



**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidated Financial Statements and  
Supplementary Information

September 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

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**KPMG LLP**  
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New York, NY 10154-0102

## **Independent Auditors' Report**

The Board of Trustees  
Yale-New Haven Health Services Corporation  
d/b/a Yale New Haven Health System and Subsidiaries:

We have audited the accompanying consolidated financial statements of Yale-New Haven Health Services Corporation, d/b/a Yale New Haven Health System and Subsidiaries, which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 did not audit the financial statements of Lawrence + Memorial Corporation and Subsidiaries (the Corporation), a wholly owned subsidiary, which statements reflect total assets constituting 9% of consolidated total assets at September 30, 2016. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Corporation, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Yale New Haven Health Services Corporation as of September 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

**Other Matter**

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

**KPMG LLP**

December 22, 2016

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidated Balance Sheets

September 30, 2016 and 2015

(In thousands)

<b>Assets</b>	<b>2016</b>	<b>2015</b>
Current assets:		
Cash and cash equivalents	\$ 188,272	194,946
Short-term investments	1,527,940	1,160,670
Accounts receivable for services to patients, less allowance for uncollectible accounts of approximately \$372,651 in 2016, and \$313,860 in 2015	416,669	405,694
Professional liabilities insurance recoveries receivable	33,733	32,170
Other assets	112,445	91,540
Assets limited as to use – debt service fund	6,935	5,465
Total current assets	2,285,994	1,890,485
Assets limited as to use	235,818	206,319
Long-term investments	538,193	420,800
Professional liabilities insurance recoveries receivable	89,416	85,394
Other assets	223,647	211,155
Property, plant, and equipment, net	1,856,468	1,545,848
Goodwill	126,165	114,308
Total assets	\$ 5,355,701	4,474,309

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidated Balance Sheets, continued

September 30, 2016 and 2015

(In thousands)

<b>Liabilities and Net Assets</b>	<b>2016</b>	<b>2015</b>
	<hr/>	<hr/>
Current liabilities:		
Accounts payable and accrued expenses	\$ 626,452	499,883
Current portion of long-term debt	31,627	16,881
Current portion of capital lease obligation	3,837	2,050
Professional liabilities	33,733	32,170
Other liabilities	99,593	92,866
	<hr/>	<hr/>
Total current liabilities	795,242	643,850
Long-term debt, net of current portion and deferred financing costs	968,195	895,656
Long-term capital lease obligations, net of current portion	141,110	107,159
Accrued pension and postretirement benefit obligations	456,861	339,901
Professional liabilities	160,924	148,303
Other liabilities	372,784	304,801
Deferred revenue	41,482	42,720
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Total liabilities	2,936,598	2,482,390
Net assets:		
Unrestricted	2,145,599	1,750,995
Temporarily restricted	163,535	147,568
Permanently restricted	109,969	93,356
	<hr/>	<hr/>
Total net assets	2,419,103	1,991,919
Commitments and contingencies		
	<hr/>	<hr/>
Total liabilities and net assets	\$ 5,355,701	4,474,309
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See accompanying notes to consolidated financial statements.

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**

(d/b/a Yale New Haven Health System and Subsidiaries)

## Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2016 and 2015

(In thousands)

	<u>2016</u>	<u>2015</u>
Operating revenue:		
Net patient service revenue	\$ 3,708,512	3,536,254
Less provision for bad debts, net	<u>(105,031)</u>	<u>(81,528)</u>
Net patient service revenue, less provision for bad debts, net	3,603,481	3,454,726
Other revenue	<u>207,981</u>	<u>147,554</u>
Total operating revenue	<u>3,811,462</u>	<u>3,602,280</u>
Operating expenses:		
Salaries and benefits	1,925,430	1,858,472
Supplies and other	1,495,511	1,344,217
Depreciation and amortization	193,387	185,944
Insurance	32,227	29,803
Interest	<u>29,112</u>	<u>24,188</u>
Total operating expenses	<u>3,675,667</u>	<u>3,442,624</u>
Income from operations	135,795	159,656
Nonoperating gains (losses), net:		
Income from investments, donations, and other, net	110,816	14,113
Contribution received in affiliation with LMC	241,106	—
Change in fair value of swap, including counterparty payments	<u>(30,160)</u>	<u>(29,678)</u>
Excess of revenue over expenses	457,557	144,091
Other changes in unrestricted net assets:		
Other changes in net assets	546	(382)
Net assets released from restrictions for purchases of fixed assets	47,263	7,342
Pension and postretirement related changes other than net periodic benefit cost	<u>(110,762)</u>	<u>(44,112)</u>
Increase in unrestricted net assets	<u>394,604</u>	<u>106,939</u>

