Baystate Health, Inc. and Subsidiaries

Consolidated Financial Statements as of and
for the Years Ended September 30, 2013 and 2012,
and Independent Auditors' Report

Baystate Health, Inc. and Subsidiaries

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Deloitte & Touche LLP
200 Berkeley Street
Boston, MA 02116
USA

Tel: +1 617 437 2000
Fax: +1 617 437 2111
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Baystate Health, Inc.:

We have audited the accompanying consolidated financial statements of Baystate Health, Inc. and Subsidiaries ("Baystate Health"), which comprise the consolidated statements of financial position as of September 30, 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Baystate Health, Inc. and Subsidiaries as of September 30, 2013, and the results of their operations, their changes in net assets, and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Predecessor Auditors' Opinion on 2012 Financial Statements

The financial statements of Baystate Health as of and for the year ended September 30, 2012, were audited by other auditors whose report, dated January 3, 2013, expressed an unmodified opinion on those statements.

Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, Baystate Health adopted the provisions of Accounting Standards Update (ASU) No. 2011-07, *Health Care Entities (Topic 954*), *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, on October 1, 2012. Our opinion is not modified with respect to this matter.

Deloitte & Touche LLP

January 30, 2014

Baystate Health, Inc. and Subsidiaries

Consolidated statements of financial position
As of September 30, 2013 and 2012
(In Thousands)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	$ 144,893	$ 140,460
Investments	342,682	323,390
Accounts receivable, patients, less allowance for uncollectible accounts of $30,519 in 2013 and $29,996 in 2012	113,697	117,772
Accounts receivable, other	33,278	43,851
Estimated final settlements receivable	28,347	26,142
Inventories	20,881	19,230
Prepaid expenses and other current assets	16,001	11,547
Total current assets	699,779	682,392
Long-term assets:		
Investments	56,377	53,825
Equity investment in unconsolidated affiliates	2,507	2,744
Notes receivable	67,050	66,270
Deferred expense and other long-term assets	16,694	11,395
Land, buildings, and equipment, net	610,749	602,006
	753,377	736,240
Assets whose use is limited:		
Board-designated funds:		
Cash and investments	234,254	218,673
Investments of captive insurance company	105,995	95,333
Investments held by trustee under debt agreements	1,335	4,528
Beneficial interest in perpetual trusts	35,118	33,889
	376,702	352,423
Total assets	$1,829,858	$1,771,055

Liabilities and net assets	2013	2012
Current liabilities:		
Accounts payable	$ 91,517	$ 109,985
Medical claims payable	52,954	45,114
Accrued salaries and wages	89,801	86,294
Accrued interest payable	2,247	2,439
Estimated final settlements payable	61,838	69,042
Refundable advances	616	707
Deferred revenue	10,252	8,853
Current portion of long-term debt	9,520	9,218
Total current liabilities	318,745	331,652
Long-term debt	445,158	454,548
Pension liability	78,552	180,442
Insurance liability loss reserves	126,793	103,767
Other liabilities	8,035	15,016
Total liabilities	977,283	1,085,425
Net assets:		
Unrestricted:		
Operating	940,070	865,790
Pension adjustment	(193,715)	(286,031)
Total unrestricted	746,355	579,759
Temporarily restricted	54,775	55,708
Permanently restricted	51,445	50,163
Total net assets	852,575	685,630
Total liabilities and net assets	$1,829,858	$1,771,055

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of operations
For the years ended September 30, 2013 and 2012
(In Thousands)

	2013	2012
Operating revenues:		
Net patient service revenue	$1,099,705	$1,083,213
Bad debts	21,736	20,710
Net patient service revenue, net of bad debts	1,077,969	1,062,503
Premiums	547,220	494,610
Other revenue	83,877	69,605
Net assets released from restrictions for operations	7,333	6,793
Total operating revenues	1,716,399	1,633,511
Operating expenses:		
Salaries and wages	666,158	637,110
Supplies and expense	558,466	542,470
Medical claims and capitation	370,001	343,398
Depreciation and amortization	60,255	54,385
Interest expense	11,284	9,476
Total operating expenses	1,666,164	1,586,839
Income from operations	50,235	46,672
Nonoperating income:		
Investment income	7,050	6,687
Net realized gain on investments	7,188	5,257
Net unrealized gain on investments	25,247	45,732
Equity (loss) gain in unconsolidated affiliates	(33)	1,238
Net interest cost on swap agreements	(2,423)	(2,650)
Change in fair value of swap agreements	3,788	(279)
Income taxes and other	(19,560)	(10,137)
Total nonoperating income	21,257	45,848
Excess of revenues over expenses	71,492	92,520
Other changes in unrestricted net assets:		
Net assets released from restrictions for capital	3,916	5,611
Transfers to restricted net assets	(785)	(381)
Pension adjustment	92,316	(38,652)
Other	(343)	(1,145)
Increase in unrestricted net assets	$ 166,596	$ 57,953

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of changes in net assets
For the years ended September 30, 2013 and 2012
(In Thousands)

	2013	2012
Unrestricted net assets:		
Excess of revenues over expenses	$ 71,492	$ 92,520
Net assets released from restrictions for capital	3,916	5,611
Transfers to restricted net assets	(785)	(381)
Pension adjustment	92,316	(38,652)
Other	(343)	(1,145)
Increase in unrestricted net assets	166,596	57,953
Temporarily restricted net assets:		
Restricted investment income	195	185
Net realized and unrealized gain on investments	4,644	5,672
Contributions	4,664	4,451
Transfers from unrestricted net assets	785	381
Net assets released from restrictions:		
For operations	(7,333)	(6,793)
For capital	(3,916)	(5,611)
Other	28	(151)
Decrease in temporarily restricted net assets	(933)	(1,866)
Permanently restricted net assets:		
Contributions	53	76
Change in value of perpetual trusts	1,229	3,812
Increase in permanently restricted net assets	1,282	3,888
Increase in net assets	166,945	59,975
Net assets, beginning of year	685,630	625,655
Net assets, end of year	$ 852,575	$ 685,630

See notes to consolidated financial statements.

Baystate Health, Inc. and Subsidiaries

Consolidated statements of cash flows
For the years ended September 30, 2013 and 2012
(In Thousands)

	2013	2012
Operating activities:		
Increase in net assets	$ 166,945	$ 59,975
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	60,255	54,385
Pension adjustment	(92,316)	38,652
Net realized and unrealized gain on investments	(40,865)	(56,383)
Provision for bad debts	24,736	23,210
Change in beneficial interest of perpetual trusts	(1,229)	(3,812)
Restricted contributions	(4,717)	(6,527)
Changes in equity investment of affiliate	(237)	(1,238)
Increase in accounts receivable, patients	(17,661)	(32,014)
Net change in estimated final settlements	(9,409)	(188)
Change in accounts payable and accrued expenses	(15,153)	8,511
Change in accrued pension liability, net	(9,574)	(11,387)
Increase in medical claims payable	7,840	3,941
Increase in insurance liability loss reserves	23,026	5,351
Other	(2,427)	(9,197)
Net cash provided by operating activities	89,214	73,279
Investing activities:		
Proceeds from sale and maturities of investments	888,384	798,444
Purchase of investments	(896,200)	(764,285)
Purchase of land, buildings, and equipment	(68,681)	(123,693)
Net cash used in investing activities	(76,497)	(89,534)
Financing activities:		
Proceeds from restricted contributions	4,717	6,527
Increase in note receivable	(3,780)	(766)
Proceeds from debt issuance		85,137
Repayments of debt	(9,221)	(17,493)
Defeasement of debt		(40,305)
Net cash (used in) provided by financing activities	(8,284)	33,100
Net increase in cash and cash equivalents	4,433	16,845
Cash and cash equivalents, beginning of year	140,460	123,615
Cash and cash equivalents, end of year	$ 144,893	$ 140,460

See notes to consolidated financial statements.

1. Organization

Baystate Health, Inc. ("Baystate Health" or BH), based in Springfield, Massachusetts, is the parent corporation of an integrated health care delivery system with the mission "to improve the health of the people in our community every day, with quality and compassion."

Baystate Health currently includes the following:

- Baystate Medical Center, Inc. (BMC), located in Springfield, Massachusetts, is the largest of the three hospitals in the Baystate Health system. BMC, the leading health facility in western Massachusetts, is the only tertiary care referral medical center and Level I trauma center in the region. It is also home to western New England's only neonatal and pediatric intensive care units. BMC is a 715-bed, tax-exempt, not-for-profit, academic teaching hospital that serves as the western campus of Tufts University School of Medicine.

- Baystate Total Home Care, Inc. (BTHC), is a tax-exempt, not-for-profit corporation, which is organized to benefit, support, and further the charitable activities of BMC by holding, leasing, improving, and managing real estate held by, or acquired on behalf of, BMC. BTHC serves as the operating entity in connection with the new markets tax credit financing for the BMC Expansion Project.

