sale of investments  | (26,882)          | (38,050)          |
| Restricted contributions  | (3,541)           | (3,274)           |
| (Gain) loss on sale of business, net of expense reductions  | (14,168)          | 8,302             |
| Loss on disposal of assets  | 161               | 1,477             |
| Gain on sale from discontinued operations   | -                 | (266)             |
| Loss on transfer of membership interest   | -                 | 14,420            |
| Change in beneficial interest in trusts   | 644               | (452)             |
| (Decrease) increase in cash resulting from a change in  |                   |                   |
| Patient accounts receivable   | (45,373)          | (21,676)          |
| Inventories, prepaid expenses and other current assets  | 4,289             | (11,194)          |
| Contributions receivable  | (23)              | (400)             |
| Accounts payable, accrued expenses and accrued compensation   | (3,261)           | (6,090)           |
| Estimated settlements with third-party payors   | (135,802)         | (64,327)          |
| Due to the University of Massachusetts  | 99,179            | 5,858             |
| Other noncurrent assets and liabilities   | 112               | 12,988            |
| Accrued pension and postretirement benefit obligations  | (59,988)          | (9,677)           |
| Estimated self-insurance costs  | (6,583)           | 415               |
| Net cash used in operating activities of discontinuing operations                                       | -                 | (1,431)           |
| Net cash provided by operating activities   | <u>59,562</u>     | <u>80,077</u>     |
| <b>Cash flows from investing activities</b>   |                   |                   |
| Purchases of property and equipment   | (58,899)          | (68,615)          |
| Proceeds on the transfer of membership interest   | -                 | 39,675            |
| Net cash used in investing activities of discontinuing operations                                       | -                 | (846)             |
| Purchases of investments  | (462,517)         | (463,057)         |
| Proceeds from sales and maturities of investments   | 469,236           | 453,358           |
| Proceeds from restricted contributions of securities  | -                 | 88                |
| Net cash used in investing activities   | <u>(52,180)</u>   | <u>(39,397)</u>   |
| <b>Cash flows from financing activities</b>   |                   |                   |
| Proceeds from restricted contributions  | 662               | 3,186             |
| Net cash provided by financing activities of discontinuing operations                                   | -                 | 618               |
| Cash received on contributions receivable for long-term purposes  | 482               | 855               |
| Cash received for beneficial interest agreements  | 9,919             | -                 |
| Payments on annuity obligation  | (562)             | -                 |
| Payments on long-term debt and capital lease obligations  | (54,906)          | (45,578)          |
| Proceeds from borrowings under line of credit and long-term debt  | <u>77,795</u>     | <u>5,625</u>      |
| Net cash provided by (used in) financing activities   | <u>33,390</u>     | <u>(35,294)</u>   |
| Net increase in cash and cash equivalents   | 40,772            | 5,386             |
| Cash and cash equivalents, beginning of year  | <u>121,684</u>    | <u>116,298</u>    |
| Cash and cash equivalents, end of year  | <u>\$ 162,456</u> | <u>\$ 121,684</u> |

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



# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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#### 1. Description of the Organization

UMass Memorial Health Care, Inc. ("UMass Memorial"), a Massachusetts not-for-profit corporation, was formed in 1998 pursuant to state legislation to develop and coordinate an integrated health care delivery system. UMass Memorial was established through the combination of Memorial Health Care, Inc., the University of Massachusetts (the "University") Medical School Teaching Hospital Trust Fund, the University of Massachusetts Clinical Services Division ("Clinical Services Division") and Worcester City Campus Corporation d/b/a UMass Health System and their affiliates. The combination is referred to herein as the "Merger." UMass Memorial is the direct or indirect member, stockholder, owner, or partner of a number of corporations, limited liability companies, and partnerships (the "Affiliates") that provide a broad range of health care and related services to Worcester and the surrounding central Massachusetts communities. The accompanying consolidated financial statements include:

##### **Hospitals**

UMass Memorial Medical Center, Inc. (the "Medical Center") operates a 779-bed acute care hospital located on two principal campuses and provides a full range of services, including all major specialties and subspecialties of inpatient care and ambulatory care.

UMass Memorial Community Hospitals, Inc. ("Hospitals, Inc.") (formerly UMass Memorial Hospitals, Inc.), a subsidiary of UMass Memorial, is the sole corporate member of Central New England HealthAlliance, Inc. ("CNEHA"). CNEHA is the parent organization of HealthAlliance Hospitals, Inc. ("HAH"), which operates a general acute-care hospital facility on two campuses in Leominster and Fitchburg, Massachusetts, with a total of 122 beds.

Hospitals, Inc. is the sole corporate member of Clinton Hospital Association, a 41-bed community hospital located in Clinton, Massachusetts; and Marlborough Hospital, a 79-bed community hospital located in Marlborough, Massachusetts. Hospitals, Inc. was the sole corporate member of Wing Memorial Hospital until September 1, 2014 (Note 17).

##### **Physician Practices**

UMass Memorial Medical Group, Inc. (the "Medical Group") is an UMass Memorial subsidiary that resulted from the merger of the Medical Group, UMass Community Physicians, Inc., and UMass Memorial Community Physician Group, Inc. The Medical Group is the principal provider of physician services to the System. The Medical Group consists of approximately 1,048 physicians who provide primary care and specialty services at various locations in and around Worcester, Massachusetts.

##### **Ventures**

UMass Memorial Health Ventures, Inc. and Affiliates ("Ventures") is comprised of several entities located in Worcester, Massachusetts. These entities focus on outpatient and non-acute healthcare services.

##### **Other Providers**

UMass Memorial and its affiliates also operate a number of related health care businesses and support organizations.

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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## 2. Summary of Significant Accounting Policies

### Reporting Entity

The accompanying financial statements include the accounts of UMass Memorial and all of its majority-owned and controlled affiliates (the "System"). Intercompany accounts and transactions have been eliminated in preparing the consolidated financial statements. The assets of any one of the members of the consolidated group may not be available to meet the obligations of other affiliates in the group. UMass Memorial, the Medical Center, Ventures and HAH are referred to herein as the "Obligated Group".

### 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. Estimates also affect the reported amounts of revenue and expenses during the reporting period. The System's significant estimates include the allowance for doubtful patient accounts receivable, valuation of its investments, estimated contractual allowances and settlements due from and to third-party payors, estimated professional liability costs, asset retirement obligations, estimated useful lives, pension and benefit obligations, and other reserves for self-insured claims. Actual results could differ from those estimates.

### Revenue Recognition

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Under the terms of various agreements, regulations, and statutes, certain elements of third-party reimbursement are subject to negotiation, audit and/or final determination by the third-party payors. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Differences between preliminary estimates of net patient service revenue and final third-party settlements are included in net patient service revenue in the year in which the settlement or change in estimate occurs. Changes in prior year estimates, excluding the impact of Special Medicaid Payments, increased net patient service revenue by approximately \$21,478,000 in 2015 and \$16,819,000 in 2014.

A portion of estimated settlements with third-party payors has been classified as noncurrent since such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year.

### Other Revenue

In fiscal years 2015 and 2014, the System received incentive payments relating to Electronic Health Records ("EHR") of \$4,276,000 and \$12,773,000, respectively, as part of the American Recovery and Reinvestment Act of 2009 ("ARRA"). The provisions of the ARRA allow for incentive payments to eligible hospitals and providers that implement and meaningfully use EHR technology by 2014. Incentive payments are contingent upon meeting certain data capture and data sharing capabilities accompanied by additional requirements for meeting increased clinical quality measures. Management believes all contingencies have been met and therefore these incentives have been recorded within Other Revenue in the consolidated statement of operations.

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

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#### **Fair Value of Financial Instruments**

The carrying amounts of UMass Memorial and its affiliates' financial instruments, as reported in the accompanying consolidated balance sheets, other than long-term debt (Note 8), approximate their fair value.

#### **Testing Financial Assets for Impairment**

The System conducts an annual assessment to determine whether it is more likely than not that the fair value of each of its intangible assets are less than their respective carrying values. If there are any such indications present, the System is required to make a formal estimate of the recoverable amount. This assessment did not have a material impact on the consolidated financial statements.

#### **Income Taxes**

The System follows a two-step approach for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. The substantial majority of UMass Memorial and its affiliate entities are recognized by the Internal Revenue Service as tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Accordingly, these entities will not incur any liability for federal income taxes except for tax on unrelated business income. Certain affiliates are taxable entities. The measurement of the amounts recorded as a provision for income taxes based upon the aforementioned approach is not material and is recorded as part of supplies and other expense in the accompanying consolidated statements of operations. The System does not believe it has any significant uncertain tax positions.

#### **Excess of Revenues Over Expenses**

The consolidated statements of operations and changes in net assets include excess of revenues over expenses, the performance indicator. Changes in unrestricted net assets that are excluded from excess of revenues over expenses include the gain on sale from discontinued operations, loss on transfer of membership interest (Note 17), contributions of property and equipment (including assets acquired using contributions which, by donor restrictions, were used for the purposes of acquiring such assets), and pension-related changes other than net periodic benefit cost.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include investments in certificates of deposit and highly liquid debt instruments with maturities of three months or less at the date of purchase, excluding amounts classified as assets whose use is limited and long-term investments.

#### **Inventories**

Supplies and other inventories are stated at the lower of cost (based upon the first-in, first-out method) or market.

#### **Investment and Other Related Income**

The System evaluates the fair values provided by its investment managers and assesses the valuation methods and assumptions used in determining their fair value. Those estimated fair values may differ significantly from the values that would have been used had a readily determinable market for these investments existed and the differences could be material. UMass Memorial and its affiliates have the ability to liquidate their investments periodically in accordance with the provisions of the respective fund agreements.

Investments, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets and statements of operations.

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

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Investment related income, as well as realized and unrealized gains and losses on investments, are recorded within excess of revenues over expenses unless the income or loss is restricted by donor or law. Realized gains and losses are determined by use of average cost. Unrealized gains and losses reflect the period-to-period changes in the fair value of investments.

#### **Investments accounted for under the Equity Method**

The System accounts for investments in entities that are not under its direct control but has the ability to exercise significant influence over the operating and financial policies of the investee under the equity method. Equity method investments are recorded at original cost and adjusted periodically to recognize the applicable proportionate share of the investees' net income or losses after the date of investment, increases for additional contributions made, decreases for dividends or distributions received, and any impairment losses resulting from adjustments to net realizable value (Note 7). UMass Memorial and certain affiliates participate in joint ventures with 50% or less ownership, and accounts for the investments in the unconsolidated affiliates as equity investments.

#### **Assets Whose Use is Limited**

Assets whose use is limited include assets held by trustees under indenture and malpractice agreements and restricted contributions from donors pooled for investment purposes.

#### **Donor Restricted Gifts**

Unconditional promises to give that are expected to be collected within one year are recorded at estimated net realizable value and are included in prepaid expenses and other current assets. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows in other assets. The discount on those amounts is computed using the interest rate applicable to the year in which the promises are received. Amortization of the discount is included in contribution revenue.

Unconditional promises to give are reported at fair value at the date the promise is received. Conditional promises to give are reported at fair value at the date the conditions have been satisfied. The 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. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of operations as net assets released from restrictions.

#### **Split-Interest Agreement**

UMass Memorial holds and administers an irrevocable charitable gift annuity recorded within other noncurrent liabilities. The contributed assets related to the annuity contract are recorded at fair value as part of investments. Contribution revenue is recognized as of the date that all donor conditions are met and a liability is recorded for the present value of the future estimated payments to the donor and/or other beneficiaries. The liability is adjusted during the term of the annuity contract consistent with the changes in the value of the assets and actuarial assumptions.

#### **Property and Equipment**

Property and equipment are recorded at cost (Note 6) or, if received by gift or donation, at fair value at the date of the gift. Depreciation is recorded over the estimated useful lives of each class of depreciable assets utilizing the straight-line method. Useful lives are determined based upon guidelines established by the American Hospital Association and range from 2 to 40 years. Expenditures for maintenance, repairs and renewals are charged to expense as incurred, whereas major betterments are capitalized as additions to property and equipment. Equipment under capital lease obligations is amortized utilizing the straight-line method over the shorter period of the

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

---

lease term or the estimated useful life of the equipment. Such amortization is recorded in depreciation and amortization expense. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of property or equipment are reported as unrestricted support and are excluded from excess of revenues over expenses unless explicit donor stipulations specify how the donated assets must be used. Gifts of property and equipment with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire property and equipment are reported as restricted support. Absent explicit donor stipulations about how long the property and equipment must be maintained, expirations of donor restrictions are reported and such assets are reclassified from temporarily restricted to unrestricted when the donated or acquired property and equipment are placed in service.

#### **Asset Retirement Obligation**

An asset retirement obligation ("ARO") is a legal obligation associated with the retirement of property and equipment. 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. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, the System records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows.

#### **Impairment of Property and Equipment**

Property and equipment to be held and used are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to dispose.

#### **Deferred Financing Costs**

Deferred financing costs and any original issue discount or premium are amortized over the period the related obligation is outstanding using the straight line method which approximates the effective interest method.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by UMass Memorial and its affiliates has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by UMass Memorial and its affiliates in perpetuity.

UMass Memorial and its affiliates have interpreted Massachusetts' Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), as requiring realized and unrealized gains on permanently restricted net assets to be retained as temporarily restricted net assets until appropriated by the Board and expended. UPMIFA allows the Board to appropriate an amount of the net appreciation as is prudent considering UMass Memorial and its affiliates' long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends and general economic conditions. Amounts appropriated by the Board for expenditure during the years ended September 30, 2015 and 2014 amounted to \$1,063,000 and \$875,000, respectively. These amounts are recorded as net assets released from restrictions.

#### **Estimated Professional Liability Costs**

Estimated professional liability costs consist of estimated liabilities for medical or general liability claims which have been reported, as well as a provision for claims incurred but not reported. It is

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

---

UMass Memorial and its affiliates' policy to provide for such claims, to the extent self-insured, on a discounted basis.

#### **Pension, Postretirement and Postemployment Benefit Plans**

The System recognizes the funded status of each defined pension, retiree health care and postemployment benefit plans.

#### **Self-Insurance**

UMass Memorial and certain of its affiliates are self-insured for certain professional liability (Note 12), general liability, health insurance, and workers' compensation benefit claims, all of which are funded and insured through the Commonwealth Professional Assurance Company, Ltd. ("CPAC"), a wholly-owned subsidiary of UMass Memorial, except for health insurance which is self-funded. Estimated losses and claims are accrued as incurred. UMass Memorial and its affiliates have provided for the cost of claims incurred during the current period, as well as estimates of the liability for claims incurred but not yet reported.

#### **Allowance for Doubtful Accounts**

Patient accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of patient accounts receivable, the System analyzes its past history and identifies trends for each of its major categories of revenue (inpatient, outpatient and professional) to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major categories of revenue in evaluating the sufficiency of the allowance for doubtful accounts. Throughout the year, the System, after all reasonable collection efforts have been exhausted, will write off the difference between the standard rates (or discounted rates if negotiated) and the amounts actually collected against the allowance for doubtful accounts. In addition to the review of the categories of revenue, management monitors the write offs against established allowances as of a point in time to determine the appropriateness of the underlying assumptions used in estimating the allowance for doubtful accounts.

Patient accounts receivable is presented net of an allowance for doubtful accounts of \$55,445,000 and \$58,323,000 as of September 30, 2015 and 2014, respectively, in the consolidated balance sheets. Management attributes this change in the allowance for doubtful accounts due to a decrease in accounts receivable and improvement in the aging where more current accounts are reflected in the current year. Bad debt expense for nonpatient related accounts receivable is reflected in operating expense on the statements of operations. Patient related bad debt expense is reflected as a reduction in patient service revenue in the statements of operations.

Net patient service revenue, before the provision for bad debts for the years ended September 30, 2015 and 2014 is comprised of third-party payor revenue of \$2,155,598,000 and \$2,131,438,000 and self-pay revenue of \$18,247,000 and \$20,649,000, respectively.

#### **Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, a principles-based standard to recognize revenue from customer contracts. ASU 2014-09 is effective for the System's fiscal year ending September 30, 2018. The System is evaluating the impact that the ASU may have on its consolidated financial statements.

In May 2015, the FASB issued ASU 2015-7, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. This guidance is effective for the System's fiscal year ending September 30, 2018; however, this guidance can be early adopted. The System is evaluating the impact that this ASU may have on its current fair value disclosures.

**Reclassifications**

Certain 2014 amounts have been reclassified to conform to the current year presentation.

**Supplemental Disclosures of Cash Flow Information**

Cash paid for interest, net of capitalized interest of \$1,146,000 and \$1,336,000, was \$14,278,000 and \$14,689,000 for the years ended September 30, 2015 and 2014, respectively.

