Partners HealthCare System, Inc. and Affiliates

Consolidated Financial Statements
September 30, 2016 and 2015

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September 30, 2016 and 2015

Report of Independent Auditors

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

We have audited the accompanying consolidated financial statements of Partners HealthCare System, Inc. and Affiliates (Partners HealthCare), which comprise the consolidated balance sheets as of September 30, 2016 and 2015 and the related consolidated statements of operations, changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Partners HealthCare System, Inc. and Affiliates at September 30, 2016 and 2015, and the results of their operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

December 9, 2016

PricewaterhouseCoopers LLP, 101 Seaport Boulevard, Suite 500, Boston, MA 02210
T: (617) 530 5000, F: (617) 530 5001, www.pwc.com/us

Partners HealthCare System, Inc. and Affiliates
Consolidated Balance Sheets
September 30, 2016 and 2015

(in thousands of dollars)	**2016**	**2015**
Assets		
Current assets		
Cash and equivalents	$ 827,683	$ 621,568
Investments	1,069,006	1,354,636
Current portion of investments limited as to use	1,588,787	1,590,203
Patient accounts receivable, net of allowance for bad debts (2016 - $121,652; 2015 - $112,630)	881,993	878,033
Research grants receivable	129,243	121,775
Other current assets	449,440	447,188
Receivable for settlements with third-party payers	55,238	60,374
Total current assets	5,001,390	5,073,777
Investments limited as to use, less current portion	3,069,175	2,832,744
Long-term investments	1,136,528	1,061,176
Pledges receivable, net and contributions receivable from trusts, less current portion	194,684	209,064
Property and equipment, net	5,881,927	5,328,782
Other assets	629,168	572,150
Total assets	$ 15,912,872	$ 15,077,693
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term obligations	$ 441,018	$ 398,990
Accounts payable and accrued expenses	732,187	646,355
Accrued medical claims and related expenses	289,866	232,268
Accrued compensation and benefits	731,674	710,929
Current portion of accrual for settlements with third-party payers	63,195	53,066
Unexpended funds on research grants	247,423	202,137
Total current liabilities	2,505,363	2,243,745
Accrual for settlements with third-party payers, less current portion	7,443	41,977
Accrued professional liability	487,705	482,640
Accrued employee benefits	2,163,540	1,705,287
Interest rate swaps liability	510,172	404,062
Accrued other	156,178	153,146
Long-term obligations, less current portion	4,608,114	3,994,034
Total liabilities	10,438,515	9,024,891
Commitments and contingencies		
Net assets		
Unrestricted	4,060,285	4,707,662
Temporarily restricted	790,886	765,562
Permanently restricted	623,186	579,578
Total net assets	5,474,357	6,052,802
Total liabilities and net assets	$ 15,912,872	$ 15,077,693

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

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Operations
Years Ended September 30, 2016 and 2015

(in thousands of dollars)	2016	2015
Operating revenue		
Net patient service revenue, net of provision for bad debts (2016 - $127,798; 2015 - $129,051)	$ 7,571,548	$ 7,317,918
Premium revenue	2,508,924	2,034,420
Direct academic and research revenue	1,363,580	1,316,283
Indirect academic and research revenue	368,192	354,942
Other revenue	647,887	642,082
Total operating revenue	12,460,131	11,665,645
Operating expenses		
Employee compensation and benefit expenses	5,987,168	5,655,073
Supplies and other expenses	2,508,630	2,325,085
Medical claims and related expenses	2,017,773	1,652,538
Direct academic and research expenses	1,363,580	1,316,283
Depreciation and amortization expenses	557,542	493,505
Interest expense	133,317	116,703
Total operating expenses	12,568,010	11,559,187
(Loss) income from operations	(107,879)	106,458
Nonoperating gains (expenses)		
Income (loss) from investments	61,102	(37,258)
Change in fair value of interest rate swaps	(106,110)	(110,315)
Gifts and other, net of fundraising and other expenses	(37,293)	(39,468)
Academic and research gifts, net of expenses	(58,831)	(11,406)
Total nonoperating gains (expenses), net	(141,132)	(198,447)
Deficit of revenues over expenses	(249,011)	(91,989)
Other changes in net assets		
Change in net unrealized appreciation on marketable investments	200,042	(224,616)
Funds utilized for property and equipment	49,162	38,288
Change in funded status of defined benefit plans	(647,180)	(639,167)
Other	(390)	1,387
Decrease in unrestricted net assets	$ (647,377)	$ (916,097)

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

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2016 and 2015

(in thousands of dollars)	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets at October 1, 2014	$ 5,623,759	$ 855,954	$ 463,774	$ 6,943,487
Increases (decreases)				
Income from operations	106,458	-	-	106,458
(Loss) income from investments	(37,258)	(46,460)	55	(83,663)
Gifts and other	(39,468)	8,029	116,449	85,010
Academic and research gifts, net of expenses	(11,406)	-	-	(11,406)
Change in net unrealized appreciation on marketable investments	(224,616)	(36,351)	(2,313)	(263,280)
Change in fair value of interest rate swaps	(110,315)	-	-	(110,315)
Funds utilized for property and equipment	38,288	(17,151)	-	21,137
Change in funded status of defined benefit plans	(639,167)	-	-	(639,167)
Other	1,387	1,541	1,613	4,541
Change in net assets	(916,097)	(90,392)	115,804	(890,685)
Net assets at September 30, 2015	4,707,662	765,562	579,578	6,052,802
Increases (decreases)				
Loss from operations	(107,879)	-	-	(107,879)
Income (loss) from investments	61,102	(21,616)	37	39,523
Gifts and other	(37,293)	39,875	44,093	46,675
Academic and research gifts, net of expenses	(58,831)	-	-	(58,831)
Change in net unrealized appreciation on marketable investments	200,042	30,170	(340)	229,872
Change in fair value of interest rate swaps	(106,110)	-	-	(106,110)
Funds utilized for property and equipment	49,162	(23,105)	-	26,057
Change in funded status of defined benefit plans	(647,180)	-	-	(647,180)
Other	(390)	-	(182)	(572)
Change in net assets	(647,377)	25,324	43,608	(578,445)
Net assets at September 30, 2016	$ 4,060,285	$ 790,886	$ 623,186	$ 5,474,357

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

Partners HealthCare System, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended September 30, 2016 and 2015