- Baystate Franklin Medical Center, Inc. (BFMC), located in Greenfield, Massachusetts, is a 90-bed, tax-exempt, not-for-profit, acute care community hospital. BFMC serves the northern tier of northwestern Massachusetts and southern Vermont.

- Baystate Mary Lane Hospital Corporation (BMLH), located in Ware, Massachusetts, is a 25-bed, tax-exempt, not-for-profit, acute care community hospital. BMLH provides services to more than 16 central Massachusetts communities.

- Baystate Medical Practices, Inc. (BMP), is a tax-exempt, not-for-profit organization formed in 2010.

  BMP includes a multispecialty academic group practice established to support the educational and research programs of Baystate Health, as well as numerous primary care and outreach services. BMP also includes community-based primary care (internists and pediatricians), medical and surgical practices, obstetrical and gynecological, and hospitalist physicians dedicated to the care and management of patients hospitalized at BH-affiliated hospitals. BMP also provides preventative, diagnostic, and therapeutic health services enhancing the cardiovascular clinical, educational, community, and research activities for BH and its service area.

- Baystate Visiting Nurse Association & Hospice (BVNAH) is a tax-exempt, not-for-profit organization that provides comprehensive home health care committed to providing the highest quality care to patients and families, primarily in the home setting. BVNAH meets individual needs by bringing experienced nurses, rehabilitation therapists, social workers, and home care aides to patients' homes.

- Health New England, Inc. (HNE), is a not-for-profit health maintenance organization located in Springfield, Massachusetts. HNE's service area in Massachusetts includes Franklin, Berkshire, Hampden, and Hampshire counties, and part of Worcester County. HNE also serves Hartford, Litchfield, and Tolland counties in Connecticut. In 2013, HNE converted from a for-profit to a not-for-profit organization and has filed an application for tax-exempt status, which is pending with the Internal Revenue Service (IRS).

- Ingraham Corporation (IC) is a for-profit, taxable corporation that currently serves as a holding company for Baystate Health Ambulance, Inc.

- Baystate Health Ambulance, Inc. (BHA) is a for-profit, taxable corporation that delivers the latest in mobile critical care providing 24-hour service throughout western New England.

- Baystate Administrative Services, Inc. (BAS), is a tax-exempt, not-for-profit corporation that provides management support for the BH subsidiaries, including human resources, marketing, strategic planning, information services, and financial services.

- Baystate Health Foundation, Inc. (BHF), is a tax-exempt, charitable organization established for the purpose of fund-raising for healthcare-related activities, in support, and for the benefit, of BH and those subsidiaries of BH that are tax-exempt, not-for-profit corporations, and to hold endowment, charitable donations, and other funds for their benefit.

- Baystate Health Insurance Company, Ltd. (BHIC), is a captive insurance company organized and licensed in the Cayman Islands, British West Indies. BHIC provides professional liability and other insurance coverage to the corporate members of BH and their employees. In 2004, BHIC began offering malpractice insurance to members of BH's medical staff who meet criteria for participation.

2. Significant accounting policies

Principles of Consolidation — The accompanying consolidated financial statements include the accounts of BH and its subsidiaries noted above. All intercompany and subsidiary accounts and transactions have been eliminated in consolidation.

Use of Estimates — The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United states of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are made in the areas of the allowance for uncollectible patient accounts receivable, reserve for contractual allowances, investment valuation, accruals for settlements with third-party payers, medical claims payable, accrued insurance liability loss reserves, pension costs, and accrued compensation and benefits.

Net Assets — Baystate Health and its subsidiaries report net assets and revenues, expenses, gains, and losses based upon the existence or absence of donor-imposed restrictions. In the accompanying consolidated financial statements, net assets that have similar characteristics have been combined into the following categories:

Unrestricted — Net assets that are not subject to donor-imposed stipulations. Net assets may be designated for specific purposes by action of the Board of Trustees, or may otherwise be limited by contractual agreements with outside parties.

Temporarily Restricted — Net assets whose use by Baystate Health and its subsidiaries are subject to donor-imposed stipulations that can be fulfilled by actions of Baystate Health and its subsidiaries, or that expire by the passage of time. At September 30, 2013 and 2012, temporarily restricted net assets consist of amounts restricted as to spending for various purposes, such as education, research, clinical, and health care programs, as well as cumulative net appreciation of permanent endowment funds.

Permanently Restricted — Net assets subject to donor-imposed stipulations that they be maintained permanently by Baystate Health and its subsidiaries. At September 30, 2013 and 2012, permanently restricted net assets consist of the original cost of permanent endowment gifts and beneficial interests in perpetual trusts.

Revenues from sources other than donor-restricted contributions are reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of temporary restrictions recognized on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period in which the assets are acquired or placed in service.

Contributions, including unconditional promises to give and grant awards, are recognized as revenues in the period received. Contributions received with donor-imposed restrictions are reported as permanently or temporarily restricted revenues, depending upon the specific restriction. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair values at the date of the gift. Contributions to be received after one year are discounted at a risk-free rate commensurate with the expected payment term. Amortization of the discount is recorded as contribution revenue in the appropriate net asset category. Allowance is made for uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant information.

Cash and Cash Equivalents — Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased.

Investments — Investments include cash equivalents, mutual funds, fixed-income securities, as well as interests in limited partnerships and common collective trusts. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at estimated fair value in the consolidated statements of financial position. The accounting for the investments held by the pension plan is discussed in Note 15.

Baystate Health has also entered into partnership agreements with limited partnerships ("alternative investments"), the majority of which are in private markets, whereby they have agreed to certain capital commitments. Baystate Health's policy is to record its ownership interest in these alternative investments of less than 5% at historical cost, subject to impairment considerations. During 2013, Baystate Health did not report any such impairments on alternative investments. For those alternative investments where the ownership interest is more than 5%, the ownership interests are reported using the equity method of accounting. As of September 30, 2013, approximately $22,555,000 of total capital commitments, including those held within the pension plan assets discussed in Note 15, remain outstanding. Certain of the partnerships may hold some securities without readily determinable fair values and, consequently, the general partner may estimate fair value for such securities. These estimates may differ significantly from the values that would have been used had a ready market existed, and may also differ significantly from the values at which such investments may be sold, and the differences could be material.

Interest and dividends on investments are included in other revenue or nonoperating income in the consolidated statements of operations unless the income or loss is restricted by donor or law. Realized gains and losses and unrealized gains and losses on investments are included in nonoperating income or temporarily restricted net assets, as applicable. Investment-related expense, such as custodial fees and investment fees, are netted against investment revenues and are immaterial for the years ended September 30, 2013 and 2012.

Baystate Health and its subsidiaries have elected the fair value option for certain of their investments. Baystate Health made this election to reflect changes in fair value of its investments, including both increases and decreases and whether realized or unrealized, in its excess of revenue over expenses. Baystate Health recognized net unrealized gains on investments totaling $25,247,000 and $45,732,000 in 2013 and 2012, respectively, within the excess of revenue over expenses.

Investments are included in pooled investment funds. Current market value is used to determine the percent of each fund in the pool. Income from investments of a pool, including gains or losses, is allocated to participating funds based on the respective fund’s percentage of the pool.

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

Note Receivable — In December and May 2009, BMC loaned $31,186,783 and $32,617,500, respectively, to a third party relating to project costs of approximately $252,000,000 for the construction of a new hospital facility at 759 Chestnut Street, Springfield, Massachusetts. The loans are part of a financing arrangement that utilizes new markets tax credits (NMTC) to reduce cash required by BMC to construct this new facility. Each loan bears interest at 2.139% annually, with annual cash payments during the first seven years of the 33-year term based on an interest rate of 1.00%. The notes are recorded as notes receivable in the consolidated statements of financial position as of September 30, 2013 and 2012.

Equity Investment in Unconsolidated Affiliates — Baystate Health participates in joint ventures with 50% or less ownership, and accounts for the investment in those unconsolidated affiliates as equity investments.

Deferred Expenses and Other Long-Term Assets — Deferred expenses include unamortized bond issuance expenses, which are amortized over the weighted-average terms of the bonds.

Goodwill is included within other long-term assets and is assessed annually for indicators of impairment on July 1 of each year. There were no such indicators in the years ended September 30, 2013 and 2012.

Assets Whose Use is Limited — Assets whose use is limited include assets held by the trustee under indenture agreements and designated assets set aside by the Board of Trustees for future capital improvements and other strategic initiatives, which are in furtherance of Baystate Health and its subsidiaries’ exempt and charitable purposes. Also included are investments of the captive insurance company and beneficial interests in perpetual trusts.

Land, Buildings, and Equipment — Land, buildings, and equipment are stated at cost, less depreciation and amortization determined on the straight-line basis.

