

Berkshire Health Systems, Inc. and Affiliates

**Audited Consolidated Financial Statements
and Supplementary Information**

Years ended September 30, 2017 and 2016

Berkshire Health Systems, Inc. and Affiliates

Audited Consolidated Financial Statements
and Supplementary Information

Years ended September 30, 2017 and 2016

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Report of Independent Certified Public Accountants

Board of Trustees
Berkshire Health Systems, Inc.

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

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Health System's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Supplementary information

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



Boston, Massachusetts
January 5, 2018

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Operations and Changes in Net Assets

	Years ended September 30	
	2017	2016
Revenues:		
Patient service revenue (net of contractual allowances and discounts)	\$ 546,446,359	\$ 537,697,202
Less: provision for bad debts	11,163,786	10,483,023
Patient service revenue, net	535,282,573	527,214,179
Other revenue	60,516,416	49,708,005
Total revenues	595,798,989	576,922,184
Expenses:		
Salaries and wages	304,255,914	290,024,692
Fringe benefits	74,724,956	73,930,378
Supplies and other	164,142,470	154,397,649
Health Safety Net assessment	5,654,809	2,144,095
Depreciation and amortization	35,374,550	32,065,281
Interest	3,229,003	3,874,963
Total expenses	587,381,702	556,437,058
Income from operations	8,417,287	20,485,126
Nonoperating gains:		
Investment gains, net	9,969,200	11,332,679
Gain on advanced refunding of long-term debt	92,892	-
Other, net	519,604	115,818
Total nonoperating gains	10,581,696	11,448,497
Excess of revenues over expenses	\$ 18,998,983	\$ 31,933,623

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Berkshire Health Systems, Inc. and Affiliates

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

	Years ended September 30	
	2017	2016
Unrestricted net assets:		
Excess of revenues over expenses	\$ 18,998,983	\$ 31,933,623
Net unrealized gains on investments	18,352,384	7,506,175
Grant funds used for property and equipment	127,250	127,829
Net assets released from restrictions used for purchase of property and equipment	376,860	489,851
Other	(41,140)	-
Increase in unrestricted net assets	37,814,337	40,057,478
Temporarily restricted net assets:		
Restricted contributions	1,189,661	1,137,724
Net realized gains on investments	607,423	682,339
Net unrealized gains on investments	1,980,278	890,525
Net assets released from restrictions for operating purposes	(330,901)	(318,382)
Net assets released from restrictions for purchase of property and equipment	(376,860)	(489,851)
Increase in temporarily restricted net assets	3,069,601	1,902,355
Permanently restricted net assets		
Contributions for endowment funds	1,135,285	-
Increase in permanently restricted net assets	1,135,285	-
Increase in net assets	42,019,223	41,959,833
Net assets, beginning of year	405,459,188	363,499,355
Net assets, end of year	\$ 447,478,411	\$ 405,459,188

See accompanying notes.

Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Cash Flows

	Years ended September 30	
	2017	2016
Operating activities		
Increase in net assets	\$ 42,019,223	\$ 41,959,833
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net unrealized gains on unrestricted investments	(18,352,384)	(7,506,175)
Realized and unrealized gains on restricted investments	(2,587,701)	(1,572,864)
Amortization of debt discount/premium	(661,659)	(799,756)
Depreciation and amortization	35,374,550	32,065,281
Equity income in Yankee Alliance, LLC	(1,081,453)	(633,744)
Restricted contributions	(2,324,946)	(1,137,724)
Gain on advanced refunding of debt	(92,892)	-
Effects of changes in operating assets and liabilities:		
Accounts receivable, net	(2,479,959)	459,431
Note and other receivables, inventories, prepaid expenses and other current assets	(2,528,316)	(3,757,513)
Accounts payable	2,490,920	(1,708,899)
Accrued salaries and related withholdings, accrued expenses, and deferred revenue	3,009,402	(2,465,815)
Due to third-party payors, net	(4,576,417)	(4,995,753)
Other liabilities	(909,147)	(386,328)
Net cash provided by operating activities	47,299,221	49,519,974
Investing activities		
Additions to property and equipment, net	(36,412,806)	(39,639,785)
Decrease (increase) in funds held by trustees	6,377,804	(195,227)
Increase in funds designated by Boards	(10,119,095)	(10,173,380)
(Increase) decrease in funds held for donor-restricted purposes	(1,089,153)	44,921
Decrease in amounts due from managed entities	225,674	171,532
Decrease in other assets	6,290	107,090
Net cash used in investing activities	(41,011,286)	(49,684,849)

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Berkshire Health Systems, Inc. and Affiliates

Consolidated Statements of Cash Flows
(continued)

	Years ended September 30	
	2017	2016
Financing activities		
Repayment of long-term obligations	\$ (6,640,000)	\$ (6,365,000)
Advanced refunding of long-term debt	(15,205,000)	-
Proceeds from issuance of long-term debt	10,540,000	-
Payment of deferred financing costs	(206,301)	-
Restricted contributions	2,324,946	1,137,724
Net cash used in financing activities	(9,186,355)	(5,227,276)
Net decrease in cash and cash equivalents	(2,898,420)	(5,392,151)
Cash and cash equivalents at beginning of year	44,388,102	49,780,253
Cash and cash equivalents at end of year	\$ 41,489,682	\$ 44,388,102
Supplemental disclosure of cash flow information for interest paid	\$ 3,757,602	\$ 4,021,613

See accompanying notes.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements

Years ended September 30, 2017 and 2016

1. Organization

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

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

1. Organization (continued)

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

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

Temporarily and Permanently Restricted Net Assets

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

Use of Estimates

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with maturities of 90 days or less from the date of purchase. Included in cash and cash equivalents are BIC liquid short-term investments of \$13,170,352 and \$11,378,820 as of September 30, 2017 and 2016, respectively. The carrying values reported in the consolidated balance sheets approximate fair value.

