

CONSOLIDATED FINANCIAL STATEMENTS

New York Society for the Relief of the Ruptured and Crippled,
Maintaining the Hospital for Special Surgery
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP



New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Consolidated Financial Statements

Years Ended December 31, 2016 and 2015

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Report of Independent Auditors

The Board of Trustees
New York Society for the Relief of the Ruptured and Crippled,
Maintaining the Hospital for Special Surgery

We have audited the accompanying consolidated financial statements of New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery, which comprise the consolidated statements of financial position as of December 31, 2016 and 2015, 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 Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity'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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery at December 31, 2016 and 2015, and the consolidated results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 31 2017

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Consolidated Statements of Financial Position

	December 31	
	2016	2015
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 95,157	\$ 89,867
Receivables:		
Patient care, less allowance for doubtful accounts (2016 – \$15,933; 2015 – \$11,530)	101,287	94,286
Insurance claims receivable	11,738	17,138
Other	30,997	18,413
Total receivables	144,022	129,837
Investments	403,106	391,631
Inventories	8,292	8,157
Prepaid expenses and other current assets	6,331	5,812
Pledges receivable	15,507	13,589
Assets limited as to use	5,625	8,131
Due from affiliates – net	10,424	10,582
Total current assets	688,464	657,606
Insurance claims receivable, net of current portion	61,412	61,384
Other noncurrent assets	10,946	9,475
Due from affiliates – net	11,071	11,071
Pledges receivable	18,845	22,361
Assets limited as to use	63,394	79,335
Long-term investments	115,123	106,027
Interest in The Hospital for Special Surgery Fund, Inc.	45,711	38,331
Property, plant and equipment – net	535,675	491,065
Total assets	\$ 1,550,641	\$ 1,476,655

	December 31	
	2016	2015
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 78,074	\$ 64,271
Accrued salaries and related liabilities	41,397	38,808
Current portion of long-term debt	41,653	39,852
Due to third-party payors – net	3,873	3,125
Insurance claims liabilities	11,738	17,138
Other current liabilities	22,752	23,030
Total current liabilities	<u>199,487</u>	<u>186,224</u>
Long-term debt	249,199	272,760
Insurance claims liabilities, net of current portion	61,412	61,384
Other noncurrent liabilities, including accrued retirement benefits and due to third-party payors – net	<u>165,371</u>	<u>153,753</u>
Total liabilities	<u>675,469</u>	<u>674,121</u>
Commitments and contingencies		
Net assets:		
Unrestricted:		
Unrestricted	556,131	497,904
Designated for quasi-endowment	3,719	3,719
Noncontrolling interest in subsidiaries	1,979	1,765
Total unrestricted	<u>561,829</u>	<u>503,388</u>
Temporarily restricted:		
Specific purpose	57,153	56,166
Plant replacement and expansion	50,117	42,851
Research	74,305	76,251
Total temporarily restricted	<u>181,575</u>	<u>175,268</u>
Permanently restricted	131,768	123,878
Total net assets	<u>875,172</u>	<u>802,534</u>
Total liabilities and net assets	<u>\$ 1,550,641</u>	<u>\$ 1,476,655</u>

See accompanying notes.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended December 31	
	2016	2015
	<i>(In Thousands)</i>	
Operating revenue		
Net patient service revenue	\$ 867,629	\$ 820,689
Other operating revenue	153,770	145,138
Net assets released from restrictions for operations	16,759	16,343
Total operating revenue	1,038,158	982,170
Operating expenses		
Salaries and wages	431,597	387,836
Employee benefits	123,450	120,132
Supplies and other	361,558	325,973
Interest expense	9,022	8,201
Depreciation and amortization	56,484	54,417
Bad debt expense	8,948	8,821
Total operating expenses	991,059	905,380
Operating income before research operations, change in unrestricted interest in The Hospital for Special Surgery Fund, Inc., bequest and operating loss attributable to non- controlling interest in subsidiaries	47,099	76,790
Research operations:		
Net assets released from restrictions for research operations	35,815	31,813
Operating expenses, including depreciation (2016 – \$3,329; 2015 – \$3,186)	41,035	39,006
Net research operations	(5,220)	(7,193)
Change in unrestricted interest in The Hospital for Special Surgery Fund, Inc.	7,380	8,091
Bequest	985	6,748
Operating income before operating loss attributable to non- controlling interest in subsidiaries	50,244	84,436
Operating loss attributable to non-controlling interest in subsidiaries	1,271	807
Operating income	51,515	85,243

Continued on pages 6 and 7.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

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

Year Ended December 31, 2016

	Unrestricted			Total Unrestricted	Temporarily Restricted					Total Temporarily Restricted	Permanently Restricted	Total
	Unrestricted	Quasi- Endowment	Non-controlling Interest in Subsidiaries		Specific Purpose	Plant Replacement and Expansion	Research					
	<i>(In Thousands)</i>											
Operating income (from page 5)	\$ 51,515	\$ -	\$ -	\$ 51,515	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 51,515
Non-controlling members' capital contribution	-	-	1,485	1,485	-	-	-	-	-	-	-	1,485
Operating loss attributable to non-controlling interest in subsidiaries	-	-	(1,271)	(1,271)	-	-	-	-	-	-	-	(1,271)
Net assets released from restrictions for capital expenditures	6,661	-	-	6,661	-	-	-	-	-	-	-	6,661
Change in net unrealized gains and losses on investments	4,571	-	-	4,571	-	-	-	-	-	-	-	4,571
Change in defined benefit pension and other postretirement plan liability to be recognized in future periods	(4,520)	-	-	(4,520)	-	-	-	-	-	-	-	(4,520)
Contributions, including research grants	-	-	-	-	16,447	11,021	27,233	54,701	7,890	-	-	62,591
Investment activity, including net investment income of \$3,792, net realized gain of \$2,587 and change in net unrealized gains and losses and equity in earnings of alternative investments of \$4,462	-	-	-	-	2,880	18	7,943	10,841	-	-	-	10,841
Net assets released from restrictions for:												
Research operations	-	-	-	-	-	-	(35,815)	(35,815)	-	-	-	(35,815)
Capital expenditures	-	-	-	-	(1,581)	(3,773)	(1,307)	(6,661)	-	-	-	(6,661)
Operating expenses	-	-	-	-	(16,759)	-	-	(16,759)	-	-	-	(16,759)
Total net assets released from restrictions	-	-	-	-	(18,340)	(3,773)	(37,122)	(59,235)	-	-	-	(59,235)
Total change in net assets	58,227	-	214	58,441	987	7,266	(1,946)	6,307	7,890	-	-	72,638
Net assets at December 31, 2015	497,904	3,719	1,765	503,388	56,166	42,851	76,251	175,268	123,878	-	-	802,534
Net assets at December 31, 2016	\$ 556,131	\$ 3,719	\$ 1,979	\$ 561,829	\$ 57,153	\$ 50,117	\$ 74,305	\$ 181,575	\$ 131,768	\$ -	\$ -	\$ 875,172

See accompanying notes.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Consolidated Statements of Operations and Changes in Net Assets

Year Ended December 31, 2015

	Unrestricted			Temporarily Restricted						Total
	Unrestricted	Quasi- Endowment	Non-controlling Interest in Subsidiary	Total Unrestricted	Specific Purpose	Plant Replacement and Expansion	Research	Total Temporarily Restricted	Permanently Restricted	
	<i>(In Thousands)</i>									
Operating income (from page 5)	\$ 85,243	\$ –	\$ –	\$ 85,243	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 85,243
Non-controlling members' capital contribution	–	–	2,572	2,572	–	–	–	–	–	2,572
Operating loss attributable to non-controlling interest in subsidiary	–	–	(807)	(807)	–	–	–	–	–	(807)
Net assets released from restrictions for capital expenditures	3,363	–	–	3,363	–	–	–	–	–	3,363
Change in net unrealized gains and losses on investments	(6,103)	–	–	(6,103)	–	–	–	–	–	(6,103)
Change in defined benefit pension and other postretirement plan liability to be recognized in future periods	(4,319)	–	–	(4,319)	–	–	–	–	–	(4,319)
Contributions, including research grants	–	–	–	–	19,614	10,768	26,800	57,182	9,311	66,493
Net assets reclassification	–	–	–	–	–	(10,112)	10,112	–	–	–
Investment activity, including net investment income of \$3,045, net realized gain of \$2,552 and change in net unrealized gains and losses and equity in earnings of alternative investments of \$336	–	–	–	–	1,150	2	4,781	5,933	–	5,933
Net assets released from restrictions for:										
Research operations	–	–	–	–	–	–	(31,813)	(31,813)	–	(31,813)
Capital expenditures	–	–	–	–	(1,358)	(1,781)	(224)	(3,363)	–	(3,363)
Operating expenses	–	–	–	–	(16,343)	–	–	(16,343)	–	(16,343)
Total net assets released from restrictions	–	–	–	–	(17,701)	(1,781)	(32,037)	(51,519)	–	(51,519)
Total change in net assets	78,184	–	1,765	79,949	3,063	(1,123)	9,656	11,596	9,311	100,856
Net assets at December 31, 2014	419,720	3,719	–	423,439	53,103	43,974	66,595	163,672	114,567	701,678
Net assets at December 31, 2015	\$ 497,904	\$ 3,719	\$ 1,765	\$ 503,388	\$ 56,166	\$ 42,851	\$ 76,251	\$ 175,268	\$ 123,878	\$ 802,534