(in thousands of dollars)	**2016**	**2015**
Cash flows from operating activities		
Change in net assets	$ (578,445)	$ (890,685)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Change in funded status of defined benefit plans	647,180	639,167
(Gain) loss on refunding of debt	(3,556)	9,649
Change in fair value of interest rate swaps	106,110	110,315
Depreciation and amortization	557,542	493,505
Provision for bad debts	127,798	129,051
Loss on disposal of property	53	196
Net realized and change in unrealized appreciation on investments	(344,727)	307,782
Restricted contributions and investment income	(129,649)	(172,749)
Cash premium upon issuance of bonds	67,636	39,969
Increases (decreases) in cash resulting from a change in		
Patient accounts receivable	(131,758)	(127,108)
Research grants receivable	(7,468)	(5,989)
Other current assets	10,799	(71,428)
Pledges receivable and contributions receivable from trusts	1,329	(3,987)
Other assets	(50,966)	(41,797)
Accounts payable and accrued expenses	85,832	(10,101)
Accrued medical claims and related expenses	57,598	(22,212)
Accrued compensation and benefits	16,516	25,006
Settlements with third-party payers	(30,561)	(41,066)
Unexpended funds on research grants	45,286	18,915
Accrued employee benefits and other	(176,520)	23,922
Net cash provided by operating activities	270,029	410,355
Cash flows from investing activities		
Purchases of property and equipment	(1,102,846)	(1,198,031)
Proceeds from sale of property	566	182
Purchase of investments	(2,758,608)	(2,772,478)
Proceeds from sales of investments	3,078,598	3,173,950
Purchases of businesses, net of cash acquired	-	(23,343)
Net cash used for investing activities	(782,290)	(819,720)
Cash flows from financing activities		
Borrowings under line of credit	74,969	-
Repayments under line of credit	(74,969)	-
Payments on long-term obligations	(70,499)	(71,353)
Proceeds from long-term obligations, net of financing costs	745,258	612,359
Deposits into refunding trusts	(86,032)	(140,066)
Restricted contributions and investment income	129,649	172,749
Net cash provided by financing activities	718,376	573,689
Net increase in cash and equivalents	206,115	164,324
Cash and equivalents		
Beginning of year	621,568	457,244
End of year	$ 827,683	$ 621,568

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

(in thousands of dollars)

1. Organization and Community Benefit Commitments

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

The Boards of MGH, Wentworth-Douglass Health System and Wentworth-Douglass Hospital (WDH) have entered into a definitive agreement pursuant to which MGH will become the parent organization of WDH and its affiliates. The parties have completed due diligence and expect to complete the regulatory approval process in the near future. The transaction is expected to close in fiscal 2017.

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

PHS and substantially all of its affiliates are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (IRC). NHP is a tax-exempt organization under Section 501(c)(4) of the IRC. Accordingly, no provision for income taxes related to these tax-exempt entities has been made. The Internal Revenue Service approved PCPO's application to become a tax-exempt organization under Section 501(c)(3) of the IRC effective October 1, 2015. Harbor Medical Associates (Harbor), a subsidiary of BWHC, applied to become a tax-exempt organization under Section 501(c)(3) of the IRC effective October 1, 2016. In 2016, Harbor recognized income tax expense of $2,700 within supplies and other expenses.

Community Benefit

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

(in thousands of dollars)

infrastructure, programming and operation and also helps with relocation, renovation and other capital requirements.

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

Uncompensated Care

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

State Programs

Charity care services are partially reimbursed to acute care hospitals through the statewide Health Safety Net Trust Fund (HSN) established by the Massachusetts Health Care Reform Law (Chapter 58 of the Acts of 2006 or Chapter 58). A portion of the funding for the HSN is paid by hospitals through a statewide acute care hospital assessment that has been set by the Massachusetts Legislature, beginning in 2014, at $160,000 plus 50% of the estimated cost of administering the HSN and related assessments, as determined by the Massachusetts Secretary of Administration and Finance. All acute care hospitals in the state are assessed their share of this total statewide hospital assessment amount ($165,200 in 2016 and $165,000 in 2015) based on each hospital's charges for private sector payers. Partners HealthCare's acute care hospitals report this assessment as a deduction from net patient service revenue.

Acute care hospitals are reimbursed for charity care based on claims for eligible patients and eligible services that are submitted to and adjudicated by the HSN. Rates of payment are based on Medicare rates and payment policies. The HSN was under-funded by approximately $110,627 and $41,327 in 2016 and 2015, respectively. This shortfall is allocated to hospitals based on their share of total statewide patient care costs with approximately $39,571 and $10,881 in 2016 and 2015, respectively, allocated to Partners HealthCare's acute care hospitals. Each hospital's share of the overall state shortfall cannot exceed its total charity care reimbursement. Hospitals with a high proportion of charity care and government funding receive more favorable reimbursement, including limiting their shortfall allocation to no more than 15% of their payments for charity care. In aggregate, Partners HealthCare's acute care hospitals received uncompensated care funding covering 38% and 68% of the estimated cost of charity care provided in 2016 and 2015, respectively, excluding the assessment.

(in thousands of dollars)

Medicaid

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

Medicaid payments to Partners HealthCare providers do not cover the full cost of services provided. In aggregate, reimbursement from Medicaid covered 60% and 62% of the estimated cost of services provided in 2016 and 2015, respectively. In addition, Medicaid premium revenue paid to NHP for the care of Medicaid patients enrolled in NHP did not cover the medical expense and administrative costs of care for these enrollees. In aggregate, the premium revenue paid to NHP by Medicaid, excluding the impact of premium deficiency reserves, was $72,542, or 3.9%, less than the cost of care in 2016, and $72,549, or 4.6%, less than the cost of care in 2015.

Federal Program

Medicare

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

Consequently, Medicare payments to Partners HealthCare providers do not cover the full cost of services provided. In aggregate, reimbursement from Medicare covered approximately 73% of the estimated cost of services provided in 2016 and 2015.

(in thousands of dollars)

Summary

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

	Years Ended September 30, 2016	2015
Cost of services provided		
Charity care, including assessment payments to HSN of $57,458 and $56,716 in 2016 and 2015, respectively	$ 138,680	$ 136,276
Medicaid	1,077,629	1,008,882
Medicare	2,982,128	2,824,890
	$ 4,198,437	$ 3,970,048
Net reimbursement		
Charity care	$ 23,293	$ 40,906
Medicaid	651,022	625,761
Medicare	2,168,664	2,073,591
	$ 2,842,979	$ 2,740,258
Cost of services in excess of reimbursement		
Charity care	$ 115,387	$ 95,370
Medicaid	426,607	383,121
Medicare	813,464	751,299
	$ 1,355,458	$ 1,229,790

Bad Debts

In addition to charity care and inadequate funding from the Medicaid and Medicare programs, there are significant losses related to self-pay patients who fail to make payment for services rendered or insured patients who fail to remit co-payments and deductibles as required under the applicable health insurance arrangement. The provision for bad debts represents charges for services provided that are deemed to be uncollectible and was $127,798 and $129,051 in 2016 and 2015, respectively. The estimated cost of providing these services was approximately $44,959 and $48,347 for 2016 and 2015, respectively.

2. Summary of Significant Accounting Policies

Basis of Accounting

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

(in thousands of dollars)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of patient accounts receivable, research grants receivable, investments, receivables and accruals for settlements with third-party payers, accrued medical claims and related expenses, accrued professional liability, accrued compensation and employee benefits, interest rate swaps and accrued other.

Fair Value of Financial Instruments

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

Cash and Equivalents

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

Investments

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

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

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

(in thousands of dollars)

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

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

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

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

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

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

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

(in thousands of dollars)

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

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

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

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

Compensated Absences
In accordance with formal policies concerning vacation and other compensated absences, accruals of $273,042 and $259,470 were recorded as of September 30, 2016 and 2015, respectively.