Maintenance and repairs are charged to expense as incurred. Betterments and major renewals are capitalized. Cost of assets sold or retired and the related amounts of accumulated depreciation are eliminated from the accounts in the year of disposal, and the resulting gain or loss is included in other revenue. Buildings and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life. Useful life is assigned in accordance with the American Hospital Association's guide, *Estimated Useful Lives of Depreciable Hospital Assets*. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Consolidated Statements of Operations — All activities of Baystate Health deemed by management to be ongoing and central to the provision of health care services are reported as operating revenues and expenses. Other activities are considered nonoperating, and include board-designated investment income and realized gains and losses, unrealized gains and losses on investments, changes in BHIC loss reserves, equity gains in unconsolidated affiliates, losses on extinguishment of debt, interest savings on swap agreements, changes in fair value of swap agreements, and income taxes.

The consolidated statements of operations include excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include net assets released from restrictions for capital, transfers to restricted net assets, and the pension adjustment.

Net Patient Service Revenue — Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Contracts, laws, and regulations governing Medicare, Medicaid, Blue Cross, and the Health Safety Net (HSN) programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Blue Cross and other managed care plans have negotiated with Baystate Health and its subsidiaries various forms of contractual payment rates. The most common payment rates include discounted charges, per case, per diems, and fee schedules.

Medicaid payment rates are negotiated between the Division of Medical Assistance and individual hospitals. Medicare Prospective Payment System (PPS) regulations determine payment due acute care hospitals for inpatient services provided to Medicare beneficiaries. Medicare payments for outpatient services are a blend of PPS and fee schedules.

During 2013 and 2012, Baystate Health recorded adjustments to amounts accrued for settlements related to prior fiscal years. The net effect of such adjustments was to increase net patient service revenue by approximately $24,535,000 and $18,419,000 in 2013 and 2012, respectively.

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

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

Baystate Health has included approximately $8,894,000 and $10,589,000 in other revenue related to the program in fiscal years 2013 and 2012, respectively. The estimate is based on cost report data, which is subject to audit, and the amounts recognized are subject to change. Baystate Health's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

Premium Revenue — Premium revenue represents insurance membership contract revenue at HNE. The contracts generally cover a 12-month period and are subject to cancellation by the employer group or HNE upon 30 days' written notice. Premiums are due monthly and are recognized as revenue during the period in which HNE is obligated to provide services to members.

Health Safety Net — In April 2006, the Commonwealth of Massachusetts passed Chapter 58 of the Acts of 2006, "An Act Providing Access to Affordable, Quality, Accountable Health Care;" the goal of which is to provide near-universal health insurance coverage to Massachusetts residents through a combination of Medicaid expansions, subsidized private insurance programs, insurance market reforms, and the HSN.

The HSN reimburses hospitals for uncompensated care based on actual services provided at rates approximating the PPS, subject to available funds. Like its predecessor, the Uncompensated Care Pool, the HSN is partially funded by acute hospitals through an assessment on gross charges billed to nongovernmental payers.

Charity Care and Community Support — It is the policy of Baystate Health to provide care to any patient in need of medical care, regardless of the patient's ability to pay for such care. Based upon the patient's financial capability to pay, such care is provided free of charge or at amounts below normal charges. Because amounts determined to qualify as charity care are not pursued, they are not reported as revenue. The net cost of charity care includes the direct and indirect cost of providing charity care services, offset by revenues received from indigent care pools (primarily the HSN). The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated care charges associated with providing charity care.

The costs of charity care provided during the years ended September 30, 2013 and 2012, are as follows (in thousands):

	2013	2012
HSN assessment	$ 5,278	$ 5,229
HSN receipts	(11,389)	(11,929)
Free care (at cost)	20,362	19,601
Total	$ 14,251	$ 12,901

In addition to the charity care provided to patients, Baystate Health and its subsidiaries have ongoing community outreach initiatives in the areas of health services access, education, safety, and community reinvestment. The initiatives include free-standing health centers, improving school-based health services, implementing an immunization tracking system to link preschool-aged children to primary care providers, youth development programs, increasing minority employment, improving the community's health status, wellness, health and safety programs for senior citizens, and health screenings and forums.

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

Baystate Health's allowance for uncollectible accounts for self-pay patients increased from 94% of self-pay accounts receivable at September 30, 2012, to 96% of self-pay accounts receivable at September 30, 2013. In addition, Baystate Health's self-pay write-offs, net of recoveries decreased $14,774,000 from $61,592,000 for fiscal year 2012 to $46,818,000 for fiscal year 2013. Baystate Health has not changed its charity care or uninsured discount policies during fiscal year 2012 or 2013. Baystate Health does not maintain a material allowance for uncollectible accounts from third-party payers, nor did it have significant write-offs from third-party payers. Baystate Health recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, Baystate Health recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of Baystate Health's uninsured patients will be unable or unwilling to pay for the services provided. Thus, Baystate Health records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Net patient service revenue (after contractual allowances and discounts) recognized during the year ended September 30, 2013, from Baystate Health's major payer sources is as follows (in thousands):

	2013	2012
Medicare	$ 433,277	$ 415,235
Medicaid	211,859	223,463
Commercial and other	417,890	406,954
Self-pay	14,943	16,851
Total	$1,077,969	$1,062,503

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

Research Grants and Contracts — Revenue related to research grants and contracts is recognized as the related costs are incurred. Indirect costs relating to certain government grants and contracts are reimbursed at fixed rates negotiated with the government agencies. Research grants and contracts have been accounted for as exchange transactions. Amounts received in advance of incurring the related expenditures are recorded as unexpended research grants and are included with refundable advances and deferred revenue in the accompanying consolidated balance sheets.

Accounting for Defined Benefit Pension and Other Postretirement Plans — Baystate Health recognizes the overfunded or underfunded status of its defined benefit and postretirement plans as an asset or liability in its consolidated balance sheets. Changes in the funded status of the plans are reported as a change in unrestricted net assets presented below the excess of revenues over expenses in the consolidated statements of operations and changes in net assets in the year in which the changes occur.

Income Taxes — All of Baystate Health's consolidated entities are recognized by the IRS as tax-exempt, not-for-profit organizations under Section 501(c)(3) of the Internal Revenue Code, except for BHIC, IC and its subsidiary, and HNE and its subsidiaries. On December 20, 2012, HNE's shareholders voted to convert HNE from a for-profit stock corporation to a 501(c) (4) not-for-profit corporation. In 2013 HNE filed an application for tax-exempt status.

Recent Accounting Pronouncements — The financial statements reflect the prospective adoption of Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, which amends Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, as of the beginning of the year ended September 30, 2013 (see Note 4). ASU No. 2011-04 expands certain disclosures about fair value measurement. The ASU No. 2011-04 requires the categorization by level for items that are only required to be disclosed at fair value and information about transfers between the levels within the fair value hierarchy. It provides guidance on measuring the fair value of financial instruments managed within a portfolio and the application of premiums and discounts on fair value measurements. The ASU No. 2011-04 requires additional disclosure for Level 3 measurements regarding the sensitivity of fair value to changes in unobservable inputs and any interrelationships between those inputs. The effect of the adoption of ASU No. 2011-04 had no impact on the Baystate Health's consolidated statements of financial position or statements of operations. See Note 15 for required disclosures.

Baystate Health adopted the provisions of ASU No. 2011-07, *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, on October 1, 2012. ASU No. 2011-07 required Baystate Health to change the presentation of its consolidated statements of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from net patient service revenue (after contractual allowances and discounts). The adoption of this ASU decreased net patient service revenue, total revenues and expenses by $20,710,000 for the year ended September 30, 2012. It also required Baystate Health to provide enhanced disclosures about its sources of patient service revenue, policies for recognizing revenue and assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for uncollectible accounts.

3. Cash and investments

The composition of cash and investments at September 30, 2013 and 2012, is as follows (in thousands):

	2013	2012
Cash and cash equivalents	$ 154,706	$ 151,032
Mutual funds	326,415	271,260
Common collective trusts	90,559	91,452
Fixed-income securities	160,923	165,365
Limited liability investments	117,185	57,725
Alternative investments — limited partnerships	35,748	99,375
Beneficial interests in perpetual trusts	35,118	33,889
	$ 920,654	$ 870,098

Cash and investments at September 30, 2013 and 2012, are included in the consolidated statements of financial position as follows (in thousands):

	2013	2012
Cash and cash equivalents	$ 144,893	$ 140,460
Investments	342,682	323,390
Long-term investments	56,377	53,825
Board-designated cash and investments	234,254	218,673
Investments of captive insurance company	105,995	95,333
Investments held by trustee	1,335	4,528
Beneficial interests in perpetual trusts	35,118	33,889
	$ 920,654	$ 870,098
Investment income included in other revenue	$ 8,543	$ 9,665

4. Fair value measurements

Baystate Health calculates fair value as described in ASC 820-10, *Fair Value Measurement*, to value its financial assets and liabilities, when applicable. Fair value is 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. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a three-level valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

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, Baystate Health utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as consider counterparty credit risk in its assessment of fair value.