See accompanying notes.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2016	2015
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ 72,638	\$ 100,856
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Change in unrestricted interest in The Hospital for Special Surgery Fund, Inc.	(7,380)	(8,091)
Gain on extinguishment of debt	–	(383)
Depreciation and amortization	59,813	57,603
Amortization of bond premium	(298)	(329)
Change in defined benefit pension and other postretirement plan liability to be recognized in future periods	4,520	4,319
Change in net unrealized gains and losses on investments and equity in earnings of alternative investments	(10,158)	5,571
Realized gains on investments	(2,806)	(7,641)
Contributions to permanently restricted net assets	(7,890)	(9,311)
Contributions restricted to acquisition of plant assets – net	(11,021)	(10,768)
Employer contributions to pension plan	(28,900)	(22,000)
Changes in operating assets and liabilities:		
Receivables, net	(19,585)	(8,919)
Net due from affiliates	674	1,102
Pledges receivable, net	1,598	(2,311)
Accounts payable and accrued expenses and accrued salaries and related liabilities	16,392	9,621
Current amount due to third-party payors	748	(524)
Other noncurrent liabilities, including due to third-party payors	35,998	27,887
Other assets and liabilities, net	(2,403)	(1,899)
Net cash provided by operating activities	<u>101,940</u>	<u>134,783</u>
Investing activities		
Additions to property, plant and equipment	(103,852)	(110,160)
Net increase in investments	(8,041)	(43,133)
Net decrease in assets limited as to use	18,365	35,767
Net cash used in investing activities	<u>(93,528)</u>	<u>(117,526)</u>
Financing activities		
Principal payments on long-term debt	(43,993)	(81,669)
Proceeds from long-term borrowings	21,960	62,875
Payment of deferred financing costs	–	(1,601)
Contributions restricted to acquisition of plant assets – net	11,021	10,768
Contributions to permanently restricted net assets	7,890	9,311
Net cash used in financing activities	<u>(3,122)</u>	<u>(316)</u>
Net increase in cash and cash equivalents	5,290	16,941
Cash and cash equivalents at beginning of year	89,867	72,926
Cash and cash equivalents at end of year	<u>\$ 95,157</u>	<u>\$ 89,867</u>
Supplemental cash flow information		
Leasehold condominium interest financed with promissory note	\$ –	\$ 26,561

See accompanying notes.

New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements

December 31, 2016

1. Organization and Significant Accounting Policies

Organization

The accompanying consolidated financial statements include the accounts of New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery (the Hospital), HSS ASC of Manhattan, LLC (Manhattan ASC), and HSS Westside ASC, LLC (Westside ASC), but do not include the Hospital's separately incorporated affiliates: HSS Properties Corporation (Properties), The Hospital for Special Surgery Fund, Inc. (Fund); HSS Horizons, Inc. (Horizons); HSS Ventures, Inc.; and Medical Indemnity Assurance Company, Ltd. (MIAC).

In 1998, The Society of the New York Hospital and The Presbyterian Hospital in the City of New York (Presbyterian) merged to form the New York Presbyterian Hospital (NYPH). Subsequently, the Hospital, NYPH and the Joan and Sanford I. Weill Medical College and Graduate School of Medical Sciences of Cornell University (Cornell) agreed to restructure their relationship, prompted in large measure by regulatory and operational issues raised by the addition of Presbyterian, a hospital with an established orthopedics department. The restructuring resulted in a Corporate Relationship Agreement (the Agreement) that reaffirms and continues the Hospital's medical and clinical affiliation with NYPH by permitting and requiring the Hospital to continue to function as the principal orthopedic and rheumatology facility for NYPH at its East 68-East 70 Street facility (East Campus).

Under the Agreement, the Hospital became a membership corporation, with the five Hospital members elected by an NYPH affiliate, subject to specific affiliation guidelines for each of the five member positions that require three of the Hospital members to come from the Hospital's Board of Trustees (with one of the three to also serve on the Board of the NYPH affiliate). The members have the authority to elect the Hospital's Board of Trustees, as nominated by the Governance Committee of the Hospital's Board of Trustees or by a member. As a result of certain procedural elements of the Agreement, the Hospital has not had any significant changes in the nominating process for, or in the composition of, its Board of Trustees. The Agreement did not involve a merger of the institutions and the Hospital's net assets remain under the Hospital's control.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

As part of the restructuring, the Hospital executed an agreement with Cornell that established the orthopedics department at the Hospital as the Department of Orthopedics at Cornell. Additionally, the Hospital, NYPH and Cornell have developed a tri-partite agreement pertaining to the academic affiliation of the institutions, which maintains and enhances the historical clinical and academic relationship among the parties.

Manhattan ASC is a limited liability company organized under the laws of the State of New York. Manhattan ASC was formed in 2014 and will offer outpatient orthopedic surgery services in collaboration with a group of Hospital surgeons. The Hospital owns 51% of Manhattan ASC and the remaining 49% is owned by members of the Hospital's surgical staff. The Hospital has consolidated its non-controlling interests relating to the investment in Manhattan ASC. These non-controlling interests represent the portion of Manhattan ASC not controlled by the Hospital, but are required to be presented in the Hospital's consolidated financial statements. Operations of Manhattan ASC are expected to commence during 2017.

Westside ASC is a limited liability company organized under the laws of the State of New York. Westside ASC was formed in 2016 and will offer outpatient orthopedic surgery services in collaboration with a group of Hospital surgeons. The Hospital owns 67% of Westside ASC and the remaining 33% is owned by certain members of the Hospital's surgical staff. The Hospital has consolidated its non-controlling interests relating to the investment in Westside ASC. These non-controlling interests represent the portion of Westside ASC not controlled by the Hospital, but are required to be presented in the Hospital's consolidated financial statements. Operations of Westside ASC are expected to commence during the fourth quarter of 2018.

In 2016, the Hospital executed a Collaboration Agreement with The Stamford Hospital (SH), an acute care hospital in Stamford, Connecticut, and Stamford Health, Inc. (SHI), the sole member of SH. Under the Collaboration Agreement, the Hospital will manage the SH Department of Orthopedic Surgery, including certain discrete orthopedic space and activities within the main building of SH (which shall be known as HSS Orthopedics at Stamford Hospital, and within SH's Tully Center, which shall be known as HSS Orthopedics at Tully, that SH will operate.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Under the terms of the Collaboration Agreement, only SH-credentialed surgeons employed by or otherwise contractually affiliated with TJA Orthopedic Surgery, P.C. (PC), a New York professional service corporation owned by a designee of the Hospital, will be permitted to perform surgery at HSS Orthopedics at Stamford Hospital and HSS Orthopedics at Tully. Activity of the PC in 2016 was not significant. The PC's activities within HSS Orthopedics at Stamford Hospital and HSS Orthopedics at Tully are expected to commence during 2017.

Cash and Cash Equivalents

The Hospital considers highly liquid financial instruments purchased with a maturity of three months or less, excluding those held in its investment portfolio and assets limited as to use, to be cash equivalents. The Hospital maintains its cash deposits with certain financial institutions. Total deposits maintained at these institutions exceed the amount insured by Federal agencies and, therefore, bear a risk of loss. Cash and cash equivalents includes approximately \$710,000 and \$950,000 of amounts held in escrow for various purposes at December 31, 2016 and 2015, respectively.

Net Patient Service Revenue and Receivables for Patient Care

Net patient service revenue and patient accounts receivable from third-party programs for which the Hospital receives payment under various reimbursement formulae or negotiated rates are stated at the estimated net amounts realizable and receivable from such payors, which are generally less than the Hospital's established billing rates. See Note 2 for additional information relative to third-party payor programs.

The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in health care coverage and other collection indicators. Additions to the allowance for doubtful accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Performance Indicator

The consolidated statements of operations and changes in net assets include operating income as the performance indicator. Excluded from the performance indicator are net assets released from restrictions for capital expenditures, change in net unrealized gains and losses on investments and unrealized losses on securities included in accounts not managed by external parties, change in defined benefit pension and other postretirement plan liability to be recognized in future periods, and operating loss attributable to non-controlling interest in subsidiaries.

Charity Care and Community Benefit

The mission of the Hospital is to provide the highest quality patient care, improve mobility and enhance the quality of life for all and to advance the science of orthopedic surgery, rheumatology and their related fields through research and education. The Hospital does this regardless of race, color, creed, sexual orientation or ethnic origin.

Consistent with its mission, the Hospital invests significant amounts for the benefit of its local, national and international communities through patient care, education, research and other community benefit activities. The calculation of community benefits is consistent with the guidelines prescribed by the Internal Revenue Service.