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

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

(in thousands of dollars)

Net Assets

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

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

Gifts

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

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

Grants

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

Contributed Securities

Partners HealthCare's policy is to sell securities contributed by donors upon receipt, unless prevented from doing so by donor request. For the years ended September 30, 2016 and 2015, contributed securities of $48,160 and $36,742, respectively, were received and liquidated. Donors restricted the proceeds received from the sale of these contributed securities of $11,634 and $14,163 for long-term purpose for the years ended September 30, 2016 and 2015, respectively.

(in thousands of dollars)

Statement of Operations

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

Partners HealthCare recognizes changes in third-party payer settlements and other estimates in the year of the change in estimate. For the years ended September 30, 2016 and 2015, adjustments to prior year estimates resulted in an increase to income from operations of $12,536 and $22,381, respectively.

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

CMS is required by its enabling statute to maintain budget neutrality by prospectively adjusting the Medicare payment rate to eliminate the effect of changes in DRG classification that do not reflect real changes in case-mix. CMS requires Congressional authority, however, to recoup any overpayments made in prior years. In 2007, Congress granted CMS the authority to recoup overpayments made to hospitals in 2008 and 2009 resulting from increased coding and documentation, which CMS did through rate reductions in 2011 and 2012. Subsequently, under the American Taxpayer Relief Act of 2012, Congress granted CMS the authority to recoup overpayments made to hospitals in 2010 through 2012 through rate reductions in 2014 through 2017.

In 2013, Partners HealthCare recorded the estimated overpayment amounts received in 2010 through 2012 of $79,020 as deferred revenue to be amortized into net patient service revenue in 2014 through 2017 to offset the rate reductions. Management believes this accounting treatment better reflects the financial impact of this rate methodology and more accurately presents the recognition of revenue. For the years ended September 30, 2016 and 2015, amortization of these overpayments amounted to $23,900 and $15,192, respectively. Partners HealthCare anticipates amortizing the remaining overpayments of $33,035 in 2017.

(in thousands of dollars)

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

Net Patient Service Revenue

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

Partners HealthCare recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, Partners HealthCare recognizes revenue on the basis of its standard rates (subject to discounts) for services provided. On the basis of historical experience, a significant portion of Partners HealthCare's uninsured patients are unable or fail to pay for the services provided. Consequently, Partners HealthCare records a provision for bad debts related to uninsured patients in the period the services are provided. For the years ended September 30, 2016 and 2015, patient service revenue net of contractual allowances and discounts (before the provision for bad debts) is as follows:

	2016	2015
Patient service revenue (net of contractual allowances and discounts)		
Third-party payers	$ 7,389,738	$ 7,156,435
Uninsured patients	309,608	290,534
Total all payers	$ 7,699,346	$ 7,446,969

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

(in thousands of dollars)

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

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

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

In the normal course of business, NHP identifies and recoups overpayments through reductions in future payments made to providers and hospitals. Such overpayments are the result of, among other things, coordination of benefits and provider claim audits. For the years ended September 30, 2016 and 2015, NHP identified approximately $62,433 and $53,396, respectively, of recoveries related to claim overpayments made for both current-year and prior-year paid claims, which are reflected as a reduction to medical claims and related expenses in the consolidated statements of operations. As of September 30, 2016 and 2015, NHP’s accounts receivable include $1,718 and $1,723, respectively, related to such overpayments.

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

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

Settlements
NHP contracts with the Executive Office of Health and Human Services (EOHHS) and certain providers at negotiated rates based on historical and anticipated experience. These methods of reimbursement result in settlements based on actual versus anticipated experience which could result in either payments due from (to) these providers. Settlements receivable of $40,388 and $78,969 were recorded as of September 30, 2016 and 2015, respectively. Settlements payable of $5,201 and $3,697 were recorded as of September 30, 2016 and 2015, respectively. The settlements are intended to include both reported and unreported incurred claims as of September 30, 2016 and 2015.

(in thousands of dollars)

In 2014, the Affordable Care Act introduced new settlements related to a risk adjustment program, a risk corridor program and a reinsurance program designed to mitigate the transitional impact on insurers for new members. The risk corridor program and reinsurance program are scheduled to end on December 31, 2016 in accordance with the provision of the Affordable Care Act. NHP's estimated net receivable due from the federal government for these programs was $36,801 and $23,687 at September 30, 2016 and 2015, respectively. Similar to the federal program, EOHHS has a risk corridor program and NHP's estimated net receivable due from EOHHS is $37,625 and $75,910 at September 30, 2016 and 2015, respectively.

Premium Deficiency Reserve

Premium deficiency reserves are assessed and recognized on a product line basis based upon expected premium revenue, medical expense and administrative expense levels, and remaining contractual obligations using historical experience. As of September 30, 2016 and 2015, premium deficiency reserves total approximately $51,735 and $32,636, respectively, and are included in accrued medical claims and related expenses in the accompanying consolidated financial statements. The premium deficiency reserves are estimates of anticipated losses in fiscal 2017 and 2016, respectively, related to NHP's MassHealth and Commercial contracts.

Claims Adjustment Expenses

Claims adjustment expenses (CAE) are those costs expected to be incurred in connection with the adjustment and recording of health claims. NHP has recorded an estimate of unpaid CAE associated with incurred but unpaid claims, which is included in medical claims and related expenses in the accompanying consolidated statements of operations. Management believes the amount of the liability for unpaid CAE as of September 30, 2016, is adequate to cover NHP's cost for the adjustment and recording of unpaid claims; however, actual expenses may differ from those established estimates. Adjustments to the estimates for unpaid CAE are reflected in operating results in the period in which the change in estimate is identified (Note 9).

Other Revenue

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

Reclassification

Certain amounts in the 2015 financial statements have been reclassified to conform with the 2016 presentation.

(in thousands of dollars)

3. Acquisitions

Multiple physician practices were acquired during the year ended September 30, 2015 for a combined purchase price of $46,917. In accordance with accounting standards, the purchase price was allocated first to tangible assets, then identifiable intangible assets and the remaining allocated to goodwill.

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

Assets		
Cash and cash equivalents	$	5,257
Patient accounts receivable, net		3,762
Property plant and equipment		3,201
Other assets		34,697
Total assets acquired	$	46,917
Liabilities		
Note payable	$	2,693
Accounts payable and accrued expenses		10,457
Accrued compensation and benefits		5,087
Accrued professional liability		80
Total liabilities assumed		18,317
Net assets		
Unrestricted		28,600
Total net assets		28,600
Total liabilities and net assets	$	46,917

A summary of the financial results of the acquired physician practices from the respective dates of acquisition through September 30, 2015 is included in the 2015 consolidated statements of operations and changes in net assets is as follows:

Total operating revenue	$	88,325
Total operating expenses		103,431
Loss from operations		(15,106)
Nonoperating gains (expenses), net		2
Deficit of revenues over expenses		(15,104)
Other changes		1,000
Decrease in unrestricted net assets	$	(14,104)

(in thousands of dollars)

A summary of the consolidated financial results of Partners HealthCare for the year ended September 30, 2015, as if the transactions had occurred on October 1, 2014 is as follows (unaudited):

Total operating revenue	$ 11,696,236
Total operating expenses	11,592,219
Income from operations	104,017
Nonoperating gains (expenses), net	(198,447)
Deficit of revenues over expenses	(94,430)
Pension related changes	(639,167)
Other changes	(186,096)
Decrease in unrestricted net assets	$ (919,693)

4. Levels of Capital and Surplus

Risk-based capital (RBC) is a methodology adopted by the National Association of Insurance Commissioners (NAIC) for determining the minimum level of capital and surplus deemed necessary for an insurer based upon the types of assets held and business written. Pursuant to a guaranty entered into by PHS when it acquired NHP in 2012 (the RBC Guaranty), PHS has committed to maintain NHP's capital and surplus at a specified minimum level, measured quarterly in accordance with an RBC methodology permitted by the Massachusetts Division of Insurance (DOI). The RBC Guaranty may be enforced by the DOI. PHS provided capital to NHP of $123,800 and $117,100 in 2016 and 2015, respectively. In order to comply with its obligations under the RBC Guaranty PHS transferred $32,400 to NHP in November 2016.