Financial assets and liabilities carried at fair value for the years ended September 30, 2013 and 2012, are classified in the table below in one of the three categories described above (in thousands):

2013	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 154,706	$ -	$ -	$ 154,706
Mutual funds:				
Corporate bond fund	183,405			183,405
Other	136,190	6,820		143,010
Total mutual funds	319,595	6,820	-	326,415
Common collective trusts:				
International stock		7,704		7,704
Domestic equity index funds		60,060		60,060
Commodity fund		22,795		22,795
Total common collective trusts	-	90,559	-	90,559
Limited liability investments:				
Hedge funds			62,859	62,859
Emerging markets equity		14,290		14,290
International stock		32,367		32,367
Other		7,669		7,669
Total limited liability investments	-	54,326	62,859	117,185
Fixed-income securities:				
Corporate bonds & U.S. government securities		160,923		160,923
Total fixed-income securities	-	160,923	-	160,923
Beneficial interests in perpetual trusts			35,118	35,118
Total assets at fair value	$ 474,301	$ 312,628	$ 97,977	884,906
Alternative investments (at cost)				35,748
Financial assets, including alternatives				$ 920,654
Liabilities — interest rate swap agreements	$ -	$ 6,916	$ -	$ 6,916

2012	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$ 151,032	$ -	$ -	$ 151,032
Mutual funds:				
Corporate bond fund	177,755			177,755
Other	86,930	6,575		93,505
Total mutual funds	264,685	6,575	-	271,260
Common collective trusts:				
International stock		6,434		6,434
Domestic equity index funds		64,083		64,083
Commodity fund	4,319	16,616		20,935
Total common collective trusts	4,319	87,133	-	91,452
Limited partnership investments:				
Hedge funds				
Emerging markets equity	4,005	9,786		13,791
International stock		35,402		35,402
Other		8,532		8,532
Total limited partnership investments	4,005	53,720	-	57,725
Fixed-income securities:				
Corporate bonds	143,294			143,294
U.S. government securities	22,071			22,071
Total-fixed income securities	165,365	-	-	165,365
Beneficial interests in perpetual trusts		33,889		33,889
Total assets at fair value	$ 589,406	$ 181,317	$ -	770,723
Alternative investments (at cost)				99,375
Financial assets, including alternatives				$ 870,098
Liabilities — interest rate swap agreements	$ -	$ 10,704	$ -	$ 10,704

The amounts classified in the tables above exclude assets invested in Baystate Health's defined benefit plan and limited partnership interests that Baystate Health has recorded at cost.

A summary of changes in the fair value of the Level 3 assets for the years ended September 30, 2013 and 2012, is as follows (in thousands):

	Level 3 Assets 2013	Level 3 Assets 2012
Balance at beginning of year	$ -	$ -
Correction of prior year classification	97,011	
Unrealized gains relating to investments still held at the reporting date	5,112	
Realized gain on investments sold	2,676	
Transfers out		
Purchases		
Sales	(6,822)	
Balance at end of year	$ 97,977	$ -

2012 Leveling Disclosure Errors Corrected in 2013 — During 2013, Baystate Health determined that there were errors in the classification of certain financial instruments within the fair value hierarchy presented for September 30, 2012. The classifications have been corrected out of period at the beginning of fiscal year 2013. A summary of the corrections is as follows (in thousands):

	Increase (Decrease)
Level 1	$ (173,689)
Level 2	139,800
Level 3	97,011
Alternative investments, at cost	(63,122)

Transfers Between Levels — The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. For the years ended, September 30, 2013 and 2012, there were no transfers between levels, other than the correction of the prior year disclosure errors discussed above.

A summary of investments (by major class) that have restrictions on Baystate Health's ability to redeem its investment at the measurement date as of September 30, 2013 and 2012, is as follows (in thousands):

	September 30, 2013		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 136,627	Monthly	5 days
Commingled emerging markets funds	30,416	Monthly	15 days
Commingled commodity funds	38,995	Monthly	30 days
Commingled fixed-income funds	84,259	Monthly	30 days
Hedge fund of funds	60,540	Annually	60 - 65 days
Hedge fund of funds	2,319	Every three years	60 - 95 days

	September 30, 2012		
Description of Investment	**Fair Value**	**Redemption Frequency**	**Redemption Notice Period**
Commingled equity mutual funds	$ 127,249	Monthly	5 days
Commingled emerging markets funds	26,912	Monthly	15 days
Commingled commodity fund	28,051	Monthly	30 days
Commingled fixed-income funds	75,279	Monthly	30 days
Hedge fund of funds	55,096	Annually	60 -65 days
Hedge fund of funds	2,079	Every three years	60 - 95 days
Commodity hedge fund	5,948	Quarterly	60 days

Valuation Techniques — Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis. There have been no changes in the methodologies used at September 30, 2013 and 2012.

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

Mutual Funds — The fair values of mutual funds are based on quoted market prices or net assets value. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by Baystate Health are deemed to be actively traded.

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

Limited Partnerships — The estimated fair values of limited partnerships, for which no quoted market prices are readily available, are determined based upon the information provided by the fund managers. Such information is generally based on NAV of the fund, which is used as a practical expedient to estimate fair value. Baystate Health has classified certain of its investments reported at NAV as Level 2 because it has the ability to redeem its investment in the fund at the NAV per share (or its equivalent) at the measurement date or within the near term and there are no other potential liquidity restrictions. Funds categorized within Level 3 are subject to a minimum holding period or lockup, cannot be redeemed at the measurement date or with 90 days thereof, are subject to redemption notice periods in excess of 90 days, or have the ability to limit the aggregate amount of shareholder redemptions. The limited partnerships allocate gains, losses, and expenses to the partners based on the ownership percentage as described in the respective partnership or hedge fund agreements.

Interest Rate Swaps — Baystate Health uses inputs other than quoted prices that are observable to value the interest rate swaps. Baystate Health considers these inputs to be Level 2 inputs in the context of the fair value hierarchy. The fair values represent the estimated amounts Baystate Health would receive or pay to terminate agreements, taking into consideration current interest rates and the current creditworthiness of the counterparty.

The following methods and assumptions were used by Baystate Health in estimating the fair value of its financial instruments that are not measured at fair value on a recurring basis for disclosures in the consolidated financial statements:

Receivables and Payables — The carrying value of Baystate Health's receivables and payables approximates fair value, as maturities are very short term.

Long-Term Debt — The estimated fair value of Baystate Health's bonds is based on current traded value.

5. Pledges receivable

Pledges receivable at September 30, 2013 and 2012, are as follows (in thousands):

	2013	2012
Receivable in less than one year	$ 3,388	$ 528
Receivable in one to five years	3,540	8,551
Receivable in more than five years		225
Total pledges receivable	6,928	9,304
Less allowance for uncollectible pledges	(818)	(923)
Net pledges receivable	$ 6,110	$ 8,381

Net pledges receivable are included in accounts receivable, other on the consolidated statements of financial position.

6. Land, buildings, and equipment

Details of land, buildings, and equipment at September 30, 2013 and 2012, are as follows (in thousands):

	2013	2012
Land, land improvements, and leasehold improvements	$ 43,524	$ 37,920
Buildings	711,418	655,292
Fixed equipment	96,434	95,324
Moveable equipment	517,565	472,556
Assets under capital leases	28,754	24,275
Construction in progress	11,311	55,961
	1,409,006	1,341,328
Less accumulated depreciation and amortization	(798,257)	(739,322)
Total land, buildings, and equipment, net	$ 610,749	$ 602,006

Depreciation expense for the years ended September 30, 2013 and 2012, was $59,937,000 and $53,925,000, respectively. As of September 30, 2013 and 2012, the accumulated depreciation on equipment under capital lease is $12,415,000 and $10,410,000, respectively.

7. Short-term obligations and commitments

Baystate Health has a 50% ownership in Baycare Health Partners, Inc. ("Baycare"), a physician hospital organization. Baystate Health has provided an unconditional guarantee for a $1,000,000 line of credit from a financial institution. There were no amounts outstanding under the line of credit at September 30, 2013 and 2012.

At September 30, 2013 and 2012, a financial institution has issued irrevocable letters of credit on behalf of BHIC totaling $1,300,000. As of September 30, 2013, investments with a fair value of approximately $2,834,000 (2012 — $2,924,800) have been pledged as security for these letters of credit.

8. Leases

Baystate Health and its subsidiaries lease certain real property and equipment under noncancelable leases expiring at various dates through 2020 with varying renewal options. Rentals generally include insurance and maintenance costs.

On November 2, 2011, BMC entered into a tax-exempt lease financing agreement with the Massachusetts Development Finance Agency (MDFA) and a financial institution in the amount of $20,000,000. Proceeds from the financing were used to fund certain equipment, some of which is related to the BMC Expansion Project. Interest on the borrowing is fixed at 2.19% with principal and interest payments due monthly until maturity on November 2, 2018. This lease is classified as a capital lease and is included in the table below.