The Hospital maintains a financial assistance program that provides full or partial uncompensated care to eligible patients. In 2016, the eligibility threshold was increased from 500% to 700% of the Federal Poverty Guidelines, which is in excess of the New York State minimum requirements of 300%. As the collection of amounts determined to qualify as financial assistance is not pursued, such amounts are not reported as a component of net patient service revenue. Costs of providing financial assistance are estimated by multiplying the total charges incurred by the patients that qualify for financial assistance by a ratio of historical expenses to charges as derived from the Hospital's accounting records.

The Hospital also provides health care services to patients with government sponsored means-tested insurance (Medicaid) at amounts less than the estimated costs of those services. Losses from Medicaid insurance are obtained from the Decision Support Accounting System to identify total cost (direct and indirect) in providing patient service to Medicaid and Medicaid Managed Care patients.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

In addition to providing health care services to Medicaid patients at a loss, the Hospital also provides services to Medicare patients at a loss. The loss related to providing services to Medicare patients is calculated in a similar manner as described above for Medicaid patients.

The Hospital is a preeminent provider of education in the field of musculoskeletal medicine for physicians and allied health professionals. The community benefit represents estimated costs in excess of amounts reimbursed by third-party payors such as direct medical education from the Medicare program.

The Hospital is a leader in the advancement of research in musculoskeletal diseases. The Hospital's community benefit in research represents fully allocated amounts used for basic, translational and clinical research from governmental, other not-for-profit and Hospital resources. Community benefit for research is estimated using historical allocation percentages from the Hospital's accounting records.

The Hospital also participates in numerous other community activities, including social service, outreach and education to patients and the general public. The community benefit is derived from actual expenditures, less amounts funded from outside sources.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

The following is a summary of the Hospital's community benefit for providing financial assistance, support of governmental sponsored insurance programs, health professions education, research and other community benefit activities. Amounts for activities as reported below are based on estimated and actual data, subject to changes in estimates upon finalization of the Hospital's cost report and other government filings.

	2016	2015
	<i>(In Thousands)</i>	
Financial assistance (charity care), net (see below)	\$ 8,150	\$ 6,432
Un-reimbursed cost of means-tested government sponsored health care (Medicaid)	22,078	19,263
Health professions education	38,893	37,651
Research	13,383	13,981
Other community benefit activities	6,344	5,277
	88,848	82,604
Un-reimbursed cost of providing Medicare sponsored health care	43,921	38,490
	\$ 132,769	\$ 121,094

Funds received to offset financial assistance provided are included above and totaled approximately \$2.0 million for each of the years ended December 31, 2016 and 2015.

Investments and Investment Income

The Hospital maintains a pooled investment program for certain investments held by the Hospital, Fund and Properties. Investments consist of money market mutual funds, equity mutual funds, including exchange-traded funds, marketable equity securities, fixed income securities, fixed income mutual funds, alternative investments and cash and cash equivalents. All investments are carried at fair value based on quoted market prices (except alternative investments).

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Alternative investments (nontraditional, not readily marketable securities) consist of common collective trust funds, event-driven funds, multi-strategy hedge funds, emerging market debt funds, global hedge funds and private equity funds. Alternative investment interests generally are structured such that the investment pool holds a limited partnership interest or an interest in an investment management company. The investment pool's ownership structure does not provide for control over the related investees and the investment pool's financial risk is limited to the carrying amount reported for each investee, in addition to any unfunded capital commitment. Future funding commitments for alternative investments aggregated approximately \$5.8 million at December 31, 2016 for the investment pool.

Individual investment holdings within the alternative investments include non-marketable and market-traded debt and equity securities and interests in other alternative investments. The investment pool may be exposed indirectly to securities lending, short sales of securities and trading in futures and forward contracts, options and other derivative products. Alternative investments often have liquidity restrictions under which the pooled investment capital may be divested only at specified times. The liquidity restrictions range from approximately one month to thirteen years. Liquidity restrictions may apply to all or portions of a particular invested amount.

Alternative investments included in the investment pool are stated in the accompanying consolidated statements of financial position based upon net asset values derived from the application of the equity method of accounting. Alternative investments held by the defined benefit pension plan are stated in the accompanying consolidated statements of financial position at fair value based upon, as a practical expedient, net asset values derived from the application of the equity method of accounting. Financial information used by the Hospital to evaluate its alternative investments is provided by the investment manager or general partner and includes fair value valuations (quoted market prices and values determined through other means) of underlying securities and other financial instruments held by the investee, and estimates that require varying degrees of judgment. The financial statements of the investee companies are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with the Hospital's annual financial statement reporting.

There is uncertainty in determining values of alternative investments arising from factors such as lack of active markets (primary and secondary), lack of transparency into underlying holdings and time lags associated with reporting by the investee companies. As a result, there is at least a reasonable possibility that estimates will change.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Investment income, including realized, and the net change in unrealized, gains and losses and equity in earnings of alternative investments, earned on permanently and temporarily restricted net assets upon which restrictions have been placed by donors, is added to temporarily restricted net assets or reduces unrestricted net assets in the event a donor restricted endowment fund falls below the level of the original principal donation and related accumulation of temporarily restricted net assets, if any, have been used. This accounting policy is not intended to create a liability of the unrestricted fund (see Note 10). All other investment income is reflected in the accompanying consolidated statements of operations. The net change in unrealized gains and losses is excluded from the performance indicator, unless deemed to be an other than temporary decline in fair value or if the unrealized loss pertains to securities included in accounts managed by external parties, in which case the amount is included within the performance indicator. See Note 3 for additional information relative to investments.

Pledges

Pledges (promises to give) are enforceable, but unsecured and derived from individuals, corporations and foundations. Allowances for uncollectible amounts are provided to reflect pledges at their estimated realizable value based on management's review of individual pledges and historical collection percentages. Outstanding pledges receivable, net of present value allowances (based on a range of interest rates of 0.7% to 4.5%) of approximately \$700,000 at December 31, 2016 and \$1.3 million at December 31, 2015 are due to be collected at December 31 over the following periods:

	2016	2015
	<i>(In Thousands)</i>	
Less than one year	\$ 17,621	\$ 15,507
One to five years	20,709	24,689
Greater than five years	305	298
	38,635	40,494
Less allowance for uncollectible amounts	4,283	4,544
	34,352	35,950
Less current portion	15,507	13,589
	\$ 18,845	\$ 22,361

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use represent assets whose use is restricted for specific purposes under terms of agreements, donor stipulations or are internally designated. Such assets consist of money market mutual funds, fixed income securities and cash and cash equivalents.

Deferred Financing Costs

Deferred financing costs represent costs incurred to obtain financing for construction and renovation projects at the Hospital. Amortization of these costs is provided using the effective interest method over the term of the related debt. The Hospital adopted Accounting Standards Update (ASU) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, retrospectively as required. As a result, unamortized deferred financing costs of \$5.1 million and \$5.7 million at December 31, 2016 and 2015, respectively, have been reported as a direct reduction from long-term debt. Amortization expense was approximately \$571,000 and \$598,000 for the years ended December 31, 2016 and 2015, respectively. In 2015, the Hospital paid and capitalized approximately \$1.6 million and wrote off approximately \$1.7 million of deferred financing costs related to the refinancing of long-term debt. See Note 5 for additional information related to debt-related matters.

Property, Plant and Equipment

Property, plant and equipment purchased are stated at cost and those acquired by gifts and bequests are stated at fair value established at the date of acquisition. The carrying amounts of assets and the related accumulated depreciation and amortization are removed from the accounts when such assets are disposed of and any resulting gain or loss is included in operations. See Note 4 for additional information relative to property, plant and equipment.

Depreciation and Amortization

Depreciation and amortization of all depreciable assets is computed using the straight-line method over the estimated useful life of the asset (ranging from 3 to 40 years) or the lesser of the estimated useful life of the asset or lease term.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital 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 Hospital in perpetuity.

Contributions

Contributions, including unconditional promises to give cash and other assets, are reported at fair value on the date the contribution is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected in temporarily restricted net assets and net assets released from restrictions in the accompanying consolidated financial statements.

Inventories of Supplies

Inventories, consisting mainly of supplies, are stated at the lower of average cost or market determined by the first-in, first-out method.

Assets Held by Related Organizations

The Hospital recognizes its accumulated interest in the unrestricted net assets of Fund as beneficial interest in net assets held by related organization in its consolidated statements of financial position and also recognizes the periodic change in such interest in its consolidated statements of operations and changes in net assets.