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidated Statements of Operations and Changes in Net Assets, continued

Years ended September 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Temporarily restricted net assets:		
Income from investments	\$ 320	2,234
Net realized and unrealized gains on investments	15,097	1,335
Bequests and contributions	55,069	30,336
Net assets released from restrictions for purchases of fixed assets	(47,263)	(5,950)
Net assets released from restrictions for operations	(19,865)	(21,196)
Net assets released from restrictions for clinical programs	(6,378)	(1,477)
Contribution received in affiliation with LMC	20,497	—
Other changes in net assets	(1,510)	574
Increase in temporarily restricted net assets	15,967	5,856
Permanently restricted net assets:		
Bequests and contributions	555	15,175
Net assets released from restrictions for purchases of fixed assets	—	(1,392)
Net realized and unrealized gains (losses) on investments	145	(1)
Contribution received in affiliation with LMC	15,704	—
Change in beneficial interest in perpetual trusts	290	(1,282)
Other changes in net assets	(81)	—
Increase in permanently restricted net assets	16,613	12,500
Increase in net assets	427,184	125,295
Net assets at beginning of year	1,991,919	1,866,624
Net assets at end of year	\$ 2,419,103	1,991,919

See accompanying notes to consolidated financial statements.



**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidated Statements of Cash Flows

Years ended September 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Operating activities:		
Increase in net assets	\$ 427,184	125,295
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	193,387	185,944
Net realized and change in net unrealized gains and losses on investments	(112,964)	(27,967)
Change in fair value of interest rate swap agreements	19,973	5,566
Amortization of long-term debt premium	(2,703)	(2,807)
Provisions for bad debts, net	105,031	81,538
Amortization of deferred financing costs	507	499
Change in perpetual trusts	(994)	1,302
Contribution received in affiliation with LMC	(277,307)	—
Bequests and contributions	(37,654)	(45,511)
Pension and postretirement related changes other than net periodic benefit cost	110,762	44,112
Changes in operating assets and liabilities:		
Accounts receivable	(67,613)	(118,890)
Other assets	(10,009)	(41,737)
Accounts payable and accrued expenses	46,458	48,853
Professional insurance recoveries and liabilities	2,273	(24,245)
Other liabilities	(34,322)	34,729
Net cash provided by operating activities	362,009	266,681
Investing activities:		
Acquisitions of property, plant, and equipment	(208,346)	(169,932)
Cash received in affiliation with Lawrence + Memorial Corporation	21,653	—
Purchases of investments	(1,033,320)	(935,433)
Sales of investments	810,967	817,716
Amounts deposited with trustee in debt service fund	(754)	(824)
Assets limited as to use, net	22,996	25,929
Net cash used in investing activities	(386,804)	(262,544)
Financing activities:		
Proceeds from notes payable	—	8,345
Payments of long-term debt	(16,781)	(19,112)
Payments on capital lease obligations	(2,752)	(4,995)
Bequests and contributions	37,654	45,512
Net cash provided by financing activities	18,121	29,750
Net (decrease) increase in cash and cash equivalents	(6,674)	33,887
Cash and cash equivalents at beginning of year	194,946	161,059
Cash and cash equivalents at end of year	\$ 188,272	194,946

See accompanying notes to consolidated financial statements.

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

**(1) Organization and Significant Accounting Policies**

Yale-New Haven Health Services Corporation (Y-NHHSC), formed in 1983, was incorporated under the Not-for-Profit Corporation Law to coordinate the activities of the members of the Yale-New Haven Health Services Corporation, d/b/a Yale New Haven Health System and Subsidiaries (collectively, the System), and is an integrated regional health care delivery system.