NHP's current contract with EOHHS requires NHP to maintain a minimum net worth and/or financial insolvency insurance in an amount equal to the Minimum Net Worth calculation as defined in Massachusetts General Law 176G, Section 25. At December 31, 2015 and 2014 (NHP's fiscal and statutory year end), the minimum net worth requirement, as determined in accordance with EOHHS guidelines, was $139,400 and $114,300, respectively. NHP's statutory net worth was $186,900 and $128,700 at December 31, 2015 and 2014, respectively, and thus exceeded the EOHHS requirements by $47,500 and $14,400, respectively.

5. Investments and Investments Limited as to Use

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

(in thousands of dollars)

Among other investments, the Partnership invests in private partnerships whose assets include equity, fixed income and other investments. As of September 30, 2016, the Partnership has unfunded commitments of approximately $626,038 which will be drawn down by the various general partners over the next several years. The maximum annual drawdown is expected to be less than 2% of investments and investments limited as to use.

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

	September 30, 2016	September 30, 2015
Current assets		
Investments	$ 1,069,006	$ 1,354,636
Current portion of investments limited as to use	1,588,787	1,590,203
	2,657,793	2,944,839
Long-term assets		
Investments limited as to use, less current portion	3,069,175	2,832,744
Long-term investments	1,136,528	1,061,176
	$ 6,863,496	$ 6,838,759

Investments limited as to use consist of the following:

	September 30, 2016		September 30, 2015	
	Current Portion	Long-Term Portion	Current Portion	Long-Term Portion
Internally designated funds				
Reserved for capital expenditures	$ 706,374	$ -	$ 863,703	$ -
Unexpended academic and research gifts	-	2,456,587	-	2,311,685
Deferred compensation	-	259,152	-	226,627
Other	410,749	318,772	394,756	263,764
	1,117,123	3,034,511	1,258,459	2,802,076
Externally limited funds				
Unexpended funds on research	247,423	-	202,137	-
Contributions held for others	1,073	-	1,269	-
Professional liability trust fund	-	34,664	-	30,668
Held by trustees under debt and other agreements	223,168	-	128,338	-
	471,664	34,664	331,744	30,668
	$ 1,588,787	$ 3,069,175	$ 1,590,203	$ 2,832,744

(in thousands of dollars)

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

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

(in thousands of dollars)

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

	September 30, 2015			
	At Fair Value	On Equity Method	On Cost Method	Total
Pooled investments				
Invested cash equivalents	$ 34,049	$ -	$ -	$ 34,049
Separately managed investments	1,834,357	-	-	1,834,357
Mutual funds	365,035	-	-	365,035
Commingled funds	1,157,965	-	-	1,157,965
Private partnerships	-	744,139	1,991,206	2,735,345
	3,391,406	744,139	1,991,206	6,126,751
Separately invested				
Invested cash equivalents	135,640	-	16	135,656
Equities	6,247	-	46,237	52,484
U.S. Government and domestic fixed income securities	32,330	-	-	32,330
Mutual funds	397,539	-	-	397,539
Other	17,416	-	76,583	93,999
	589,172	-	122,836	712,008
	$ 3,980,578	$ 744,139	$ 2,114,042	$ 6,838,759

Separately managed investments include cash and equivalents of $212,882, equities of $612,948 and fixed income securities of $1,008,527 as of September 30, 2015.

For the private partnerships reflected in the balance sheet at cost, the difference (unrecorded net unrealized appreciation) between the value reported by the investment managers and the cost for these investments was $928,510 and $863,084 as of September 30, 2016 and 2015, respectively.

(in thousands of dollars)

The fair value and gross unrealized depreciation of investments and investments limited as to use, with a fair value less than cost, that are not deemed to be other-than-temporarily impaired as of September 30, 2016 are as follows:

	Less than 12 Months		12 Months or Greater	
	Fair Value	Gross Unrealized Depreciation	Fair Value	Gross Unrealized Depreciation
Pooled investments				
Separately managed investments	$ -	$ -	$ 99	$ (6)
Commingled funds	134,036	(25,459)	172,377	(3,107)
	134,036	(25,459)	172,476	(3,113)
Separately invested				
Equities	-	-	11	(4)
Fixed income securities	7,491	(18)	2,954	(28)
Mutual funds	-	-	24,803	(1,765)
External trusts	-	-	1	(20)
	7,491	(18)	27,769	(1,817)
	$ 141,527	$ (25,477)	$ 200,245	$ (4,930)

In addition, for certain private partnerships recorded at cost, gross unrealized depreciation amounted to $16,351 as of September 30, 2016, with $6,418 of that amount unrealized for 12 months or greater.

Based on management's quantitative and qualitative assessment, investments whose cost exceeds fair value are not considered to be other-than-temporarily impaired as of September 30, 2016. Management believes these investments will recover their values and there is no intention to liquidate these positions.

(in thousands of dollars)

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

	Years Ended September 30, 2016	2015
Unrestricted		
Dividends, interest and other income	$ 35,535	$ 59,941
Endowment income distributions, net of reinvested gains	43,359	39,059
Net realized gains (losses) on investments		
Realized gains	87,259	158,402
Other-than-temporary impairment	(80,553)	(139,474)
Change in value of equity method investments	76,644	(46,860)
Recovery (losses) on endowment funds	4,133	(11,045)
Total investment activity included in excess of revenues over expenses	166,377	60,023
Change in net unrealized appreciation on marketable investments	200,042	(224,616)
Total unrestricted investment activity	366,419	(164,593)
Temporarily restricted		
Dividends and interest income	2,397	5,286
Endowment income distributions	(51,339)	(47,133)
Net realized gains (losses) on investments		
Realized gains	21,934	31,890
Other-than-temporary impairment	(17,604)	(24,558)
	(44,612)	(34,515)
Change in value of equity method investments	22,996	(11,945)
Change in net unrealized appreciation on marketable investments	34,303	(47,396)
(Recovery) losses on endowment funds	(4,133)	11,045
	53,166	(48,296)
Total temporarily restricted investment activity	8,554	(82,811)
Permanently restricted		
Dividends and interest income	(9)	(3)
Net realized gains on investments	46	58
Change in net unrealized appreciation on marketable investments	(340)	(2,313)
Change in value of beneficial interests in perpetual trusts	(182)	(970)
Total permanently restricted investment activity	(485)	(3,228)
	$ 374,488	$ (250,632)

(in thousands of dollars)

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

	Years Ended September 30, 2016	2015
Investment income included in operations and reported in other revenue	$ 12,282	$ 11,841
Investment income included in nonoperating gains and reported in		
Income (loss) from investments	61,102	(37,258)
Academic and research gifts, net of expenses	92,993	85,440
Total investment activity included in excess of revenues over expenses	$ 166,377	$ 60,023

6. Fair Value Measurements

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

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

The hierarchy is described below.