New York Society for the Relief of the Ruptured and
Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, such as estimated uncollectible for accounts receivable for services to patients, the fair values of alternative investments, insurance claims liabilities and receivables and estimated receivables from and payables to third-party payors, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. The allowance for doubtful accounts, the fair value of investments that are not readily marketable, insurance claims liabilities and receivables and the estimated net amount due to third-party payors, among other accounts, require significant use of estimates. Actual results could differ from those estimates. Management believes that amounts recorded based on estimates and assumptions are reasonable and any differences between estimates and actual should not have a material effect on the Hospital's consolidated financial position.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The core principle of ASU 2014-09 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 those goods or services. The guidance in ASU 2014-09 supersedes the FASB's current revenue recognition requirements in Accounting Standards Codification Topic 605, *Revenue Recognition*, and most industry-specific guidance. The FASB subsequently issued ASU 2015-14, *Revenue from Contracts with Customers*, which deferred the effective dates of ASU 2014-09. Based on ASU 2015-14, the provisions of ASU 2014-09 are effective for the Hospital for annual periods beginning after December 15, 2017. The Hospital has not completed the process of evaluating the impact of ASU 2014-09 on its consolidated financial statements.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern* (ASU 2014-15), that requires management of public and nonpublic companies to evaluate and disclose where there is substantial doubt about an entity's ability to continue as a going concern. The standard is effective for annual periods ending after December 15, 2016, and for annual periods thereafter. Management adopted ASU 2014-15 for the year ended December 31, 2016. There was no effect on the accompanying consolidated financial statements or disclosures.

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* (ASU 2015-05). ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If certain criteria are met, an entity may account for such an arrangement under the internal use software guidance included in Accounting Standards Codification (ASC) 350-40, *Internal Use Software*, whereby amounts are capitalized. If such criteria are not met, the cloud computing arrangement is considered a service contract and the related costs are expensed as incurred. ASU 2015-05 is effective for public business entities for fiscal years beginning after December 15, 2015 with the option to apply the guidance prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Hospital adopted ASU 2015-05 prospectively as of January 1, 2016 with no effect on the 2016 consolidated financial statements.

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value Per Share (or its Equivalent)* (ASU 2015-07). ASU 2015-07 removes the requirement to categorize within the fair value hierarchy investments for which fair values are estimated using the net asset value practical expedient provided by Accounting Standards Codification 820, *Fair Value Measurement*. Disclosures about investments in certain entities that calculate net asset value per share are limited under ASU 2015-07 to those investments for which the entity has elected to estimate the fair value using the net asset value practical expedient. ASU 2015-07 is effective for entities (other than public business entities) for fiscal years beginning after December 15, 2016, with retrospective application to all periods presented. The Hospital has adopted ASU 2015-07 at December 31, 2016. The adoption of ASU 2015-07 did not have a significant effect on the Hospital's consolidated financial statements.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01). ASU 2016-01 will require business-oriented health care not-for-profit entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value, and recognize any changes in fair value in the performance indicator unless the investments qualify for a new practicability exception. The practicability exception is available for equity investments without readily determinable fair values. Health care not-for-profit entities will no longer be able to recognize unrealized gains and losses on equity securities they classify today as other than trading separately from the performance indicator. The guidance is effective for annual periods beginning after December 15, 2018, and for interim periods within annual periods beginning a year later. Early adoption is permitted for annual periods beginning after December 15, 2017, and interim periods therein. Adoption of ASU 2016-01 will require the Hospital to present the change in unrealized gains and losses on unrestricted investments within the performance indicator.

In February 2016, the FASB issued ASU 2016-02, *Leases* (ASU 2016-02), which will require lessees to report most leases on their statements of financial position and recognize expenses on their income statements in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions. Lessors continue to recognize the underlying asset and recognize lease income on either a straight line or another systematic and rational basis. The provisions of ASU 2016-02 are effective for the Hospital for annual periods beginning after December 15, 2018, and interim periods the following year. Early adoption is permitted. The Hospital has not completed the process of evaluating the impact of ASU 2016-02 on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Financial Statement Presentation* (ASU 2016-14), which eliminates the requirement for not-for-profits (NFPs) to classify net assets as unrestricted, temporarily restricted and permanently restricted. Instead, NFPs will be required to classify net assets as net assets with donor restrictions or without donor restrictions. Among other things, the guidance also modifies required disclosures and reporting related to net assets, investment expenses and qualitative information regarding liquidity. NFPs will also be required to report all expenses by both functional and natural classification in one location. The provisions of ASU 2016-14 are effective for the Hospital for annual periods beginning after December 15, 2017 and interim periods thereafter. Early adoption is permitted. The Hospital has not completed the process of evaluating the impact of ASU 2016-14 on its consolidated financial statements.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

In March 2017, the FASB issued ASU 2017-07, *Compensation—Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU 2017-07). ASU 2017-07 addresses how employers that sponsor defined benefit pension and/or other postretirement benefit plans present the net periodic benefit cost in the income statement. Employers will be required to present the service cost component of net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers will present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating income, if one is presented. The standard is effective for the Hospital for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. Adoption of ASU 2017-07 will require the Hospital to include the service cost component of net periodic benefit cost related to its cash balance defined benefit plan and other postretirement benefit plan (aggregate of approximately \$16.9 million for 2016) within salaries and wages on the consolidated statements of operations and changes in net assets and to present all other components (aggregate of approximately \$9.1 million for 2016) as a separate line item outside of any subtotal of the performance indicator. Net periodic benefit cost is recorded currently as a component of employee benefits on the consolidated statements of operations and changes in net assets.

Tax Status

The Hospital is a Section 501(c)(3) organization exempt from Federal income taxes under Section 501(a) of the Internal Revenue Code and is exempt from New York state and local income taxes. The Manhattan ASC and Westside ASC are New York limited liability companies classified as a partnership for U.S. Federal income tax purposes.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements to conform to the presentation in the 2016 financial statements.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

2. Net Patient Service Revenue and Receivables for Patient Care

Net patient service revenue is reported at the estimated net realizable amounts due from patients; third-party payors and others for services rendered and includes estimated future retroactive revenue adjustments due to ongoing and future audits and reviews. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such adjustments are recorded in future periods as they become known or as years are no longer subject to audits, reviews and investigations. There were no significant prior year settlements and adjustments during 2016 and 2015.

Non-Medicare Reimbursement

In New York State, hospitals and all non-Medicare payors, except Medicaid, workers' compensation and no-fault insurance programs, negotiate hospitals' payment rates. If negotiated rates are not established, payors are billed at hospitals' established charges. Medicaid, workers' compensation and no-fault payors pay inpatient and outpatient hospital rates promulgated by the New York State Department of Health on a prospective payment basis system. Medicaid rate methodologies are subject to approval at the Federal level by the Centers for Medicare and Medicaid Services (CMS), which may routinely request information about such methodologies prior to approval. Revenue related to specific rate components that have not been approved by CMS are not recognized until the Hospital is reasonably assured that such amounts are realizable. Adjustments to the current and prior years' payment rates for those payors will continue to be made in future years.

Medicare Reimbursement

Medicare pays hospitals for most inpatient and outpatient services under its respective national prospective payment systems, and uses other, generally fee schedule based, methodologies for payment for other services. Federal regulations provide for certain adjustments to current and prior years' payment rates, based on industry-wide and Hospital-specific data, including quality measures.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

2. Net Patient Service Revenue and Receivables for Patient Care (continued)

The Hospital has established estimates, based on information presently available, of amounts due to or from Medicare and non-Medicare payors for adjustments to current and prior years' payment rates, based on industry-wide and Hospital-specific data. Such estimates are included in third-party payor liabilities in the accompanying consolidated statements of financial position. Medicare cost reports, which serve as a basis for final settlement with the Medicare program, have been audited by the Medicare fiscal intermediary and settled through 2013. Other years remain open for audit and settlement as are cost reports and other issues related to the New York State Medicaid program for prior years. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount when open years are settled and additional information is obtained. The current Medicaid, Medicare and other third-party payor programs are based upon extremely complex laws and regulations that are subject to interpretation. Noncompliance with such laws and regulations could result in fines, penalties and exclusion from such programs. The Hospital is not aware of any allegations of noncompliance that could have a material adverse effect on the consolidated financial statements and believes that it is in compliance, in all material respects, with all applicable laws and regulations.

There are various proposals at the Federal and State levels that could, among other things, significantly reduce payment rates or modify payment methods. The ultimate outcome of these proposals and other market changes, including the potential effects of health care reform that have been enacted by the Federal and State governments, cannot presently be determined.

Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse effect on the Hospital. Additionally, certain payors' payment rates for various years have been appealed by the Hospital. If the appeals are successful, additional income applicable to those years might be realized.

The Hospital grants credit without collateral to its patients, most of whom are insured under various third-party agreements. The significant concentrations of accounts receivable for services to patients include 11.1% from government-related programs at December 31, 2016 (12.3% from government-related programs at December 31, 2015).

In 2016, approximately 18.4% of the Hospital's net patient service revenue was derived from the Medicare program (approximately 19.4% in 2015).

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

3. Investments and Assets Limited as to Use

The Hospital maintains a pooled investment program for certain investments owned by the Hospital, Fund and Properties. The Hospital's pro rata share of the pooled investment program and its pro rata share of investment income, including realized, and the net change in unrealized gains and losses and equity in earnings of alternative investments, are reflected in the accompanying consolidated financial statements.