Inventories

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

Investments and Investment Income

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

The Medical Center accounts for its investment in Yankee Alliance, LLC on the equity method of accounting. The Medical Center's ownership in Yankee Alliance, LLC was 16.66% for both the years ended September 30, 2017 and 2016. The Medical Center's interest in the earnings of Yankee Alliance, LLC was \$1,081,453 and \$633,744 for the years ended September 30, 2017 and 2016, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

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

Costs of Borrowing

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

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Allowance for Uncollectable Amounts

Accounts receivable are reduced by an allowance for uncollectable amounts. In evaluating the collectability of accounts receivable, the Health System analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable amounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectable amounts. For receivables associated with services provided to patients who have third-party coverage, the Health System analyzes contractually due amounts and provides for bad debts, if necessary, on anticipated patient balances. For receivables associated with self-pay patients, the Health System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectable amounts.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

The allowance for uncollectable amounts was approximately \$20,447,000 and \$20,063,000 as of September 30, 2017 and 2016, respectively. This balance as a percentage of accounts receivable, net of contractual adjustments, was approximately 26% and 27% as of September 30, 2017 and 2016, respectively.

Gifts and Bequests

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

Professional Liability Insurance

The Health System covers its primary hospital and physician professional liability and commercial general liability risk on a claims-made basis with tail coverage through a captive insurance company, BIC. The Health System establishes reserves for unpaid losses, with the assistance of consulting actuaries, based on a combination of industry and hospital-specific data. Management believes these reserves, recorded in other liabilities in the accompanying consolidated balance sheets, which at September 30, 2017 and 2016, totaled \$10,215,000 and \$11,227,000, respectively, are adequate; however, no assurance can be given that the ultimate settlement of losses may not vary materially from the liability recorded. Future adjustments to the amounts recorded resulting from the continual review process, as well as differences between estimates and ultimate payments, will be reflected in the consolidated statements of operations and changes in net assets of future years when such adjustments, if any, become known.

Income Taxes

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

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

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

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

Asset Retirement Obligation

Conditional asset retirement obligations for certain buildings and land improvements amounted to approximately \$3,187,000 and \$3,015,000 as of September 30, 2017 and 2016, respectively. The change in amounts resulted from \$203,445 and \$91,233 of accretion expense, less \$31,132 and \$39,730 of abatement work for 2017 and 2016, respectively. The obligations are recorded within other liabilities in the accompanying consolidated balance sheets.

Reclassification

Certain amounts for the year ended September 30, 2016 have been reclassified to be consistent with the presentation of the amounts for the year ended September 30, 2017. The reclassifications had no effect on the excess of revenues over expenses, or the increase in total net assets, or on total net assets as previously reported.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods and services. This standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. An entity will apply the amendments in this update using either a full retrospective application, which applies the standard to each prior period presented, or under the modified retrospective application, in which an entity recognizes the cumulative effect of initially applying the new standard as an adjustment to the opening balance sheet of retained earnings at the date of initial application. Revenue in periods presented before that date will continue to be reported under guidance in effect before the change.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

2. Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, to make targeted improvements to how entities: (1) account for equity investments; (2) present and disclose financial instruments; and (3) measure the valuation allowance on deferred tax assets related to available-for-sale debt securities. The new standard is effective for fiscal years beginning after December 15, 2017. Early application of the guidance in ASU 2016-01 is not permitted.

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

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

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

3. Third-Party Payment Arrangements

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

3. Third-Party Payment Arrangements (continued)

Medicare

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

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

BFS receives payment on standard fee schedules.

Medicaid

The Commonwealth Executive Office of Health & Human Services utilizes a prospective payment methodology for acute hospital services provided to Medicaid beneficiaries. Medicaid pays hospitals a case mix adjusted fixed amount per discharge for inpatient services. Outpatient services were paid on a prospective payment methodology based upon a Payment Amount Per Episode (PAPE) through November 30, 2016 and based on an Adjudicated Payment per Episode of Care (APEC) methodology from December 1, 2016 to present. The APEC reimburses hospitals a payment that is specific to each outpatient episode by multiplying an outpatient statewide standard by a case mix weight for that particular case. The Hospital is reimbursed on a reasonable cost basis for inpatient and outpatient services. BFS is paid under fee schedules. The Medical Center and the Hospital contract with various Medicaid HMOs. Payments are based on the Medicaid payment methodology for inpatient services and a percentage of charges or the Medicaid fee schedule for outpatient services.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

3. Third-Party Payment Arrangements (continued)

Health Safety Net Program

The Health Safety Net (HSN) program reimburses hospitals for uncompensated care based on actual services provided at rates approximating the Medicare PPS. Reimbursement rates are subject to available funds. The HSN program is partially funded by acute hospitals through an assessment on gross charges billed to non-government payors. The Medical Center and the Hospital have recorded estimates of their final settlements with the HSN program. During 2017, HSN also paid hospitals incentive payments to support patient access to medical and diagnostic equipment. The Medical Center and the Hospital have recorded their gross obligations to the program as an expense in the consolidated statements of operations and changes in net assets. Reimbursement from the HSN program for uncompensated care is recorded as net patient service revenue and for the incentive payments as other operating revenue. During 2017, the Medical Center and the Hospital received \$4,189,953 for the incentive payments. During 2017 and 2016, the Medical Center and the Hospital received \$1,207,203 and \$1,618,404, respectively, from the HSN program for reimbursement of charity care. During 2017 and 2016, the Medical Center and the Hospital paid an assessment into the HSN program of \$5,654,809 and \$2,144,095, respectively.