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

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

(in thousands of dollars)

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

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

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

The following tables summarize fair value measurements as of September 30, 2016 and 2015 for financial assets and liabilities measured at fair value on a recurring basis:

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

(in thousands of dollars)

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at September 30, 2015
Assets				
Pooled investments				
Invested cash equivalents	$ 33,027	$ 1,021	$ -	$ 34,048
Separately managed investments	1,331,564	502,793	-	1,834,357
Mutual funds	365,034	-	-	365,034
Commingled funds	-	1,157,967	-	1,157,967
	1,729,625	1,661,781	-	3,391,406
Separately invested				
Invested cash equivalents	135,640	-	-	135,640
Equities	6,247	-	-	6,247
U.S. Government and domestic fixed income securities	32,330	-	-	32,330
Mutual funds	397,539	-	-	397,539
Other	-	-	17,416	17,416
	571,756	-	17,416	589,172
	$ 2,301,381	$ 1,661,781	$ 17,416	$ 3,980,578
Liabilities				
Interest rate swaps		$ 404,062		$ 404,062

As of and for the years ended September 30, 2016 and 2015, the fair value of the assets and change in the value of the assets measured using significant unobservable inputs (Level 3) were related to beneficial interests in perpetual assets.

(in thousands of dollars)

7. Pledges Receivable and Contributions Receivable From Trusts

Pledges receivable represent unconditional promises to give and are net of allowances for uncollectible amounts. Pledges are recorded at the present value of their estimated future cash flows. Pledges collectible within one year are classified as other current assets, net of allowances, and total $100,280 and $87,229 as of September 30, 2016 and 2015, respectively. Estimated cash flows due after one year are discounted using published treasury bond and note yields that are commensurate with estimated collection risks. The blended discount rate was 0.9% and 1.0% for 2016 and 2015, respectively. Pledges are expected to be collected as follows:

	September 30, 2016	September 30, 2015
Amounts due		
Within one year	$ 109,111	$ 108,865
In one to five years	126,786	138,411
In more than five years	49,693	56,120
Total pledges receivable	285,590	303,396
Less: Unamortized discount	5,540	6,840
	280,050	296,556
Less: Allowance for uncollectibles	12,359	26,711
Net pledges receivable	267,691	269,845
Contributions receivable from trusts	27,273	26,448
	$ 294,964	$ 296,293

8. Property and Equipment

Property and equipment consists of the following:

	September 30, 2016	September 30, 2015
Land and land improvements	$ 180,156	$ 179,954
Buildings and building improvements	6,471,440	5,955,908
Equipment	2,297,392	1,826,766
Construction in progress	1,062,074	1,098,134
	10,011,062	9,060,762
Accumulated depreciation	(4,129,135)	(3,731,980)
Property and equipment, net	$ 5,881,927	$ 5,328,782

Depreciation expense for the years ended September 30, 2016 and 2015 was $549,082 and $487,980, respectively. Interest costs, net of interest earned, aggregating $40,042 and $35,063 were capitalized in 2016 and 2015, respectively.

(in thousands of dollars)

For the years ended September 30, 2016 and 2015, fully depreciated assets with an original cost of $151,927 and $199,970, respectively, were written off.

9. Accrued Medical Claims and Related Expenses

Accrued medical claims and related expenses include estimates of expected trends in claims severity, frequency, and other factors, which could vary as the claims are ultimately settled and are based principally upon historical experience. For the years ended September 30, 2016 and 2015, changes in estimates resulted in a decrease of accrued medical claims and related expense of $43,872 and $27,221, respectively. Increases (decreases) of this nature occur as the result of claim settlements and recoveries during the current year and as additional information is received regarding individual claims, causing changes from the original estimates of the cost of these claims. Ongoing analysis of the recent loss development trends is also taken into account in evaluating the overall adequacy of the reserves.

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

	2016	2015
Balance at beginning of year	$ 232,268	$ 254,480
Less:		
Premium deficiency reserve	(32,636)	(91,555)
Medical loss ratio rebate payable	-	(611)
Accrual for claims adjustment expenses	(4,877)	(4,381)
Accrued medical payables - other	(14,477)	-
Claim recoveries	(8,300)	(7,567)
Plus: Settlements payable, net	13,058	22,020
Net balance at beginning of year	185,036	172,386
Incurred related to		
Current year	2,470,782	2,007,380
Prior years	(43,872)	(27,221)
Total incurred	2,426,910	1,980,159
Paid related to		
Current year	2,219,247	1,822,513
Prior years	158,685	144,996
Total paid	2,377,932	1,967,509
Net balance at end of year	234,014	185,036
Plus:		
Premium deficiency reserve	51,735	32,636
Accrual for claims adjustment expenses	6,192	4,877
Accrued medical payables - other	14,577	14,477
Claims recoveries	-	8,300
Less: Settlements payable, net	(16,652)	(13,058)
Balance at end of year	$ 289,866	$ 232,268

(in thousands of dollars)

Medical claims and related expenses in the accompanying consolidated statements of operations include these amounts along with other nonclaims related costs. These nonclaims related expenses were for directly delivered services and medical cost risk sharing and incentives, totaling approximately $23,545 and $17,422 for the years ended September 30, 2016 and 2015, respectively.