Noncash investing and financing activities:

| <i>(in thousands of dollars)</i>   | <b>2015</b> | <b>2014</b> |
|--|-------------|-------------|
| Property and equipment included in accounts payable and due to the University of Massachusetts | \$ 19,731   | \$ 8,729    |
| Property and equipment financed with/by capital lease obligation                               | 304         | -           |

During fiscal year 2015, the Medical Center exercised its option to purchase an 18.9% equity ownership in the newly formed joint venture Quest Diagnostics Massachusetts, LLC. ("Quest Diagnostics") (Note 15) During fiscal year 2014, the value of the joint venture was reassessed. Upon revaluing and then exercising the option, noncash items related to the assets received and liabilities incurred for the years ended September 30 were as follows:

| <i>(in thousands of dollars)</i>          | <b>2015</b>      | <b>2014</b>        |
|---|------------------|--------------------|
| Prepaid expenses and other current assets | \$ (6,164)       | \$ -               |
| Property and equipment                    | (323)            | (404)              |
| Other assets                              | 31,633           | (10,198)           |
| Note payable                              | (11,849)         | -                  |
| Net assets received                       | <u>\$ 13,297</u> | <u>\$ (10,602)</u> |
| Liabilities incurred                      | <u>\$ 1,196</u>  | <u>\$ 2,300</u>    |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

During fiscal year 2014, Central Massachusetts Magnetic Imaging Center, Inc., a wholly owned subsidiary of UMass Memorial, sold its operations to a partially owned joint venture entity (Note 15). In conjunction with the sale, noncash items related to assets received were as follows:

| <i>(in thousands of dollars)</i>          | <b>2014</b> |
|---|-------------|
| Prepaid expenses and other current assets | \$ 874      |
| Property and equipment                    | (1,328)     |
| Other assets                              | 454         |
| Net assets received                       | <u>\$ -</u> |

### **3. Charity Care and Community Benefit Programs**

#### **Charity Care**

UMass Memorial and its affiliates provide services to patients regardless of their ability to pay. Certain uninsured and underinsured patients qualify for care without charge or care at reduced rates based on established policies of UMass Memorial and its affiliates. Patient eligibility under such policies is based on income using the federal poverty guideline levels or financial hardship if medical expenses to gross income meet predefined levels. Charges foregone under these policies are not reported as net patient service revenue.

Management estimates that the cost associated with the charity care provided by UMass Memorial and its affiliates was approximately \$30,117,000 and \$33,967,000 for the years ended September 30, 2015 and 2014, respectively. Such costs have been estimated based on the ratio of expenses to established patient service revenue charges. Massachusetts law provides coverage for healthcare services via the Health Safety Net. During 2015 and 2014, the System received reimbursement from the Commonwealth of Massachusetts in the amounts of \$6,277,000 and \$5,913,000, respectively, from this program.

In addition to providing direct patient charity care, UMass Memorial and its affiliates make other significant contributions to the community. UMass Memorial and its affiliates file annual Community Benefit Reports with the Commonwealth of Massachusetts, pursuant to state Attorney General guidelines, which provides an overview of the major community programs it supports.

#### **Community Benefit Programs**

UMass Memorial has a strong history of working closely with many stakeholders and supporting programs that address health disparities to improve the health and quality of life in Central Massachusetts through its community benefits programs.

Building on the World Health Organization ("WHO") definition of health as a "state of complete physical, mental, and social well-being, and not merely the absence of disease", UMass Memorial and its affiliates, like WHO, understand that there are a host of social determinant factors that impact the ability to achieve optimal health.

In adopting this broad definition of health, UMass Memorial charges themselves with the duty of improving access to care and responding to those socio-cultural and economic barriers that negatively impact the health and well-being of individuals and the community. As a not-for-profit



# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

---

hospital, UMass Memorial is required to conduct a Community Health Needs Assessment ("CHA") every three years. The CHA utilizes quantitative and qualitative data to identify and develop strategies to address the needs of the medically underserved in Central Massachusetts.

Working in collaboration with local health departments, neighborhood residents, community-based organizations, city and state officials, advocacy groups, schools, coalitions, churches and other stakeholders, UMass Memorial and its affiliates are involved in community benefits activities that target long-term solutions while addressing the root causes of disease.

#### **The Community Benefit Strategic Implementation Plan**

UMass Memorial's Community Benefit Strategic Implementation Plan aligns with the priorities identified by the 2013-2015 Community Health Assessment and Community Health Improvement Plan ("CHIP") developed in collaboration with the Worcester Division of Public Health. UMass Memorial and its affiliates have implemented programs and initiatives to address the needs of medically underserved patients as well as other priorities and strategies outlined in the CHIP. The target populations include:

- Underinsured/uninsured
- Populations living in poverty
- Children and youth at risk
- Ethnic and linguistic minorities
- Residents of targeted low-income neighborhoods
- Elders.

A partial listing of the UMass Memorial Community Benefits programs and efforts include the following:

- The UMass Memorial Asthma Home Visiting Intervention Pilot in Bell Hill was expanded in 2014-2015 under the Prevention and Wellness Trust Fund grant award to the City of Worcester to develop a city-wide, comprehensive model including a total of 11 partners. Partners include: two community health centers, the Worcester Public Schools, the Worcester Head Start Program, Worcester Community Legal Aid and the City of Worcester Division of Public Health and Office of Healthy Homes. This community/clinical linkage model is being implemented to address high rates of pediatric asthma in the City of Worcester utilizing community health workers.
- Working in collaboration with Clark University, UMass Memorial established an Academic Health Department to support the CHIP and strengthen the City of Worcester Public Health Infrastructure
- A Care Mobile program provides medical and dental services to vulnerable populations in 10 neighborhood sites and a preventive dental service to 20 schools. These programs address the high incidence of dental caries due to a lack of fluoridation in the City's water supply
- Programs and collaborative efforts that improve access to care (e.g. support of oral health initiatives, medical services for low-income elderly, outreach and support to immigrant/refugee communities, capacity building at community health centers)
- Support programs that promote positive development for at-risk youth as a way to address substance abuse, tobacco, mental health and violence prevention through advocacy, public

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

---

health-related policy initiatives, social norms campaigns, and onsite mental health services at youth-serving organizations

- Obesity/healthy weight efforts (e.g. access to physical activity, food insecurity, community gardens, veggie mobile, and cooking/nutrition education)
- Programs that promote health equity by addressing health disparities (substance abuse residential recovery program for Latino males, and elder medical care at public housing)
- Coalition building efforts and partnerships that engage local residents and community stakeholders in identifying and planning solutions to address community needs (e.g. development of CHA) and the Worcester Free Clinics Coalition)
- Secured funding to conduct hot-spotting with the University to identify needs of super-utilizers; developed a partnership with Community Legal Aid to address the social factors impacting vulnerable populations
- Development of a community-clinical linkage program with the Trauma Department to reduce falls among the elderly population.

In partnership with community groups, each affiliate hospital is addressing identified needs and striving to improve the health and well-being needs of the residents of Central New England.

#### 4. Third-Party Reimbursement and Uncompensated Care

UMass Memorial and its affiliates have agreements with third-party payors that provide for payments at amounts different from their established rates. A summary of payment arrangements with major third-party payors follows:

##### **Medicare**

Acute care hospitals are subject to a federal prospective payment system for most Medicare inpatient hospital services and for certain outpatient services. Under this arrangement, Medicare pays a prospectively determined per discharge or per visit rate for nonphysician services. These rates vary according to the severity based Diagnosis Related Group ("DRG") or Ambulatory Payment Classification ("APC") of each patient.

Certain transplant services and medical education costs related to Medicare beneficiaries are paid based on a cost-reimbursement methodology, subject to certain limits. Hospitals are reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Certain other outpatient services are reimbursed according to fee screens.

##### **Other Payor Arrangements**

The System's acute care hospitals have entered into other payment arrangements with BlueCross BlueShield of Massachusetts ("Blue Cross"), the Massachusetts Executive Office of Health and Human Services ("EOHHS"), certain commercial insurance carriers, Health Maintenance Organizations ("HMO"), and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge and per day, discounts from

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

---

established charges and fee screens. Certain arrangements also include quality and performance initiatives that may result in additional payments if quality measures are achieved.

#### **Risk Arrangement**

During 2015, the System's acute care hospitals and Medical Group entered its third year in a risk arrangement with Blue Cross covering HMO members comprising of fully and self insured accounts. This agreement is referred to as the Alternative Quality Contract ("AQC") and is effective for four years.

#### **Special Medicaid Payments**

During 2015 and 2014, the Division of Medical Assistance revised certain of UMass Memorial's affiliates' standard Medicaid rates for unreimbursed charges related to providing services to patients eligible for medical assistance under Title XIX or to low-income patients ("Special Medicaid Payments"). Special Medicaid Payments totaling \$168,649,000 in 2015 and \$240,000,000 in 2014, respectively, were recognized as net patient service revenue in the accompanying consolidated financial statements. The Special Medicaid Payment of \$168,649,000 in 2015 reflects \$210,786,000 in services related to 2015 and a change in prior year estimates that decreased net patient service revenue by approximately \$42,138,000. Special Medicaid Payments of \$352,649,000 and \$212,000,000 were recorded as a receivable as of September 30, 2015 and 2014. Differences between preliminary estimates and final settlements are included in net patient service revenue in the year the change in estimate occurs. The outstanding 2014 Special Medicaid Payment after the change in prior year estimates of \$182,787,000 was received in November 2015.

#### **Health Safety Net**

The Commonwealth of Massachusetts operates a program called the Health Safety Net ("HSN"). The program, which became effective October 1, 2007, is designed to reimburse hospitals for a portion of the uncompensated care provided to patients subject to certain eligibility rules. Hospitals are required to contribute to the HSN trust fund and are assessed a fee based upon estimates of the statewide cost of uncompensated care. The hospital has recorded its gross obligation to the HSN, net of reimbursement received as part of its net patient service revenue in the accompanying financial statements.

#### **Accountable Care Organization**

UMass Memorial commenced operations of an Accountable Care Organization ("ACO") beginning January 1, 2015 and joined the voluntary Medicare Savings Program that was established under the Affordable Care Act. The program rewards ACOs that lower their growth in health care costs while meeting performance standards on quality.

## **5. Assets Whose Use is Limited and Investments**

UMass Memorial and certain of its affiliates have combined the management of certain of their investments in the UMass Memorial Investment Partnership, LLP (the "Partnership"). Each of the participating affiliates reports its proportionate share of the Partnership's investments in its financial statements. Pooled investment income and gains and losses of the Partnership are allocated to the participating affiliates based on their respective units in the Partnership. Investments held within the Partnership totaled approximately \$453,171,000 and \$457,383,000 as of September 30, 2015 and 2014, respectively.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

Investments, including those held within the Investment Partnership, consist of the following at September 30:

| <i>(in thousands of dollars)</i>          | <b>2015</b>       | <b>2014</b>       |
|---|-------------------|-------------------|
| Mutual funds and common collective trusts | \$ 288,813        | \$ 291,843        |
| Hedge funds                               | 152,863           | 170,521           |
| Bonds and notes                           | 109,179           | 138,845           |
| Cash and cash equivalents                 | 79,708            | 68,544            |
| Common stocks                             | 50,435            | 64,119            |
| Private equity funds                      | 25,523            | 5,309             |
| Other investments                         | 3,654             | 2,079             |
| Subtotal                                  | 710,175           | 741,260           |
| Beneficial interest in trusts             | 7,991             | 15,675            |
| Other assets                              | 3,956             | 4,990             |
|   | <u>\$ 722,122</u> | <u>\$ 761,925</u> |

Such amounts are reported in the consolidated balance sheets at September 30 as follows:

| <i>(in thousands of dollars)</i>                     | <b>2015</b>       | <b>2014</b>       |
|--|-------------------|-------------------|
| Short-term investments                               | \$ 31,792         | \$ 36,926         |
| Current portion of assets whose use is limited       | 8,700             | 6,705             |
| Assets whose use is limited                          |                   |                   |
| Funds held in escrow under bond indenture agreements |                   |                   |
| Debt service funds                                   | 13                | 13                |
| Debt service reserve funds                           | 12,090            | 11,996            |
|  | 12,103            | 12,009            |
| Restricted investments                               | 88,195            | 81,889            |
| Captive insurance company investments                | 164,440           | 172,258           |
| Long-term investments                                | 404,945           | 431,473           |
| Subtotal   | 710,175           | 741,260           |
| Beneficial interest in trusts                        | 7,991             | 15,675            |
| Other assets   | 3,956             | 4,990             |
|  | <u>\$ 722,122</u> | <u>\$ 761,925</u> |

Funds held in escrow under bond indenture agreements include the debt service funds for payments of principal and interest. Included in total investments as of September 30, 2015 and 2014, were pending sales of \$1,652,000 and \$578,000 and purchases of \$1,909,000 and \$742,000, respectively.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

The composition of investment (loss) return for the years ended September 30 was as follows:

| <i>(in thousands of dollars)</i>                       | <b>2015</b>        | <b>2014</b>      |
|--|--------------------|------------------|
| Interest, dividend and other related income            |                    |                  |
| Other operating revenue                                | \$ 4,116           | \$ 2,948         |
| Nonoperating revenue                                   | 5,608              | 5,490            |
| Temporarily restricted                                 | 1,143              | 1,110            |
| Net realized gains on sale of investments              |                    |                  |
| Other operating revenue                                | 10,282             | 6,713            |
| Nonoperating revenue                                   | 13,838             | 25,728           |
| Temporarily restricted                                 | 2,762              | 5,609            |
| Change in net unrealized (losses) gains on investments |                    |                  |
| Nonoperating revenue                                   | (44,653)           | 387              |
| Temporarily restricted                                 | (6,568)            | (891)            |
| Permanently restricted                                 | (644)              | 612              |
| Total investment (loss) return                         | <u>\$ (14,116)</u> | <u>\$ 47,706</u> |

UMass Memorial and its affiliates report investments at fair value. Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

*Level 1* -Observable inputs such as quoted prices for identical assets and liabilities in active markets;

*Level 2* -Inputs, other than the quoted prices for similar assets and liabilities, that are observable either directly or indirectly in active markets; and

*Level 3* -Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The fair value hierarchy also requires UMass Memorial and its affiliates to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy does not attempt to measure the quality of the investments. Management believes that the investment values are fairly stated.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

UMass Memorial and its affiliates primarily use market values as provided by the custodian along with consideration of the prices as provided by the investment managers. These market values are set with reference to market activity for highly liquid assets such as U.S. Treasury and agency securities and agency residential mortgage-backed securities, and matrix pricing for other asset classes, such as commercial mortgage and other asset-backed securities. Values for corporate bonds, convertible bonds and municipal bonds may be determined using discounted cash flow pricing models considering adjustments for spreads and prepayments for the instruments. Prices for fixed income securities may also be priced using dealer quotes.

Management has ongoing procedures in place to evaluate and monitor new and ongoing third party valuations including regular communication with investment advisors, monthly and quarterly performance benchmarking, and the review of partnership financial statements.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Investments may be classified as Level 2 when market information (including observable net asset values) is available, yet the investment is not traded in an active market. Market information, including observable net asset values, subscription and redemption activity, if applicable, and the length of time until the investment will become redeemable are considered when determining the proper categorization of the investment's fair value measurement within the fair valuation hierarchy. Investments that have observable market inputs (such as net asset values) and UMass Memorial has the ability to redeem at the measurement date are classified in the fair value hierarchy as Level 2. Investments that have unobservable inputs or for which UMass Memorial does not have the ability to redeem at the measurement date are classified in the fair value hierarchy as Level 3.