The System currently includes the following entities:

Y-NHHSC is the parent company of Yale-New Haven Hospital, Inc. (Y-NHH), Y-NHH-MSO, Inc. (MSO), Bridgeport Hospital and Subsidiaries (BH), Greenwich Hospital and Subsidiaries (GH), and Northeast Medical Group, Inc. (NEMG). Effective September 8, 2016, Lawrence + Memorial Corporation and Subsidiaries (LMC) became affiliated with the System.

Y-NHH is a voluntary association incorporated under the General Statutes of the State of Connecticut. The Board of Trustees of Y-NHH, appointed by Y-NHHSC, controls the operations of Y-NHH. Y-NHH is the parent of:

YNHCCC, a Connecticut nonstock corporation, is a wholly owned subsidiary of Y-NHH. YNHCCC provides long-term care for those unable to live independently and short-term rehabilitation for patients who have experienced elective surgery, an injury, or a traumatic major illness. Its services include respite care for family members and caregivers, stroke recovery for victims of strokes, orthopedic recovery services, medications and diagnostic services (such as radiological services).

Yale-New Haven Ambulatory Services Corporation and Subsidiaries, a Connecticut nonstock, taxable corporation, is a wholly owned subsidiary of Y-NHH, and is 51% owner of Shoreline Surgery Center, LLC (SSC) and SSC II, LLC.

York Enterprises, Inc. and Subsidiaries (York), a Connecticut corporation was formed for the purpose of initiating or acquiring business entities. Currently, York has two subsidiaries: Medical Center Pharmacy and Home Care, Inc. (MCP) and Medical Center Realty, Inc. (MCR). MCP is a Connecticut stock, for-profit company, which operated a retail pharmacy with multiple locations until February 2011. MCR is a Connecticut stock, for-profit company, which owns or holds leases on the System's affiliated commercial space. York is the sole shareholder of MCP and MCR. On October 1, 2016, York and MCR were dissolved and MCP became a subsidiary of Y-NHH with all real property and holdings transferred to Y-NHH.

Caritas Insurance Company, Ltd. (Caritas) is a Vermont-domiciled, captive insurance company licensed under Chapter 141 of Title 8 of the Vermont Statutes Annotated. Caritas is a tax-exempt supporting organization having Y-NHH as its sole shareholder. Caritas provides excess professional liability coverage and general liability coverage. Prior to the 2012 acquisition of the stock of Caritas by Y-NHH from the Hospital of Saint Raphael (HSR), Caritas was a wholly owned subsidiary of HSR. Caritas was dissolved on December 15, 2014 and the insurance liabilities were transferred to Medical Centre Insurance Company, Ltd (see note 10).

## YALE-NEW HAVEN HEALTH SERVICES CORPORATION

(d/b/a Yale New Haven Health System and Subsidiaries)

### Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Lukan Indemnity Company, Ltd. (Lukan) is a Bermuda-domiciled captive insurance company that provides primary professional liability coverage. Prior to the 2012 acquisition of the stock of Lukan by Y-NHH from HSR, Lukan was a wholly owned subsidiary of HSR. Lukan was dissolved on March 31, 2015 and the insurance liabilities were transferred to Medical Centre Insurance Company, Ltd (see note 10).

BH is a voluntary association incorporated under the General Statutes of the State of Connecticut. The Board of Trustees of BH, appointed by YNHHSC, controls the operations of BH. BH is the parent of:

Bridgeport Hospital Foundation (Foundation) solicits contributions for the benefit of BH and all other tax-exempt health care organizations associated with BH.

Southern Connecticut Health System Properties, Inc. is a real estate holding company, which sold primarily all of its assets to Bridgeport Hospital during 1998.

NEMG is a tax-exempt medical foundation that provides physician-related services to Bridgeport, Greenwich, and Yale-New Haven Hospitals and their surrounding communities. NEMG operates autonomously with a separate board, management, and medical staff. Y-NHHSC must approve the strategic plans, operating budgets, capital budgets, and board appointments of NEMG.