10. Long-Term Obligations

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

	September 30,	
	2016	**2015**
Massachusetts Health and Educational Facilities Authority (Authority) Revenue Bonds		
Series D*, variable interest rate of 0.78% and 0.01%, final maturity in 2017	$ 1,010	$ 1,940
Series F*, variable interest rate of 0.80% and 0.29%, final maturity in 2040	237,350	245,500
Series G*, average fixed interest rate of 4.92%, variable interest of 0.90% and 0.24%, final maturity in 2047	303,240	316,455
Series H*, variable interest rate of 0.59% and 0.08%, final maturity in 2042	170,915	171,320
Series I*, average fixed interest rate of 4.82%, variable interest of 0.84% and 0.01%, final maturity in 2044	157,175	165,960
Series J*, average fixed interest rate of 5.01%, final maturity in 2039	415,010	434,245
Series P*, variable interest rate of 0.78% and 0.01%, final maturity in 2027	150,000	150,000
Massachusetts Development Finance Agency (Agency) Revenue Bonds		
Series K*, average fixed interest rate of 4.99%, variable interest of 0.87% and 0.02%, final maturity in 2046	244,760	331,085
Series L, average fixed interest rate of 4.95%, final maturity in 2041	311,735	320,985
Series M*, average fixed interest rate of 4.95%, variable interest rate of 1.18% and 0.34%, final maturity in 2048	493,100	494,175
Series N*, variable interest rate of 0.87% and 0.65%, final maturity in 2044	137,350	139,400
Series O*, average fixed interest rate of 4.60%, variable interest rate of 1.32% and 0.50%, final maturity in 2050	317,615	317,615
Series Q*, average fixed interest rate of 4.79%, final maturity in 2047	423,990	-
Series R*, variable interest rate of 0.92%, final maturity in 2052	100,000	-
PHS Taxable Debt		
Series 2007 taxable bonds, fixed interest rate of 6.26%, final maturity in 2037	100,000	100,000
Series 2011 taxable bonds, fixed interest rate of 3.44%, final maturity in 2021	250,000	250,000
2012 Taxable Senior Notes, fixed interest rate of 4.11%, final maturity in 2052	400,000	400,000
2014 Taxable Senior Notes, fixed interest rate of 4.73%, final maturity in 2044	150,000	150,000
Series 2015 taxable bonds, fixed interest rate of 4.12%, final maturity in 2055	300,000	300,000
2016 Taxable Senior Notes, fixed interest rate of 3.89%, final maturity in 2046	225,000	-
Other obligations	5,712	6,092
Capital lease obligations	796	1,187
Total long-term obligations, par value	4,894,758	4,295,959
Unamortized discounts and premiums, net	154,374	97,065
Total long-term obligations, net	5,049,132	4,393,024
Less: Current portion	441,018	398,990
	$ 4,608,114	$ 3,994,034

* Denotes series is issued in multiple subseries.
Variable interest rates are presented at September 30, 2016 and 2015, respectively.

(in thousands of dollars)

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

	Scheduled Maturities	Bonds Supported by Partners HealthCare Liquidity	Bonds Supported by Bank Facilities	Total
2017	$ 65,508	$ 250,510	$ 125,000	$ 441,018
2018	70,927	-	-	70,927
2019	72,897	-	-	72,897
2020	75,559	-	-	75,559
2021	330,788	-	-	330,788
Thereafter	4,057,943	-	-	4,057,943
	$ 4,673,622	$ 250,510	$ 125,000	$ 5,049,132

The scheduled maturities represent annual payments as required under debt repayment schedules. The current portion of long-term obligations includes the payments scheduled to be made in 2017 along with bonds supported by Partners HealthCare liquidity and bonds supported by bank facilities (standby bond purchase agreements or letters of credit) with financial institutions that expire prior to September 30, 2017. The bonds supported by Partners HealthCare liquidity provide the bondholder with an option to tender the bonds to Partners HealthCare. Accordingly, these bonds are classified as a current liability. The bonds supported by bank facilities provide the bondholder with an option to tender the bonds to the liquidity provider. Generally accepted accounting principles require bonds backed by bank facilities expiring within one year of the balance sheet date to be classified as a current liability.

Interest expense paid during the years ended September 30, 2016 and 2015 was $185,358 and $165,225, respectively.

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

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

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

In January 2015, PHS issued $317,615 of Partners HealthCare System Series O Revenue Bonds, plus bond premium of $39,969. The bond proceeds, net of issuance costs of $2,814, were used to refund portions of Series F Bonds ($20,865) and Series G Bonds ($119,201) and to finance certain capital projects ($214,704).

(in thousands of dollars)

In January 2015, PHS issued $300,000 of Partners HealthCare System Taxable Bonds. Proceeds from the bonds were used to finance certain capital projects.

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

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

Credit Agreement

Partners HealthCare maintains a $150,000 Credit Agreement (the Agreement) that provides access to same day funds. Advances under the Agreement bear a variable rate of interest based on the London Interbank Offered Rate (LIBOR). As of September 30, 2016, there were no amounts outstanding under the Agreement. The Agreement expires in June 2017.

11. Derivatives

Interest Rate Swaps

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

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

(in thousands of dollars)

The following is a summary of the outstanding positions under these swap contracts as of September 30, 2016:

Effective Date	Notional Amount	Maturity	Rate Paid	Rate Received
5/1/03	$ 150,000	7/1/35	4.40 %	67% 1-month LIBOR
7/1/05	150,000	7/1/40	3.63 %	67% 1-month LIBOR
7/1/05	34,500	7/1/25	5.11 %	67% 6-month LIBOR
7/1/07	150,000	7/1/42	3.46 %	67% 1-month LIBOR
7/1/09	100,000	7/1/44	3.71 %	67% 1-month LIBOR
7/1/11	100,000	7/1/46	3.74 %	67% 1-month LIBOR
7/1/13	100,000	7/1/48	3.80 %	67% 1-month LIBOR
7/1/15	50,000	7/1/50	3.80 %	67% 1-month LIBOR
4/1/16	50,000	7/1/50	3.93 %	67% 1-month LIBOR
4/1/16	50,000	7/1/52	3.59 %	67% 1-month LIBOR
7/1/17	50,000	7/1/52	3.74 %	67% 1-month LIBOR

Partners HealthCare's swap contracts contain provisions that require collateral to be posted if the fair value of the swap exceeds certain thresholds. The collateral thresholds reflect the current credit ratings issued by major credit rating agencies on Partners HealthCare's and the counterparty's debt. Declines in Partners HealthCare's or the counterparty's credit ratings would result in lower collateral thresholds and, consequently, the potential for additional collateral postings by Partners HealthCare or the counterparty. As of September 30, 2016 and 2015, Partners HealthCare had posted collateral of $222,926 and $128,208, respectively. Partners HealthCare has established procedures to ensure that liquidity and securities are available to meet collateral posting requirements.

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

Derivatives - Other

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

(in thousands of dollars)

12. Commitments

Leases

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

	Capital Leases	Operating Leases
2017	$ 437	$ 185,382
2018	396	163,973
2019	-	120,843
2020	-	104,455
2021	-	88,765
Thereafter	-	377,891
Total lease payments	833	$ 1,041,309
Less: Amount representing interest	37	
Capital lease obligations at September 30, 2016	$ 796	

Rental expense under operating leases approximated $238,081 in 2016 and $196,946 in 2015.

13. Pension and Postretirement Healthcare Benefit Plans

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

Total expense for these plans consists of the following:

	Years Ended September 30,	
	2016	2015
Defined benefit plans	$ 287,156	$ 233,670
Defined contribution plans	159,974	150,745
Postretirement healthcare benefit plans	6,754	4,368
	$ 453,884	$ 388,783

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

(in thousands of dollars)

Benefit Obligations

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	**2015**	**2016**	**2015**
Change in benefit obligations				
Benefit obligations at beginning of year	$ 5,678,875	$ 5,102,117	$ 156,875	$ 136,502
Service cost	295,014	267,328	5,060	5,059
Interest cost	262,977	231,953	5,725	4,966
Plan amendments (gain) loss	(85,804)	5,045	(34,797)	-
Actuarial (gain) loss	856,616	204,937	16,615	7,622
Benefits paid	(134,790)	(126,127)	(5,971)	(5,301)
Expenses paid	(17,174)	(6,565)	-	-
Employee contributions	175	187	8,368	8,027
Benefit obligations at end of year	$ 6,855,889	$ 5,678,875	$ 151,875	$ 156,875

The accumulated benefit obligation for all defined benefit pension plans at the end of 2016 and 2015 was $6,485,483 and $5,371,220, respectively.