The following fair value hierarchy table presents information about the System's financial assets measured at fair value on a recurring basis based upon the lowest level of significant input to the valuations as of September 30, 2015 and 2014.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

| <b>September 30, 2015</b>                 |                |                |                |              |
|---|----------------|----------------|----------------|--------------|
| <i>(in thousands of dollars)</i>          |                |                |                |              |
|   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| <b>Financial assets</b>                   |                |                |                |              |
| Investments                               |                |                |                |              |
| Mutual funds and common collective trusts | \$ 174,321     | \$ 114,492     | \$ -           | \$ 288,813   |
| Hedge funds                               | -              | 40,284         | 112,579        | 152,863      |
| Bonds and notes                           | 20,266         | 88,913         | -              | 109,179      |
| Cash and cash equivalents                 | 79,708         | -              | -              | 79,708       |
| Common stocks                             | 50,435         | -              | -              | 50,435       |
| Private equity funds                      | -              | -              | 25,523         | 25,523       |
| Other investments                         | 823            | 1,624          | 1,207          | 3,654        |
| Total investments at fair value           | 325,553        | 245,313        | 139,309        | 710,175      |
| Beneficial interest in trusts             | -              | -              | 7,991          | 7,991        |
| Other assets                              | 3,956          | -              | -              | 3,956        |
| Total financial assets at fair value      | \$ 329,509     | \$ 245,313     | \$ 147,300     | \$ 722,122   |
| <b>September 30, 2014</b>                 |                |                |                |              |
| <i>(in thousands of dollars)</i>          |                |                |                |              |
|   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| <b>Financial assets</b>                   |                |                |                |              |
| Investments                               |                |                |                |              |
| Mutual funds and common collective trusts | \$ 191,444     | \$ 100,399     | \$ -           | \$ 291,843   |
| Hedge funds                               | -              | 59,410         | 111,111        | 170,521      |
| Bonds and notes                           | 13,123         | 125,722        | -              | 138,845      |
| Cash and cash equivalents                 | 68,544         | -              | -              | 68,544       |
| Common stocks                             | 64,119         | -              | -              | 64,119       |
| Private equity funds                      | -              | -              | 5,309          | 5,309        |
| Other investments                         | 1,443          | 636            | -              | 2,079        |
| Total investments at fair value           | 338,673        | 286,167        | 116,420        | 741,260      |
| Beneficial interest in trusts             | -              | -              | 15,675         | 15,675       |
| Other assets                              | 4,990          | -              | -              | 4,990        |
| Total financial assets at fair value      | \$ 343,663     | \$ 286,167     | \$ 132,095     | \$ 761,925   |

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions on model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. For the year ended September 30, 2015, there was one transfer of \$1,207,000 from Level 1 to Level 3. For the year ended September 30, 2014, there were no transfers between levels.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

---

The following table presents the activity for the year for all assets categorized as Level 3 for the years ended September 30, 2015 and 2014:

| <i>(in thousands of dollars)</i>                 | Private<br>Equity<br>Funds | Hedge<br>Funds    | Other<br>Investments | Beneficial<br>Interest<br>in Trusts | Total             |
|--|----------------------------|-------------------|----------------------|-------------------------------------|-------------------|
| <b>Fair Value, September 30, 2014</b>            | \$ 5,309                   | \$ 111,111        | \$ -                 | \$ 15,675                           | \$ 132,095        |
| Realized gains (losses)                          | (1,467)                    | 3,869             | -                    | -                                   | 2,402             |
| Unrealized gains (losses)                        | (26)                       | (6,172)           | -                    | -                                   | (6,198)           |
| Purchases  | 21,707                     | 12,014            | -                    | -                                   | 33,721            |
| Sales  | -                          | (8,243)           | -                    | -                                   | (8,243)           |
| Transfers into Level 3                           |                            |                   | 1,207                |                                     | 1,207             |
| Cash received from beneficial interest in trusts | -                          | -                 | -                    | (7,060)                             | (7,060)           |
| Change in value of beneficial interest in trusts | -                          | -                 | -                    | (624)                               | (624)             |
| <b>Fair Value, September 30, 2015</b>            | <u>\$ 25,523</u>           | <u>\$ 112,579</u> | <u>\$ 1,207</u>      | <u>\$ 7,991</u>                     | <u>\$ 147,300</u> |

  

|  | Private<br>Equity<br>Funds | Hedge<br>Funds    | Other<br>Investments | Beneficial<br>Interest<br>in Trusts | Total             |
|--|----------------------------|-------------------|----------------------|-------------------------------------|-------------------|
| <b>Fair Value, September 30, 2013</b>            | \$ 2,965                   | \$ 73,481         | \$ -                 | \$ 17,258                           | \$ 93,704         |
| Realized gains                                   | 420                        | (15)              | -                    | -                                   | 405               |
| Unrealized gains                                 | (11)                       | 5,961             | -                    | -                                   | 5,950             |
| Purchases  | 3,331                      | 32,000            | -                    | -                                   | 35,331            |
| Sales  | (1,396)                    | (316)             | -                    | -                                   | (1,712)           |
| Change in value of beneficial interest in trusts | -                          | -                 | -                    | (1,583)                             | (1,583)           |
| <b>Fair Value, September 30, 2014</b>            | <u>\$ 5,309</u>            | <u>\$ 111,111</u> | <u>\$ -</u>          | <u>\$ 15,675</u>                    | <u>\$ 132,095</u> |



# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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The System uses Net Asset Value (NAV) to determine the fair value of its investments which (a) do not have a readily determinable fair market value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table summarizes the key provisions for the System's alternative investments as of September 30, 2015 and 2014:

*(in thousands of dollars)*

#### 2015 Level 2

| Investment              | Strategy   | Fair Value | # of Funds | Redemption Terms   | Redemption Restrictions  |
|-------------------------|--|------------|------------|--|--|
| Hedge Fund              | Multi-strategy; equities, commodities, currencies, and fixed income securities   | \$ 29,877  | 2          | May withdraw all or any part of its distributable amount the first day of any fiscal period (first business day of the month) with 14 days advance written notice. | Payments for withdrawals will be made no later than 30 business days after the effective date of withdrawal. A reasonable reserve for the Partner's share of any future expenses or definite or contingent liabilities of the Partnership that have not been taken into account will be held until the next occurring audit. |
| Common collective trust | Capital growth through investment in a professionally managed portfolio of international securities  | 19,849     | 1          | 5 business days  | The redemption of Units is subject to certain restrictions and limitations set forth in the Trust Agreement (Suspension of Subscriptions, Redemptions and Valuations).   |
| Common collective trust | Combination of Treasury bills and notes, corporate obligations, commercial paper, repurchase agreements, and obligations of government sponsored enterprises | 24,307     | 1          | 2 business days  | None   |
| Hedge Fund              | Senior secured debt, loans, notes, bonds   | 10,407     | 1          | Monthly liquidity with 30 days written notice  | None   |
| Mutual Fund             | Growth   | 5,437      | 1          | Weekly   | None   |
| Common collective trust | Return   | 19,114     | 1          | Daily  | None   |

There were no unfunded commitments as of September 30, 2015.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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*(in thousands of dollars)*

**2014 Level 2**

| <b>Investment</b>       | <b>Strategy</b>  | <b>Fair Value</b> | <b># of Funds</b> | <b>Redemption Terms</b>  | <b>Redemption Restrictions</b>   |
|-------------------------|--|-------------------|-------------------|--|--|
| Hedge Fund              | Multi-strategy; equities, commodities, currencies, and fixed income securities   | \$ 49,316         | 3                 | May withdraw all or any part of its distributable amount the first day of any fiscal period (first business day of the month) with 14 days advance written notice. | 30 business days.  |
| Mutual Fund             | Private placement portfolio primarily of senior floating rate loans (Senior Loans)   | 10,042            | 1                 | Redemption requests are generally paid one month after the redemption request contingent on Fund liquidation constraints.  | Minimum of \$100,000.  |
| Common collective trust | Capital growth through investment in a professionally managed portfolio of international securities  | 20,358            | 1                 | Requires written notice at least 5 business days prior to the dealing date.  | The redemption of Units is subject to certain restrictions and limitations set forth in the Trust Agreement (Suspension of Subscriptions, Redemptions and Valuations). |
| Mutual Fund             | Exchange-traded funds, open-end, mutual funds, and private private investment funds  | 27,655            | 1                 | May be redeemed on any business day upon request.  | None   |
| Common collective trust | Combination of Treasury bills and notes, corporate obligations, commercial paper, repurchase agreements, obligations of government sponsored enterprises | 24,403            | 1                 | May be redeemed within 2 business days upon written request.   | None   |
| Common collective trust | Fixed income.  | 10,223            | 1                 | May be redeemed any business day.  | No restrictions.   |
| Hedge Fund              | Senior secured debt, loans, notes, bonds   | 10,094            | 1                 | Monthly liquidity with 30 days written notice.   | None   |
| Mutual Fund             | International Commingled Funds   | 7,448             | 1                 | Liquidation allowed weekly.  | None   |

There were no unfunded commitments as of September 30, 2014.

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

(in thousands of dollars)

#### 2015 Level 3

| Investment     | Strategy   | Fair Value | # of Funds | Remaining Life | \$ Amount of Unfunded Commitments | Timing to Draw Commitments | Redemption Terms   | Redemption Restrictions   | Redemption Restrictions in Place at Year End  |
|----------------|--|------------|------------|----------------|-----------------------------------|----------------------------|--|---|---|
| Private Equity | Global private equity  | \$ 2,200   | 3          | 3 to 5 years   | \$ 809                            | Term of agreement.         | Restricted   | Amount, timing and form of distributions determined by the fund.  | Not redeemable.   |
| Hedge Fund     | Arbitrage, distressed investments, long/short equity and fixed income                  | 16,778     | 3          | None           | -                                 | None                       | Redemptions are valued one month after the repurchase request (the "Valuation Date") and generally paid one month after Valuation Date contingent on Fund liquidation constraints. | Quarterly only if there has been a tender offer by the fund.  | Redemption restrictions have been met at year end.  |
| Hedge Fund     | Arbitrage, hedged equity and special situations  | 42,245     | 2          | None           | -                                 | None                       | December 31 or on calendar quarter associated with investment date applicable to each class of shares each with 100 days notice.   | Redemptions are permitted on December 31 or on calendar quarter associated with investment date subject to 100 days written notice, after a lock-up period of 1 or 3 years. If members do not redeem shares at end of lock-up, they will be subject to a new lock-up period of 1 or 3 years applicable to each class of shares. | Lock up provisions reset December 31, 2013 through December 31, 2015.                               |
| Hedge Fund     | Private investments in funds and hedge funds   | 12,600     | 1          | None           | -                                 | None                       | Any calendar quarter on or after the 12th month of initial investment.   | 95 days written notice.   | Redemption restrictions have been met at year end.  |
| Hedge Fund     | Multi-strategy   | 255        | 4          | None           | -                                 | None                       | Currently liquidating positions.   | Distribution made as positions are liquidated.  | Redemptions are in process.   |
| Private Equity | Structured debt products   | 2,529      | 1          | None           | -                                 | None                       | None   | None  | None  |
| Hedge Fund     | Event Driven Strategy in stressed and distressed segments of corporate credit market   | 9,718      | 1          | None           | -                                 | None                       | Redemptions are valued at a per share price based on the Net Asset Value of series with 90 days written notice.  | As of the first calendar quarter-end occurring immediately after the end of the 11th month following the date of issuance.  | Redemption restrictions have been met at year end.  |
| Private Equity | Debt financing   | 2,208      | 1          | None           | -                                 | None                       | Redemptions are not permitted.   | Redemptions are not permitted.  | Periodic distributions will be made to return capital and achieve a predetermined preferred return. |
| Hedge Fund     | Investment in securities and other investments to achieve above-average capital growth | 18,851     | 1          | None           | -                                 | None                       | 45 days written notice required for redemption.  | Class B Shares may not be redeemed until shares held for a continuous period of at least 12 months. Thereafter, redeemable as of December 31 of each year on 45 days written notice.  | Redemption restrictions have not been met.  |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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(in thousands of dollars)

**2015 Level 3 (continued)**

| <b>Investment</b> | <b>Strategy</b>   | <b>Fair Value</b> | <b># of Funds</b> | <b>Remaining Life</b> | <b>\$ Amount of Unfunded Commitments</b> | <b>Timing to Draw Commitments</b> | <b>Redemption Terms</b>                                   | <b>Redemption Restrictions</b>  | <b>Redemption Restrictions in Place at Year End</b>                     |
|-------------------|---|-------------------|-------------------|-----------------------|--|-----------------------------------|---|---|---|
| Private Equity    | Senior secured lending and other investment products to generate attractive risk-adjusted returns | 1,375             | 1                 | None                  | 3,830                                    | None                              | Redemptions are not permitted.                            | Redemptions are not permitted.  | Capital will be distributed to investors as investments are liquidated. |
| Hedge Fund        | Various investments strategies to provide superior risk-adjusted returns while preserving capital | 12,132            | 1                 | None                  | -  | None                              | 45 days written notice required for redemption.           | Annually, on December 31.   | Redemption restrictions have not been met.                              |
| Private Equity    | Diversification through farm land investments   | 7,174             | 1                 | None                  | -  | None                              | Written notice before September 30th after holding period | Annually  | Holding period requirement has not been met.                            |
| Private Equity    | Diversification through real estate investments   | 432               | 1                 | None                  | 9,568                                    | None                              | Not applicable  | Closed-end fund with no redemptions.  | Not redeemable.   |
| Private Equity    | Diversification through special investments   | 9,605             | 1                 | None                  | -  | None                              | 60 days written notice required for redemption.           | Initial lock-up period of 24 months during which withdrawals are permitted but are subject to a penalty and capped. | Redemption restrictions have not been met.                              |
| Other asset       | Closely held stock  | 1,207             | -                 | None                  | -  | No commitment                     | No restriction  | No restriction  | None  |
|                   |   | <u>\$ 139,309</u> | <u>22</u>         |                       | <u>\$ 14,207</u>                         |                                   |   |   |   |

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

(in thousands of dollars)

#### 2014 Level 3

| Investment     | Strategy   | Fair Value        | # of Funds | Remaining Life | \$ Amount of Unfunded Commitments | Timing to Draw Commitments | Redemption Terms   | Redemption Restrictions   | Redemption Restrictions in Place at Year End                          |
|----------------|--|-------------------|------------|----------------|-----------------------------------|----------------------------|--|---|---|
| Private Equity | Global private equity  | \$ 2,677          | 3          | 3 to 5 years   | \$ 269                            | Term of agreement.         | Restricted   | Amount, timing and form of distributions determined by the fund.  | Not redeemable.   |
| Hedge Fund     | Arbitrage, distressed investments, long/short equity and fixed income                  | 16,540            | 3          | None           | -                                 | None                       | Redemptions are valued one month after the repurchase request (the "Valuation Date") and generally paid one month after Valuation Date contingent on Fund liquidation constraints. | Quarterly only if there has been a tender offer by the fund.  | Redemption restrictions have been met at year end.                    |
| Hedge Fund     | Arbitrage, hedged equity and special situations  | 49,132            | 4          | None           | -                                 | None                       | December 31 or on calendar quarter associated with investment date applicable to each class of shares each with 100 days notice.   | Redemptions are permitted on December 31 or on calendar quarter associated with investment date subject to 100 days written notice, after a lock-up period of 1 or 3 years. If members do not redeem shares at end of lock-up, they will be subject to a new lock-up period of 1 or 3 years applicable to each class of shares. | Lock up provisions reset December 31, 2013 through December 31, 2015. |
| Hedge Fund     | Private investments in funds and hedge funds   | 12,623            | 1          | None           | -                                 | None                       | Any calendar quarter on or after the 12th month of initial investment.   | 95 days written notice.   | Redemption restrictions have been met.                                |
| Hedge Fund     | Multi-strategy   | 336               | 5          | None           | -                                 | None                       | Currently liquidating positions.   | Distribution made as positions are liquidated.  | Redemptions are in process.   |
| Private Equity | Structured debt products   | 428               | 1          | None           | 2,546                             | On call.                   | None   | None  | None  |
| Hedge Fund     | Event Driven Strategy in stressed and distressed segments of corporate credit market   | 10,235            | 1          | None           | -                                 | None                       | Redemptions are valued at a per share price based on the Net Asset Value of series with 90 days written notice.  | As of the first calendar quarter-end occurring immediately after the end of the 11th month following the date of issuance.  | Redemption restrictions have not been met.                            |
| Private Equity | Debt financing   | 2,204             | 1          | None           | 480                               | On call.                   | Redemptions are not permitted.   | Redemptions are not permitted.  | Redemption restrictions have not been met.                            |
| Hedge Fund     | Investment in securities and other investments to achieve above-average capital growth | 22,245            | 1          | None           | -                                 | None                       | 45 days written notice required for redemption.  | Class B Shares may not be redeemed until shares held for a continuous period of at least 12 months. Thereafter, redeemable as of December 31 of each year on 45 days written notice.  | Redemption restrictions have not been met.                            |
|                |  | <u>\$ 116,420</u> | <u>20</u>  |                |                                   |                            | <u>\$ 3,295</u>  |   |   |

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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#### **Valuation Techniques**

Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis.

The fair value of investments is determined in accordance with the current fair value guidance and as described below. Net asset value (NAV) would not be used as a practical expedient for fair value when it is determined to be probable that the investment would sell for an amount different than the reported net asset value. In such situations, management would estimate the fair value of the investment in good faith based on the available information and will update the fair value methodology if a significant event occurs which has the potential of impacting the ultimate value of the investment.

*Cash Equivalents* – The carrying value of cash equivalents approximates fair value as maturities are less than three months and/or include money market funds that are based on quoted prices and are actively traded.

*Mutual Funds and Common Stocks* – The fair values of mutual funds and common stocks are based on quoted market prices or net assets value. These mutual funds are required to publish the NAV and to transfer at that price. The mutual funds held by UMass Memorial and its affiliates are deemed to be actively traded. The fair value of domestic and international equity securities are principally based on quoted market prices that are traded in an active market.