Concurrent with the issuance of the Connecticut Health and Educational Facilities Authority (CHEFA) Revenue Bonds, Yale-New Haven Health Obligated Group Issue, Series A, B, C, D and E dated May 20, 2014, six members of the System were combined to form an Obligated Group. The Obligated Group comprises of Y-NHHSC, Y-NHH, YNHCCC, BH, the Foundation and NEMG. The members of the Obligated Group have adopted certain governance provisions in their certificates of incorporation and by-laws pursuant to which Y-NHHSC retains the authority to directly take certain actions on behalf of each Obligated Group member without the approval of the board of trustees of the applicable Obligated Group member, including the incurrence of indebtedness on behalf of each Obligated Group member, the management and control of the liquid assets of each, and the appointment of the president and chief executive officer of each Obligated Group member. GH and its subsidiaries are not members of the Obligated Group.

Y-NHHSC is the sole member of GH. GH operates autonomously with a separate board management and medical staff. Y-NHHSC must approve the strategic plans, operating budgets, capital budgets and board appointments of GH. GH is the sole member of the following not-for-profit, nonstock corporations:

GH is the parent corporation of a group of wholly owned subsidiaries, including The Perryridge Corporation, the Greenwich Hospital Endowment Fund, Inc., and Greenwich Ambulatory Surgery Center, LLC. Effective May 12, 2016, the GH's former parent company, Greenwich Health Care Services, Inc., was merged with and into the Hospital and GH is the surviving entity. As a result, Yale-New Haven Health Services Corporation (YNHHSC) became the sole member of the GH. GH and its subsidiaries are Section 501(c)(3) not-for-profit organizations, and are exempt from federal income taxes under Section 501(a) of the Code. Greenwich Hospital, a nonstock Connecticut corporation, provides health care services to the lower Fairfield County and Westchester County, New York communities. GH and the Greenwich Hospital Endowment Fund, Inc. are an Obligated Group under the State of Connecticut Health and Educational Facilities Authority Trust Indenture.

## YALE-NEW HAVEN HEALTH SERVICES CORPORATION

(d/b/a Yale New Haven Health System and Subsidiaries)

### Notes to Consolidated Financial Statements

September 30, 2016 and 2015

MSO, a for-profit stock corporation, was formed to manage physician practices and provide third-party administration services on certain managed care contracts. The capital stock of MSO consists of 20,000 shares of common stock, par value of one one-hundredth of a dollar per share. The Board of Directors of MSO is appointed by Y-NHHSC, the sole shareholder, who controls MSO's operations.

#### **Lawrence + Memorial Corporation and Subsidiaries affiliation**

On September 8, 2016 (the Transaction Date), the System entered into an affiliation agreement whereby YNHHSC became the sole corporate member of LMC, a system of healthcare that provides a wide array of services throughout the region including Lawrence + Memorial Hospital (L+M), L+M Physician Association Inc. (LMPA), L+M Systems, Inc., VNA of Southeastern Connecticut, L+M Healthcare, L+M Indemnity Ltd, VNA of Southeastern Connecticut Inc. (VNA), and LMW Healthcare Inc. (Westerly Hospital). LMC has continued to operate as a separate entity with a separate Board of Directors, and management. However, YNHHSC holds the same reserve powers it holds over the other Hospital networks in the System which include approving the strategic plans, operating budgets, capital budgets, any transfer of assets or additional borrowings, and Board of Director appointments of LMC and its subsidiaries.

L+M is a nonprofit organization incorporated under the General Statutes of the State of Connecticut. L+M and LMC form an obligated group under their Series F Bond agreements. Westerly Hospital is a nonprofit organization incorporated under the General Statutes of the State of Rhode Island. LMPA was formed exclusively for the charitable purpose of benefiting, supporting, and furthering the charitable activities of L+M by engaging physicians to provide physician services to the Hospital, organizations affiliated with the Hospital and communities they serve for purpose of practicing medicine and health care services. VNA of Southeastern Connecticut (VNA) – VNA is a not-for-profit organization under the general statutes of the State of Connecticut that provides home healthcare services. L+M Indemnity Ltd. is a wholly owned subsidiary of L+M. L+M Indemnity Ltd. provides professional and general liability insurance to cover medical malpractice claims to LMH, Westerly Hospital, LMPA, and VNA.