Investments, including the pooled investment program pertaining to the Hospital, were as follows at December 31:

	2016	2015
	<i>(In Thousands)</i>	
Money market mutual funds	\$ 139,171	\$ 141,998
Marketable equity securities	22,561	22,539
Equity mutual funds	103,728	97,902
Fixed income mutual funds	24,265	24,121
Fixed income securities	43,267	42,635
Alternative investments:		
Hedge funds:		
U.S. equity large/small cap	31,176	32,703
International equity	17,901	19,378
Long/short equity	65,059	53,724
Multi-strategy	55,872	48,177
Real assets	2,902	2,386
Private equity	12,327	12,095
	518,229	497,658
Less current portion	403,106	391,631
	\$ 115,123	\$ 106,027

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

3. Investments and Assets Limited as to Use (continued)

Additionally, a portion of Fund's investment portfolio represents net assets received by Fund on behalf of the Hospital which are due to the Hospital. These investments and related investment income, including change in net unrealized gains and losses and equity in earnings of alternative investments, are reflected in the accompanying consolidated financial statements within the amounts due from affiliates (approximately \$20.2 million in 2016 and 2015). At December 31, 2016 and 2015, investments include amounts set aside by the Hospital's Board of Trustees for quasi-endowment of approximately \$3.9 million and \$3.7 million. Investment income earned during the year is included in other operating revenue on the consolidated statements of operations and changes in net assets.

The composition of assets limited as to use at December 31, at fair value, is as follows:

	2016	2015
	<i>(In Thousands)</i>	
Money market mutual funds	\$ 33,512	\$ 27,178
Fixed income securities	26,479	25,824
Cash and cash equivalents	9,028	34,464
	69,019	87,466
Less current portion of assets limited as to use	5,625	8,131
	\$ 63,394	\$ 79,335

	2016	2015
	<i>(In Thousands)</i>	
Mortgage reserve funds	\$ 26,626	\$ 25,944
Equipment loans	9,028	34,464
Restricted assets – future campus expansion	33,365	27,058
	69,019	87,466
Less current portion of assets limited as to use	5,625	8,131
	\$ 63,394	\$ 79,335

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

4. Property, Plant and Equipment

A summary of property, plant and equipment is as follows at December 31:

	<u>2016</u>	<u>2015</u>
	<i>(In Thousands)</i>	
Land and land improvements	\$ 2,006	\$ 2,006
Buildings and improvements	598,089	570,522
Furniture and equipment	469,749	360,751
	<u>1,069,844</u>	<u>933,279</u>
Less accumulated depreciation and amortization	573,428	514,492
	<u>496,416</u>	<u>418,787</u>
Construction-in-progress	39,259	72,278
	<u>\$ 535,675</u>	<u>\$ 491,065</u>

At December 31, 2016, the Hospital had capital commitments of approximately \$41.0 million related to construction and renovation projects, information technology, and certain other capital projects.

In 2016, the Hospital removed from its accounts, furniture and equipment with a historical cost of approximately \$306,000, which was fully depreciated and no longer in use.

Rent expense, the majority of which is paid to Properties, was approximately \$40.2 million in 2016 and \$35.7 million in 2015.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

5. Debt-Related Matters

Long-Term Debt

Long-term debt consisted of the following at December 31:

	2016	2015
	<i>(In Thousands)</i>	
Insured mortgage loan (2009) ^(a)	71,544	73,324
Insured mortgage loan (2011) ^(b)	\$ 38,598	\$ 44,125
Insured mortgage loan (2015) ^(c)	41,399	43,522
Promissory note ^(d)	23,516	25,577
Commercial mortgage loan ^(e)	3,166	4,572
Manhattan ASC – Construction Loan ^(f)	1,967	–
Tax-exempt loans ^(g)	114,635	125,738
	294,825	316,858
Less unamortized deferred financing costs	5,080	5,651
	289,745	311,207
Unamortized mortgage premium, net of accumulated amortization of \$1,801 in 2016 (\$1,503 in 2015)	1,107	1,405
Less current portion of long-term debt	41,653	39,852
	\$ 249,199	\$ 272,760

^(a) The Hospital's 2009 mortgage loan is insured under the provisions of the FHA 241 program.

The mortgage loan bears interest at a rate of 6.03% per annum, reduced from 6.08% following the final endorsement of the mortgage loan on September 17, 2015. Monthly principal and interest payments of approximately \$513,000 are due during each of the ensuing 20 years, with final payment due no later than January 1, 2037. The mortgage loan may be prepaid after August 15, 2019. The mortgage loan is collateralized by certain of the Hospital's property and equipment.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

5. Debt-Related Matters (continued)

The provisions of the loan and related agreements required the Hospital to establish and maintain a mortgage reserve fund. The mortgage reserve fund approximated \$5.3 million and \$4.0 million at December 31, 2016 and 2015, respectively (see mortgage reserve funding requirements below). The Hospital is also required to maintain specified current, debt service coverage, and other financial ratios. At December 31, 2016 and 2015, the Hospital met the various financial ratio and mortgage reserve requirements.

- (b) The Hospital's 2011 mortgage loan is insured under the provisions of the Federal Housing Administration (FHA) 242 Program.

The mortgage loan bears interest at an annual rate of 3.835%. Monthly principal and interest payments of approximately \$594,000 are due, with final payment due no later than January 1, 2023. The mortgage loan may be prepaid at any time after June 30, 2021. The mortgage loan is collateralized by certain of the Hospital's property and equipment. The mortgage premium is being amortized over the remaining term of the loan using the effective interest method.

The provisions of the loan and related agreements require the Hospital to establish and maintain a mortgage reserve fund and to maintain specified current debt service coverage, and other financial ratios. The mortgage reserve fund approximated \$14.0 million and \$14.8 million at December 31, 2016 and 2015, respectively (see mortgage reserve funding requirements below). At December 31, 2016 and 2015, the Hospital met the various financial ratio and mortgage reserve funding requirements.

- (c) In October 2005, the Hospital entered into an approximate \$57.6 million mortgage loan agreement with the New York State Dormitory Authority (the Dormitory Authority) to finance a portion of the Hospital's major expansion and renovation project. The mortgage loan is insured under the provisions of the FHA 241 Program.

In April 2015, the mortgage loan was refinanced. As a result, the total principal of the loan was reduced by approximately \$500,000 and the annual interest rate of 4.80% was reduced to 3.17%. The Hospital recorded a gain on refinancing of long-term debt of approximately \$383,000, which is included as a component of interest expense in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015. Monthly principal and interest payments of approximately

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

5. Debt-Related Matters (continued)

\$289,000 are due during each of the ensuing 16 years, with final payment due no later than December 31, 2031. The mortgage loan may be prepaid at any time after May 31, 2022. The mortgage loan is collateralized by certain of the Hospital's property and equipment. This refinancing did not change the loan's status as an insured loan under the FHA 241 Program.

The provisions of the loan and related agreements require the Hospital to establish and maintain a mortgage reserve fund. The mortgage reserve fund approximated \$7.3 million and \$7.1 million at December 31, 2016 and 2015, respectively (see mortgage reserve funding requirements below). The Hospital is also required to maintain specified current, debt service coverage, and other financial ratios. At December 31, 2016 and 2015, the Hospital met the various financial ratio and mortgage reserve funding requirements.

- (d) In January 2015, the Hospital entered into an approximate \$26.6 million promissory note agreement to finance a portion of the purchase of a leasehold condominium interest. The note bears interest at a rate of 6.0% per annum. Monthly principal and interest payments of approximately \$295,000 are due, with final payment due no later than July 1, 2025. The note can be prepaid at any time without penalty.
- (e) The commercial mortgage loan is collateralized by a first mortgage lien on the Caspary Building and also by marketable securities held by the Hospital and Fund (having a total fair value of approximately \$4.0 million at December 31, 2016), which have been pledged to reduce the interest rate. The variable interest rate is reduced to the extent that there is additional investment collateral pledged to the bank. The variable interest is calculated based on the bank's quarterly money market rates, plus 65 basis points (1.17% at December 31, 2016). The provisions of the mortgage loan require that the Hospital maintain specified financial ratios. As of December 31, 2016 and 2015, the Hospital met the various financial ratio requirements.
- (f) In May 2016, Manhattan ASC entered into a loan agreement with a commercial bank to borrow a total of \$15.75 million (\$14.50 million Project Loan for construction and equipment, and \$1.25 million Working Capital Loan). The Hospital has guaranteed its proportionate share (51%) of the debt. The loans are expected to be fully drawn by the end of 2017.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

5. Debt-Related Matters (continued)

For a period of up to two years from date of closing (the Draw Period), interest only payments are due on amounts drawn. Interest is charged at a variable rate equal to one month LIBOR plus 140 basis points during the Draw Period. At the end of the Draw Period, the Project Loan can be converted to an eight or ten year term loan and the working capital loan can be converted to a five year term loan. Interest on the term loans is fixed at the then 10 year U.S. Treasury rate plus 140 basis points for the Project Loan and the 5 year U.S. Treasury rate plus 140 basis points for the working capital loan.