*Common Collective Trusts* - The fair value of common collective trusts are based on the NAV of the fund, representing the fair value of the underlying investments, which are generally securities traded on an active market. The NAV is used as a practical expedient to estimate fair value. Such investments are classified as Level 2 when UMass Memorial and its affiliates has the ability to redeem the investment in the fund at the NAV (or its equivalent) at the measurement date or within the near term and there are no other potential liquidity restrictions.

*Private Equity and Hedge Funds* – The estimated fair values of these investments for which no quoted market prices are readily available, are determined based upon the information provided by the fund managers. Such information is generally based on the NAV of the fund, which is used as a practical expedient to estimate fair value. UMass Memorial and its affiliates has classified certain of its investments reported at NAV as Level 2 because it has the ability to redeem its investments in the fund at the NAV per share (or its equivalent) at the measurement date or within the near term and there are no other potential liquidity restrictions. Funds categorized within Level 3 may be subject to a minimum holding period or lockup may not be able to redeem at the measurement date or within 90 days thereof, can be subject to redemption notice periods in excess of 90 days, or have the ability to limit the aggregate amount of shareholder redemptions. Investment gains, losses, and expenses are allocated to the investors based on the ownership percentage as described in the respective partnership or hedge fund agreements.

*Bonds and Notes* – Certain bonds are valued at the closing price reported in the active market in which the bond is traded. Other bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued under a discounted cash flow approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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*Beneficial Interest in Trusts* – The estimated fair values of UMass Memorial and its affiliates beneficial interest in trusts are determined based upon information provided by the trustees. Such information is generally based on the pro rata interest in the net assets of the underlying investments. The assets held in trust consist primarily of cash equivalents and marketable securities. The fair values of the perpetual trusts are measured using the fair value of the assets contributed to the trusts. The measurement for a beneficial interest in a perpetual trust is categorized as a Level 3 fair value measurement because UMass Memorial and its affiliates will never receive the trust's assets.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although UMass Memorial and its affiliates believes its valuation methods or assumptions are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There have been no changes in the methodologies used at September 30, 2015 and 2014.

**6. Property and Equipment**

Property and equipment consist of the following at September 30:

| <i>(in thousands of dollars)</i>                | <b>2015</b>              | <b>2014</b>              |
|---|--------------------------|--------------------------|
| Land and land improvements                      | \$ 21,764                | \$ 21,608                |
| Buildings and building improvements             | 874,124                  | 872,108                  |
| Major movable and fixed equipment               | <u>753,708</u>           | <u>712,612</u>           |
|   | 1,649,596                | 1,606,328                |
| Less: Accumulated depreciation and amortization | <u>1,103,602</u>         | <u>1,010,546</u>         |
|   | 545,994                  | 595,782                  |
| Construction in progress                        | <u>48,228</u>            | <u>32,591</u>            |
| Property and equipment, net                     | <u><u>\$ 594,222</u></u> | <u><u>\$ 628,373</u></u> |

Depreciation expense (excluding amortization of capital lease assets of \$671,000 and \$657,000 for the years ended September 30, 2015 and 2014, respectively) amounted to approximately \$103,202,000 and \$91,886,000 for the years ended September 30, 2015 and 2014, respectively.

In connection with the Merger, the University transferred to UMass Memorial substantially all of the assets of the Clinical Services Division, except to the extent that the assets were shared by the University. With respect to such shared assets, the University and UMass Memorial have entered into a 99-year occupancy and shared services agreement (the "Occupancy Agreement") under which the University has granted UMass Memorial the right to use such assets for the term of the agreement. UMass Memorial has agreed to maintain and be responsible for 50% of the capital costs under this agreement (Note 14). The Occupancy Agreement provides that if the University ceases operations as a medical school, UMass Memorial and the University will enter into a lease at the then fair value of the related space, adjusted to give effect to any improvements subsequent to the Merger and the debt assumed by UMass Memorial at the date of the Merger.

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

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UMass Memorial recorded its interest in the assets covered by the Occupancy Agreement utilizing the original cost and related accumulated depreciation, as reflected on the consolidated balance sheets of the Clinical Services Division on the date of the Merger. The net book value of the assets covered by the Occupancy Agreement at the date of the Merger was approximately \$56,000,000.

On July 20, 2015, management executed a contract obligation for the purchase and implementation of a System wide, fully integrated Electronic Medical Record ("EMR") and billing system (Note 12). The implementation is expected to be completed during fiscal year 2017. As a result of the pending implementation, the estimated useful lives of certain Medical Center assets expected to be replaced by the EMR were adjusted to reflect the new system's implementation date. Certain other Medical Center ongoing projects were discontinued and expensed. As of September 30, 2015, the amount of additional depreciation incurred was \$7,496,000 and the amount of discontinued projects was \$1,644,000.

#### **7. Equity Method Investments**

UMass Memorial and certain of its affiliates have investments in joint ventures accounted for under the equity method reported as other assets in the consolidated balance sheets. Amounts related to these investments were \$63,228,000 and \$11,087,000 for the years ended September 30, 2015 and 2014, respectively. Joint venture income associated with these investments is reported as other revenue in the consolidated statements of operations and amounted to \$14,247,000 and \$27,365,000, for the years ended September 30, 2015 and 2014, respectively. Of the total System joint venture investments, the Medical Center participates in an 18.9% ownership of Quest Diagnostics (Note 15) which amounted to \$54,092,000 as of September 30, 2015 and had related joint venture income of \$561,000 as of September 30, 2015.

Ventures has a joint venture ownership interest in Fairlawn Rehabilitation Hospital with HealthSouth Corporation. On June 1, 2014, Ventures sold a 30% partial interest of its ownership in to its joint venture partner, HealthSouth Corporation. After completing this partial sale, Ventures retained a 20% ownership interest in Fairlawn Rehabilitation Hospital. Ventures recognized a \$16,500,000 gain on the partial sale of its interest which has been recorded within Other Revenue in the 2014 consolidated statement of operations.



**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

**8. Debt**

Debt consists of the following at September 30:

| <i>(in thousands of dollars)</i>                                | <b>Interest<br/>Rate at<br/>September 30,<br/>2015</b> | <b>Final<br/>Maturity</b> | <b>2015</b>       | <b>2014</b>       |
|---|--|---------------------------|-------------------|-------------------|
| Massachusetts Development Finance Agency ("MDFA") Revenue Bonds |  |                           |                   |                   |
| UMass Memorial, Series A  | 5.00%  | 2028                      | \$ 33,275         | \$ 33,275         |
| UMass Memorial Variable Rate, Series B                          | 0.382%   | 2023                      | 12,500            | 13,700            |
| UMass Memorial, Series D  | 5.0%-5.25%   | 2033                      | 107,450           | 107,450           |
| UMass Memorial Variable Rate, Series E                          | 1.33%  | 2035                      | 26,525            | 27,290            |
| UMass Memorial Variable Rate, Series F                          | 1.14%  | 2035                      | 26,525            | 27,290            |
| UMass Memorial, Series G  | 4.0%-5.0%  | 2022                      | 37,595            | 41,870            |
| UMass Memorial, Series H  | 4.0%-5.5%  | 2031                      | 74,145            | 80,140            |
| Marlborough Hospital Variable Rate, Series A                    | 2.241%   | 2034                      | 8,217             | 8,445             |
| Revolving Loan  | 0.81%  | 2016                      | 50,000            | -                 |
| Master leases and subleases, and other notes payable            | 0%-5.26%   | 2016-2044                 | 48,464            | 50,040            |
| Capital lease obligations (Note 9)                              |  |                           | 872               | 872               |
| Total debt  |  |                           | 425,568           | 390,372           |
| Less: Net unamortized original issue premium                    |  |                           | 1,179             | 1,332             |
| Less: Current portion   |  |                           | (87,698)          | (27,772)          |
| Debt, net of current portion                                    |  |                           | <u>\$ 339,049</u> | <u>\$ 363,932</u> |

**Revenue Bonds and Notes Payable**

UMass Memorial and certain of its affiliates are obligated under various MDFA revenue bonds and notes payable covered by a Master Trust Indenture ("MTI"). The MTI, dated as of December 1, 1998 and subsequently supplemented, includes UMass Memorial and other Members of the Obligated Group. The Master Trustee defines the terms and conditions upon which Obligations will be issued, authenticated, delivered and accepted as well as setting forth certain economic covenants. Under the terms of the loan agreements, the obligations are collateralized by property and equipment and gross receipts, as defined. The terms of the mortgage and trust agreements also require the establishment of certain reserve funds that are held by trustees (Note 5). The bonds require periodic interest and principal payments to these funds held in trust that are proportionate to the annual interest and principal payments or sinking fund installments. The revenue bonds are generally redeemable prior to maturity at premiums ranging up to 4%.

**Issuance of Debt**

UMass Memorial, Series E – These bonds were issued in 2009 directly to a financial institution with an initial tender date of May, 2012. In January 2012, the Obligated Group (Note 2) entered into an agreement with the same financial institution to remarket these bonds under a new Index Floating Rate Mode effective through April, 2015. On April 1, 2015, UMass Memorial and the financial institution refinanced with a five year mandatory purchase date of April 1, 2020. The principal amortization schedule remains as it had existed before and the interest rate is variable. UMass Memorial entered into a new Continuing Covenant Agreement ("CCA") with the financial institution with economic covenants that are similar to the MTI.

UMass Memorial, Series F – These bonds were issued in 2009 directly to a financial institution with an initial tender date of May, 2014. UMass Memorial also entered into a CCA with the financial

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

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institution at the time the bonds were originally issued. The CCA included covenants related to debt service coverage, days cash on hand and maintaining certain investment credit ratings. In February 2014, the Obligated Group entered into an agreement with the same financial institution to extend the tender date to May 2016. In addition, the CCA was amended to redefine the calculation for debt service coverage and the credit rating covenant.

On May 21, 2015, UMass Memorial and the same financial institution amended the Series F loan agreement to extend the mandatory purchase date to May 22, 2018; the amendment also provides for 2 additional one year extensions of the tender date (effectively to May 22, 2020) absent an event of default. The principal amortization schedule remains as it had existed before and the interest rate is variable. UMass Memorial and the financial institution also amended the CCA with economic covenants that are similar to the MTI and deleted the credit rating covenant.

On July 1, 2015, the Medical Center exercised its option to purchase an 18.9% equity ownership in Quest Diagnostics. Upon exercising this option, and to retain its 18.9% ownership, an additional \$11,849,000 capital contribution was incurred as a note payable to the newly formed joint venture subsidiary (Note 15). The note payable will bear interest at 0.45% annually and is due and payable on or before January 1, 2016.

In November 2014, Marlborough Hospital entered into an agreement with a commercial bank to amend its Series A bond payable to waive its initial tender date of November 24, 2014 to November 24, 2019.

#### **Revolving Loan Agreement**

On June 30, 2015, the Obligated Group entered into a \$50,000,000 unsecured revolving loan agreement with a financial institution. The loan agreement expires June 29, 2016. The amount outstanding under this agreement at September 30, 2015 was \$50,000,000. The interest rate at the close of business on September 30, 2015 was 0.81%.

#### **Affiliate notes payable**

Certain of the affiliates have borrowed funds from other affiliates. Total outstanding notes payable between the affiliates was \$32,351,000 and \$33,479,000 at September 30, 2015 and 2014, respectively. The notes bear interest at rates ranging from 1.25% - 5.26% and are due between 2016 and 2044. The notes are recorded as notes receivable and notes payable to affiliates in the consolidating information.

#### **Debt Covenants**

UMass Memorial and its affiliates' debt agreements contain limitations on additional indebtedness, mergers, and other covenants, including required debt service coverage ratios. In addition, the Obligated Group is required to maintain a specified amount of cash and unrestricted investments. Several of the debt agreements limit the transfer of assets outside of the Obligated Group. Accordingly, the assets of an affiliate included in the consolidated financial statements may not be available to meet the obligations of other affiliates.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**Principal Payments and Sinking Fund Requirements**

Annual principal payments and sinking fund requirements on debt for the next five years and thereafter are as follows at September 30, 2015:

*(in thousands of dollars)*

|            |    |                       |
|------------|----|-----------------------|
| 2016       | \$ | 87,559                |
| 2017       |    | 22,745                |
| 2018       |    | 21,973                |
| 2019       |    | 20,705                |
| 2020       |    | 18,529                |
| Thereafter |    | <u>254,057</u>        |
| Total debt | \$ | <u><u>425,568</u></u> |

**Interest Paid**

Total interest paid during 2015 and 2014 was approximately \$15,424,000 and \$16,025,000, respectively. Interest capitalized as a component of the cost of assets constructed was approximately \$1,146,000 and \$1,336,000 in 2015 and 2014, respectively.

**Fair Value**

The fair value of UMass Memorial and its affiliates' fixed rate revenue bonds are based on quoted market prices. Other debt instruments have variable interest rates and management believes that their carrying values approximate fair value. As of September 30, 2015 and 2014, the estimated fair values of bonds payable based on Level 2 inputs was \$437,778,000 and \$402,082,000, respectively. The fair value of bonds payable generally represents a mid-market estimate, a market bid and/or market ask, or any other price or estimate within a market spread.

**9. Leases**

UMass Memorial and its affiliates lease certain office and clinical equipment under leases with terms exceeding one year. Rent expense under operating leases was approximately \$27,706,000 and \$27,364,000 for the years ended September 30, 2015 and 2014, respectively.

During 2015, UMass Memorial and its affiliates entered into capital leases totaling \$304,000. There were no capital leases entered into for 2014.

The following assets under capital leases are included in property and equipment (excluding assets covered under the Occupancy Agreement) at September 30:

*(in thousands of dollars)*

|                                | 2015                   | 2014                   |
|--------------------------------|------------------------|------------------------|
| Property and equipment         | \$ 18,957              | \$ 20,709              |
| Less: Accumulated amortization | <u>16,199</u>          | <u>17,644</u>          |
| Net unamortized balance        | <u><u>\$ 2,758</u></u> | <u><u>\$ 3,065</u></u> |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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Amortization expense of assets recorded under capital leases of approximately \$671,000 and \$657,000 in 2015 and 2014, respectively, and is included in depreciation and amortization expense.

Future minimum lease payments under noncancelable capital leases and operating leases consisted of the following at September 30, 2015:

| <i>(in thousands of dollars)</i>            | <b>Capital<br/>Leases</b> | <b>Operating<br/>Leases</b> |
|---|---------------------------|-----------------------------|
| 2016  | \$ 321                    | \$ 21,874                   |
| 2017  | 269                       | 19,762                      |
| 2018  | 177                       | 16,100                      |
| 2019  | 43                        | 13,022                      |
| 2020  | 44                        | 11,592                      |
| Thereafter                                  | 54                        | 72,862                      |
| Total minimum lease payments                | 908                       | <u>\$ 155,212</u>           |
| Less: Amounts representing interest         | 36                        |                             |
| Present value of net minimum lease payments | <u>\$ 872</u>             |                             |

Minimum payments have not been reduced by minimum sublease rentals of \$1,829,000 due in the future under noncancelable subleases.