Future minimum lease payments at September 30, 2013, are as follows (in thousands):

Year Ending September 30	Capital Leases	Operating Leases
2014	$ 3,351	$ 10,174
2015	3,351	6,140
2016	3,174	4,226
2017	3,085	2,328
2018	3,085	1,187
Thereafter	514	42
Total minimum lease payments	16,560	$ 24,097
Less amount representing interest	(945)	
Present value of net minimum lease payments	15,615	
Less current portion	(3,007)	
Long-term portion	$ 12,608	

Rental expense of operating leases amounted to approximately $14,529,000 and $12,602,000 for the years ended September 30, 2013 and 2012, respectively.

9. Long-term debt

BMC and BFMC have loan agreements with the MDFA (effective October 1, 2010, Massachusetts Health and Educational Facilities Authority (MHEFA) merged into MDFA) and with the MHEFA for construction projects and equipment. Long-term obligations outstanding at September 30, 2013 and 2012, consist of the following (in thousands):

	Amount Outstanding	
	2013	2012
MDFA and MHEFA issues:		
BMC Series M	$ 39,097	$ 40,137
BMC Series L	24,096	24,642
BMC Series I	63,380	63,380
BMC Series J-1	45,000	45,000
BMC Series J-2	45,000	45,000
BMC Series K-1	20,045	20,045
BMC Series K-2	26,365	26,365
BMC Series M-2	7,722	8,268
BMC Series H	5,555	6,222
BFMC Series M-4A	6,362	6,763
BMC Series G	49,815	52,910
BTHC NMTC debt	107,628	107,550
	440,065	446,282
Less original issue discount	(1,002)	(1,057)
Capital leases	15,615	18,541
Total long-term debt	454,678	463,766
Less current portion	(9,520)	(9,218)
Long-term debt, excluding current portion	$ 445,158	$ 454,548

Summary information for each issue is as follows:

Series M Bonds — On August 9, 2012, BMC issued Series M MDFA Revenue Bonds in the aggregate principal amount of $40,137,000. BMC used the proceeds from the bonds to redeem 100% of Series F MHEFA Revenue Bonds, exercising an early redemption option related to the Series F obligation. The bonds are subject to mandatory tender on August 8, 2022. Interest on the bonds is fixed at 2.37% through August 8, 2022, with final maturity on July 1, 2033.

The Series F bonds were issued on June 1, 2002, to reimburse and fund certain capital renovation and equipment expenditures and fund the construction of a new cancer center known as the D'Amour Center for Cancer Care.

Series L Bonds — On November 2, 2011, BMC issued Series L MDFA Revenue Bonds in the aggregate principal amount of $25,000,000. Proceeds from the bonds were used to fund the construction of a new emergency department in conjunction with the BMC Expansion Project. Interest on the bonds is initially fixed at 2.95% through November 1, 2021, with final maturity on July 1, 2041.

BMC Hospital Expansion MHEFA Bond Issuances — On June 25, 2009, BMC issued Series I, J-1, J-2, K-1, and K-2 MHEFA Revenue Bonds in a combined aggregate principal amount of $199,790,000. Proceeds from the bonds were used to pay off the Bank of America, NA loan of $65,000,000 (borrowed in October 2008), and fund the construction, improvement, equipping, and other related capital expenditures of a seven-story building located at 759 Chestnut Street in Springfield, Massachusetts ("BMC Expansion Project"). Details of the related MHEFA bond issuances are as follows:

Series I Bonds — BMC issued Series I MHEFA Revenue Bonds in the aggregate amount of $63,380,000. Interest rates range from 5.5% to 5.75%. Final maturity on the bonds is July 1, 2036.

Series J-1 Bonds — BMC issued Series J-1 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.08% and 0.17% at September 30, 2013 and 2012, respectively. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2015.

Series J-2 Bonds — BMC issued Series J-2 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.08% and 0.20% at September 30, 2013 and 2012, respectively. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2015.

Series K-1 Bonds — BMC issued Series K-1 MHEFA Revenue Bonds in the aggregate amount of $20,045,000. The bonds are subject to mandatory tender on July 1, 2013. The initial interest on the bonds is fixed at 5.0% through June 30, 2013, with final maturity on July 1, 2039.

On July 1, 2013, the Series K-1 MHEFA Revenue Bonds were purchased pursuant to the mandatory tender and remarketed on such date. The reoffering of the bonds contained a conversion of the interest rate from the long-term fixed rate to a daily rate, 0.04% at September 30, 2013, along with a provision of a letter of credit from a financial institution. The daily interest rate is determined by the remarketing agent and the letter of credit will expire on July 1, 2015.

Series K-2 Bonds — BMC issued Series K-2 MHEFA Revenue Bonds in the aggregate amount of $26,365,000. The bonds are subject to mandatory tender on July 1, 2015. The initial interest on the bonds is fixed at 5.0% through June 30, 2015, with final maturity on July 1, 2039.

Series M-2 — On June 30, 2008, BMC entered into a loan commitment under a Capital Asset Program financed by MHEFA through the issuance of variable-rate demand Revenue Bonds, Series M-2. Proceeds of $10,158,000 were used to refund the then-outstanding Revenue Bonds, BMC Issue, Series J-2, which were issued in 1995 ("Series J-2-1995"). The Series J-2-1995 bonds were issued to reimburse and fund certain capital renovation and equipment expenditures, and fund the purchase of an office building. Interest on the Series M-2 bonds is variable, and resets weekly to reflect current market rates, and was 0.12% and 0.20% at September 30, 2013 and 2012, respectively. Final maturity of the bonds is June 15, 2023.

Series H Bonds — On January 18, 2007, BMC issued Series H MHEFA Revenue Bonds in the aggregate principal amount of $10,000,000. Proceeds from the bonds were used to reimburse and fund certain capital additions, and fund the construction of a new parking garage. Interest on the bonds is variable based on monthly resets, and was 0.97% and 0.94% at September 30, 2013 and 2012, respectively. Final maturity of the bonds is January 1, 2022.

Series M-4A Bonds — On February 1, 2005, BFMC entered into a loan commitment under a Capital Asset Program financed by MHEFA through the issuance of variable rate demand Revenue Bonds, Series M-4A. Proceeds of $9,100,000 were used to fund certain capital additions, renovations, and equipment expenditures related to the emergency department, radiology department, and in-patient facilities. Interest on the bonds is variable, and resets weekly to reflect current market rates, and was 0.12% and 0.20% at September 30, 2013 and 2012, respectively. Final maturity of the bonds is June 15, 2024.

Series G Bonds — On October 27, 2005, BMC issued Series G MHEFA Revenue Bonds in the aggregate principal amount of $71,740,000. Proceeds from the bonds were used to advance refund a portion of the outstanding Revenue Bonds, BMC Issue, Series E. The Series E bonds were issued to finance or refinance the following: (a) construction of a new 104,500 gross square foot Ambulatory Care Center; (b) construction of a new 100,000 gross square foot building to house the Ambulatory Surgery Center, Medical Library, and education space; (c) renovation of various existing spaces within BMC; and (d) acquisition of equipment for the new facilities. Series G bond proceeds were also used to finance routine capital construction, renovations, and equipping of various facilities of BMC. Interest on the bonds is variable, and resets every 35 days and was 0.04% and 0.22% at September 30, 2013 and 2012, respectively. Final maturity of the bonds is July 1, 2026. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates November 13, 2017.

New Markets Tax Credit Debt — In December and May 2009, BMC entered into financing arrangements with U.S. Bancorp Community Development Corporation (“U.S. Bancorp”), Banc of America Community Development Corporation (“Banc of America”), and MHIC New Markets Fund II, LLC (MHIC) to fund a portion of the costs of the construction of a new hospital facility (BMC Expansion Project) in Springfield, Massachusetts, using the New Markets Tax Credit Program (“NMTC Program”). The NMTC Program is a program of the Community Development Financial Institutions Fund, a bureau of the United States Treasury. The NMTC Program permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs).

In connection with the December and May 2009 financing arrangements, BMC loaned $23,580,283 and $32,617,500, respectively, to USBCDE Investment Fund XXXIII, LLC (the “Investment Fund”), a wholly owned subsidiary of U.S. Bancorp. The notes bear interest at 2.139% annually, with annual cash payments during the first seven years of each 33-year term based on an interest rate of 1.00%. Also in connection with the December 2009 financing arrangement, BMC loaned $7,606,500 to MHIC. The note bears interest at 1% annually, with no cash payments during the first seven years of the 33-year term. The notes are recorded as notes receivable in the consolidated statements of financial position as of September 30, 2013 and 2012.