Qualified Health Plans (QHP)

The Hospital and Medical Center have entered into contracts with Health New England, Celticare and Network Health and are paid at discounted rates under these programs.

Non-governmental Payors

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

3. Third-Party Payment Arrangements (continued)

Third-Party Settlements

Medicare and Medicaid agreements require the Medical Center and the Hospital to prepare and file settlement reports annually. Net revenue from the Medicare and Medicaid programs accounted for approximately 45% and 6%, and 44% and 7%, respectively, of the Health System's net patient service revenue for the years ended September 30, 2017 and 2016. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and noncompliance could result in significant regulatory action, including fines and penalties. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Health System believes that it is in compliance with applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subjected to future government review and interpretations, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Settlement reports have been submitted for all prior years; final settlements have been made with Medicare through 2014 for the Medical Center and through 2015 for the Hospital. Provisions have been made in the consolidated financial statements for prior and current year estimated final settlements.

Adjustments to estimates of prior year settlements with third-party payors are reflected in current year net patient service revenue and increased net patient service revenue by approximately \$6,651,000 and \$5,292,000 in 2017 and 2016, respectively.

4. Charity Care

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

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

4. Charity Care (continued)

During 2017 and 2016, the Health System provided \$5,015,559 and \$5,436,974 in charity care, respectively, based on established rates. The net cost of charity includes the direct and indirect cost of providing charity care services, offset by revenues received from financial assistance donations. The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity care. The cost of charity care provided during the years ended September 30, 2017 and 2016 was \$2,127,428 and \$2,265,093, respectively. Donations received to offset charity services provided totaled \$62,042 and \$58,981 for the years ended September 30, 2017 and 2016, respectively.

5. Related-Party Transactions

As of September 30, 2017 and 2016, BHS had \$1,334,263 and \$1,313,054, respectively, due from the Managed Entities for ongoing management fees and purchased services. The management fee revenue recorded by BMS related to these services was \$15,755,844 and \$15,114,976 for 2017 and 2016, respectively, and is recorded in other revenue in the consolidated statements of operations and changes in net assets.

On August 31, 2009, the Managed Entities issued a promissory note to BHS related to the transfer of Pittsfield Management Systems, Inc. The note bears interest at 2.75% with monthly installments of \$25,308 through September 1, 2024. As of September 30, 2017 and 2016, the note had a balance of \$1,931,809 and \$2,178,693, respectively, of which \$253,760 and \$246,884 is included in note and other receivables, and \$1,678,049 and \$1,931,809 is included in other assets in 2017 and 2016, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments

Assets Limited as to Use

The composition and classification of investments at September 30, 2017 and 2016 is set forth in the following table. Investments are stated at fair value.

	2017	2016
Cash and cash equivalents	\$ 41,489,682	\$ 44,388,102
Funds held by trustees – current	7,744,513	8,991,686
Assets whose use is limited:		
Funds designated by Boards	234,669,328	206,197,849
Funds held by trustees	-	5,130,631
Funds held as endowments	8,141,444	7,006,159
Funds held for donor-restricted purposes	18,947,241	16,405,672
Deferred compensation	12,589,046	9,854,695
	<u>\$ 323,581,254</u>	<u>\$ 297,974,794</u>

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

	2017	2016
Cash and cash equivalents	\$ 45,654,623	\$ 54,636,652
Equity securities:		
Consumer discretionary	27,041,035	26,925,021
Energy and utilities	10,240,146	9,271,073
Financials	22,276,380	16,977,549
Health care	21,225,227	14,161,891
Industrials and materials	21,576,738	16,306,291
Information technologies	32,565,728	21,311,002
Telecommunication services	2,412,739	4,964,521
Total U.S. equities	137,337,993	109,917,348
Non-U.S. equities	22,402,507	26,731,460
U.S. Treasury and U.S. Government Agency debt	17,477,387	8,014,843
Other government debt issues	33,025,455	26,329,847
Corporate debt securities	22,757,951	31,557,894
REITs and mortgage-backed securities	27,734,373	25,291,160
Mutual funds	17,190,965	15,495,590
	<u>\$ 323,581,254</u>	<u>\$ 297,974,794</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments (continued)

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

	<u>2017</u>	<u>2016</u>
Income:		
Other revenue – interest income	<u>\$ 1,611,525</u>	<u>\$ 455,980</u>
Nonoperating gains:		
Interest income, net	<u>\$ 5,582,641</u>	<u>\$ 5,111,691</u>
Realized gains on sale of investments	<u>4,386,559</u>	<u>6,220,988</u>
Total investment gains	<u>\$ 9,969,200</u>	<u>\$ 11,332,679</u>
Other changes in net assets:		
Net unrealized gains – unrestricted net assets	<u>\$ 18,352,384</u>	<u>\$ 7,506,175</u>
Net realized gains – restricted net assets	<u>607,423</u>	<u>682,339</u>
Net unrealized gains – restricted net assets	<u>1,980,278</u>	<u>890,525</u>

Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other than temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors, and the length of time and extent to which the market value has been less than cost. During the years ended September 30, 2017 and 2016, the Health System recorded losses of \$19,435 and \$588,152, respectively, for other than temporary declines in the fair value of investments within investment gains in the accompanying consolidated statements of operations and changes in net assets.