The Obligated Group has a 99-year office building lease through 2097 with the University, which requires UMass Memorial to make annual rental payments, which are included in the preceding table. In addition to the rental component, the agreement requires the Obligated Group to pay certain operating expenses related to the leased building. During the years ended September 30, 2015 and 2014, operating expenses paid by the Obligated Group to the University amounted to approximately \$785,000 and \$859,000, respectively.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**10. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets, including accumulated net realized and unrealized gains on permanently restricted net assets that are available for Board appropriation in accordance with state law, are available for the following purposes at September 30:

| <i>(in thousands of dollars)</i>   | <b>2015</b>      | <b>2014</b>      |
|--|------------------|------------------|
| Health care services   | \$ 10,862        | \$ 12,927        |
| Research   | 6,896            | 7,326            |
| Medical education  | 2,083            | 2,476            |
| Buildings and equipment  | 1,712            | 2,258            |
| Charity care   | 1,345            | 1,468            |
| Accumulated gains available for Board appropriation<br>which are expendable to support health care services<br>or other purposes designated by the donor | 19,639           | 21,451           |
|  | <u>\$ 42,537</u> | <u>\$ 47,906</u> |

Permanently restricted net assets are restricted for the following at September 30:

| <i>(in thousands of dollars)</i>  | <b>2015</b>      | <b>2014</b>      |
|---|------------------|------------------|
| Investments to be held in perpetuity, the income from<br>which is expendable to support health care services<br>or other purposes designated by the donor | \$ 46,378        | \$ 36,459        |
| Beneficial interest in trusts   | 7,991            | 15,675           |
|   | <u>\$ 54,369</u> | <u>\$ 52,134</u> |

**Pledges**

Pledges consist of unconditional promises to give in the future. Pledges are reported at their present value, net of allowances and discounts, at discount rates ranging from 0.37% to 2.06% and 1.00% to 2.52% at September 30, 2015 and 2014, respectively. At September 30, 2015 and 2014, pledges are expected to be received according to the following schedule:

| <i>(in thousands of dollars)</i>     | <b>2015</b>   | <b>2014</b>     |
|--------------------------------------|---------------|-----------------|
| In one year or less                  | \$ 461        | \$ 575          |
| Between one year and five years      | 203           | 881             |
|                                      | 664           | 1,456           |
| Less: Discount to present value      | (33)          | (85)            |
| Less: Allowance for doubtful pledges | (69)          | (95)            |
| Pledges receivable, net              | <u>\$ 562</u> | <u>\$ 1,276</u> |

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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#### **Endowment**

The System's endowment consists of approximately 182 individual funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The System has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date absent explicit donor stipulations to the contrary. As a result, the System classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Board in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the System and the Board considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the System 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 System
- The investment policies of the System.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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Endowment net asset composition by fund as of September 30 is as follows:

**September 30, 2015**

*(in thousands of dollars)*

|                                  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>     |
|----------------------------------|-----------------------------------|-----------------------------------|------------------|
| Donor restricted endowment funds |                                   |                                   |                  |
| Income restricted                | \$ 6,852                          | \$ 25,890                         | \$ 32,742        |
| Income unrestricted              | 12,787                            | 28,479                            | 41,266           |
|                                  | <u>\$ 19,639</u>                  | <u>\$ 54,369</u>                  | <u>\$ 74,008</u> |

**September 30, 2014**

*(in thousands of dollars)*

|                                  | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>     |
|----------------------------------|-----------------------------------|-----------------------------------|------------------|
| Donor restricted endowment funds |                                   |                                   |                  |
| Income restricted                | \$ 7,705                          | \$ 23,239                         | \$ 30,944        |
| Income unrestricted              | 13,746                            | 28,895                            | 42,641           |
|                                  | <u>\$ 21,451</u>                  | <u>\$ 52,134</u>                  | <u>\$ 73,585</u> |

Changes in endowment net assets for the year ended September 30 are as follows:

**September 30, 2015**

*(in thousands of dollars)*

|   | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>     |
|---|-----------------------------------|-----------------------------------|------------------|
| Endowment net assets, beginning of year           | \$ 21,451                         | \$ 52,134                         | \$ 73,585        |
| Investment return                                 |                                   |                                   |                  |
| Investment and other related income               | 717                               | -                                 | 717              |
| Net depreciation (realized and unrealized)        | (1,690)                           | -                                 | (1,690)          |
| Net investment return                             | (973)                             | -                                 | (973)            |
| Gifts   | -                                 | 2,879                             | 2,879            |
| Appropriation of endowment assets for expenditure | (839)                             | -                                 | (839)            |
| Change in beneficial interest in trusts and other | -                                 | (644)                             | (644)            |
| Endowment net assets, end of year                 | <u>\$ 19,639</u>                  | <u>\$ 54,369</u>                  | <u>\$ 74,008</u> |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**September 30, 2014**

*(in thousands of dollars)*

|   | <b>Temporarily<br/>Restricted</b> | <b>Permanently<br/>Restricted</b> | <b>Total</b>     |
|---|-----------------------------------|-----------------------------------|------------------|
| Endowment net assets, beginning of year           | \$ 19,478                         | \$ 53,877                         | \$ 73,355        |
| Investment return                                 |                                   |                                   |                  |
| Investment and other related income               | 984                               | -                                 | 984              |
| Net appreciation (realized and unrealized)        | 3,533                             | -                                 | 3,533            |
| Net investment return                             | 4,517                             | -                                 | 4,517            |
| Gifts   | 6                                 | -                                 | 6                |
| Appropriation of endowment assets for expenditure | (2,550)                           | -                                 | (2,550)          |
| Change in beneficial interest in trusts and other | -                                 | (1,743)                           | (1,743)          |
| Endowment net assets, end of year                 | <u>\$ 21,451</u>                  | <u>\$ 52,134</u>                  | <u>\$ 73,585</u> |

The primary long-term management objective for the System's endowment funds is to maintain the permanent nature of each endowment fund, while providing a predictable, stable, and constant stream of earnings. Consistent with that objective, the primary investment goal is to earn an average annual return equal to or greater than an assumed 5% annual spending policy rate for the endowment funds plus the rate of inflation, net of all fees, including investment management and related fees and expenses, over the long-term. The endowment funds are invested in the Partnership to diversify exposure and minimize risk consistent with System investment policy.

## **11. Benefit Plans**

UMass Memorial and its affiliates sponsor several noncontributory defined contribution plans and defined benefit pension plans covering substantially all employees who have met age and service requirements.

### **Defined Contribution Retirement Plans**

UMass Memorial and its affiliates make annual contributions to their defined contribution plans based on specific percentages of annual compensation and/or employee contributions. Pension expense related to these defined contribution plans was approximately \$25,162,000 and \$24,940,000 for the years ended September 30, 2015 and 2014, respectively.

### **Defined Benefit Retirement Plans**

The benefits under the defined benefit plans are based primarily on years of service and employees' compensation. The funding policy is to make contributions to the plans at least equal to the minimum amount required by law. Plan assets consist principally of mutual funds, bonds and notes and common stock. In addition, UMass Memorial and its affiliates sponsor certain postretirement medical plans.

### **Funded Status**

The funded status of UMass Memorial and affiliates' plans are recognized as liabilities. Unrecognized actuarial losses and prior service costs previously recorded as charges to net assets are "recycled" out of net assets as components of net periodic (cost) credit.



**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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The amounts in unrestricted net assets as of September 30, 2015 and 2014 that are not yet recognized as a component of net periodic (cost) credit are as follows:

| <b>September 30, 2015</b><br><i>(in thousands of dollars)</i> | <b>Pension</b> | <b>Postretirement<br/>Benefits</b> | <b>Total</b> |
|---|----------------|------------------------------------|--------------|
| Net prior service (cost) credit                               | \$ (66,177)    | \$ -                               | \$ (66,177)  |
| Net actuarial loss  | 361,148        | 4,458                              | 365,606      |

| <b>September 30, 2014</b><br><i>(in thousands of dollars)</i> | <b>Pension</b> | <b>Postretirement<br/>Benefits</b> | <b>Total</b> |
|---|----------------|------------------------------------|--------------|
| Net prior service (cost) credit                               | \$ (73,690)    | \$ -                               | \$ (73,690)  |
| Net actuarial loss  | 308,330        | 7,470                              | 315,800      |

Changes in plan assets and benefit obligations recognized in unrestricted net assets during 2015 and 2014 include:

| <i>(in thousands of dollars)</i>            | <b>2015</b>        | <b>2014</b>        |
|---|--------------------|--------------------|
| Current year actuarial net gain             | \$ (71,131)        | \$ (47,883)        |
| Amortization of prior actuarial net loss    | 21,325             | 18,887             |
| Amortization of prior service (cost) credit | (7,512)            | (7,402)            |
|   | <u>\$ (57,318)</u> | <u>\$ (36,398)</u> |

The amounts in unrestricted net assets as of September 30, 2015 that are expected to be recognized as a component of net periodic (cost) credit during fiscal 2016 are as follows:

| <i>(in thousands of dollars)</i> | <b>Pension</b> | <b>Postretirement<br/>Benefits</b> | <b>Total</b> |
|----------------------------------|----------------|------------------------------------|--------------|
| Net prior service (cost) credit  | \$ 7,515       | \$ -                               | \$ 7,515     |
| Net actuarial gain               | (19,812)       | (168)                              | (19,980)     |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

The following tables provide a reconciliation of benefit obligations, plan assets and the funded status of UMass Memorial and its affiliates' defined benefit plans and the related amounts that are recognized in the accompanying consolidated balance sheets at September 30:

| <i>(in thousands of dollars)</i>       | <b>Pension Benefits</b> |                     |
|--|-------------------------|---------------------|
|  | <b>2015</b>             | <b>2014</b>         |
| Accumulated benefit obligation         | \$ 932,632              | \$ 876,015          |
| Change in projected benefit obligation |                         |                     |
| Projected benefit obligation           | \$ 873,106              | \$ 775,978          |
| Service cost                           | 40,391                  | 38,155              |
| Interest cost                          | 38,301                  | 38,286              |
| Actuarial loss                         | 14,719                  | 58,987              |
| Benefits paid                          | (47,110)                | (37,343)            |
| Expenses paid                          | (2,264)                 | (957)               |
| Projected benefit obligation           | \$ 917,143              | \$ 873,106          |
| Change in plan assets                  |                         |                     |
| Fair value of plan assets              | 699,856                 | 622,522             |
| Actual return on plan assets           | (11,573)                | 58,448              |
| Employer contributions                 | 107,415                 | 57,186              |
| Benefits paid                          | (47,110)                | (37,343)            |
| Expenses paid                          | (2,264)                 | (957)               |
| Fair value of plan assets              | 746,324                 | 699,856             |
| Funded status, end of year             | <u>\$ (170,819)</u>     | <u>\$ (173,250)</u> |

The amounts recognized in the consolidated balance sheets for the defined benefit plans on a combined basis as of September 30 were as follows:

| <i>(in thousands of dollars)</i>  | <b>2015</b>         | <b>2014</b>         |
|---|---------------------|---------------------|
| Amounts recognized in the consolidated balance sheet consist of the following |                     |                     |
| Accounts payable and accrued expenses   | \$ (801)            | \$ (2,327)          |
| Accrued pension and postretirement obligations                                | (170,018)           | (170,923)           |
|   | <u>\$ (170,819)</u> | <u>\$ (173,250)</u> |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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UMass Memorial and its affiliates' used the following assumptions in determining its September 30 projected benefit obligation amounts:

|   | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
| Discount rate   | 4.50-4.81%  | 4.27-4.47%  |
| Rate of compensation increase<br>(based on age and position classification) | 5.95-2.45%  | 5.60-2.10%  |

UMass Memorial updated the mortality table used to value annuities to reflect longer anticipated life expectancies. The change in the mortality assumption increased the liability of the UMass Memorial Health Care Pension Plan by \$28,800,000.

The following is a summary of the allocation of plan assets for the benefit plans as of the measurement date:

| <b>Asset Category</b> | <b>2015</b> | <b>2014</b> |
|-----------------------|-------------|-------------|
| Mutual funds          | 46 %        | 48 %        |
| Bonds and notes       | 21 %        | 23 %        |
| Common stocks         | 14 %        | 16 %        |
| Private equity funds  | 10 %        | 2 %         |
| Cash investments      | 6 %         | 2 %         |
| Hedge funds           | 3 %         | 9 %         |

The following is a summary of the target allocation of plan assets for the benefit plans as of the measurement date:

| <b>Asset Category</b> | <b>2015</b> | <b>2014</b> |
|-----------------------|-------------|-------------|
| Mutual funds          | 40 %        | 18 %        |
| Bonds and notes       | 22 %        | 28 %        |
| Common stocks         | 20 %        | 40 %        |
| Private equity funds  | 13 %        | 9 %         |
| Hedge funds           | 5 %         | 5 %         |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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The following table presents the assets of the defined benefit plans as of September 30, 2015 and 2014, measured at fair value on a recurring basis using the fair value hierarchy described in Note 5. Included in the asset totals of \$746,324,000 and \$699,856,000 as of September 30, 2015 and 2014, were pending sales of \$1,467,000 and \$1,203,000 and purchases of \$2,020,000 and \$3,003,000, respectively:

**September 30, 2015**

*(in thousands of dollars)*

|   | Level 1           | Level 2           | Level 3          | Total             |
|---|-------------------|-------------------|------------------|-------------------|
| Mutual funds and common collective trusts | \$ 175,442        | \$ 143,027        | \$ -             | \$ 318,469        |
| Bonds and notes                           | 21,285            | 137,128           | -                | 158,413           |
| Common stocks                             | 107,477           | -                 | -                | 107,477           |
| Hedge funds                               | -                 | 48,164            | 33,582           | 81,746            |
| Cash investments                          | 46,987            | -                 | -                | 46,987            |
| Private equity funds                      | -                 | -                 | 33,233           | 33,233            |
| Total investments at fair value           | <u>\$ 351,191</u> | <u>\$ 328,319</u> | <u>\$ 66,815</u> | <u>\$ 746,325</u> |

**September 30, 2014**

*(in thousands of dollars)*

|   | Level 1           | Level 2           | Level 3          | Total             |
|---|-------------------|-------------------|------------------|-------------------|
| Mutual funds and common collective trusts | \$ 180,535        | \$ 134,554        | \$ -             | \$ 315,089        |
| Bonds and notes                           | 18,454            | 141,857           | -                | 160,311           |
| Common stocks                             | 111,225           | -                 | -                | 111,225           |
| Hedge funds                               | -                 | 41,524            | 37,215           | 78,739            |
| Cash investments                          | 17,278            | -                 | -                | 17,278            |
| Private equity funds                      | -                 | -                 | 17,214           | 17,214            |
| Total investments at fair value           | <u>\$ 327,492</u> | <u>\$ 317,935</u> | <u>\$ 54,429</u> | <u>\$ 699,856</u> |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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The following table presents the activity for the year for all assets categorized as Level 3 for the years ended September 30, 2015 and 2014:

| <i>(in thousands of dollars)</i>      | <b>Private<br/>Equity<br/>Funds</b> | <b>Hedge<br/>Funds</b> | <b>September 30,<br/>2015</b> |
|---------------------------------------|-------------------------------------|------------------------|-------------------------------|
| <b>Fair value, October 1, 2014</b>    | \$ 17,214                           | \$ 37,215              | \$ 54,429                     |
| Realized gains (losses)               | (2,941)                             | 6,246                  | 3,305                         |
| Unrealized gains (losses)             | 1,252                               | (5,570)                | (4,318)                       |
| Purchases                             | 17,708                              | 33,000                 | 50,708                        |
| Sales                                 | -                                   | (37,309)               | (37,309)                      |
| <b>Fair value, September 30, 2015</b> | <u>\$ 33,233</u>                    | <u>\$ 33,582</u>       | <u>\$ 66,815</u>              |

| <i>(in thousands of dollars)</i>      | <b>Private<br/>Equity<br/>Funds</b> | <b>Hedge<br/>Funds</b> | <b>September 30,<br/>2014</b> |
|---------------------------------------|-------------------------------------|------------------------|-------------------------------|
| <b>Fair value, October 1, 2013</b>    | \$ 2,965                            | \$ 34,475              | \$ 37,440                     |
| Realized gains (losses)               | 420                                 | (15)                   | 405                           |
| Unrealized gains                      | 276                                 | 2,794                  | 3,070                         |
| Purchases                             | 15,135                              | -                      | 15,135                        |
| Sales                                 | (1,582)                             | (39)                   | (1,621)                       |
| <b>Fair value, September 30, 2014</b> | <u>\$ 17,214</u>                    | <u>\$ 37,215</u>       | <u>\$ 54,429</u>              |

UMass Memorial and its affiliates' investment strategy is to utilize broadly diversified passive vehicles where appropriate, with an investment mix and risk profile consistent with pension liabilities. Periodic studies are undertaken to determine the asset mix that will meet pension obligations at a reasonable cost to UMass Memorial and which are consistent with the fiduciary requirements of pension regulations.

In selecting the expected long-term rate of return on assets, UMass Memorial and its affiliates' considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of these plans. This included considering the trusts' asset allocation and the expected returns likely to be earned over the life of the plan. This basis is consistent with the prior year.