Under the terms of the affiliation agreement YNHHSC committed, directly and through its affiliates, to deploy approximately \$300 million in resources in the Eastern Connecticut and Western Rhode Island region over a period of five years to enhance and support clinical and operational capabilities and services consistent with community need, the YNHHSC strategic plan, and mutually agreed upon business plans which display positive return on investment.

LMC joined the System by means of a member substitution which resulted in an inherent contribution where no consideration was transferred by the System. The System accounted for this business combination by applying the acquisition method of accounting, and, accordingly, the inherent contribution received was valued as the excess of assets acquired over liabilities assumed. In determining the inherent contribution received, all assets acquired and liabilities assumed were measured at fair value as of the Transaction Date. The transaction resulted in an inherent contribution of approximately \$277.3 million which has been appropriately recorded within the three net asset classes within the statement of changes in net assets in fiscal year 2016 as unrestricted of \$241.1 million, temporarily restricted of \$20.5 million and permanently restricted of \$15.7 million. The results of LMC's operations have been included in the consolidated financial statements commencing on the transaction date.

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the Transaction Date. Determining the fair value of the assets acquired and liabilities assumed requires judgment and involves the use of significant accounting estimates and assumptions, including assumptions with respect to future cash inflows and outflows and discount rates, among others.

	<b>September 8, 2016</b>	
	<u>(In thousands)</u>	
Assets assumed:		
Cash and cash equivalents	\$	21,653
Short-term investments		149,346
Accounts receivable, net		48,393
Other current assets		15,335
Amounts on deposit with trustee in debt service fund		1
Assets limited to use		51,501
Other assets		6,500
Property, plant ,and equipment, net		236,244
Goodwill		<u>11,864</u>
Total assets	\$	<u><u>540,837</u></u>
	<b>September 8, 2016</b>	
Liabilities assumed:		
Accounts payable and accrued expenses	\$	56,922
Current portion of long-term debt		5,642
Other current liabilities		10,638
Long-term debt, net of current portion		100,620
Accrued pension and postretirement benefit obligations		55,442
Other long-term liabilities		<u>34,266</u>
Total liabilities	\$	<u><u>263,530</u></u>
Net assets assumed:		
Unrestricted	\$	241,106
Temporarily restricted		20,497
Permanently restricted		<u>15,704</u>
Excess of assets assumed over liabilities assumed	\$	<u><u>277,307</u></u>

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
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Notes to Consolidated Financial Statements

September 30, 2016 and 2015

The following table summarizes amounts attributed to LMC since the Transaction Date that are included in the accompanying consolidated financial statements (in thousands):

		<b>Period from September 8, 2016 to September 30, 2016</b>
		<u>                    </u>
Total operating revenue	\$	25,246
Total operating expense		<u>28,789</u>
Loss from operations		(3,543)
Nonoperating gains and losses, net		<u>1,192</u>
Deficiency of revenue over expenses	\$	<u><u>(2,351)</u></u>
Change in net assets:		
Unrestricted net assets		(1,953)
Temporarily restricted net assets		—
Permanently restricted net assets		<u>—</u>
Total change in net assets	\$	<u><u>(1,953)</u></u>

The following table represents pro forma unaudited financial information, assuming the affiliation of LMC had taken place on October 1, 2014. The pro forma information included adjustments for the amortization of intangible assets. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transaction been effected on the Transaction Date (in thousands):

		<b>Year ended September 30</b>	
		<u>2016</u>	<u>2015</u>
Total operating revenue	\$	4,223,711	4,062,270
Total operating expense		<u>4,111,988</u>	<u>3,912,910</u>
Income from operations		111,723	149,360
Nonoperating gains and losses, net		<u>323,130</u>	<u>(3,732)</u>
Excess of revenue over expenses	\$	<u><u>434,853</u></u>	<u><u>145,628</u></u>
Change in net assets:			
Unrestricted net assets	\$	133,284	315,053
Temporarily restricted net assets		(4,270)	21,869
Permanently restricted net assets		<u>1,454</u>	<u>27,204</u>
Total change in net assets	\$	<u><u>130,468</u></u>	<u><u>364,126</u></u>

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**

(d/b/a Yale New Haven Health System and Subsidiaries)

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

**(a) Principles of Consolidation**

The accompanying consolidated financial statements present the accounts and transactions of the System and its subsidiaries. All significant intercompany revenue and expenses and inter-company balance sheet accounts have been eliminated in consolidation.