^(g) The Hospital has balances outstanding under tax-exempt financing agreements under the Dormitory Authority Tax-Exempt Leasing Program relating primarily to investments in information technology and equipment purchases with some associated construction and soft costs. The following is a summary of the loans, for which the related equipment serves as collateral:

Origination Year	Original Loan Amount	Monthly Principal and Interest Payments	Fixed Interest Rates	Final Payment
2011	\$ 16.0 million	\$ 234,465	1.78%	July 2017
2012	22.0 million	316,195	1.16	October 2018
2013	26.0 million	375,802	1.32	July 2019
2014	28.0 million	403,571	1.24	May 2020
2014	62.4 million	916,608	1.86	August 2021
2015	18.0 million	260,664	1.43	June 2021
2016	20.0 million	287,058	1.10	June 2022

Interest paid on all debt was approximately \$10.7 million and \$10.8 million in 2016 and 2015, respectively. Capitalized interest was approximately \$92,000 and \$1.9 million in 2016 and 2015, respectively.

New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

5. Debt-Related Matters (continued)

Annual principal payments on all debt, mortgage premium amortization and required mortgage reserve funding for each of the next five years and thereafter are as follows:

	Principal Payments	Mortgage Premium Amortization	Total	Mortgage Reserve Funding Requirements
	<i>(In Thousands)</i>			
2017	\$ 41,387	\$ 266	\$ 41,653	\$ 1,333
2018	43,091	232	43,323	1,128
2019	37,976	197	38,173	1,179
2020	33,117	160	33,277	1,230
2021	26,782	123	26,905	1,282
Thereafter	112,472	129	112,601	1,128
Total obligations	<u>\$ 294,825</u>	<u>\$ 1,107</u>	<u>\$ 295,932</u>	<u>\$ 7,280</u>

In July 2015, the Hospital entered into revolving loan agreements with a commercial bank for two lines of credit (the Lines), which are unsecured, for \$25.0 million and \$50.0 million. The Lines are intended for general working capital needs and to provide additional funding, if needed, for temporary cash flow interruptions relating to certain information technology projects. No amounts have been drawn in 2016 and 2015. The \$25.0 million line of credit expires July 30, 2017 and the \$50.0 million line of credit was cancelled in August 2016.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

6. Other Operating Revenue

A summary of the components of other operating revenue is as follows for the years ended December 31:

	2016	2015
	<i>(In Thousands)</i>	
Physician practice revenue and overhead recovery	\$ 135,633	\$ 126,246
Investment income (interest and dividends)	3,664	3,504
Net realized gains on investments	219	5,089
Operating component of change in net unrealized gains and losses on investments and equity in earnings of alternative investments	1,125	196
Royalty income	3,425	683
Rebates and discounts	2,397	1,530
Dietary income	1,065	1,016
Other	6,242	6,874
	\$ 153,770	\$ 145,138

7. Insurance Coverage

The Hospital maintained commercial insurance for professional and general liabilities prior to March 1976 and for workers' compensation coverage prior to March 1980. Subsequent to those dates, those coverages have been purchased by the Hospital from commercial carriers that reinsure the majority of the primary portions of such coverages with MIAC, a Cayman Islands corporation organized by the Hospital in 1981 and licensed under Cayman Islands law to conduct an insurance business. Effective June 15, 2003, MIAC commenced to directly insure a buffer layer between the primary and excess positions of certain of such coverages. MIAC also reinsures the primary professional liability coverage of the majority of Hospital physicians and directly insures a buffer layer above the primary portion of such coverage. The Hospital, which in March 1981 had purchased for \$10,000 all of the outstanding stock of MIAC, transferred its interest in MIAC to the Hospital's affiliate, Fund as of January 1, 1985.

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

7. Insurance Coverage (continued)

The Hospital has guaranteed payment of certain of MIAC's obligations related to MIAC's existing professional, general liability and workers' compensation reinsurance commitments to the extent that MIAC's insurance liabilities might require such support.

MIAC's insurance liabilities, which have been evaluated by an independent actuarial firm, approximated \$105.5 million at December 31, 2016 and \$106.1 million at December 31, 2015. Total assets were approximately \$120.8 million and \$120.4 million at December 31, 2016 and 2015, respectively. Underwriting income approximated \$20.6 million and \$23.7 million for 2016 and 2015, respectively. MIAC's net operating results in 2016 and 2015 were not significant.

In the accompanying consolidated financial statements, the Hospital has recognized estimated discounted professional claims liabilities, certain workers' compensation claims liabilities, and insurance recovery receivables of approximately \$73.1 million (approximately \$11.7 million current and \$61.4 million long term) as of December 31, 2016, and approximately \$78.5 million (approximately \$17.1 million current and \$61.4 million long term) as of December 31, 2015.

8. Benefit Plans

The Hospital maintains a noncontributory cash balance defined benefit pension plan (the Plan) that covers certain employees of the Hospital and its affiliates. The Hospital's funding policy is to contribute amounts to the Plan sufficient to meet the minimum funding requirements pursuant to the Employee Retirement Income Security Act of 1974, plus such additional amounts as the Hospital may deem appropriate from time to time.

Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. At December 31, 2016, the assets of the Plan consist primarily of money market mutual funds, equity mutual funds, and alternative investments.

In 2009, the Hospital amended the Plan to implement a "soft freeze" effective January 1, 2010. Any new employees hired after October 15, 2009 are not eligible to participate in the Plan. In addition, existing employees had the option to remain active in the Plan or freeze their status, with new benefits accruing to a new defined contribution plan effective January 1, 2010. The soft freeze did not constitute a curtailment of the Plan.

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Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

In addition to providing pension benefits, the Hospital provides certain health care benefits for certain retired employees through a postretirement plan. The Hospital accrues the obligation to provide postretirement health care and other welfare benefits during the years in which employees provide service and funds such benefits on a pay-as-you-go basis.

The Hospital recognizes the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of the defined benefit and postretirement benefit plans in its consolidated statements of financial position.

Net actuarial losses and the net prior service costs at the reporting date will be subsequently recognized in the future as net periodic benefit cost pursuant to the Hospital's accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of unrestricted net assets.

Included in other changes in unrestricted net assets at December 31, 2016 and 2015 are the following amounts that have not yet been recognized in net periodic benefit cost:

	2016	2015
	<i>(In Thousands)</i>	
Net actuarial loss recognized in unrestricted net assets	\$ (147,501)	\$ (143,324)
Net prior service cost recognized in unrestricted net assets	-	(38)
	\$ (147,501)	\$ (143,362)

The actuarial loss and prior service cost included in other changes in unrestricted net assets at December 31, 2016 and expected to be recognized in net periodic benefit cost during the year ending December 31, 2017 are as follows (in thousands):

Net actuarial loss recognized in unrestricted net assets	\$ 8,206
	\$ 8,206

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Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

The following tables provide a reconciliation of the changes in each of the plans' projected benefit obligations and fair value of plan assets as of December 31:

	Pension Plan		Postretirement Plan	
	2016	2015	2016	2015
	<i>(In Thousands)</i>			
Reconciliation of the projected benefit obligation				
Obligation at beginning of year	\$ 319,828	\$ 301,562	\$ 5,408	\$ 6,240
Service cost	16,884	16,272	63	92
Interest cost	13,968	12,031	204	217
Actuarial loss (gain)	11,366	286	(78)	(781)
Benefit payments, net	(10,796)	(10,323)	(299)	(360)
Obligation at end of year	<u>\$ 351,250</u>	<u>\$ 319,828</u>	<u>\$ 5,298</u>	<u>\$ 5,408</u>
Reconciliation of fair value of plan assets				
Fair value of plan assets at beginning of year	\$ 206,256	\$ 196,188	\$ —	\$ —
Actual return on plan assets	11,743	(1,609)	—	—
Employer contributions	28,900	22,000	299	360
Plan participants' contributions	—	—	373	392
Benefit payments	(10,796)	(10,323)	(672)	(752)
Fair value of plan assets at end of year	<u>\$ 236,103</u>	<u>\$ 206,256</u>	<u>\$ —</u>	<u>\$ —</u>

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Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

The following table provides the amounts recognized as liabilities in the consolidated statements of financial position at December 31:

	Pension Plan		Postretirement Plan	
	2016	2015	2016	2015
	<i>(In Thousands)</i>			
Funded status				
Unfunded status at end of year	\$ (115,147)	\$ (113,572)	\$ (5,298)	\$ (5,408)

The following table provides the components of the net periodic benefit cost for each of the plans for the years ended December 31:

	Pension Plan		Postretirement Plan	
	2016	2015	2016	2015
	<i>(In Thousands)</i>			
Service cost – benefits earned during the year	\$ 16,884	\$ 16,272	\$ 63	\$ 92
Interest cost on projected benefit obligations	13,968	12,031	204	217
Expected return on plan assets	(13,996)	(13,703)	–	–
Amortization of prior service cost	38	67	–	–
Recognized actuarial loss	8,650	9,962	264	340
Net periodic benefit cost	\$ 25,544	\$ 24,629	\$ 531	\$ 649

The accumulated benefit obligation for the Plan as of December 31, 2016 and 2015 was approximately \$350.9 million and \$319.3 million, respectively.