Under the December 2009 financing arrangement, BTHC has borrowed $37,692,500 from four CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp through the Investment Fund controls two of the CDEs and MHIC controls the other two. As of September 30, 2013 and 2012, BTHC has outstanding loans of $27,490,000 and $10,202,500 due to U.S. Bancorp CDEs and MHIC CDEs, respectively, related to the December 2009 financing. The loans were issued in four tranches from each of the controlling entities. U.S. Bancorp loans were issued in tranches A, B, C, and D. The U.S. Bancorp CDEs A loan totaled $19,886,783, the B loan $2,653,217, the C loan $3,693,500, and the D loan $1,256,500. Each of the loans has a 33-year term, and bear interest at rates ranging from 0.8911% to 1.8315% annually. MHIC loans were issued in tranches A, B, Series 2, and Series 4. The MHIC CDEs A loan totaled $7,606,500, the B loan $1,366,000, the Series 2 loan $1,000,000, and the Series 4 loan $230,000. Each of the loans has a 33-year term, and bear interest at rates ranging from 1.00% to 1.935%.

Under the May 2009 financing arrangement, BTHC has borrowed approximately $69,424,000 from CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp, through the Investment Fund, controls four of the CDEs and Banc of America controls the other CDE. As of September 30, 2013 and 2012, BTHC has outstanding loans of approximately $43,340,000 and $26,084,000 due to U.S. Bancorp CDEs and Banc of America CDE, respectively. The loans were issued in two tranches, an A tranche and a B tranche. The A loans from the U.S. Bancorp CDEs totaled $32,617,500, have a 33-year term, and bear interest at rates ranging from 0.816% to 1.00% annually. The B loans from the U.S. Bancorp CDEs totaled $10,722,500, have a 33-year term, and bear interest at rates ranging from 0.5% to 1.2832% annually. The A loan from the Banc of America CDE of $20,000,000 has a seven-year term and bears interest at 5.992% annually. The B loan from the Banc of America-controlled CDE of $6,084,000 has a seven-year term, and provides that if there has been no default, the principal balance will be forgiven at the end of the seven-year term. The B loan bears interest at 2.00% annually. Interest payments are due quarterly.

BMC recorded interest income of approximately $1,350,000 in 2013 and $1,338,000 in 2012, and BTHC recorded net interest capitalized of approximately $913,000 in 2012, related to the financing arrangement agreements. No interest was capitalized at BTHC in 2013 relating to the financing arrangement agreements.

In 2016, U.S. Bancorp may put its interest in the Investment Fund to BMC for a put price of $1,000. If U.S. Bancorp does not exercise its put rights, BMC may call its interest in the Investment Fund for a call price equal to the fair value of U.S. Bancorp's interest in the Investment Fund.

Significant Debt Covenants — The bond agreements include various financial covenants, the most restrictive of which are a pledge of revenues and the maintenance of a ratio of Net Revenue Available to Meet Debt Service to Total Principal and Interest Requirements of at least 1.1 (as defined by the agreement). Baystate Health was in compliance with those covenants during the fiscal years ended September 30, 2013 and 2012.

Certain buildings and equipment have been pledged as collateral for the borrowings.

A debt service fund has been established in accordance with these agreements. Debt services fund balances amounted to approximately $1,335,000 at September 30, 2013, and $4,528,000 at September 30, 2012.

The combined aggregate future principal payments of all long-term borrowings are as follows (in thousands):

Year Ending September 30	
2014	$ 9,520
2015	9,845
2016	30,698
2017	12,912
2018	13,543
Thereafter	379,162
	$ 455,680

BMC has entered into a guaranty agreement on behalf of BFMC in connection with outstanding MHEFA bonds.

The fair value of the bonds payable at September 30, 2013 and 2012, approximates $442,726,000 and $471,652,000, respectively.

Interest paid was $11,906,000 and $13,297,000 for 2013 and 2012, respectively.

Interest Rate Swap Agreements — BMC periodically enters into interest rate swap agreements to moderate its exposure to interest rate changes and to lower the overall cost of borrowings. Gains and losses realized on termination of contracts are deferred and amortized over the remaining life of the associated contract.

BMC entered into an interest rate swap agreement with a financial institution with an original notional amount of $67,470,000. The notional amount outstanding at September 30, 2013 and 2012, was $29,394,000 and $34,498,000, respectively. Under the terms of the agreement, BMC pays a fixed rate of 3.26%, and receives variable payments based upon the SIFMA Rate. The agreement, in effect, converts $29,394,000 of notional variable-rate debt to fixed-rate debt.

In September 2005, BMC, in anticipation of the issuance of the Series G bonds, entered into an interest rate swap agreement with a financial institution with an original notional amount of $71,740,000. The notional amount outstanding at September 30, 2013 and 2012, was $49,815,000 and $52,910,000, respectively. The agreement provides for the financial institution to pay variable-rate payments to BMC equal to 56.9% of one-month London InterBank Offered Rate (LIBOR) plus 0.32%, and for BMC to pay the financial institution a fixed rate of 3.021%. The LIBOR was 0.18% and 0.22% at September 30, 2013 and 2012, respectively. The agreement, in effect, converts $49,815,000 of variable rate debt to a fixed rate of interest. There are termination provisions to this contract for each party.

The fair value of these agreements resulted in swap liabilities of approximately $6,916,000 and $10,704,000 at September 30, 2013 and 2012, respectively, and is included in other long-term liabilities in the consolidated statements of financial position.

The net interest savings (cost) and the change in the fair value of the associated interest rate swaps are included in nonoperating income in the consolidated statements of operations.

10. Interest expense

Baystate Health and its subsidiaries capitalize interest cost as part of the historical cost of acquiring certain significant qualifying assets. During the years ended September 30, 2013 and 2012, interest cost was as follows (in thousands):

	2013	2012
Total interest cost	$ 11,776	$ 13,481
Net interest cost capitalized	(492)	(4,005)
Net interest cost expensed	$ 11,284	$ 9,476

11. Insurance liability loss reserves

Baystate Health, with the exception of HNE, addresses its professional and general liability expense, in part, by depositing funds with BHIC, which utilizes these funds to pay claims and, in part, to purchase commercial excess liability insurance. The commercial insurance generally provides coverage on a "claims-made" basis. Under the claims-made policies, claims based on occurrences during their term by reported subsequently will be uninsured should the policy not be renewed or replaced with other coverage. Management has the intention of renewing its insurance policies in the future and believes it will have the ability to obtain such policy renewals. Baystate Health and certain of its subsidiaries have also purchased excess professional and general coverage from other insurers. In addition, BHIC insures the workers' compensation, employer's liability, excess workers' compensation, and long-term disability of certain of Baystate Health's subsidiaries.

BHIC reinsures a portion of its risks in order to limit its exposure to losses. Reinsurance contracts do not relieve Baystate Health from its obligations to policy holders. Failure of reinsurers to honor their obligations could result in losses to Baystate Health. Consequently, Baystate Health evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Reinsurance recoverables were based on actuarial reports prepared by independent consulting actuaries. At September 30, 2013, reinsurance recoverables of $10,150,000 were recorded as deferred expense and other long-term assets. There were no specifically identified claims subject to reinsurance recoverables at September 30, 2013, or deducted from losses incurred and paid during the year then ended.

Reserves have been provided with the assistance of a consulting actuary for asserted claims and for unasserted claims probable of assertion arising from both reported and unreported incidents, which are based on historical experience and existing reported incidents.

Activity in the BHIC liability for losses and loss adjustment expenses is summarized as follows (in thousands):

	2013	2012
Balance at beginning of year	$ 18,760	$ 19,037
Incurred (recovered) related to:		
Current year	3,500	5,500
Prior years	(3,130)	(3,300)
Total incurred	370	2,200
Paid related to:		
Current year	(20)	(54)
Prior years	(2,612)	(2,423)
Total paid	(2,632)	(2,477)
Balance at end of year	$ 16,498	$ 18,760

12. Medical claims and capitation expense

Medical claims and capitation expense for the years ended September 30, 2013 and 2012, include the following components (in thousands):

	2013	2012
Physician and other outpatient specialty services	$ 192,258	$ 172,464
Inpatient care and same-day surgery	69,759	63,321
Pharmacy	75,987	73,148
Primary care capitation	4,265	4,166
Other medical services	17,100	21,467
Coordination of benefits	(447)	(406)
Net reinsurance losses (recoveries)	2,364	1,381
	361,286	335,541
Provider risk-sharing — net	8,715	7,857
Total medical claims and capitation expense	$ 370,001	$ 343,398

Activity in medical claims payable for 2013 and 2012 is as follows (in thousands):

	2013	2012
Medical claims payable:		
Claims payable, beginning of year	$ 38,778	$ 34,830
Risk-sharing payable, beginning of year	6,336	14,958
	45,114	49,788
Reclassification of other medical claims payable	6,857	
Claims incurred:		
Current year	389,429	333,882
Prior years	2,498	2,105
	391,927	335,987
Claims paid:		
Current year	(354,128)	(312,243)
Prior years	(36,816)	(28,418)
	(390,944)	(340,661)
Risk-sharing payable, end of year	11,072	6,336
Medical claims payable, end of year	41,882	38,778
Total	$ 52,954	$ 45,114

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

13. Income taxes

Income tax expense (benefit) for the years ended September 30, 2013 and 2012, for HNE and its subsidiaries, was approximately $10,311,000 and $(367,000), respectively. Net federal and state deferred tax assets totaled approximately $25,000 and $4,724,000 as of September 30, 2013 and 2012, respectively. There is no valuation allowance recorded.