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	**2015**	**2016**	**2015**
Weighted-average assumptions used to determine end of year benefit obligation				
Discount rate	3.70%	4.50%	2.40% - 3.50%	3.00% - 4.55%
Rate of compensation increase				
Professional staff	4.45%	4.45%	N/A	N/A
Other than professional staff	3.00% - 3.50%	3.00% - 3.50%	N/A	N/A
Healthcare cost trend rate for next year	N/A	N/A	6.50%	7.00%
Rate to which the cost trend rate is to decline	N/A	N/A	5.00%	5.00%
Year that rate reaches the ultimate trend rate	N/A	N/A	2020	2020

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

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on postretirement benefit obligation	$ 916	$ (739)

(in thousands of dollars)

Plan Assets

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	**2015**	**2016**	**2015**
Change in plan assets				
Fair value of plan assets at beginning of year	$ 4,332,095	$ 4,365,566	$ 73,205	$ 68,438
Actual return on plan assets	376,198	(147,938)	4,120	(3,003)
Employer contributions	512,553	246,972	5,704	5,044
Employee contributions	175	187	8,368	8,027
Benefits paid	(134,790)	(126,127)	(5,971)	(5,301)
Expenses paid	(17,174)	(6,565)	-	-
Fair value of plan assets at end of year	$ 5,069,057	$ 4,332,095	$ 85,426	$ 73,205

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

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

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

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

	September 30, 2016			September 30, 2015		
	Dollars	**Reported Exposures**	**Policy Benchmark**	**Dollars**	**Reported Exposures**	**Policy Benchmark**
Global equity	$ 411,834	8 %	10 %	$ 205,596	4 %	7 %
Traditional U.S. equity	502,439	10	13	537,524	12	10
Traditional foreign developed equity	605,920	12	11	585,803	14	12
Traditional emerging markets equity	561,745	11	11	552,140	13	11
Private equity	424,014	8	9	388,336	9	8
Real assets	306,147	6	3	284,808	7	7
Less: Market sensitive managers	1,821,446	36	36	1,502,556	35	36
Fixed income managers	435,512	9	7	275,332	6	9
	$ 5,069,057	100 %	100 %	$ 4,332,095	100 %	100 %

(in thousands of dollars)

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

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

The following table presents plan assets, by form of ownership, as of September 30, 2016 and 2015 measured at fair value on a recurring basis using the fair value hierarchy defined in Note 6:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Investments Valued Using NAV as a Practical Expedient**	**Fair Value at September 30, 2016**
Defined benefit pension plans				
Invested cash equivalents	$ 187,184	$ -	$ -	$ 187,184
Separately managed investments	589,274	229,128	-	818,402
Mutual funds	100,478	-	-	100,478
Commingled funds	-	1,132,414	-	1,132,414
Private partnerships	-	-	2,830,579	2,830,579
	876,936	1,361,542	2,830,579	5,069,057
Postretirement healthcare benefit plans				
Commingled funds	-	65,940	-	65,940
Mutual funds	-	12,251	-	12,251
Separately managed investments	7,235	-	-	7,235
	7,235	78,191	-	85,426
Total plan assets	$ 884,171	$ 1,439,733	$ 2,830,579	$ 5,154,483

(in thousands of dollars)

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Investments Valued Using NAV as a Practical Expedient	Fair Value at September 30, 2015
Defined benefit pension plans				
Invested cash equivalents	$ 43,315	$ -	$ -	$ 43,315
Separately managed investments	366,713	201,603	-	568,316
Mutual funds	257,734	-	-	257,734
Commingled funds	-	1,072,581	-	1,072,581
Private partnerships	-	-	2,390,149	2,390,149
	667,762	1,274,184	2,390,149	4,332,095
Postretirement healthcare benefit plans				
Commingled funds	-	56,325	6,900	63,225
Mutual funds	5,168	-	-	5,168
Separately managed investments	4,812	-	-	4,812
	9,980	56,325	6,900	73,205
Total plan assets	$ 677,742	$ 1,330,509	$ 2,397,049	$ 4,405,300

In evaluating the Level at which Partners HealthCare's private partnerships have been classified within the fair value hierarchy, management has assessed factors including, but not limited to price transparency, the ability to redeem these investments at net asset value at the measurement date, and the existence or absence of certain restrictions at the measurement date. Investments in private partnerships generally have limited redemption options for investors and, subsequent to final closing, may or may not permit subscriptions by new or existing investors. These entities may also have the ability to impose gates, lockups and other restrictions on an investor's ability to readily redeem out of their investment interest in the fund. As of September 30, 2016 and 2015, Partners HealthCare has excluded all assets from the fair value hierarchy for which fair value is measured at net asset value per share using the practical expedient.

(in thousands of dollars)

Funded Status

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

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	2015	2016	2015
End of year				
Fair value of plan assets at measurement date	$ 5,069,057	$ 4,332,095	$ 85,426	$ 73,205
Benefit obligations at measurement date	(6,855,889)	(5,678,875)	(151,875)	(156,875)
Funded status	$ (1,786,832)	$ (1,346,780)	$ (66,449)	$ (83,670)
Amounts recognized in the balance sheet consist of				
Current liabilities	$ (6,493)	$ (2,116)	$ (3,437)	$ (3,586)
Long-term liabilities	(1,780,339)	(1,344,664)	(63,012)	(80,084)
	$ (1,786,832)	$ (1,346,780)	$ (66,449)	$ (83,670)
Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets consist of				
Actuarial net loss (gain)	$ 2,604,947	$ 1,850,126	$ 28,258	$ 11,730
Prior service cost (credit)	(79,519)	9,852	(34,797)	-
	$ 2,525,428	$ 1,859,978	$ (6,539)	$ 11,730
Amounts recognized in unrestricted net assets consist of				
Current year actuarial (gain) loss	$ 844,931	$ 698,377	$ 17,793	$ 15,746
Amortization of actuarial gain (loss)	(90,109)	(75,983)	(1,267)	535
Current year prior service cost (credit)	(85,804)	4,402	(34,797)	-
Amortization of prior service (cost) credit	(3,567)	(3,910)	-	-
	$ 665,451	$ 622,886	$ (18,271)	$ 16,281

At the end of 2016 and 2015, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with an accumulated benefit obligation in excess of plan assets were as follows:

	2016	2015
Accumulated benefit obligation in excess of plan assets		
Projected benefit obligation	$ 6,855,789	$ 5,678,875
Accumulated benefit obligation	6,485,483	5,371,220
Fair value of plan assets	5,069,057	4,332,095

(in thousands of dollars)

Expected Cash Flows

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

	Defined Benefit Pension Plans	Postretirement Healthcare Benefit Plans	
Expected employer contributions			
2017	$ 353,739	$ 7,474	
			Medicare Subsidy
Expected benefit payments (receipts)			
2017	$ 261,364	$ 7,627	$ (153)
2018	278,038	7,899	(17)
2019	293,967	9,057	(16)
2020	319,824	10,214	(14)
2021	333,578	11,323	(13)
2022-2026	1,901,313	74,125	(43)