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Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

Prior service costs are amortized on a straight-line basis over the average remaining service period to full retirement eligibility of active participants. Gains and losses in excess of 10% of the greater of the benefit obligations and the market-related value of assets are amortized over the average remaining service period of active participants. The weighted-average assumptions used in the measurement of the Hospital's benefit obligations at December 31 were:

	Pension Plan		Postretirement Plan	
	2016	2015	2016	2015
Discount rate	4.30%	4.50%	3.80%	3.90%
Rate of increase in compensation levels	3.70	3.50	–	–

The actuarial loss in 2016 primarily relates to a higher discount rate and investment losses partially offset by an updated mortality assumptions used to measure the projected benefit obligation.

The weighted-average assumptions used in the measurement of the Hospital's net periodic benefit cost for the years ended December 31 were as follows:

	Pension Plan		Postretirement Plan	
	2016	2015	2016	2015
Discount rate	4.50%	4.10%	3.90%	3.60%
Expected long-term rate of return on plan assets	6.50	7.00	–	–
Rate of increase in compensation levels	3.50	4.00	–	–

The Plan's weighted-average asset allocations at December 31, 2016 and 2015, by asset category, are as follows:

	2016	2015
Asset category:		
Money market mutual funds	8%	6%
Equity mutual funds	11	12
Fixed income mutual funds	40	41
Alternative investments	41	41
Total	100%	100%

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

To develop the expected long-term rate of return on plan assets assumption, the Hospital considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The defined benefit pension plan's investment objectives are to achieve long-term growth in excess of long-term inflation and to provide a rate of return that meets or exceeds the expected long-term rate of return on Plan assets over a long-term time horizon. In order to minimize the risk, the Plan aims to minimize the variability in yearly returns. The Plan also aims to diversify its holding among sectors, industries, and companies.

The assets of the Plan are managed in accordance with the Employee Retirement Income Security Act of 1974. The assets of the Plan are measured at fair value in accordance with the policies discussed in Note 1. Refer to Note 16 for fair value measurement information related to the defined benefit plan asset categories noted in the table above.

The Hospital expects to make contributions of approximately \$31.5 million and \$300,000 to the Pension Plan and Postretirement Plan, respectively, during 2017.

Benefit payments, which reflect expected future benefit accruals, as appropriate, are expected to be paid as follows:

	Pension Plan	Postretirement Plan
	<i>(In Thousands)</i>	
2017	\$ 23,172	\$ 330
2018	12,859	347
2019	13,036	356
2020	13,655	365
2021	13,686	374
2022 to 2026	83,889	1,876

New York Society for the Relief of the Ruptured and Crippled, Maintaining the Hospital for Special Surgery

Notes to Consolidated Financial Statements (continued)

8. Benefit Plans (continued)

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement plans. A 1% change in assumed health care cost trend rates would have the following effects relating to the postretirement plans:

	2016		2015	
	1% Increase	1% Decrease	1% Increase	1% Decrease
	<i>(In Thousands)</i>			
Effect on total of service and interest cost components of net periodic postretirement benefit cost	\$ 1	\$ (1)	\$ 1	\$ (1)
Effect on the health care component of the accumulated postretirement benefit obligation	4	(9)	4	(8)

The Hospital also provides pension benefits to certain employees through a defined contribution plan. Pension expense related to this plan was approximately \$11.3 million and \$10.1 million for the years ended December 31, 2016 and 2015, respectively.

9. Functional Expenses

The Hospital provides musculoskeletal health care and related services, including research and graduate medical education. It is not practicable to separately identify the expenses relating to each of the Hospital's programs. Expenses related to primary services were as follows:

	Year Ended December 31	
	2016	2015
	<i>(In Thousands)</i>	
Health care and related services	\$ 869,815	\$ 817,548
General and administrative	121,244	87,832
Research operations	41,035	39,006
	<u>\$ 1,032,094</u>	<u>\$ 944,386</u>

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Notes to Consolidated Financial Statements (continued)

10. Permanently Restricted Net Assets

Permanently restricted net assets are restricted as follows at December 31:

	2016	2015
	<i>(In Thousands)</i>	
Assets to be held in perpetuity, the income from which is restricted for research	\$ 95,844	\$ 90,547
Assets to be held in perpetuity, the income from which is restricted for other specific purposes	35,514	32,921
Assets to be held in perpetuity, the income from which is unrestricted as to use	410	410
	\$ 131,768	\$ 123,878

Changes in endowment investments for the year ended December 31, 2016 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Endowment investments, beginning balance	\$ 5,797	\$ 49,752	\$ 117,099	\$ 172,648
Total investment return	700	8,559	–	9,259
(Transfers) contributions	–	(250)	9,095	8,845
Appropriation of endowment investments for expenditure	(72)	(7,531)	–	(7,603)
Endowment investments, ending balance	\$ 6,425	\$ 50,530	\$ 126,194	\$ 183,149

New York Society for the Relief of the Ruptured and
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Notes to Consolidated Financial Statements (continued)

10. Permanently Restricted Net Assets (continued)

Changes in endowment investments for the year ended December 31, 2015 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Endowment investments, beginning balance	\$ 5,707	\$ 51,542	\$ 109,807	\$ 167,056
Total investment return	158	4,023	–	4,181
Contributions	–	1,000	7,292	8,292
Appropriation of endowment investments for expenditure	(68)	(6,813)	–	(6,881)
Endowment investments, ending balance	<u>\$ 5,797</u>	<u>\$ 49,752</u>	<u>\$ 117,099</u>	<u>\$ 172,648</u>

Permanently restricted net assets represent endowments that have been restricted by donors to be maintained in perpetuity. Quasi-endowment represents amounts set aside by the Hospital's Board of Trustees for certain internally designated purposes. The Hospital follows the requirements of the New York Prudent Management of Institutional Funds Act (NYPMIFA) passed into law effective September 2010, as they relate to its permanently restricted net assets. The Hospital has interpreted NYPMIFA as requiring the preservation of the fair value of the original gift, as of the gift date, of the donor-restricted endowment fund absent explicit donor stipulations to the contrary. The Hospital classifies as permanently restricted net assets the original value of the gifts donated to the permanent endowment and the original value of subsequent gifts to the permanent endowment. Returns on the permanent endowment are used in accordance with the direction of the applicable donor gift. Returns on permanently restricted net assets are classified as temporarily restricted net assets until the amounts are appropriated for expenditure in accordance with a manner consistent with the standard of prudence prescribed by NYPMIFA. In accordance with NYPMIFA, the Hospital considers 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 purposes of the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effects of inflation and deflation; (5) where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution; (6) the expected total return from

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Notes to Consolidated Financial Statements (continued)

10. Permanently Restricted Net Assets (continued)

income and the appreciation of investments; (7) other resources of the Hospital; and (8) the investment and spending policies of the Hospital. The Hospital has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment.

Under Hospital policy, as approved by the Board of Trustees, the endowment assets are invested in a manner to provide that sufficient assets are available as a source of liquidity for the intended use of the funds, achieve the optimal return possible within the specified risk parameters, prudently invest assets in a high-quality diversified manner and adhere to the established guidelines.

To satisfy its long-term rate-of-return objectives, the Hospital relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Hospital targets a diversified allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The Hospital's permanently restricted endowment funds are managed according to endowment and similar fund policies that guide investment of donations, spending and distribution of total return investment income. The policies also provide the guidelines for setting the annual endowment spend rate (5% for 2016 and 2015 or income if the fair value is below the original endowment donation) and the treatment of any investment returns in excess of the annual spending rate. The 5% endowment spend rate is calculated on the year-end average three-year rolling fair value of each endowed fund. Any excess investment returns beyond the spending rate, to the extent available, are added to temporarily restricted funds and classified appropriately.

The Hospital distributes the investment income earned on the endowment funds as required for the donor-restricted purpose of the endowment assets held in perpetuity.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level of the original principal donation. There are no significant deficiencies of this nature that are reported in unrestricted net assets as of December 31, 2016 and 2015.

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Notes to Consolidated Financial Statements (continued)

11. United States Public Health Service Research Grants

Expenditures and overhead allocations charged to United States Public Health Service research grants are subject to audit by the funding agencies. It is management's opinion that adjustments, if any, will not be materially different from recorded amounts. The revenue from these grants is included in net assets released from restrictions for research operations.

12. Bicknell Trust

The Hospital's institutional research funds are the beneficiary of income from the Bicknell Trust. The fair value of investments in the trust was approximately \$35.7 million and \$34.7 million at December 31, 2016 and 2015, respectively. Income received from this trust was approximately \$1.8 million and \$1.9 million in 2016 and 2015, respectively, and is recorded directly in the research funds (temporarily restricted net assets).

13. Bequest

The Hospital is a beneficiary of a charitable trust (the Trust) established by certain donors (the Donors). Under the terms of the Trust agreement, the Hospital received distributions from the Trust upon the death of the Donors (which has occurred), finalization of the probate administration process and upon settlement of certain other matters. In 2016 and 2015, the Hospital received distributions and recorded revenue from the Trust of approximately \$985,000 and \$6.7 million, respectively. The Hospital received the final distribution in 2016.

14. Transactions With Affiliates

Fund is a not-for-profit corporation organized under the Not-for-Profit Corporation Law of the State of New York for the purpose of supporting the charitable, educational, and scientific purposes of the Hospital and other related health care organizations.