At September 30, 2017, investments with a fair value of \$50,707,192 had unrealized losses of \$1,075,444, of which \$1,053,008 had been unrealized for over one year. At September 30, 2016, investments with a fair value of \$74,740,242 had unrealized losses of \$1,435,117, of which \$759,898 had been unrealized for over one year. The Health System has the intent and ability to hold these investments until recovery.

Investment management fees were \$98,614 and \$159,641 for the years ended September 30, 2017 and 2016, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments (continued)

Fair Value of Financial Instruments

As of September 30, 2017, the Health System held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents, investments and assets whose use is limited. The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs are generally unsupported by market activity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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

Level 2: Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. For the Health System, investments classified in this level are pooled investment funds which are not traded on an exchange.

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

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments (continued)

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

2017	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 45,474,743	\$ 179,880	\$ -	\$ 45,654,623
Equity securities:				
Consumer discretionary	20,331,972	5,986,563	722,500	27,041,035
Energy and utilities	7,494,788	2,745,358	-	10,240,146
Financials	17,924,841	4,351,539	-	22,276,380
Health care	16,902,159	4,323,068	-	21,225,227
Industrials and materials	17,642,345	3,934,393	-	21,576,738
Information technologies	25,643,755	6,921,973	-	32,565,728
Telecommunication services	1,765,833	646,906	-	2,412,739
Non-U.S. equities	22,402,507	-	-	22,402,507
U.S. Treasury and U.S.				
Government Agency debt	10,749,177	6,728,210	-	17,477,387
Other government debt issues	32,745,576	279,879	-	33,025,455
Corporate debt securities	19,309,289	3,448,662	-	22,757,951
REITs and mortgage-backed securities	26,844,865	889,508	-	27,734,373
Mutual funds	17,190,965	-	-	17,190,965
	\$ 282,422,815	\$ 40,435,939	\$ 722,500	\$ 323,581,254

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments (continued)

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

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

	Year ended September 30	
	2017	2016
Balance, beginning of year	\$ 667,500	\$ 582,500
Net change in fair value	55,000	85,000
Balance, end of year	\$ 722,500	\$ 667,500

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

6. Investments (continued)

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

	September 30, 2017		September 30, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Long-term debt	\$103,671,200	\$ 86,987,876	\$105,429,600	\$ 99,068,644

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

7. Property and Equipment

Property and equipment consisted of the following at September 30:

	2017	2016
Land and improvements	\$ 17,462,633	\$ 16,408,108
Buildings and building improvements	277,082,723	249,067,103
Fixed equipment	101,962,449	98,596,164
Major movable equipment	201,058,718	181,777,653
	597,566,523	545,849,028
Less accumulated depreciation and amortization	(383,689,101)	(349,344,673)
	213,877,422	196,504,355
Construction in progress	15,509,423	31,659,149
	\$ 229,386,845	\$ 228,163,504

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

7. Property and Equipment (continued)

The estimated cost to complete construction in progress at September 30, 2017 and 2016 was approximately \$1,350,000 and \$3,537,000, respectively.

8. Long-Term Obligations

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

	<u>2017</u>	<u>2016</u>
Obligated Group:		
Massachusetts Development Finance Agency (MDFA), formerly MHEFA, Revenue Bonds, Berkshire Health Systems, Inc. Issues:		
2016 Series H, net of unamortized debt issuance costs of \$112,952 in 2017	\$ 10,427,048	\$ -
2012 Series G, net of unamortized premium and debt issuance costs of \$4,620,828 in 2017 and \$5,185,211 in 2016	76,560,828	79,730,211
2005 Series F, net of unamortized premium and debt issuance costs of \$98,433 in 2016	-	19,338,433
	<u>86,987,876</u>	<u>99,068,644</u>
Less portion classified as current	<u>(5,935,000)</u>	<u>(6,640,000)</u>
Total long-term obligations	<u>\$ 81,052,876</u>	<u>\$ 92,428,644</u>

Obligated Group

On November 18, 2016, MDFA issued Revenue Bonds, Series H, with a face value of \$10,540,000, which were used to refund the outstanding Series F bonds. The Series H bonds are fixed rate bonds and bear interest at 1.41% per annum with principal payment ranging from \$815,000 to \$3,315,000 maturing in 2020. The Series H bonds were privately placed with a bank.

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

8. Long-Term Obligations (continued)

On July 15, 2005, MHEFA issued Revenue Bonds, Series F, with a face value of \$50,190,000, which were used to refund debt and finance additions to property and equipment. The Series F bonds were advanced refunded on November 18, 2016 through the issuance of the Series H bonds.

Under a Master Trust Indenture (MTI), Berkshire Medical Center, Fairview Hospital and Berkshire Health Systems (the Obligated Group) granted MDFA a lien on its revenues, excluding revenues related to endowment funds whose principal and income are restricted and not available to be pledged.

The MTI provides for, among other requirements, the maintenance by the Obligated Group of a minimum debt service ratio and restrictions on incurring additional debt and the sale or disposition of assets, and requires the Obligated Group to comply with various financial and other reporting requirements. The Obligated Group is in compliance with those requirements at September 30, 2017 and 2016.