**(b) Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, including estimated uncollectible accounts receivable for services to patients, and liabilities, including estimated net settlements with third-party payors and professional liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the amounts of revenue and expenses reported during the reporting period. Actual results could differ from those estimates.

During the years ended September 30, 2016 and 2015 the System recorded a favorable change in estimate of approximately \$8.9 million and \$29.8 million, respectively, which increased net patient service revenue. Included in the change are amounts related to third-party payor settlements.

**(c) Related Party Transaction**

For the year ended 2016, YNHH funded approximately \$30.0 million as part of its participation in the New Clinical Program Development Corporation (NCPDC) which is included in supplies and other expenses in the accompanying consolidated statement of operations and changes in net assets. The NCPDC is a separate corporation established by YNHH and Yale University (the University) for the purpose of funding and supporting clinical research and clinical programs. The NCPDC Board of Directors approves the funding of initiatives and consists of equal representative from both YNHH and the University.

YNHH also received \$30.0 million during the year ended September 30, 2016 from NCPDC which was recorded as temporarily restricted and released in the same year for capital expenditures. There were no funding or receipts for the year ended September 30, 2015.

**(d) Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose, and appreciation on permanently restricted net assets. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity. The System is a partial beneficiary to various perpetual trust agreements. Assets recorded under these agreements are recognized at fair value. The investment income generated from the trusts is temporarily restricted, and the assets are classified as permanently restricted by the donor.

Certain restricted funds investments are pooled with certain unrestricted investments to facilitate their management. Investment income is allocated to both restricted and unrestricted funds participating in the investment pool on pro rata basis based on the market value of the fund. The Board of Trustees approves spending for certain pooled funds based on the spending policy. Realized

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
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Notes to Consolidated Financial Statements

September 30, 2016 and 2015

gains and losses from the sale of securities are computed using the average cost method and the first-in, first-out method.

Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions receivable to be received after one year are discounted at a discount rate commensurate with the risks involved. Amortization of the discount is recognized as revenue, and is classified as either unrestricted or temporarily restricted in accordance with donor-imposed restrictions, if any, on the contributions. Contributions are reduced by an allowance for uncollectible contributions. The amount of the allowances for uncollectible contributions is based upon management's assessment of historical and expected net collections.

(e) ***Capital Campaign and Pledges Receivable***

Contributions and pledges receivable, included in other current assets and other assets in the accompanying consolidated balance sheets at September 30, 2016 and 2015, are expected to be received as follows (in thousands):

	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Less than one year	\$ 3,063	4,379
One to five years	3,664	3,415
Thereafter	45	60
	6,772	7,854
Less unamortized discount on contributions receivable (0.1% to 4.2%)	(140)	(232)
	6,632	7,622
Allowance for uncollectible contributions	(199)	(229)
Contributions receivable, net	\$ 6,433	7,393

(f) ***Donor Restricted Gifts***

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. All gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets.

(g) ***Cash and Cash Equivalents***

Cash and cash equivalents include investments in highly liquid financial instruments with original maturities of three months or less when purchased, which are not classified as assets limited as to use, and which are not maintained in the short-term or long-term investment portfolios.



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Cash and cash equivalents are maintained with domestic financial institutions with deposits which exceed federally insured limits. It is the System's policy to monitor the financial strength of these institutions.

**(h) *Accounts Receivable***

Patient accounts receivable result from the health care services provided by the System. Additions to the allowance for uncollectible accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

The amount of the allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in Medicare and Medicaid health care coverage, and other collection indicators. Management periodically assesses the adequacy of this allowance based upon historical collection and write-off experience by payor category. The results of these reviews are used to modify, as necessary, the provision for bad debts and to establish appropriate allowances for uncollectible patient accounts receivable. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain patient balances with collection agencies, subject to certain restrictions on collection efforts as determined by the System policy. See note 2 for additional information relative to third-party payor programs.

Net patient accounts receivable has been adjusted to the estimated amounts expected to be collected. These estimated amounts are subject to further adjustments upon review by third-party payors. Such receivables do not bear interest.