UMass Memorial and its affiliates expect to contribute approximately \$2,020,000 to their defined benefit pension plans during the year ended September 30, 2016.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, are expected to be paid during the period ended September 30:

*(in thousands of dollars)*

|                   |    |         |
|-------------------|----|---------|
| 2016              | \$ | 56,857  |
| 2017              |    | 59,090  |
| 2018              |    | 60,366  |
| 2019              |    | 61,273  |
| 2020              |    | 64,787  |
| 2021 through 2025 |    | 326,635 |

The following are the components of net periodic (cost) credit for UMass Memorial and its affiliates' defined benefit plans:

*(in thousands of dollars)*

|                                | 2015             | 2014             |
|--------------------------------|------------------|------------------|
| Net periodic (cost) credit     |                  |                  |
| Service cost                   | \$ 40,391        | \$ 38,155        |
| Interest cost                  | 38,301           | 38,286           |
| Expected return on plan assets | (47,474)         | (43,064)         |
| Net amortization               | 13,436           | 11,286           |
| Net periodic (cost) credit     | <u>\$ 44,654</u> | <u>\$ 44,663</u> |

Assumptions used in determining net periodic (cost) credit of the defined benefit plans were:

|   | 2015       | 2014       |
|---|------------|------------|
| Discount rate   | 4.27-4.47% | 4.92-5.11% |
| Rate of compensation increase<br>(based on age and position classification) | 5.60-2.10% | 6.25-2.75% |
| Expected return on plan assets  | 7.00 %     | 7.00 %     |

**UMass Memorial Postretirement Medical Benefits**

UMass Memorial and its affiliates provide postretirement medical benefits to certain of its employees. Benefits are funded from the general assets of the System on a current basis. Such plans pay a portion of health insurance costs for eligible participants.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

Presented below is financial information related to the postretirement medical plans for the years ended September 30:

| <i>(in thousands of dollars)</i>                        | <b>Postretirement<br/>Medical Benefits</b> |                    |
|---|--|--------------------|
|   | <b>2015</b>                                | <b>2014</b>        |
| Change in accumulated postretirement benefit obligation |  |                    |
| Accumulated postretirement benefit obligation           | \$ 37,273                                  | \$ 31,426          |
| Service cost  | 246  | 257                |
| Interest cost   | 1,658                                      | 1,597              |
| Actuarial (gain) loss                                   | (2,636)                                    | 4,280              |
| Benefits paid   | (312)                                      | (287)              |
| Accumulated postretirement benefit obligation           | <u>36,229</u>                              | <u>37,273</u>      |
| Change in plan assets                                   |  |                    |
| Employer contributions                                  | 312  | 287                |
| Benefits paid   | (312)                                      | (287)              |
| Fair value of plan assets                               | <u>-</u>                                   | <u>-</u>           |
| Funded status, end of year                              | <u>\$ (36,229)</u>                         | <u>\$ (37,273)</u> |

The amounts recognized in the consolidated balance sheets for the post-retirement benefit plans as of September 30 were as follows:

| <i>(in thousands of dollars)</i>               | <b>2015</b>        | <b>2014</b>        |
|--|--------------------|--------------------|
| Accounts payable and accrued expenses          | \$ (450)           | \$ (402)           |
| Accrued pension and postretirement obligations | (35,779)           | (36,871)           |
|  | <u>\$ (36,229)</u> | <u>\$ (37,273)</u> |

UMass Memorial and its affiliates' used the following assumptions in determining its September 30 projected benefit obligation amounts:

|   | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
| Discount rate                             | 4.81 %      | 4.47 %      |
| Current year health care cost trend rate  | 7.00 %      | 7.50 %      |
| Ultimate year health care cost trend rate | 5.00 %      | 5.00 %      |

UMass Memorial and its affiliates expect to contribute approximately \$458,000 to its postretirement benefit plans during the year ended September 30, 2016.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**Estimated Future Benefit Payments**

The following benefit payments related to the postretirement benefit plan are expected to be paid during the periods ended September 30:

*(in thousands of dollars)*

|                   |    |       |
|-------------------|----|-------|
| 2016              | \$ | 485   |
| 2017              |    | 552   |
| 2018              |    | 638   |
| 2019              |    | 746   |
| 2020              |    | 857   |
| 2021 through 2025 |    | 6,179 |

**Estimated Medicare Part D Subsidies**

The following Medicare Part D subsidies related to the postretirement benefit plan are expected to be received during the periods ended September 30:

*(in thousands of dollars)*

|                   |    |     |
|-------------------|----|-----|
| 2016              | \$ | 25  |
| 2017              |    | 28  |
| 2018              |    | 31  |
| 2019              |    | 36  |
| 2020              |    | 42  |
| 2021 through 2025 |    | 377 |

The assumed health care cost trend rate used in measuring the postretirement medical benefit obligation was 7.00% in 2015, declining gradually to 5.00% by 2019 and remaining level thereafter. Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement benefit plan. A one-percentage-point change in the assumed health care cost trend rates would have the following effects:

| <i>(in thousands of dollars)</i>             | <b>1 Percentage<br/>Point<br/>Increase</b> | <b>1 Percentage<br/>Point<br/>Decrease</b> |
|--|--|--|
| Effect on total of service and interest cost | \$ 2,348                                   | \$ (1,557)                                 |
| Effect on postretirement benefit obligation  | 8,505                                      | (6,571)                                    |



**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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The following are the components of net periodic (cost) credit for UMass Memorial and its affiliates' postretirement medical plan:

| <i>(in thousands of dollars)</i> | <b>2015</b>     | <b>2014</b>     |
|----------------------------------|-----------------|-----------------|
| Net periodic (cost) credit       |                 |                 |
| Service cost                     | \$ 246          | \$ 257          |
| Interest cost                    | 1,658           | 1,597           |
| Net amortization                 | <u>377</u>      | <u>199</u>      |
| Net periodic (cost) credit       | <u>\$ 2,281</u> | <u>\$ 2,053</u> |

Assumptions used in determining net periodic (cost) credit of the postretirement medical plan were:

|   | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
| Discount rate                             | 4.47 %      | 5.11 %      |
| Current year health care cost trend rate  | 7.00 %      | 7.50 %      |
| Ultimate year health care cost trend rate | 5.00 %      | 5.00 %      |

## **12. Commitments and Contingencies**

### **Self-Insurance**

CPAC is a wholly-owned captive insurance company incorporated and based in the Cayman Islands for the purpose of providing professional and general liability, workers' compensation insurance and several other smaller lines of insurance or deductibles, including medical stop-loss insurance.

Estimated malpractice costs, as calculated by CPAC's consulting actuaries, consist of specific reserves to cover the estimated liability resulting from medical or general liability incidents, as well as potential claims which have been reported and a provision for claims incurred but not reported. Estimated malpractice liabilities are based on claims reported, historical experience and industry trends. These liabilities include estimates of future trends in loss severity and frequency and other factors that could vary as the claims are ultimately settled. Although it is not possible to measure the degree of variability inherent in such estimates, management believes the reserves for claims are adequate. These estimates are periodically reviewed and necessary adjustments are recorded in the year the need for such adjustments becomes known. Management is unaware of any claims that would cause the final expense for medical malpractice risks to vary materially from the amounts provided.

CPAC estimates that the expected claims liabilities at September 30, 2015 and 2014, on an undiscounted basis, are approximately \$171,000,000 and \$175,000,000, respectively, assuming losses are limited to \$5,000,000 for professional liability and \$3,000,000 for general liability per individual claim, respectively. These amounts are then discounted at 2% and 3%, respectively, at September 30, 2015 and 2014, over an estimated payout period of 12 years.

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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#### **Excess Liability Coverage**

UMass Memorial and its affiliates have excess liability coverage of \$50,000,000 for malpractice losses in excess of \$5,000,000 per individual claim and for annual aggregate malpractice losses in excess of \$60,000,000 on a claims-made basis. The existence of this reinsurance coverage does not relieve UMass Memorial and its affiliates of its primary obligation with respect to losses incurred. UMass Memorial and its affiliates would be liable for claims ceded to reinsurers in the event such reinsurers were unable to meet their obligations. UMass Memorial records the gross exposure of claim liabilities and a corresponding receivable for insurance recoveries when such circumstances are present.

#### **Surety Bond**

UMass Memorial and its affiliates have surety bonds in the aggregate amount of \$14,380,000 related to two workers' compensation self-insurance programs.

#### **Electronic Medical Record and Billing System**

On July 20, 2015, management executed a license and support agreement for the development, licensing and implementation of a System wide, fully integrated Electronic Medical Record ("EMR") and billing system. The implementation is expected to be completed during fiscal year 2017. The design and implementation costs are expected to be funded through ongoing operations, current financial resources and additional financing. The software license and implementation fees will be paid in sixty monthly installments of \$463,000, which includes interest at the 1-month LIBOR plus 2%. In connection with the implementation, the estimated useful lives of assets expected to be replaced by the EMR, has been adjusted to reflect the new system's implementation date. See Note 6 for further discussion on related property and equipment.

#### **Other Contingencies**

UMass Memorial and its affiliates are parties to various legal proceedings and potential claims arising in the ordinary course of business. In addition, the health care industry as a whole is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at the time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations. These could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that the System and its affiliates are in compliance with current laws and regulations and does not believe that these matters will have a material adverse effect on its consolidated financial statements.

*Centers for Medicare and Medicaid Services ("CMS") Notice of Disallowance/Request for Information* - Following a 2009 audit report by the Office of Audit Services of the Office of Inspector General of the United States Health and Human Services (the "OIG"), under which the Commonwealth of Massachusetts' (the "Commonwealth") Medicaid Program returned approximately \$1,500,000 in federal financial participation ("FFP") to the CMS regarding supplemental Medicaid payments to the Medical Center from fiscal years 2000 through and including 2005, CMS informed the Commonwealth on February 7, 2011, of its intention to disallow \$25,500,000 in FFP for the same supplemental payments made to UMass Memorial for a subset of the same time period (2000 through 2003). The stated reason for the disallowance was that the Commonwealth had not complied with the time limit for claiming payment for Medicaid expenditures. The Commonwealth filed a request for reconsideration of the disallowance. On April 13, 2012, CMS issued a letter to the Commonwealth affirming the disallowance except with respect to \$8,100,000 for supplemental payments for fiscal year 2003 which CMS acknowledges were

# UMass Memorial Health Care, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### September 30, 2015 and 2014

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claimed timely. Management worked with the Commonwealth to file an appeal to the Department of Health and Human Services Departmental Appeals Board (the "DAB") on June 12, 2012. After the Commonwealth filed its brief with the DAB, CMS submitted its brief in May 2013 and asked the DAB to increase the disallowance of the federal share from \$17,000,000 to \$21,000,000 due to an earlier CMS calculation error. UMass Memorial intervened in the matter and contested the proposed increase in the disallowance. A hearing on the appeal was held on June 18, 2013.

On September 30, 2013, the DAB issued its decision reversing the CMS disallowance of approximately \$21,500,000 in FFP based on a finding that the claim for FFP had been timely and sustaining the disallowance of approximately \$4,250,000 in FFP based on the OIG's audit report finding that the relevant expenditures were not authorized by the Commonwealth plan. The Commonwealth Medicaid Agency has not recouped any funds from UMass Memorial as a result of the disallowance or, as noted above, for the prior return of funds related to the OIG audit report, although it is expected that such a recoupment will be asserted. The Medical Center has sufficient reserves to reimburse the Commonwealth for the amount sustained by the decision.

*Privacy Breach* – A purported class action lawsuit was filed against the Medical Center alleging damages arising from a data information breach by a former employee who is under criminal indictment for identity theft and larceny. At this time, UMass Memorial is only aware of two plaintiffs represented in the case. UMass Memorial has retained experienced counsel to defend the case. There can be no assurance as to the outcome of this matter.

#### 13. Concentration of Credit Risk

Financial instruments that potentially subject UMass Memorial and its affiliates to concentrations of credit risk are patient and other accounts receivable, cash equivalents and investments. UMass Memorial and its affiliates generally invest available cash in certificates of deposit and repurchase agreements with various banks, commercial paper of domestic companies with high credit ratings and securities backed by the United States government.

UMass Memorial and its affiliates grant credit without collateral to their patients, many of whom are local residents and are insured under third-party payor agreements. Net patient accounts receivable consist of the following at September 30:

|                               | 2015         | 2014         |
|-------------------------------|--------------|--------------|
| Commercial insurance and HMOs | 40 %         | 40 %         |
| Medicaid                      | 21 %         | 20 %         |
| Patients                      | 18 %         | 19 %         |
| Medicare                      | 16 %         | 18 %         |
| Other                         | 5 %          | 3 %          |
|                               | <u>100 %</u> | <u>100 %</u> |

#### 14. Transactions with the University

In connection with the Merger discussed in Note 1, UMass Memorial entered into several agreements with the University (the "Definitive Agreement"), including:

# **UMass Memorial Health Care, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements**

### **September 30, 2015 and 2014**

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- The Obligated Group was granted the right to occupy certain portions of the University's Worcester, Massachusetts campus (the "Occupancy and Shared Services Agreement"). The University and the Medical Center agreed to share responsibility for various capital and operating expenses related to the occupied premises (Note 6).
- UMass Memorial and its affiliates agreed to make certain payments to the University including: (1) an annual fee of \$12,000,000 (plus an inflation adjustment), which totaled approximately \$18,661,000 and \$18,476,000 for the years ended September 30, 2015 and 2014, respectively, so long as the University continues to operate a medical school with substantial numbers of students and amounts of research funding, and (2) a percent of the net combined operating income of UMass Memorial and its affiliates (with certain exceptions) based on an agreed-upon formula ("Participation Payment", the participation payment may be adjusted under certain conditions if the University's ongoing programs and research activities substantially decrease). UMass Memorial incurred expense of approximately \$3,841,000 and \$0 for the years ended September 30, 2015 and 2014, respectively, pursuant to the agreed-upon formula.
- The System contracts University employees for medical residency, physician and other services. The cost of these contracted employees is reported as salaries, benefits and contracted labor in the accompanying consolidated financial statements. Total payroll expense related to these employees for the years ended September 30, 2015 and 2014 was \$65,424,000 and \$64,658,000, respectively.

The cost incurred for fringe benefits related to these employees for the years ended September 30, 2015 and 2014 was approximately \$13,575,000 and \$13,411,000, respectively.

Subsequent to the Merger, the University and UMass Memorial agreed to amend certain aspects of the Definitive Agreement as follows:

- The Medical Center agreed to segregate a portion of its unrestricted net assets, totaling approximately \$15,500,000 at September 30, 2001, to be designated as Department Education Funds (the "Ed Funds"). During 2002, the Medical Center transferred the balance of the Ed Funds to the Medical Group and the Medical Group segregated these funds within its unrestricted net assets. The balance of the Ed Funds at September 30, 2015 is approximately \$42,000,000. These funds have been frozen, until such time as the Chancellor of the University (the "Chancellor") and the Chief Executive Officer of UMass Memorial (the "CEO") mutually agree to release any and all of these funds.

In September of 2011, the Medical Group established Academic Investment Funds (the "AIF") at the University. The Medical Group has transferred \$6,600,000 in 2015 and 2014, respectively, to the AIF. UMass Memorial has also committed to fund \$2,000,000 to the AIF. These amounts have been recorded as expense in the accompanying consolidated statements of operations. In fiscal year 2016, the Medical Group anticipates funding the AIF by approximately \$6,600,000. The use of the AIF is controlled jointly by the Chancellor and the CEO. In addition, the Chancellor and the CEO jointly approve the annual operating budgets of each clinical department in the Medical Group.

The following significant transactions with the University have been recorded in income from operations:

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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**Purchased Services**

The Obligated Group reimburse and are reimbursed by the University for certain common services purchased and provided. The net services purchased by the Obligated Group amounted to \$20,397,000 and \$22,995,000 for 2015 and 2014, respectively.

**Due to the University**

The amounts due to the University at September 30 consisted of the following:

| <i>(in thousands of dollars)</i>                     | <b>2015</b>       | <b>2014</b>      |
|--|-------------------|------------------|
| Medical education services and participation payment | \$ 146,229        | \$ 58,062        |
| Accrued compensation and benefits                    | 11,162            | 2,550            |
| Accounts payable - net of accounts receivable        | 7,252             | 4,117            |
| Other  | 1,577             | 2,304            |
| Total due to the University, net                     | <u>\$ 166,220</u> | <u>\$ 67,033</u> |

**Medical Education Services**

As part of the academic affiliation between the University and the Medical Center and pursuant to the enabling legislation creating UMass Memorial, the University is the exclusive academic and medical teaching affiliate of the Medical Center. In connection with this affiliation, the Medical Center and other UMass Memorial affiliates compensate the University for the cost of teaching and education services and support the University contributes to the delivery of medical care by the Medical Center and other UMass Memorial affiliates. The cost of these services was approximately \$128,074,000 and \$163,750,000 for 2015 and 2014, respectively. The cost for these educational services is recorded as supplies and other expense. Certain of the amounts due to and from the University are subject to settlement between the System and the University. Management has recorded its best estimate of the amounts due to and from the University. Differences between current estimates of such assets and liabilities and final settlements are included in operations in the year in which the settlement or change in estimate occurs. Management does not expect such differences to be material to the consolidated balance sheets, results of operations, or cash flows of the System.

**15. UMass Memorial Transition of Lab Outreach Business**

On January 3, 2013, certain assets and the operations of the clinical and anatomic laboratory outreach businesses owned by the Medical Center were sold to Quest Diagnostics. The sales agreements included a transitional period of 18-24 months to complete the full transition of service. The consideration received in conjunction with the sale was a combination of cash and an option to purchase an equity interest in a newly formed Quest Diagnostics subsidiary (Note 7).