Maturities

Aggregate maturities of the long-term obligations of the Health System subsequent to September 30, 2017 are as follows:

Year ending September 30,	
2018	\$ 5,935,000
2019	6,080,000
2020	6,330,000
2021	3,225,000
2022	4,260,000
2023 and thereafter	<u>56,650,000</u>
Total face maturities	82,480,000
Unamortized bond premiums and debt issuance costs	<u>4,507,876</u>
	<u>\$ 86,987,876</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

9. Funds Held by Trustees

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

	<u>2017</u>	<u>2016</u>
Escrow for long-term obligations:		
Debt service fund	\$ 7,744,513	\$ 8,991,686
Debt service reserve fund	-	5,130,631
	<u>7,744,513</u>	<u>14,122,317</u>
Less portion classified as current	<u>(7,744,513)</u>	<u>(8,991,686)</u>
	<u>\$ -</u>	<u>\$ 5,130,631</u>

These funds are primarily invested in money market funds and United States Government securities and are carried at fair value. Income earned of \$43,349 and \$182,277 in 2017 and 2016, respectively, on certain debt-financed funds held in escrow has been reported as other revenue. Income of \$318 and \$1,638 in 2017 and 2016, respectively, has been reported as nonoperating gains since the related funds held in escrow have been contributed by the Obligated Group. The debt service fund was used as part of the advanced refunding of Series F. The agreements for outstanding issues no longer require a debt service reserve fund.

10. Lease Commitments

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

Year ending September 30,	<u>Operating Leases</u>
2018	\$ 421,928
2019	<u>125,440</u>
Total minimum lease payments	<u>\$ 547,368</u>

Rent expense under noncancelable operating leases approximated \$830,000 for both years ended September 30, 2017 and 2016, and is included within supplies and other on the accompanying consolidated statements of operations and changes in net assets.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

11. Temporarily and Permanently Restricted Net Assets

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

	<u>2017</u>	<u>2016</u>
Health care services:		
Patient care	\$ 2,222,883	\$ 2,111,802
Education	1,230,505	1,259,102
Property and equipment	3,276,393	2,826,228
Scholarship	533,199	433,773
Undistributed appreciation on permanently restricted funds	17,648,723	15,211,197
	<u>\$ 24,911,703</u>	<u>\$ 21,842,102</u>

Permanently restricted net assets at September 30 are restricted to:

	<u>2017</u>	<u>2016</u>
Investments to be held in perpetuity, the income from which is restricted as to use	\$ 5,504,205	\$ 5,504,205
Investments to be held in perpetuity, the income from which is unrestricted	2,637,239	1,501,954
	<u>\$ 8,141,444</u>	<u>\$ 7,006,159</u>

During 2017 and 2016, net assets of \$707,761 and \$808,233, respectively, were released from donor restrictions by incurring expenses satisfying the restricted purposes as noted above.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

11. Temporarily and Permanently Restricted Net Assets (continued)

Interpretation of Relevant Law

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

The following represents the net asset classifications of the Health System endowment funds, as well as the changes in endowments, for the year ended September 30, 2017:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2016	\$ 16,953,650	\$ 7,006,159	\$ 23,959,809
Contributions	-	1,135,285	1,135,285
Investment income	104,850	-	104,850
Net realized gains on investments	502,579	-	502,579
Net unrealized gains on investments	1,980,278	-	1,980,278
Endowment net assets at September 30, 2017	\$ 19,541,357	\$ 8,141,444	\$ 27,682,801

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

11. Temporarily and Permanently Restricted Net Assets (continued)

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

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

12. Pension Plans

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

The Plan allows employees of the Health System, age 21 or older, who are regularly scheduled to work at least 20 hours per week, to participate in the Plan upon the completion of one year of service. Employees may contribute up to 21.5% of their base pay.

Each week, the Health System makes a minimum fixed contribution to the Plan from 2.5% to 3.5% of each participant's salary, and a matching contribution of 50% of employee voluntary contributions on the first 4% of a participant's salary for those employees who elect to contribute. Contributions made by the Health System to the Plan in the years ended September 30, 2017 and 2016 were \$11,317,408 and \$11,059,076, respectively.

The 457(b) Plan is a non-qualified supplemental retirement plan available to certain executives of BHS. The contribution limit for employees in 2017 was \$18,000. Contributions made by the Health System to the 457(b) Plan in the years ended September 30, 2017 and 2016 were \$314,521 and \$322,134, respectively.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

13. Commitments and Contingencies

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

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

At September 30, 2017, there was no amount outstanding under the Health System's \$5,000,000 secured demand line of credit from TD Bank. Interest is equal to LIBOR plus 1.5%, resulting in an interest rate of 2.03% at September 30, 2017. The line of credit expires on May 31, 2018.

14. Functional Expenses

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

	<u>2017</u>	<u>2016</u>
Health care services	\$516,634,366	\$480,447,540
General and administrative	70,747,336	75,989,518
	<u>\$587,381,702</u>	<u>\$556,437,058</u>

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

15. Concentration of Credit Risk

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

	2017	2016
Medicare	41%	43%
Medicaid and connector products	14	13
Commercial insurances	35	34
Patients	10	10
	100%	100%

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

	2017	%	2016	%
Medicare	\$245,486,846	45%	\$237,364,042	44%
Medicaid and connector products	33,770,306	6	38,307,701	7
Commercial insurances	257,636,751	47	253,671,142	47
Patients	9,552,456	2	8,354,317	2
Patient service revenues	\$546,446,359	100%	\$537,697,202	100%

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

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

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

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

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

The Health System has included \$115,000 and \$554,000 in other revenue related to the program in the years ended September 30, 2017 and 2016, respectively. The payments are based on submitted cost report data from the year 2016 and prior used to project the total incentive payments. Each subsequent payment will be adjusted for changes in the projected total incentive payment. The Health System's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