In 2013, HNE reorganized and converted to a not-for-profit corporation effective January 1, 2013. HNE has submitted an application to the IRS seeking recognition of tax exemption under Section 501(c)(4) of the Internal Revenue Code as of January 1, 2013. The IRS's review of the application is in its early stages, and they may submit questions and/or requests for additional information to HNE before it renders a decision on the application. Baystate Health believes that, based on the merits of the HNE exemption request application, it is more likely than not that the IRS will grant the exemption. Accordingly, Baystate Health has accounted for HNE income tax consequences on the assumption that it will become tax exempt effective January 1, 2013. HNE's income tax provision for 2013 includes approximately $5,556,000 increase in the deferred tax valuation allowance and an estimated $4,947,000 of income taxes associated with the conversion.

IC and its subsidiary incurred income tax expense of approximately $2,000 for the year ended September 30, 2013. IC and its subsidiary did not incur income tax expense for the year ended September 30, 2012. As of September 30, 2013, operating loss carry forwards for federal income tax purposes totaled approximately $1,287,000 and $17,892,000 for IC and BMC, respectively, which expire in various years ranging from 2014 to 2032. This results in a deferred tax asset; however, because utilization of these net operating losses is not reasonably assured, IC and BMC have recorded a full valuation allowance offsetting this deferred tax asset.

14. Funds held in trust by others

Baystate Health and its subsidiaries are beneficiaries of certain perpetual trusts (the "Trusts"), from which they receive unrestricted income. Appreciation or depreciation in the value of the Trusts is recorded as an increase or decrease to permanently restricted net assets. During fiscal years 2013 and 2012, Trust distributions of approximately $1,451,000 and $1,087,000, respectively, are included in operating revenue.

15. Pension plans

Baystate Health and certain of its consolidated subsidiaries and other ownership interests participate in a noncontributory, defined benefit cash balance retirement plan (the "plan") covering substantially all of their eligible employees.

Baystate Health's policy is to fund amounts as are necessary on an actuarial basis to provide for benefits in accordance with the Employee Retirement Income Security Act of 1974, using the accrued benefit (net credit) actuarial cost method.

The following table presents the change in the plan's projected benefit obligation, change in plan assets, and funded status of the plan as of September 30, 2013 and 2012, net of unconsolidated other ownership interest (in thousands):

	2013	2012
Change in pension obligation		
Pension obligation at beginning of year	$ 906,113	$ 792,839
Service cost	33,036	31,150
Interest cost	37,132	41,656
Actuarial (gain) loss	(109,348)	151,257
Benefits paid	(41,253)	(29,467)
Plan amendments	(2,112)	(81,322)
Pension obligation at end of year	$ 823,568	$ 906,113
Change in plan assets		
Fair value of plan assets at beginning of year	$ 724,745	$ 638,888
Actual return on plan assets	21,353	75,324
Employer contributions	40,000	40,000
Benefits paid	(41,253)	(29,467)
Fair value of plan assets at end of year	$ 744,845	$ 724,745
Funded status		
Funded status of the plan	$ (78,723)	$ (181,368)
Pension liability	$ (78,723)	$ (181,368)
Amounts recognized in unrestricted net assets consist of		
Net actuarial loss	$ 292,404	$ 395,896
Prior service credit	(97,925)	(108,577)
Pension adjustment	$ 194,479	$ 287,319

Exclusive of other ownership interest, the underfunded status of the plan at September 30, 2013, is approximately $78,552,000; the change in the pension adjustment is $92,316,000; and the total pension adjustment is $193,715,000.

In September 2012, Baystate Health made the following changes to the plan effective January 1, 2013, that have been reflected in the change in benefit obligation, plan amendments line for 2012, and have been reflected in the fiscal 2013 pension cost:

- The Plan's fixed annuity conversion factors were replaced with variable annuity factors, based on 417(e) (3) interest and mortality, for benefits accrued on or after January 1, 2013.

- The age 65 requirement for eligibility to receive a lump-sum distribution on benefits accrued after 2004 is removed.

- Participants will become eligible to make separate lump-sum and annuity elections on benefits earned prior to 2013 and after 2012.

The net actuarial loss and prior service credit expected to be recognized in benefit cost in 2014 is approximately $23,475,000 and $12,997,000, respectively.

The assumptions used to develop the projected benefit obligation as of September 30, 2013 and 2012, are as follows:

	2013	2012
Discount rate	5.05 %	4.10 %
Rate of compensation increase	3.00	3.25

The accumulated benefit obligation was approximately $780,075,000 and $863,642,000 at September 30, 2013 and 2012, respectively.

Net Periodic Pension Cost — Net pension cost for the defined benefit plan for the years ended September 30, 2013 and 2012, includes the following components (in thousands):

	2013	2012
Service cost	$ 33,036	$ 31,150
Interest cost	37,133	41,656
Expected return on plan assets	(57,254)	(54,566)
Amortization of prior service credit	(12,766)	(3,969)
Recognized net actuarial loss	30,046	14,275
Net pension cost	$ 30,195	$ 28,546

The assumptions used to determine net pension cost for the years ended September 30, 2013 and 2012, are as follows:

	2013	2012
Discount rate	4.10 %	5.20 %
Expected return on plan assets	7.75	7.75
Rate of compensation increase	3.25	3.25

Plan Assets — The plan's investment objectives are to achieve long-term growth in excess of inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets. In order to minimize risk, the plan attempts to minimize the variability in yearly returns. The plan diversifies its holdings among sectors, industries, and companies. The target allocations of assets at September 30, 2013, were equities 30%, fixed income 40%, and other 30%.

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

Baystate Health's pension plan asset allocation by asset category as of September 30, 2013 and 2012, is as follows:

	2013	2012
Common and preferred equity securities	33 %	31 %
U.S. government and domestic fixed-income securities	37	40
Other investments	30	29
	100 %	100 %

Financial assets invested in Baystate Health's defined benefit pension plan (the "Plan"), in one of the three categories described previously, as of September 30, 2013 and 2012, are classified as follows (in thousands):

	Assets at Fair Value as of September 30, 2013			
	Level 1	Level 2	Level 3	Total
Money market	$ 3,184	$ 2,562	$ -	$ 5,746
Mutual funds:				
Corporate bond fund	153,979			153,979
Other	108,471			108,471
Total mutual funds	262,450	-	-	262,450
Common collective trusts:				
International stock		18,066		18,066
Domestic equity index funds		67,420		67,420
Commodity fund		30,267		30,267
Total common collective trusts	-	115,753	-	115,753
Limited liability and partnership investments:				
Private equity funds			37,707	37,707
Real estate fund			12,841	12,841
Hedge funds			116,585	116,585
International stock		60,532		60,532
Other		8,421		8,421
Total limited liability and partnership investments	-	68,953	167,133	236,086
Fixed-income securities — U.S. government securities		110,928		110,928
Total assets — at fair value	$265,634	$298,196	$167,133	730,963
Pension assets — at contract value				13,882
Total pension plan assets				$744,845

	Assets at Fair Value as of September 30, 2012			
	Level 1	Level 2	Level 3	Total
Money market	$ 1,887	$ 2,791	$ -	$ 4,678
Mutual funds:				
Corporate bond fund	157,216			157,216
Other	74,470			74,470
Total mutual funds	231,686	-	-	231,686
Closed end real estate funds			13,727	13,727
Common collective trusts:				
International stock	14,564			14,564
Domestic equity index funds	85,315			85,315
Commodity fund	22,501			22,501
Total common collective trusts	122,380	-	-	122,380
Limited partnership investments:				
Private equity funds			36,633	36,633
Real estate fund			112,234	112,234
Hedge funds			20,455	20,455
International stock	44,909			44,909
Other		9,583	1,175	10,758
Total limited partnership investments	44,909	9,583	170,497	224,989
Fixed-income securities — U.S. government securities		113,697		113,697
Total assets — at fair value	$400,862	$126,071	$184,224	711,157
Pension assets — at contract value				13,588
Total pension plan assets				$724,745

The following table sets forth a summary of changes in the fair value of the Level 3 assets for the years ended September 30, 2013 and 2012 (in thousands):

	Level 3 Assets 2013	Level 3 Assets 2012
Balance at beginning of year	$ 184,224	$ 163,954
Correction of prior year classification	(20,456)	
Realized gain on investments sold	4,494	
Unrealized gains relating to investments still held at the reporting date	12,684	15,790
Transfers out	(313)	
Purchases		6,404
Sales	(13,500)	(1,924)
Balance at end of year	$ 167,133	$ 184,224

2012 Leveling Disclosure Errors Corrected in 2013 — During 2013, Baystate Health determined that there were errors in the classification of certain financial instruments within the fair value hierarchy presented for September 30, 2012. The classifications have been corrected out of period at the beginning of fiscal year 2013. A summary of the corrections is as follows (in thousands):

	Increase (Decrease)
Level 1	$ (167,289)
Level 2	187,745
Level 3	(20,456)

Transfers Between Levels — The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. During 2013, certain limited liability and partnership investments were transferred from Level 3 to Level 2 due to the expiration of redemption restrictions.