During fiscal year 2014, the valuation of the joint venture option was reassessed and the value was decreased by \$10,198,000 offset by a \$1,043,000 adjustment to proceeds from sale. These two transactions combined resulted in a loss on sale of \$9,155,000 in 2014. Expenses associated with the sale of this business were reduced by \$853,000 in 2014. The value of the option as of September 30, 2014 was \$21,236,000.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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Effective July 1, 2015, the Medical Center exercised its option to purchase an equity interest in the newly formed Quest Diagnostics subsidiary once the aforementioned transitional period ended. This transaction resulted in an 18.9% ownership in the subsidiary and a gain on the option exercise of \$13,620,000, offset by a \$325,000 adjustment to proceeds from sale related to Ventures. These two transactions combined resulted in a gain on sale of \$13,295,000 in 2015. Expenses associated with the sale of this business were reduced by \$873,000 in 2015. The Medical Center's 18.9% ownership as of September 30, 2015 was \$54,092,000.

The table below summarizes adjustments to the gain (loss) recognized on the sale transaction and associated expenses as of September 30:

| <i>(in thousands of dollars)</i>                    | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|
| Gain (loss) on sale of business                     | \$ 13,295   | \$ (9,155)  |
| Expense reductions associated with sale of business | \$ 873      | \$ 853      |

**16. Reduction in force**

During fiscal year 2014, UMass Memorial and certain affiliates had a reduction in force. Total expenses of the System in the amount of \$16,478,000 were incurred in conjunction with a strategic initiative aimed at reducing staffing levels and operating losses. Such costs consist of severance payouts, associated benefits and unemployment costs.

**17. Discontinued Operations**

Effective September 1, 2014, Wing Memorial Hospital ("Wing") was assumed by Baystate Health ("Baystate") via a membership substitution. Substantially all assets and liabilities transferred to Baystate on that date. As a result of the transfer, a loss on transfer of membership interest of \$11,187,000 was recorded in unrestricted net assets. The consolidated financial statements for all periods present the operations of Wing as a discontinued operation. For the eleven month period ended August 31, 2014, Wing reported revenue of \$74,900,000 and excess of revenue over expenses of \$1,400,000 in discontinued operations in the statement of changes in net assets. As of August 31, 2014, assets held for sale were \$77,655,000 and liabilities held for sale were \$23,863,000. The assets and liabilities held for sale consisted of:

*(in thousands of dollars)*

| Assets                      |                  | Liabilities                            |                  |
|-----------------------------|------------------|--|------------------|
| Patient accounts receivable | \$ 7,668         | Current liabilities                    | 79               |
| Other current assets        | 13,471           | Accounts payable and accrued expenses  | 7,769            |
| Property and equipment, net | 42,928           | Current portion of long-term debt      | 547              |
| Restricted investments      | 974              | Long-term debt, net of current portion | 13,204           |
| Other assets                | 12,614           | Other noncurrent liabilities           | 2,264            |
| Total assets                | <u>\$ 77,655</u> | Total liabilities                      | <u>\$ 23,863</u> |

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**September 30, 2015 and 2014**

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The table below summarizes the loss recognized on the sale of these asset groups as of September 30, 2014:

*(in thousands of dollars)*

|   |                    |
|---|--------------------|
| Proceeds from sale                                      | \$ 39,675          |
| Net book value of assets sold and related costs of sale |                    |
| Property and equipment, net                             | 42,928             |
| Other net assets  | 6,661              |
| Incremental transaction costs                           | <u>1,273</u>       |
|   | <u>50,862</u>      |
| Loss on sale  | <u>\$ (11,187)</u> |

The operations and sale of these assets are presented in the statements of operations as a discontinued operation. Included within the discontinued operations caption are the respective loss on the sale of assets and the loss from operations. Included in the 2014 loss on the discontinued operations is a loss on the transfer of membership interest of \$11,187,000 and an operating gain prior to the sale of \$1,439,000.

The cash flow amounts related to the discontinued operations are presented within the respective aggregated categories of the consolidated statements of cash flows.

**18. Functional Expenses**

UMass Memorial and its affiliates provide general health care services to residents within its geographic location. Expenses related to providing these services, including the 2014 expenses related to the reduction of force (Note 16), are as follows for the years ended September 30:

*(in thousands of dollars)*

|                            | <b>2015</b>         | <b>2014</b>         |
|----------------------------|---------------------|---------------------|
| Health care services       | \$ 1,802,980        | \$ 1,773,210        |
| General and administrative | <u>380,692</u>      | <u>441,649</u>      |
|                            | <u>\$ 2,183,672</u> | <u>\$ 2,214,859</u> |

**19. Subsequent Events**

The System recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheets. The System does not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheets but arose after the consolidated balance sheets date but before the consolidated financial statements are issued. For these purposes, UMass Memorial has evaluated events occurring subsequent to the consolidated balance sheets date through December 17, 2015, the date the consolidated financial statements were issued. There were no subsequent events that required recognition or disclosure in the consolidated financial statements.

**SUPPLEMENTAL CONSOLIDATING INFORMATION**



**UMass Memorial Health Care, Inc. and Affiliates**  
**Supplemental Consolidating Balance Sheet Information - Obligated Group**  
**September 30, 2015**  
(In thousands of dollars)

|  | UMass<br>Memorial<br>Health<br>Care,<br>Inc. | UMass<br>Memorial<br>Medical<br>Center,<br>Inc. | UMass<br>Memorial<br>Health<br>Ventures,<br>Inc. | HealthAlliance<br>Hospitals,<br>Inc. | Eliminations | Total<br>Obligated<br>Group | Non<br>Obligated<br>Group<br>Entities | Eliminations<br>and<br>Consolidating<br>Entries | Consolidated |
|--|--|---|--|--------------------------------------|--------------|-----------------------------|---------------------------------------|---|--------------|
| <b>Assets</b>  |  |   |  |                                      |              |                             |                                       |   |              |
| Current assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Cash and cash equivalents  | \$ 6,331                                     | \$ 90,531                                       | \$ 6,197   | \$ 12,461                            | \$ -         | \$ 115,520                  | \$ 46,188                             | \$ 748  | \$ 162,456   |
| Short-term investments   | 1,801  | 5,090   | 8,533  | 8,918                                | -            | 24,342                      | 7,450                                 | -   | 31,792       |
| Current portion of assets whose use is limited                               | -  | 6,148   | -  | -                                    | -            | 6,148                       | 2,552                                 | -   | 8,700        |
| Patient accounts receivable, net   | -  | 171,102   | -  | 14,022                               | -            | 185,124                     | 52,187                                | 347   | 237,658      |
| Inventories  | -  | 25,731  | -  | 1,606                                | -            | 27,337                      | 1,781                                 | 17  | 29,135       |
| Prepaid expenses and other current assets                                    | 7,722  | 11,905  | 1,514  | 1,815                                | (1,325)      | 21,631                      | 8,857                                 | -   | 30,488       |
| Current portion of notes receivable from affiliates                          | -  | 1,516   | -  | -                                    | (596)        | 920                         | -                                     | (920)   | -            |
| Due from related parties   | 14,733                                       | 47,607  | 1,097  | 2,237                                | (15,093)     | 50,581                      | 65,838                                | (116,419)                                       | -            |
| Due from the University of Massachusetts                                     | -  | -   | -  | -                                    | -            | -                           | -                                     | -   | -            |
| Estimated settlements receivable from third-party payors                     | -  | 301,524   | -  | 28,152                               | -            | 329,676                     | 24,117                                | -   | 353,793      |
| Total current assets   | 30,587                                       | 661,154   | 17,341   | 69,211                               | (17,014)     | 761,279                     | 208,970                               | (116,227)                                       | 854,022      |
| Assets whose use is limited  |  |   |  |                                      |              |                             |                                       |   |              |
| Funds held in escrow under bond indenture agreements, net of current portion | -  | 10,777  | -  | -                                    | -            | 10,777                      | 1,326                                 | -   | 12,103       |
| Restricted investments   | 63,139                                       | -   | -  | 19,585                               | -            | 82,724                      | 5,471                                 | -   | 88,195       |
| Captive insurance company investments  | 164,440                                      | -   | -  | -                                    | (164,440)    | -                           | 164,440                               | -   | 164,440      |
| Total assets whose use is limited  | 227,579                                      | 10,777  | -  | 19,585                               | (164,440)    | 93,501                      | 171,237                               | -   | 264,738      |
| Long-term investments  | 239,248                                      | 44,075  | 28,617   | 39,153                               | -            | 351,093                     | 53,852                                | -   | 404,945      |
| Property and equipment, net  | 2,049  | 433,546   | -  | 73,610                               | -            | 509,205                     | 84,946                                | 71  | 594,222      |
| Beneficial interest in trusts  | 582  | 63,849  | -  | 4,677                                | (63,849)     | 5,259                       | 2,732                                 | -   | 7,991        |
| Notes receivable from affiliates, net of current portion                     | -  | 30,109  | -  | -                                    | (9,692)      | 20,417                      | -                                     | (20,417)  | -            |
| Other assets   | 564  | 74,085  | 9,349  | 5,209                                | (11,639)     | 77,568                      | 23,035                                | (22,855)  | 77,748       |
| Total assets   | \$ 500,609                                   | \$ 1,317,595                                    | \$ 55,307  | \$ 211,445                           | \$ (266,634) | \$ 1,818,322                | \$ 544,772                            | \$ (159,428)                                    | \$ 2,203,666 |
| <b>Liabilities and Net Assets</b>  |  |   |  |                                      |              |                             |                                       |   |              |
| Current liabilities  |  |   |  |                                      |              |                             |                                       |   |              |
| Accounts payable and accrued expenses  | \$ 25,302                                    | \$ 89,198                                       | \$ 586   | \$ 12,373                            | \$ (21)      | \$ 127,438                  | \$ 17,719                             | \$ 131  | \$ 145,288   |
| Accrued compensation   | 11,023                                       | 60,937  | 76   | 6,153                                | -            | 78,189                      | 64,146                                | -   | 142,335      |
| Estimated settlements payable to third-party payors                          | -  | 2,161   | -  | 597                                  | -            | 2,758                       | 18,835                                | -   | 21,593       |
| Debt, current  | -  | 86,357  | -  | 74                                   | -            | 86,431                      | 1,267                                 | -   | 87,698       |
| Current portion of notes payable to affiliates                               | -  | -   | -  | 596                                  | (596)        | -                           | 920                                   | (920)   | -            |
| Due to related parties   | 31,075                                       | 58,745  | 7  | 20,665                               | (29,380)     | 81,112                      | 35,307                                | (116,419)                                       | -            |
| Due to the University of Massachusetts                                       | 3,122  | 158,855   | -  | 276                                  | -            | 162,253                     | 3,967                                 | -   | 166,220      |
| Total current liabilities  | 70,522                                       | 456,253   | 669  | 40,734                               | (29,997)     | 538,181                     | 142,161                               | (117,208)                                       | 563,134      |
| Estimated settlements payable to third-party payors, net of current portion  | -  | 28,150  | -  | 2,303                                | -            | 30,453                      | 9,392                                 | -   | 39,845       |
| Other noncurrent liabilities   | 2,947  | 15,633  | -  | 1,510                                | -            | 20,090                      | 2,918                                 | 421   | 23,429       |
| Accrued pension and postretirement benefit obligations                       | -  | 199,259   | -  | -                                    | -            | 199,259                     | 5,868                                 | -   | 205,127      |
| Estimated self-insurance costs   | 165,112                                      | 11,354  | -  | 405                                  | (145,345)    | 31,526                      | 155,950                               | (22,104)  | 165,372      |
| Notes payable to affiliates, net of current portion                          | -  | -   | -  | 9,692                                | (9,692)      | -                           | 20,417                                | (20,417)  | -            |
| Debt, net of current portion   | -  | 320,453   | -  | 25                                   | -            | 320,478                     | 18,571                                | -   | 339,049      |
| Total liabilities  | 238,581                                      | 1,031,102                                       | 669  | 54,669                               | (185,034)    | 1,139,987                   | 355,277                               | (159,308)                                       | 1,335,956    |
| Net assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Unrestricted   | 198,179                                      | 222,644   | 54,638   | 132,313                              | (17,751)     | 590,023                     | 180,901                               | (120)   | 770,804      |
| Temporarily restricted   | 34,462                                       | 34,462  | -  | 4,623                                | (34,462)     | 39,085                      | 3,452                                 | -   | 42,537       |
| Permanently restricted   | 29,387                                       | 29,387  | -  | 19,840                               | (29,387)     | 49,227                      | 5,142                                 | -   | 54,369       |
| Total net assets   | 262,028                                      | 286,493   | 54,638   | 156,776                              | (81,600)     | 678,335                     | 189,495                               | (120)   | 867,710      |
| Total liabilities and net assets   | \$ 500,609                                   | \$ 1,317,595                                    | \$ 55,307  | \$ 211,445                           | \$ (266,634) | \$ 1,818,322                | \$ 544,772                            | \$ (159,428)                                    | \$ 2,203,666 |

The accompanying note is an integral part of these supplemental consolidating financial statements.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Supplemental Consolidating Balance Sheet Information - Obligated Group**  
**September 30, 2014**  
(In thousands of dollars)

|  | UMass<br>Memorial<br>Health<br>Care,<br>Inc. | UMass<br>Memorial<br>Medical<br>Center,<br>Inc. | UMass<br>Memorial<br>Health<br>Ventures,<br>Inc. | HealthAlliance<br>Hospitals,<br>Inc. | Eliminations | Total<br>Obligated<br>Group | Non<br>Obligated<br>Group<br>Entities | Eliminations<br>and<br>Consolidating<br>Entries | Consolidated |
|--|--|---|--|--------------------------------------|--------------|-----------------------------|---------------------------------------|---|--------------|
| <b>Assets</b>  |  |   |  |                                      |              |                             |                                       |   |              |
| Current assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Cash and cash equivalents  | \$ 3,301                                     | \$ 42,469                                       | \$ 17,271  | \$ 10,081                            | \$ -         | \$ 73,122                   | \$ 47,836                             | \$ 726  | \$ 121,684   |
| Short-term investments   | 1,604  | 6,288   | 9,825  | 8,146                                | -            | 25,863                      | 11,063                                | -   | 36,926       |
| Current portion of assets whose use is limited                               | -  | 5,931   | -  | -                                    | -            | 5,931                       | 774                                   | -   | 6,705        |
| Patient accounts receivable, net   | -  | 174,269   | -  | 14,341                               | -            | 188,610                     | 52,156                                | 382   | 241,148      |
| Inventories  | -  | 21,573  | -  | 1,509                                | -            | 23,082                      | 1,658                                 | 23  | 24,763       |
| Prepaid expenses and other current assets                                    | 6,575  | 24,940  | 2,403  | 2,390                                | (1,654)      | 34,654                      | 10,028                                | -   | 44,682       |
| Current portion of notes receivable from affiliates                          | -  | 1,293   | -  | -                                    | (569)        | 724                         | -                                     | (724)   | -            |
| Due from related parties   | 46,655                                       | 23,763  | 8  | 1,835                                | (47,802)     | 24,459                      | 29,468                                | (53,927)  | -            |
| Estimated settlements receivable from third-party payors                     | -  | 182,456   | -  | 15,376                               | -            | 197,832                     | 14,430                                | -   | 212,262      |
| Total current assets   | 58,135                                       | 482,982   | 29,507   | 53,678                               | (50,025)     | 574,277                     | 167,413                               | (53,520)  | 688,170      |
| Assets whose use is limited  |  |   |  |                                      |              |                             |                                       |   |              |
| Funds held in escrow under bond indenture agreements, net of current portion | -  | 10,685  | -  | -                                    | -            | 10,685                      | 1,324                                 | -   | 12,009       |
| Restricted investments   | 56,081                                       | -   | -  | 20,543                               | -            | 76,624                      | 5,265                                 | -   | 81,889       |
| Captive insurance company investments  | 172,258                                      | -   | -  | -                                    | (172,258)    | -                           | 172,258                               | -   | 172,258      |
| Total assets whose use is limited  | 228,339                                      | 10,685  | -  | 20,543                               | (172,258)    | 87,309                      | 178,847                               | -   | 266,156      |
| Long-term investments  | 195,253                                      | 114,274   | 15,388   | 40,852                               | -            | 365,767                     | 65,706                                | -   | 431,473      |
| Property and equipment, net  | -  | 466,138   | -  | 74,859                               | -            | 540,997                     | 87,106                                | 270   | 628,373      |
| Beneficial interest in trusts  | 7,622  | 65,051  | -  | 5,043                                | (65,051)     | 12,665                      | 3,010                                 | -   | 15,675       |
| Notes receivable from affiliates, net of current portion                     | -  | 31,625  | -  | -                                    | (10,288)     | 21,337                      | -                                     | (21,337)  | -            |
| Other assets   | 159  | 41,132  | 12,556   | 5,203                                | (10,428)     | 48,622                      | 21,167                                | (20,713)  | 49,076       |
| Total assets   | \$ 489,508                                   | \$ 1,211,887                                    | \$ 57,451  | \$ 200,178                           | \$ (308,050) | \$ 1,650,974                | \$ 523,249                            | \$ (95,300)                                     | \$ 2,078,923 |
| <b>Liabilities and Net Assets</b>  |  |   |  |                                      |              |                             |                                       |   |              |
| Current liabilities  |  |   |  |                                      |              |                             |                                       |   |              |
| Accounts payable and accrued expenses  | \$ 26,109                                    | \$ 84,120                                       | \$ 1,394   | \$ 12,170                            | \$ (910)     | \$ 122,883                  | \$ 19,269                             | \$ 123  | \$ 142,275   |
| Accrued compensation   | 7,871  | 63,836  | 407  | 5,975                                | -            | 78,089                      | 60,388                                | -   | 138,477      |
| Estimated settlements payable to third-party payors                          | -  | 7,403   | -  | 159                                  | -            | 7,562                       | 8,915                                 | -   | 16,477       |
| Debt, current  | -  | 26,398  | -  | 70                                   | -            | 26,468                      | 1,304                                 | -   | 27,772       |
| Current portion of notes payable to affiliates                               | -  | -   | -  | 569                                  | (569)        | -                           | 724                                   | (724)   | -            |
| Due to related parties   | 1,907  | 66,457  | 36   | 13,207                               | (49,479)     | 32,128                      | 21,799                                | (53,927)  | -            |
| Due to the University of Massachusetts                                       | 3,368  | 62,577  | -  | 268                                  | -            | 66,213                      | 820                                   | -   | 67,033       |
| Total current liabilities  | 39,255                                       | 310,791   | 1,837  | 32,418                               | (50,958)     | 333,343                     | 113,219                               | (54,528)  | 392,034      |
| Estimated settlements payable to third-party payors, net of current portion  | -  | 29,070  | -  | 2,699                                | -            | 31,769                      | 7,463                                 | -   | 39,232       |
| Other noncurrent liabilities   | 2,483  | 17,242  | -  | 1,552                                | -            | 21,277                      | 3,404                                 | 511   | 25,192       |
| Accrued pension and postretirement benefit obligations                       | -  | 201,658   | -  | -                                    | -            | 201,658                     | 6,136                                 | -   | 207,794      |
| Estimated self-insurance costs   | 171,694                                      | 10,181  | -  | 367                                  | (149,508)    | 32,734                      | 159,047                               | (19,826)  | 171,955      |
| Notes payable to affiliates, net of current portion                          | -  | -   | -  | 10,288                               | (10,288)     | -                           | 21,337                                | (21,337)  | -            |
| Debt, net of current portion   | -  | 344,961   | -  | 99                                   | -            | 345,060                     | 18,872                                | -   | 363,932      |
| Total liabilities  | 213,432                                      | 913,903   | 1,837  | 47,423                               | (210,754)    | 965,841                     | 329,478                               | (95,180)  | 1,200,139    |
| Net assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Unrestricted   | 211,025                                      | 232,933   | 55,614   | 126,864                              | (32,245)     | 594,191                     | 184,673                               | (120)   | 778,744      |
| Temporarily restricted   | 38,543                                       | 38,543  | -  | 5,685                                | (38,543)     | 44,228                      | 3,678                                 | -   | 47,906       |
| Permanently restricted   | 26,508                                       | 26,508  | -  | 20,206                               | (26,508)     | 46,714                      | 5,420                                 | -   | 52,134       |
| Total net assets   | 276,076                                      | 297,984   | 55,614   | 152,755                              | (97,296)     | 685,133                     | 193,771                               | (120)   | 878,784      |
| Total liabilities and net assets   | \$ 489,508                                   | \$ 1,211,887                                    | \$ 57,451  | \$ 200,178                           | \$ (308,050) | \$ 1,650,974                | \$ 523,249                            | \$ (95,300)                                     | \$ 2,078,923 |