17. Other Operating Revenues

Other operating revenues consisted of the following:

	<u>2017</u>	<u>2016</u>
Meaningful use and incentives	\$ 266,893	\$ 861,466
Retail pharmacy	25,921,519	19,158,363
Unrestricted donations	139,356	160,440
Rent	1,130,070	1,386,585
Grants	4,768,290	5,916,024
Management services	15,755,844	15,114,976
Psychiatric and other services	3,933,708	4,529,181
Dietary food sales	1,650,493	1,481,466
Interest income	1,611,646	398,805
HSN Incentive payments	4,189,953	-
Miscellaneous	1,148,644	700,699
Total	<u>\$ 60,516,416</u>	<u>\$ 49,708,005</u>

18. Union Relationship

Approximately 21% of the Health System employees are represented by labor unions, and all union contracts except one have been successfully resolved. Negotiations for a replacement contract for Berkshire Medical Center registered nurses began in September 2016 and were ongoing as of January 5, 2018. The union terminated the existing contract on September 2, 2017, and a work stoppage occurred between October 3, 2017 and October 7, 2017. During 2017, the Health System expensed \$4,473,472 related to temporary labor, legal and other costs associated with contract negotiations and union action. Management has made its best and final offer and, as of January 5, 2018, continues in good faith to seek contract resolution.

Berkshire Health Systems, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

Years ended September 30, 2017 and 2016

19. Subsequent Events

The Health System evaluated its September 30, 2017 consolidated financial statements for subsequent events through January 5, 2018, the date the consolidated financial statements were available to be issued. The Health System is not aware of any subsequent events which would require recognition or disclosure in the consolidated financial statements.

SUPPLEMENTARY INFORMATION

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet

September 30, 2017

Assets	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Other Controlled Entities	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Current assets:							
Cash and cash equivalents	\$ 41,489,682	\$ -	\$ -	\$ 9,226	\$ 192,180	\$ -	\$ 13,500,523
Patient accounts receivable, less allowance for uncollectable amounts of \$20,447,000	58,074,965	-	-	2,925,150	564,646	-	-
Note and other receivables	7,510,071	-	515,229	58,391	1,480	-	85,642
Inventories	12,007,651	-	-	-	31,152	-	-
Funds held by trustees	7,744,513	-	-	-	-	-	-
Due from managed entities	1,334,263	-	-	-	-	-	-
Prepaid expenses and other current assets	4,184,567	(3,155,810)	2,127,161	20,236	-	-	-
Due from affiliates	-	(5,067,750)	3,877,636	1,190,114	-	-	-
Total current assets	132,345,712	(8,223,560)	6,520,026	4,203,117	789,458	-	13,586,165
Due from affiliates	-	(68,276)	-	-	-	-	-
Assets whose use is limited:							
Funds designated by Boards	234,669,328	-	-	-	-	-	-
Funds held by trustees	-	-	-	-	-	-	-
Funds held as endowments	8,141,444	-	-	-	-	-	-
Funds held for donor-restricted purposes	18,947,241	-	-	-	-	-	-
Deferred compensation	12,589,046	-	3,849,701	3,175,164	-	-	-
Total assets whose use is limited	274,347,059	-	3,849,701	3,175,164	-	-	-
Property and equipment, net	229,386,845	-	15,405	-	-	75,004	-
Other assets	7,166,642	(100)	-	-	-	-	-
Investments in subsidiaries	-	-	-	-	-	-	-
Total assets	\$ 643,246,258	\$ (8,291,936)	\$ 10,385,132	\$ 7,378,281	\$ 789,458	\$ 75,004	\$ 13,586,165

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2017

	Assets				
	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Current assets:					
Cash and cash equivalents	\$ 27,787,753	\$ -	\$ 27,694,783	\$ 87,048	\$ 5,922
Patient accounts receivable, less allowance for uncollectable amounts of \$19,163,000	54,585,169	-	49,595,315	4,989,854	-
Note and other receivables	6,849,329	-	6,542,568	52,841	253,920
Inventories	11,976,499	-	11,227,607	748,892	-
Funds held by trustees	7,744,513	-	7,366,351	378,162	-
Due from managed entities	1,334,263	-	-	-	1,334,263
Prepaid expenses and other current assets	5,192,980	-	5,177,809	15,171	-
Due from affiliates	-	(10,634,203)	-	906,413	9,727,790
Total current assets	115,470,506	(10,634,203)	107,604,433	7,178,381	11,321,895
Due from affiliates	68,276	(7,053,575)	7,053,575	68,276	-
Assets whose use is limited:					
Funds designated by Boards	234,669,328	-	211,835,220	22,834,108	-
Funds held by trustees	-	-	-	-	-
Funds held as endowments	8,141,444	-	7,883,202	258,242	-
Funds held for donor-restricted purposes	18,947,241	-	17,647,097	1,300,144	-
Deferred compensation	5,564,181	-	5,298,363	265,818	-
Total assets whose use is limited	267,322,194	-	242,663,882	24,658,312	-
Property and equipment, net	229,296,436	-	217,855,051	11,441,385	-
Other assets	7,166,642	-	5,416,250	12,343	1,738,049
Investments in subsidiaries	100	-	-	-	100
Total assets	\$619,324,154	\$ (17,687,778)	\$ 580,593,191	\$ 43,358,697	\$ 13,060,044