A summary of investments (by major class) that have restrictions on the Plan's ability to redeem its investment at the measurement date as of September 30, 2013 and 2012, is as follows (in thousands):

	September 30, 2013		
Description of Investment	Fair Value	Redemption Frequency	Redemption Notice Period
Commingled equity mutual funds	$ 85,486	Monthly	5 days
Commingled emerging markets funds	21,252	Monthly	15 days
Commingled commodity fund	38,688	Monthly	30 days
Hedge fund of funds	116,585	Quarterly	60 days

	September 30, 2012		
Description of Investment	Fair Value	Redemption Frequency	Redemption Notice Period
Commingled equity mutual funds	$ 146,591	Monthly	5 days
Commingled emerging markets funds	23,336	Monthly	15 days
Commingled commodity fund	22,501	Monthly	30 days
Commingled high-yield fixed-income fund	5,798	Monthly	30 days
Hedge fund of funds	104,528	Quarterly	60 days
Commodity hedge fund	7,705	Quarterly	60 days

Contributions — Baystate Health expects to contribute approximately $40,000,000 to its pension plan in 2014.

Estimated Future Benefit Payments — The following approximate benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next 10 calendar years (in thousands):

Calendar Year	Pension Benefits
2014	$ 70,700
2015	54,300
2016	55,400
2017	64,700
2018	60,700
Years 2019–2023	304,500
	$ 610,300

Defined Contribution Plans — Baystate Health and certain of its consolidated subsidiaries and other ownership interest participate in a defined contribution retirement plan, which covers all employees hired after December 31, 2004. Under this plan, Baystate Health contributes up to 7.5% of the employee's compensation based on age and years of service. Total expense under this plan was approximately $9,048,000 in 2013 and $10,240,000 in 2012.

HNE provides a 401(k) retirement plan (the "Plan"). Each year, employees may contribute up to 75% of pretax annual compensation, as defined in the Plan document. HNE matches 100% of the first 6% of employee contributions to the Plan. Additional contributions may be made by HNE at its discretion. Contributions and compensation levels are subject to certain limitations under the Internal Revenue Code. The Plan expense amounted to approximately $1,418,000 and $1,674,000 in 2013 and 2012, respectively.

16. Concentrations of credit risk

Baystate Health and its subsidiaries grant credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2013 and 2012, is as follows:

	2013	2012
Medicare	20 %	18 %
Medicaid	15	18
Blue Cross	1	1
Health maintenance organizations	38	37
Commercial	12	12
Self-pay patients	14	14
	100 %	100 %

17. Functional expenses

Baystate Health and its subsidiaries provide general health care services to residents within their geographic location. Expenses related to providing these services for the years ended September 30, 2013 and 2012, are as follows (in thousands):

	2013	2012
Health care services	$1,574,367	$1,487,793
General and administrative	91,797	99,046
	$1,666,164	$1,586,839

18. Temporarily and permanently restricted net assets

Temporarily restricted net assets at September 30, 2013 and 2012, are available for the following purposes (in thousands):

	2013	2012
Research and education	$11,705	$12,079
Patient care services	43,070	43,629
Total	$54,775	$55,708

Permanently restricted net assets are invested in perpetuity, the income from which is generally expendable to support the delivery of health care services.

ASC 958-205, *Endowment of Not-for-Profit Organizations*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Massachusetts enacted UPMIFA on July 2, 2009. Baystate Health is subject to ASC 958-205 disclosure requirements regarding its endowment funds.

Baystate Health's endowments consist of numerous individual funds established for a variety of purposes. As required by accounting principles generally accepted in the United States of America, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

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

Endowment net asset composition by type of fund as of September 30, 2013 and 2012, consisted of the following (in thousands):

As of September 30, 2013	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 36,194	$ 16,327	$ 52,521
Board-designated endowment funds	22,088			22,088
Endowment net assets at September 30, 2013	$ 22,088	$ 36,194	$ 16,327	$ 74,609

As of September 30, 2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ -	$ 33,926	$ 16,273	$ 50,199
Board-designated endowment funds	20,938			20,938
Endowment net assets at September 30, 2012	$ 20,938	$ 33,926	$ 16,273	$ 71,137

For the year ended September 30, 2013, Baystate Health had the following endowment-related activities (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2012	$ 20,938	$ 33,926	$ 16,273	$ 71,137
Investment return:				
Investment income	135	323		458
Net appreciation	1,865	4,449		6,314
Total investment return	2,000	4,772	-	6,772
Contributions	171		54	225
Net asset reclassifications		(66)		(66)
Amounts appropriated for expenditures	(1,021)	(2,438)		(3,459)
Total change in endowment funds	1,150	2,268	54	3,472
Endowment net assets at September 30, 2013	$ 22,088	$ 36,194	$ 16,327	$ 74,609

For the year ended September 30, 2012, Baystate Health had the following endowment-related activities (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2011	$ 19,543	$ 30,919	$ 16,198	$ 66,660
Investment return:				
Investment income	125	299		424
Net appreciation	2,269	5,432		7,701
Total investment return	2,394	5,731	-	8,125
Contributions	80		75	155
Net asset reclassifications		(130)		(130)
Amounts appropriated for expenditures	(1,079)	(2,594)		(3,673)
Total change in endowment funds	1,395	3,007	75	4,477
Endowment net assets at September 30, 2012	$ 20,938	$ 33,926	$ 16,273	$ 71,137

Baystate Health's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Baystate Health must hold in perpetuity or for a donor-specified term. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that will generate an 8.5% total return annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, Baystate Health 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). Baystate Health targets a diversified asset allocation that consists of equities, fixed income, and alternative investments.

Baystate Health has a policy of appropriating for distribution each year, no more than 5% of its endowment funds' current fair value. In establishing this policy, Baystate Health considered the long-term expected return on its endowments.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Baystate Health to retain as a fund of perpetual duration. There was no deficiency of this nature at September 30, 2013 and 2012.

19. State surplus revenue retention

Through September 30, 2013, BMC had no surplus in excess of the Commonwealth of Massachusetts regulations governing the excess of state revenues over expenses for not-for-profit organizations. The total deficit attributable to state contracting for BMC was approximately $82,000 (2012 — $54,000). As of September 30, 2013, the cumulative deficit attributable to state contracting of approximately $6,262,000 is included in the unrestricted net assets of BMC.

20. Subsequent events

Premier — On October 2, 2013, Premier, Inc. ("Premier"), a national health care alliance, in which Baystate Health was a member owner, completed a reorganization and initial public offering (the "Reorganization"). Following the Reorganization, Premier now operates as a publicly traded company. In conjunction with the Reorganization, Premier has undertaken an initial public offering of its Class A common stock. As a result, the holders of the shares of Class A common stock hold 100% of the economic interest and approximately 22% of the voting rights in Premier. Premier's member owners hold a beneficial interest in shares of Premier's Class B common stock in proportion to each member owner's capital balance in Premier. The Class B common stock is held in a voting trust. The Class B common stock has approximately 78% of the voting rights in Premier but no economic rights.

Immediately following the closing of the initial public offering, Premier acquired a portion of the Class B common units from the member owners under the terms of the Unit Put/Call Agreement. These transactions result in direct "up front" cash payments to member owners. Baystate Health received approximately $3,686,000 in connection with the exercise of the Unit Put/Call Agreement.

Member owners may annually exchange up to one-seventh of its initial allocation of Class B common units and any additional Class B common units purchased for cash, Class A common stock, or both. Cash payments will be determined by the average 20-day closing price of the Class A common stock ending three days prior to the notification deadline. Class A common stock will be issued on a 1-to-1 basis for each Class B common unit exchanged.

Wing Memorial Hospital — On December 18, 2013 the boards of trustees of UMass Memorial Health Care ("UMMHC"), Baystate Health, Inc. and Wing Memorial Hospital and Medical Centers ("Wing") authorized the organizations to sign a letter of intent to propose the transfer of ownership of Palmer, Massachusetts based Wing to Baystate Health, Inc.

Subsequent events have been evaluated for potential recognition in the consolidated financial statements through January 30, 2014, which is the date the financial statements were issued.

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