The accompanying note is an integral part of these supplemental consolidating financial statements.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Supplemental Consolidating Statement of Operations Information - Obligated Group**  
**Year Ended September 30, 2015**  
(In thousands of dollars)

|   | UMass<br>Memorial<br>Health<br>Care,<br>Inc. | UMass<br>Memorial<br>Medical<br>Center,<br>Inc. | UMass<br>Memorial<br>Health<br>Ventures,<br>Inc. | HealthAlliance<br>Hospitals,<br>Inc. | Eliminations | Total<br>Obligated<br>Group | Non<br>Obligated<br>Group<br>Entities | Eliminations<br>and<br>Consolidating<br>Entries | Consolidated |
|---|--|---|--|--------------------------------------|--------------|-----------------------------|---------------------------------------|---|--------------|
| Unrestricted revenues, gains and other support                                    |  |   |  |                                      |              |                             |                                       |   |              |
| Net patient service revenue   | \$ -   | \$ 1,466,259                                    | \$ -   | \$ 166,075                           | \$ -         | \$ 1,632,334                | \$ 537,926                            | \$ 3,585  | \$ 2,173,845 |
| Less: Provision for bad debts   | -  | (21,052)  | -  | (6,129)                              | -            | (27,181)                    | (21,622)                              | (60)  | (48,863)     |
| Net patient service revenue less provision for bad debts                          | -  | 1,445,207                                       | -  | 159,946                              | -            | 1,605,153                   | 516,304                               | 3,525   | 2,124,982    |
| Net assets released from restrictions used for operations                         | 643  | 329   | -  | 860                                  | -            | 1,832                       | 786                                   | -   | 2,618        |
| Other revenue   | 199,297                                      | 62,804  | 13,481   | 6,281                                | (156,152)    | 125,711                     | 191,460                               | (203,061)                                       | 114,110      |
| Total revenues, gains and other support   | 199,940                                      | 1,508,340                                       | 13,481   | 167,087                              | (156,152)    | 1,732,696                   | 708,550                               | (199,536)                                       | 2,241,710    |
| Expenses  |  |   |  |                                      |              |                             |                                       |   |              |
| Salaries, benefits and contracted labor   | 66,912                                       | 654,479   | 14   | 81,329                               | (5,690)      | 797,044                     | 501,796                               | 157   | 1,298,997    |
| Supplies and other expenses   | 123,109                                      | 708,553   | 239  | 68,466                               | (149,874)    | 750,493                     | 214,777                               | (198,971)                                       | 766,299      |
| Depreciation and amortization   | -  | 86,583  | -  | 9,243                                | -            | 95,826                      | 8,203                                 | 201   | 104,230      |
| Interest  | -  | 13,518  | -  | 391                                  | (504)        | 13,405                      | 1,664                                 | (923)   | 14,146       |
| Total expenses  | 190,021                                      | 1,463,133                                       | 253  | 159,429                              | (156,068)    | 1,656,768                   | 726,440                               | (199,536)                                       | 2,183,672    |
| Income (loss) from operations before nonrecurring income and expenses             | 9,919  | 45,207  | 13,228   | 7,658                                | (84)         | 75,928                      | (17,890)                              | -   | 58,038       |
| (Loss) gain on sale of business (Note 15)   | -  | 13,620  | (325)  | -                                    | -            | 13,295                      | -                                     | -   | 13,295       |
| Expense reductions associated with sale of business (Note 15)                     | -  | 873   | -  | -                                    | -            | 873                         | -                                     | -   | 873          |
| Income (loss) from operations after nonrecurring income and expenses              | 9,919  | 59,700  | 12,903   | 7,658                                | (84)         | 90,096                      | (17,890)                              | -   | 72,206       |
| Nonoperating income (loss)  |  |   |  |                                      |              |                             |                                       |   |              |
| Investment and other related income   | 3,245  | 1,147   | 69   | 412                                  | -            | 4,873                       | 735                                   | -   | 5,608        |
| Net realized and unrealized gain (loss) on investments                            | (25,701)                                     | (757)   | (948)  | (1,114)                              | 14,578       | (13,942)                    | (16,873)                              | -   | (30,815)     |
| Actuarial change in the present value of annuities                                | (352)  | -   | -  | -                                    | -            | (352)                       | -                                     | -   | (352)        |
| Total nonoperating income (loss)  | (22,808)                                     | 390   | (879)  | (702)                                | 14,578       | (9,421)                     | (16,138)                              | -   | (25,559)     |
| Excess (deficiency) of revenues over expenses                                     | (12,889)                                     | 60,090  | 12,024   | 6,956                                | 14,494       | 80,675                      | (34,028)                              | -   | 46,647       |
| Other changes in net assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Gain (loss) on sale from discontinued operations (Note 17)                        | -  | -   | -  | -                                    | -            | -                           | -                                     | -   | -            |
| Gain (loss) on transfer of membership interest (Note 17)                          | -  | -   | -  | -                                    | -            | -                           | -                                     | -   | -            |
| Contributions for property and equipment  | -  | 983   | -  | -                                    | -            | 983                         | 975                                   | -   | 1,958        |
| Net assets released from restrictions used for purchase of property and equipment | -  | 425   | -  | 178                                  | -            | 603                         | 170                                   | -   | 773          |
| Pension-related changes other than net periodic (cost) credit                     | -  | (57,350)  | -  | -                                    | -            | (57,350)                    | 32                                    | -   | (57,318)     |
| Transfers (to) from related parties   | 43   | (14,437)  | (13,000)   | (1,685)                              | -            | (29,079)                    | 29,079                                | -   | -            |
| Increase (decrease) in unrestricted net assets                                    | (12,846)                                     | (10,289)  | (976)  | 5,449                                | 14,494       | (4,168)                     | (3,772)                               | -   | (7,940)      |
| Unrestricted net assets, beginning of year  | 211,025                                      | 232,933   | 55,614   | 126,864                              | (32,245)     | 594,191                     | 184,673                               | (120)   | 778,744      |
| Unrestricted net assets, end of period  | \$ 198,179                                   | \$ 222,644                                      | \$ 54,638  | \$ 132,313                           | \$ (17,751)  | \$ 590,023                  | \$ 180,901                            | \$ (120)  | \$ 770,804   |

The accompanying note is an integral part of these supplemental consolidating financial statements.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Supplemental Consolidating Statement of Operations Information - Obligated Group**  
**Year Ended September 30, 2014**  
(In thousands of dollars)

|   | UMass<br>Memorial<br>Health<br>Care,<br>Inc. | UMass<br>Memorial<br>Medical<br>Center,<br>Inc. | UMass<br>Memorial<br>Health<br>Ventures,<br>Inc. | HealthAlliance<br>Hospitals,<br>Inc. | Eliminations | Total<br>Obligated<br>Group | Non<br>Obligated<br>Group<br>Entities | Eliminations<br>and<br>Consolidating<br>Entries | Consolidated |
|---|--|---|--|--------------------------------------|--------------|-----------------------------|---------------------------------------|---|--------------|
| Unrestricted revenues, gains and other support                                    |  |   |  |                                      |              |                             |                                       |   |              |
| Net patient service revenue   | \$ -   | \$ 1,449,372                                    | \$ 3,665   | \$ 156,992                           | \$ -         | \$ 1,610,029                | \$ 538,532                            | \$ 3,526  | \$ 2,152,087 |
| Less: Provision for bad debts   | -  | (17,596)  | (527)  | (5,535)                              | -            | (23,658)                    | (20,217)                              | (114)   | (43,989)     |
| Net patient service revenue less provision for bad debts                          | -  | 1,431,776                                       | 3,138  | 151,457                              | -            | 1,586,371                   | 518,315                               | 3,412   | 2,108,098    |
| Net assets released from restrictions used for operations                         | 564  | 303   | -  | 1,585                                | -            | 2,452                       | 533                                   | -   | 2,985        |
| Other revenue   | 216,310                                      | 79,866  | 27,156   | 7,350                                | (170,867)    | 159,815                     | 186,702                               | (205,392)                                       | 141,125      |
| Total revenues, gains and other support   | 216,874                                      | 1,511,945                                       | 30,294   | 160,392                              | (170,867)    | 1,748,638                   | 705,550                               | (201,980)                                       | 2,252,208    |
| Expenses  |  |   |  |                                      |              |                             |                                       |   |              |
| Salaries, benefits and contracted labor   | 70,866                                       | 651,163   | 2,402  | 79,669                               | (6,192)      | 797,908                     | 495,311                               | (198)   | 1,293,021    |
| Supplies and other expenses   | 140,324                                      | 743,520   | 2,424  | 68,447                               | (163,000)    | 791,715                     | 205,486                               | (199,187)                                       | 798,014      |
| Depreciation and amortization   | -  | 75,370  | 208  | 9,016                                | -            | 84,594                      | 8,105                                 | 206   | 92,905       |
| Interest  | -  | 14,539  | -  | 369                                  | (530)        | 14,378                      | 1,704                                 | (1,641)   | 14,441       |
| Total expenses  | 211,190                                      | 1,484,592                                       | 5,034  | 157,501                              | (169,722)    | 1,688,595                   | 710,606                               | (200,820)                                       | 2,198,381    |
| Income (loss) from operations before nonrecurring income and expenses             | 5,684  | 27,353  | 25,260   | 2,891                                | (1,145)      | 60,043                      | (5,056)                               | (1,160)   | 53,827       |
| (Loss) gain on sale of business (Note 15)   | -  | (9,155)   | -  | -                                    | -            | (9,155)                     | -                                     | -   | (9,155)      |
| Expense reductions associated with sale of business (Note 15)                     | -  | 853   | -  | -                                    | -            | 853                         | -                                     | -   | 853          |
| Expenses associated with reduction in force (Note 16)                             | (4,539)                                      | (9,057)   | -  | (1,178)                              | -            | (14,774)                    | (1,704)                               | -   | (16,478)     |
| Income (loss) from operations after nonrecurring income and expenses              | 1,145  | 9,994   | 25,260   | 1,713                                | (1,145)      | 36,967                      | (6,760)                               | (1,160)   | 29,047       |
| Nonoperating income (loss)  |  |   |  |                                      |              |                             |                                       |   |              |
| Investment and other related income   | 2,564  | 1,799   | 18   | 384                                  | -            | 4,765                       | 725                                   | -   | 5,490        |
| Net realized and unrealized gain (loss) on investments                            | 13,224                                       | 8,037   | 76   | 1,813                                | (4,321)      | 18,829                      | 7,286                                 | -   | 26,115       |
| Actuarial change in the present value of annuities                                | 190  | -   | -  | -                                    | -            | 190                         | -                                     | -   | 190          |
| Total nonoperating income (loss)  | 15,978                                       | 9,836   | 94   | 2,197                                | (4,321)      | 23,784                      | 8,011                                 | -   | 31,795       |
| Excess (deficiency) of revenues over expenses                                     | 17,123                                       | 19,830  | 25,354   | 3,910                                | (5,466)      | 60,751                      | 1,251                                 | (1,160)   | 60,842       |
| Other changes in net assets   |  |   |  |                                      |              |                             |                                       |   |              |
| Gain (loss) on sale from discontinued operations (Note 17)                        | -  | -   | 13   | -                                    | -            | 13                          | 266                                   | 1,160   | 1,439        |
| Gain (loss) on transfer of membership interest (Note 17)                          | 38,402                                       | -   | -  | -                                    | -            | 38,402                      | (49,589)                              | -   | (11,187)     |
| Net assets released from restrictions used for purchase of property and equipment | -  | 21  | -  | 713                                  | -            | 734                         | 1,826                                 | -   | 2,560        |
| Pension-related changes other than net periodic cost                              | -  | (33,846)  | -  | -                                    | -            | (33,846)                    | (2,552)                               | -   | (36,398)     |
| Transfers (to) from related parties   | 20,671                                       | (15,074)  | (21,000)   | (1,376)                              | -            | (16,779)                    | 16,779                                | -   | -            |
| Increase (decrease) in unrestricted net assets                                    | 76,196                                       | (29,069)  | 4,367  | 3,247                                | (5,466)      | 49,275                      | (32,019)                              | -   | 17,256       |
| Unrestricted net assets, beginning of year  | 134,829                                      | 262,002   | 51,247   | 123,617                              | (26,779)     | 544,916                     | 216,692                               | (120)   | 761,488      |
| Unrestricted net assets, end of period  | \$ 211,025                                   | \$ 232,933                                      | \$ 55,614  | \$ 126,864                           | \$ (32,245)  | \$ 594,191                  | \$ 184,673                            | \$ (120)  | \$ 778,744   |

The accompanying note is an integral part of these supplemental consolidating financial statements.

**UMass Memorial Health Care, Inc. and Affiliates**  
**Notes to Supplemental Consolidating Information**  
**September 30, 2015 and 2014**

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**1. Basis of Presentation**

The accompanying supplemental consolidating information includes the consolidating balance sheets and the consolidating statement of operations of the individual consolidated affiliates of UMass Memorial Health Care, Inc. All intercompany accounts and transactions between affiliates have been eliminated. The consolidating information presented is prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America consistent with the consolidated financial statements. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements and is not required as part of the basic financial statements.