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2017

	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Other Controlled Entities	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Current liabilities:							
Accounts payable	\$ 19,844,637	\$ (3,155,810)	\$ 1,805,003	\$ 336,530	\$ 61,287	\$ 525	\$ 3,169,096
Accrued salaries and related withholdings	28,811,621	-	4,104,865	3,504,242	738,225	-	-
Accrued expenses	14,705,429	-	619,063	343,903	-	6,203	-
Deferred revenue	996,043	-	6,500	18,442	-	-	-
Due to third-party payors	17,930,219	-	-	-	-	-	-
Current portion of long-term obligations	5,935,000	-	-	-	-	-	-
Due to affiliates	-	(5,067,750)	-	-	1,148,684	-	-
Total current liabilities	88,222,949	(8,223,560)	6,535,431	4,203,117	1,948,196	6,728	3,169,096
Due to affiliates	-	(68,276)	-	-	-	68,276	-
Deferred compensation	12,589,046	-	3,849,701	3,175,164	-	-	-
Other liabilities	13,902,976	-	-	-	-	-	10,224,663
Long-term obligations, less current portion	81,052,876	-	-	-	-	-	-
Total liabilities	195,767,847	(8,291,836)	10,385,132	7,378,281	1,948,196	75,004	13,393,759
Net assets:							
Unrestricted	414,425,264	(100)	-	-	(1,158,738)	-	192,406
Temporarily restricted	24,911,703	-	-	-	-	-	-
Permanently restricted	8,141,444	-	-	-	-	-	-
Total net assets	447,478,411	(100)	-	-	(1,158,738)	-	192,406
Total liabilities and net assets	\$ 643,246,258	\$ (8,291,936)	\$ 10,385,132	\$ 7,378,281	\$ 789,458	\$ 75,004	\$ 13,586,165

Berkshire Health Systems, Inc. and Affiliates

Consolidating Balance Sheet (continued)

September 30, 2017

	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Current liabilities:					
Accounts payable	\$ 17,628,006	\$ -	\$ 16,970,697	\$ 656,610	\$ 699
Accrued salaries and related withholdings	20,464,289	-	18,591,685	1,872,604	-
Accrued expenses	13,736,260	-	13,133,171	602,964	125
Deferred revenue	971,101	-	872,512	98,589	-
Due to third-party payors	17,930,219	-	17,010,963	919,256	-
Current portion of long-term obligations	5,935,000	-	5,643,720	291,280	-
Due to affiliates	3,919,066	(10,634,203)	14,553,269	-	-
Total current liabilities	80,583,941	(10,634,203)	86,776,017	4,441,303	824
Due to affiliates	-	(7,053,575)	-	-	7,053,575
Deferred compensation	5,564,181	-	5,298,363	265,818	-
Other liabilities	3,678,313	-	2,866,838	811,475	-
Long-term obligations, less current portion	81,052,876	-	77,146,131	3,906,745	-
Total liabilities	170,879,311	(17,687,778)	172,087,349	9,425,341	7,054,399
Net assets:					
Unrestricted	415,391,696	-	379,608,447	29,777,604	6,005,645
Temporarily restricted	24,911,703	-	21,014,193	3,897,510	-
Permanently restricted	8,141,444	-	7,883,202	258,242	-
Total net assets	448,444,843	-	408,505,842	33,933,356	6,005,645
Total liabilities and net assets	\$ 619,324,154	\$ (17,687,778)	\$ 580,593,191	\$ 43,358,697	\$ 13,060,044

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2017

	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Other Controlled Entities	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Revenues:							
Net patient service revenue	\$ 546,446,359	\$ -	\$ -	\$ 39,577,376	\$ 5,491,407	\$ -	\$ -
Less: provision for bad debts	11,163,786	-	-	1,135,960	73,768	-	-
Patient service revenue, net	535,282,573	-	-	38,441,416	5,417,639	-	-
Other revenue	60,516,416	(44,722,783)	58,699,899	3,015,606	107,864	79,083	673,085
Total revenues	595,798,989	(44,722,783)	58,699,899	41,457,022	5,525,503	79,083	673,085
Expenses:							
Salaries and wages	304,255,914	-	27,893,255	41,479,971	4,682,161	-	-
Fringe benefits	74,724,956	-	8,331,778	6,426,632	704,523	-	-
Supplies and other	164,142,470	(44,722,783)	22,470,945	12,412,802	2,156,073	48,261	673,085
Health Safety Net assessment	5,654,809	-	-	-	-	-	-
Depreciation and amortization	35,374,550	-	3,921	-	26,100	39,159	-
Interest	3,229,003	-	-	-	4,556	-	-
Total expenses	587,381,702	(44,722,783)	58,699,899	60,319,405	7,573,413	87,420	673,085
Income (loss) from operations	8,417,287	-	-	(18,862,383)	(2,047,910)	(8,337)	-
Nonoperating gains:							
Investment gains, net	9,969,200	-	-	873	-	-	-
Gain on advanced refunding of long-term debt	92,892	-	-	-	-	-	-
Other, net	519,604	-	-	-	352,988	-	-
Loss on investments in subsidiary	8,337	8,337	-	-	-	-	-
Total nonoperating gains	10,581,696	8,337	-	873	352,988	-	-
Excess of (deficiency in) revenues over expenses	\$ 18,998,983	\$ 8,337	\$ -	\$ (18,861,510)	\$ (1,694,922)	\$ (8,337)	\$ -

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets (continued)