**(i) *Investments***

The System has designated its investment portfolio as trading. Investment income or loss (including realized gains and losses on investments, interest, and dividends) and the change in net unrealized gains and losses are included in the excess of revenue over expenses unless the income or loss is restricted by donor or law.

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value (quoted market prices) in the accompanying consolidated balance sheets.

Certain alternative investments (nontraditional, not-readily marketable assets) are structured such that the System holds limited partnership interests or pooled units and are accounted for utilizing net asset value per unit for measurement of the units' fair value. Individual investment holdings within the alternative investments may, in turn, include investments in both nonmarketable and market-traded securities. Fund of funds investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The investments may indirectly expose the System to securities lending, short sales of securities, and trading in futures and forwards contracts, options, swap contracts and other derivative products. While these financial instruments may contain varying degrees of risk, the System's risk with respect to such transactions is limited to its capital balance in

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each investment. The financial statements of the investees are audited annually by independent auditors. The System maintains the Yale New Haven Health System Investment Trust (the Trust), a unitized Delaware Investment Trust created to pool assets for investment by the Health System's nonprofit entities. The Trust is comprised of two pools: the Long-Term Investment Pool (L-TIP) and the Intermediate-Term Investment Pool (I-TIP). Governance of the Trust is performed by the Yale New Haven Health System Investment Committee.

Under the terms of the investment management agreement with the Trust, withdrawals of investments in the L-TIP can be made annually by each Hospital on July 1. Amounts withdrawn are subject to a schedule that allows larger withdrawals with longer notice periods. As of September 30, 2016, each Hospital can withdrawal 100% of its investment in the L-TIP on July 1, 2016. Withdrawals of investments in the I-TIP in any amount can be made quarterly with 30 days advance notice.

The Trust has entered into an agreement (the Investment Management Agreement) with the University. The University's investment office which allows the University to manage a portion of the Trust's investments as part of the University's Endowment Pool (the Pool). The Trust did not make any transfers for the year ended September 30, 2016 and transferred approximately \$50.0 million to the University in exchange for units in the Pool for the year ended September 30, 2015. The Trust's interest in the Pool is reported at fair value based on the net asset value per units held. The Pool invests in domestic equity, foreign equity, absolute return, private equity, real assets, fixed income, and cash.

Under the terms of the Investment Management Agreement with the University, withdrawals of the Trust's investment in the Pool can be made annually by the Trust on July 1. For withdrawals of amounts less than \$150.0 million, or 75% of the Trust's investment in the Pool, \$100.0 million, or 50% of the Trust's investment in the Pool, and \$50.0 million, or 25% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 180 days, 90 days, and 30 days, respectively, prior to the University's fiscal year ending June 30. For withdrawals greater than \$150.0 million or more than 75% of the Trust's investment in the Pool, the advance notice period is set to a maximum of 270 days prior to the University's fiscal year end of June 30.

In March 2006, Y-NHH entered into an arrangement with the University, whereby the University will manage certain Board-designated assets of Y-NHH. These Board-designated assets are commingled in the University's endowment pool. As of September 30, 2016 and 2015, the carrying value of assets managed by the University under this agreement was approximately \$11.0 million and \$10.6 million, respectively. Because of the limitations on their use, the assets are separately classified from assets invested under the Investment Management Agreement.

In 2011, the investment management agreement between the Trust and the University was modified to allow the Trust to obtain a cash advance, up to a maximum of \$75 million, on a monthly basis. For these advances, interest of U.S. Prime rate, plus 2% will be paid by the Trust. Repayments on the advances are made by the Trust by way of redemptions of a sufficient number of Trust's units in the Endowment using the June 30th unit valuation. No advances have been requested or taken by the Trust in 2015 or 2016.

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Short-term investments represent those securities that are available for the System's operations, and can be converted to cash within one year.

**(j) Inventories**

Inventories (included in other current assets) are stated at the lower of cost or market. The System values its inventories using the first-in, first-out method, with the exception of Y-NHH's pharmacy inventories, which are valued at average cost.