Net Periodic Benefit Cost

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	**2015**	**2016**	**2015**
Service cost	$ 295,014	$ 267,328	$ 5,060	$ 5,059
Interest cost	262,977	231,953	5,725	4,966
Expected return on plan assets	(364,511)	(345,504)	(5,298)	(5,123)
Amortization of				
Prior service cost (credit)	3,567	3,910	-	-
Actuarial net (gain) loss	90,109	75,983	1,267	(534)
Net periodic benefit cost	$ 287,156	$ 233,670	$ 6,754	$ 4,368

Amounts expected to be amortized from unrestricted net assets into net periodic benefit cost during the year ending September 30, 2017 are as follows:

	Defined Benefit Pension Plans	Postretirement Healthcare Benefit Plans
Actuarial net loss (gain)	$ 160,112	$ 1,936
Prior service cost (credit)	(6,662)	(5,289)

(in thousands of dollars)

	Defined Benefit Pension Plans		Postretirement Healthcare Benefit Plans	
	2016	**2015**	**2016**	**2015**
Weighted-average assumptions used to determine net periodic pension and postretirement cost				
Discount rate	4.50 %	4.40 %	3.00 % - 4.55 %	3.05 % - 4.40 %
Expected return on plan assets	7.75 %	8.00 %	7.50 %	7.50 %
Rate of compensation increase				
Professional staff	4.45 %	4.45 %	N/A	N/A
Other than professional staff	3.00 % - 3.50 %	3.00 % - 3.50 %	N/A	N/A
Healthcare cost trend rate for this year	N/A	N/A	7.00 %	7.00 %
Rate to which the cost trend rate is to decline	N/A	N/A	5.00 %	5.00 %
Year that rate reaches the ultimate trend rate	N/A	N/A	2021	2021

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

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

	One-Percentage-Point	
	Increase	**Decrease**
Effect on service and interest cost	$ 43	$ (40)

14. Professional Liability Insurance

Partners HealthCare insures substantially all of its professional and general liability risk on a claims-made basis in cooperation with other healthcare organizations in the Greater Boston area through a captive insurance company, Controlled Risk Insurance Company Ltd. (CRICO). PHS owns 10% of CRICO. The investment is accounted for on the cost basis of accounting. The policies cover claims made during their respective terms, but not those occurrences for which claims may be made after expiration of the policy, except for certain tail liabilities which CRICO has assumed on an occurrence basis through December 31, 2016. Management intends to renew its coverage on a claims-made basis and has no reason to believe that it will be prevented from such renewal. During 2015, CRICO announced and paid a dividend to member organizations. As a result, Partners HealthCare recognized a dividend of $54,779 as a nonoperating gain.

(in thousands of dollars)

Partners HealthCare follows the accounting policy of establishing reserves to cover the ultimate costs of medical malpractice claims, which include costs associated with litigating or settling claims. The liability also includes an estimated tail liability, established to cover all malpractice claims incurred but not reported to the insurance company as of the end of the year. The total malpractice liability of $487,705 and $482,640 as of September 30, 2016 and 2015, respectively, is presented as an accrued professional liability in the consolidated balance sheets. These reserves have been recorded on a discounted basis using an interest rate of 3.00% and 3.50% as of September 30, 2016 and 2015, respectively.

Partners HealthCare also recognizes an insurance receivable from CRICO, at the same time that it recognizes the liability, measured on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts. The insurance receivable of $402,649 and $397,958 as of September 30, 2016 and 2015, respectively, is reported as a component of other assets in the consolidated balance sheets.

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

15. Concentration of Credit Risk

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

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

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

Partners HealthCare minimizes the credit risk it is exposed to under interest rate swap agreements by utilizing several counterparties and requiring the counterparties to post collateral for the benefit of Partners HealthCare when the fair value of the swap is positive. Partners HealthCare minimizes its counterparty risk by contracting with six counterparties, none of which accounts for more than 30% of the aggregate notional amount of the swap contracts.

(in thousands of dollars)

16. Net Assets

Restricted net assets are available for the following purposes:

	September 30, 2016	September 30, 2015
Temporarily restricted		
Charity care	$ 90,525	$ 89,032
Buildings and equipment	80,644	89,990
Clinical care, research and academic	619,717	586,540
	$ 790,886	$ 765,562
Permanently restricted		
Charity care	$ 20,001	$ 20,550
Buildings and equipment	2,433	2,444
Clinical care, research and academic	600,752	556,584
	$ 623,186	$ 579,578

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

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

Endowment Funds with Deficits
From time to time, the value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts. When such endowment deficits exist, they are classified as a reduction to unrestricted net assets. Deficits of this nature reported in unrestricted net assets were $7,159 and $11,292 as of September 30, 2016 and 2015, respectively. These deficits resulted from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions or subsequent endowment additions.

(in thousands of dollars)

The following presents the endowment net asset composition by type of fund as of September 30, 2016 and 2015 and the changes in endowment assets for the years ended September 30, 2016 and 2015:

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

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net asset composition by type of fund as of September 30, 2015				
Donor-restricted endowment funds	$ (11,292)	$ 410,816	$ 558,507	$ 958,031
Board-designated endowment funds	885,380	-	-	885,380
Total funds	$ 874,088	$ 410,816	$ 558,507	$ 1,843,411

(in thousands of dollars)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Changes in endowment net assets				
Endowment net assets at October 1, 2014	$ 942,119	$ 498,238	$ 447,607	$ 1,887,964
Investment return				
Investment income	3,856	4,588	(1)	8,443
Net realized and unrealized appreciation (depreciation)	(51,213)	(40,005)	(30)	(91,248)
Total investment return	(47,357)	(35,417)	(31)	(82,805)
Contributions	5,898	(172)	116,449	122,175
Appropriation of endowment assets for expenditure	(40,515)	(49,813)	-	(90,328)
Other changes	13,943	(2,020)	(5,518)	6,405
Total changes	(68,031)	(87,422)	110,900	(44,553)
Endowment net assets at September 30, 2015	$ 874,088	$ 410,816	$ 558,507	$ 1,843,411

Conditional Pledge

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

Through September 30, 2016, total funding of $98,052 was received (including $3,052 of endowment earnings distributed), with $13,161 received for the year ended September 30, 2016 (including $2,161 of endowment earnings distributed), and total net expenses of $78,858 were incurred, including $7,945 for the year ended September 30, 2016. As of September 30, 2016, unspent funding has been recorded as temporarily restricted net assets, to be released to unrestricted net assets after qualifying expenses have been incurred.

(in thousands of dollars)

17. Functional Expenses

Total operating expenses by function are as follows:

	Years Ended September 30, 2016	Years Ended September 30, 2015
Healthcare services	$ 7,624,800	$ 7,167,823
Research and academic	1,731,772	1,671,225
Medical claims and related expenses	2,017,773	1,652,538
General and administrative	1,193,665	1,067,601
	$ 12,568,010	$ 11,559,187

18. Contingencies

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

19. Subsequent Events

Partners HealthCare has assessed the impact of subsequent events through December 9, 2016, the date the audited financial statements were issued. During this period, there were no subsequent events that require adjustment to the audited financial statements.