Year ended September 30, 2017

	Consolidated	Eliminations and Reclassifications	BHS Management Services, Inc.	Berkshire Faculty Services, Inc.	Other Controlled Entities	Tri-State Medical Management Corp.	Berkshire Indemnity Company SPC, LTD.
Unrestricted net assets:							
Excess of (deficiency in) revenues over expenses	\$ 18,998,983	\$ 8,337	\$ -	\$ (18,861,510)	\$ (1,694,922)	\$ (8,337)	\$ -
Net unrealized gains (losses) on investments	18,352,384	-	-	-	-	-	(966,216)
Grant funds used for property and equipment	127,250	-	-	-	-	-	-
Net assets released from restrictions used for purchase of property and equipment	376,860	-	-	-	-	-	-
Equity transfer	-	-	-	18,861,510	788,087	-	-
Investment from Parent	-	(8,337)	-	-	-	8,337	-
Other	(41,140)	-	-	-	(41,140)	-	-
Increase (decrease) in unrestricted net assets	37,814,337	-	-	-	(947,975)	-	(966,216)
Temporarily restricted net assets:							
Restricted contributions	1,189,661	-	-	-	-	-	-
Net realized gains on investments	607,423	-	-	-	-	-	-
Net unrealized gains on investments	1,980,278	-	-	-	-	-	-
Net assets released from restrictions for operating purposes	(330,901)	-	-	-	-	-	-
Net assets released from restrictions for purchase of property and equipment	(376,860)	-	-	-	-	-	-
Increase in temporarily restricted net assets	3,069,601	-	-	-	-	-	-
Permanently restricted net assets							
Contributions for endowment funds	1,135,285	-	-	-	-	-	-
Increase in permanently restricted net assets	1,135,285	-	-	-	-	-	-
Increase (decrease) in net assets	42,019,223	-	-	-	(947,975)	-	(966,216)
Net assets, beginning of year	405,459,188	(100)	-	-	(210,763)	-	1,158,622
Net assets, end of year	\$ 447,478,411	\$ (100)	\$ -	\$ -	\$ (1,158,738)	\$ -	\$ 192,406

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets (continued)

Year ended September 30, 2017

	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Revenues:					
Net patient service revenue	\$ 501,377,576	-	\$ 451,380,753	\$ 49,996,823	-
Less: provision for bad debts	9,954,058	-	8,848,551	1,105,507	-
Patient service revenue, net	491,423,518	-	442,532,202	48,891,316	-
Other revenue	42,663,662	(2,123,600)	43,465,597	1,321,545	120
Total revenues	534,087,180	(2,123,600)	485,997,799	50,212,861	120
Expenses:					
Salaries and wages	230,200,527	-	206,185,752	24,014,775	-
Fringe benefits	59,262,023	-	53,585,612	5,676,411	-
Supplies and other	171,104,087	(2,123,600)	157,637,128	15,592,285	(1,726)
Health Safety Net assessment	5,654,809	-	5,196,794	458,015	-
Depreciation and amortization	35,305,370	-	33,322,813	1,982,557	-
Interest	3,224,447	-	3,069,114	155,333	-
Total expenses	504,751,263	(2,123,600)	458,997,213	47,879,376	(1,726)
Income from operations	29,335,917	-	27,000,586	2,333,485	1,846
Nonoperating gains (losses):					
Investment gains, net	9,968,327	-	9,092,394	875,933	-
Gain on advanced refunding of long-term debt	92,892	-	88,249	4,643	-
Other, net	166,616	-	99,283	10,515	56,818
Loss on investments in subsidiary	(8,337)	-	-	(8,337)	-
Total nonoperating gains	10,219,498	-	9,279,926	882,754	56,818
Excess of revenues over expenses	\$ 39,555,415	\$ -	\$ 36,280,512	\$ 3,216,239	\$ 58,664

Berkshire Health Systems, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets (continued)

Year ended September 30, 2017

	Obligated Group	Eliminations and Reclassifications	Berkshire Medical Center, Inc.	Fairview Hospital, Inc.	Berkshire Health Systems, Inc.
Unrestricted net assets:					
Excess of revenues over expenses	\$ 39,555,415	\$ -	\$ 36,280,512	\$ 3,216,239	\$ 58,664
Net unrealized gains on investments	19,318,600	-	17,458,592	1,860,008	-
Grant funds used for property and equipment	127,250	-	127,250	-	-
Net assets released from restrictions used for purchase of property and equipment	376,860	-	-	376,860	-
Equity transfer	(19,649,597)	-	(18,121,566)	(1,528,031)	-
Other	-	-	-	-	-
Increase in unrestricted net assets	39,728,528	-	35,744,788	3,925,076	58,664
Temporarily restricted net assets:					
Restricted contributions	1,189,661	-	420,390	769,271	-
Net realized gains on investments	607,423	-	554,603	52,820	-
Net unrealized gains on investments	1,980,278	-	1,928,384	51,894	-
Net assets released from restrictions for operating purposes	(330,901)	-	(159,018)	(171,883)	-
Net assets released from restrictions for purchase of property and equipment	(376,860)	-	-	(376,860)	-
Increase in temporarily restricted net assets	3,069,601	-	2,744,359	325,242	-
Permanently restricted net assets	1,135,285	-	1,135,285	-	-
Contributions for endowment funds	1,135,285	-	1,135,285	-	-
Increase in permanently restricted net assets	1,135,285	-	1,135,285	-	-
Increase in net assets	43,933,414	-	39,624,432	4,250,318	58,664
Net assets, beginning of year	404,511,429	-	368,881,410	29,683,038	5,946,981
Net assets, end of year	\$ 448,444,843	\$ -	\$ 408,505,842	\$ 33,933,356	\$ 6,005,645