Fund and Properties purchase certain administrative, general and plant services from the Hospital. Amounts charged for these services (approximately \$5.1 million and \$5.0 million in 2016 and 2015, respectively) are determined principally on the basis of allocated costs. Fund provides certain fundraising services to the Hospital valued at approximately \$5.9 million in 2016 and \$6.3 million in 2015, respectively. The methodology used to allocate costs is based on a formula of historical contributions received. Amounts due to and from the Hospital for these

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Notes to Consolidated Financial Statements (continued)

14. Transactions With Affiliates (continued)

services are reimbursed in the normal course of business. Additionally, Properties leases various facilities to the Hospital. Rental expense under these arrangements amounted to approximately \$39.0 million and \$34.5 million for the years ended December 31, 2016 and 2015, respectively.

At December 31, amounts due from the Hospital's affiliates are as follows:

	2016	2015
	<i>(In Thousands)</i>	
Fund	\$ 1,493	\$ 1,213
Properties	136	432
Horizons	3,421	3,281

Certain lease agreements entered into between the Hospital and Properties in 2016 include tenant improvement allowances to be used for future renovations. The tenant improvement allowances will be amortized over the life of the leases as a reduction of rental expense. In accordance with the lease agreements, the Hospital will be reimbursed by Properties for renovation expenditures. Amounts to be reimbursed by Properties are recorded as a tenant improvement receivable. The balance of the tenant improvement receivable, which is included as a component of other receivables on the accompanying consolidated balance sheet, is approximately \$12.2 million at December 31, 2016. The balance of the leasehold incentive liability, which is included as a component of current and noncurrent other liabilities on the accompanying consolidated balance sheet, is approximately \$11.2 million at December 31, 2016.

In addition to the amounts above (and as discussed in Note 3), a portion of Fund's investment portfolio represents net assets received by Fund on behalf of the Hospital which are due to the Hospital (approximately \$20.2 million in 2016 and 2015).

Amounts due to and from affiliates generally are not interest-bearing, except for the amount due from Horizons, for which interest is charged at the prime rate.

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Notes to Consolidated Financial Statements (continued)

14. Transactions With Affiliates (continued)

Following is a summary of consolidated financial information for Fund as of December 31, 2016 and 2015 and for the years then ended:

	<u>2016</u>	<u>2015</u>
	<i>(In Thousands)</i>	
Total assets	<u>\$ 323,509</u>	<u>\$ 285,527</u>
Total liabilities	<u>\$ 219,122</u>	<u>\$ 194,213</u>
Total net assets (unrestricted)	<u>\$ 104,387</u>	<u>\$ 91,314</u>
Operating revenue	<u>\$ 78,046</u>	<u>\$ 76,922</u>
Operating expenses	<u>\$ 66,396</u>	<u>\$ 63,541</u>

The Hospital is not responsible for the debts or obligations of its affiliates, nor are such affiliates responsible for the debts or obligations of the Hospital other than as disclosed in Notes 5 and 7.

15. Contingencies

The Hospital is a defendant in certain legal actions arising out of the normal course of its operations, the final outcome of which cannot presently be determined. Hospital management is of the opinion that the ultimate liability, if any, with respect to all of these matters will not have a material effect on the Hospital's consolidated financial position.

16. Fair Value Measurements

For assets and liabilities required to be measured at fair value, the Hospital measures fair value based on 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. Fair value measurements are applied based on the unit of account from the Hospital's perspective.

The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

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Notes to Consolidated Financial Statements (continued)

16. Fair Value Measurements (continued)

The Hospital follows a valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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.

Level 2 – Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

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 Hospital uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

Financial instruments, excluding the defined benefit plan assets, carried at fair value as of December 31, 2016 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Cash and cash equivalents	\$ 104,185	\$ –	\$ –	\$ 104,185
Marketable equity securities ^(a)	22,561	–	–	22,561
Money market mutual funds ^(b)	172,683	–	–	172,683
Equity mutual funds ^(c)	103,728	–	–	103,728
Fixed income mutual funds ^(d)	24,265	–	–	24,265
Fixed income securities ^(e)	69,746	–	–	69,746
	\$ 497,168	–	–	\$ 497,168

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Notes to Consolidated Financial Statements (continued)

16. Fair Value Measurements (continued)

Financial instruments, excluding the defined benefit plan assets, carried at fair value as of December 31, 2015 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Cash and cash equivalents	\$ 124,329	\$ —	\$ —	\$ 124,329
Marketable equity securities ^(a)	22,539	—	—	22,539
Money market mutual funds ^(b)	169,176	—	—	169,176
Equity mutual funds ^(c)	97,902	—	—	97,902
Fixed income mutual funds ^(d)	24,121	—	—	24,121
Fixed income securities ^(e)	68,459	—	—	68,459
	\$ 506,526	—	—	\$ 506,526

The Hospital's alternative investments, excluding alternative investments in the defined benefit plan, of approximately \$185.2 million and \$168.5 million at December 31, 2016 and 2015, respectively, are reported using the equity method of accounting and, therefore, are not included in the table above (see Note 1).

Defined benefit plan assets, carried at fair value as of December 31, 2016 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Money market mutual funds ^(b)	\$ 20,013	\$ —	\$ —	\$ 20,013
Equity mutual funds ^(c)	25,475	—	—	25,475
Fixed income mutual funds ^(d)	94,218	—	—	94,218
	\$ 139,706	—	—	139,706
Alternative investments measured at net asset value:				
Hedge funds ^(f)				93,390
Private equity ^(g)				3,007
				\$ 236,103

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Notes to Consolidated Financial Statements (continued)

16. Fair Value Measurements (continued)

Defined benefit plan assets, carried at fair value as of December 31, 2015 are classified in the table below in one of the three categories described above:

	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Money market mutual funds ^(b)	\$ 11,884	\$ —	\$ —	\$ 11,884
Equity mutual funds ^(c)	24,012	—	—	24,012
Fixed income mutual funds ^(d)	85,012	—	—	85,012
	120,908	—	—	120,908
Alternative investments measured at net asset value:				
Hedge funds ^(f)				82,262
Private equity ^(g)				3,086
				\$ 206,256

^(a)Includes large cap common stock of corporations primarily domiciled in the United States.

^(b)Includes investments in mutual funds that invest primarily in short-term debt securities, including U.S. Treasury bills, commercial paper and certificates of deposit.

^(c)Includes investments in domestic and international equity mutual funds and exchange traded funds.

^(d)Investment in a fixed income mutual fund that maintains a diverse portfolio of short-term high quality bonds actively managed across the mortgage backed security, U.S. Treasury, corporate and international fixed income sectors.

^(e)Fixed income securities, consisting of credit mortgage and asset backed securities and U.S. Government obligations.

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Notes to Consolidated Financial Statements (continued)

16. Fair Value Measurements (continued)

^(f) Consists of the following:

- Hedge funds and common collective trust funds of common stock of corporations primarily domiciled in the United States.
- Hedge funds of common stock of corporations primarily domiciled outside of the United States, including emerging market countries.
- Hedge fund investments consisting primarily of publicly traded equity holdings with both long and short positions.
- Hedge fund investments which are designed to provide returns largely independent of overall market movement, with lower correlations to domestic stock and bond markets. Underlying strategies can include credit, event driven, relative value and various arbitrage strategies.

^(g) Venture capital, buyout and distressed debt partnerships.

The following is a description of the Hospital valuation methodologies for assets measured at fair value. Fair value for Level 1 is based upon quoted market prices. 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 Hospital 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.

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Notes to Consolidated Financial Statements (continued)

16. Fair Value Measurements (continued)

The following is a summary of investments, including alternative investments reported using the equity method and the nature of restrictions on the Hospital's ability to redeem its investments at the measurement date, any unfunded capital commitments and investments strategies of the investees as of December 31, 2016, including the defined benefit plan:

	Carrying Value	Unfunded Commitments	Redemption Notice Period	Funds Availability
	<i>(In Thousands)</i>			
U.S. equity large/small cap	\$ 46,039	\$ n/a	0 days – 30 days	1 month to 2 years
International equity	29,456	n/a	14 days – 120 days	1 week to 0.5 years
Long/short equity	108,333	n/a	45 days – 180 days	1 month to 2 years
Multi-strategy	79,570	n/a	60 days – 120 days	6 months to 1 year
Real assets	2,902	n/a	0 days – 45 days	3 months to 6 months
Private equity	15,334	5,225	none	9 months to 12 years
	<u>\$ 281,634</u>	<u>\$ 5,225</u>		

The carrying values and fair values (net of deferred financing costs) of the Hospital's financial instruments that are not required to be carried at fair value are as follows at December 31:

	2016		2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	<i>(In Thousands)</i>			
Long-term debt, including unamortized mortgage premium	\$ 296,966	\$ 290,852	\$ 326,450	\$ 312,612

The fair value of the Hospital's long-term debt is based on discounted cash flow analyses, using current borrowing rates for similar types of debt and is classified as Level 2 within the valuation hierarchy.

17. Events Subsequent to December 31, 2016

Subsequent events have been evaluated through March 31, 2017, which is the date the consolidated financial statements were issued. No subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.

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