**(k) Assets Limited as to Use**

Assets limited as to use represent assets held by trustees under indenture agreements, beneficial interest in perpetual trusts and designated assets set aside by the Board for future capital improvements and other Board approved uses. The Board retains control of board designated funds and, at its discretion, may use for other purposes for plant improvements and expansion. Amounts required to meet current liabilities are reported as current assets. These funds consist primarily of U.S. government securities, mutual funds and money market funds.

**(l) Perpetual Trusts**

The System is the beneficiary of certain perpetual trusts held and administered by others. The present values of the estimated future cash receipts, which are measured based on the fair value of the assets held by the trust, are recognized as assets and contribution revenue at the dates the trusts are established. Beneficial interest in perpetual trusts is recorded as permanently restricted net assets and is adjusted for any changes in the fair value of the trusts. Income distributions received from the trusts are recorded as temporarily restricted contributions when received.

**(m) Interest Rate Swap Agreements**

The System utilizes interest rate swap agreements to reduce risks associated with changes in interest rates. Interest rate swap agreements are reported at fair value with changes in fair value during the year recorded as nonoperating gains (losses), net. The System is exposed to credit risk in the event of nonperformance by the counterparties to its interest rate swap agreements. The System is also exposed to the risk that the swap receipts may not offset its variable rate debt service. To the extent these variable rate swap receipts do not equal variable interest payments on the bonds, there will be a net loss or net benefit to the System.

**(n) Benefits and Insurance**

The System is self-insured for medical, dental, hospitalization, and prescription drug benefits provided to employees and has a stop loss arrangement to limit exposure for these self-insured benefits. Y-NHH and Y-NHHSC make annual contributions to the Y-NHHSC Voluntary Employee Beneficiary Association (VEBA) plan to fund medical, dental, hospitalization, group term life insurance and prescription drug benefits. Annually, premiums are set to reflect the estimated cost of benefits. During the years ended September 30, 2016 and 2015, Y-NHH and Y-NHHSC made actuarially determined contributions, net of premium adjustments, to the VEBA plan of

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approximately \$184.6 million and \$179.7 million, respectively, and are included in salaries and benefits expense.

**(o) Workers Compensation and Professional Liability Insurance**

The System is self-insured for workers' compensation claims. The System has a stop loss arrangement to limit exposure for workers' compensation claims. Estimated amounts are accrued for claims, including claims incurred but not reported (IBNR). At September 30, 2016 and 2015, the estimated discounted liabilities for self-insured workers' compensation claims and IBNR aggregated approximately \$59.0 million and \$31.4 million, respectively, discounted at approximately 2.0% for the Hospitals and are included in other long-term liabilities in the accompanying consolidated balance sheets.

The System records the actuarially determined liabilities for IBNR professional and general liabilities (note 10).

**(p) Property, Plant and Equipment**

Property, plant and equipment purchased are carried at cost, and those acquired by gifts and bequests are carried at fair value established at the date of contribution. The carrying amounts of assets and the related accumulated depreciation are removed from the accounts when such assets are disposed of, and any resulting gain or loss is included in income from operations. Depreciation of property, plant and equipment is computed by the straight-line method in amounts sufficient to depreciate the cost of the assets over their estimated useful lives, ranging from 3 to 50 years. The cost of additions and improvements are capitalized, and expenditures for repairs and maintenance, including the cost of replacing minor items not considered substantial enhancements, are expensed as incurred.

Leases are classified as capital leases or operating leases in accordance with the terms of the underlying lease agreements. Lease payments under operating leases are charged directly to rental expense, and are included in supplies and other expenses in the accompanying consolidated statements of operations.

**(q) Goodwill**

Goodwill is evaluated at least annually for impairment or more frequently when events or changes in circumstances indicate that the assets might be impaired. This impairment test is performed at the reporting unit level. The System evaluates goodwill at the entity level as management has determined that the System's operations comprise a single reporting entity. Goodwill is considered to be impaired if the carrying value of the reporting unit, including goodwill, exceeds the reporting unit's fair value. The System has determined that no goodwill impairment exists at September 30, 2016 or 2015.

**(r) Deferred Revenue**

Deferred revenue includes amounts which have been received that relate to future years. Amounts will be reduced as revenue is earned (note 11).

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(s) ***Derivative Contracts***

The System procures fuel and has entered into forward delivery agreements and commodity contracts. Substantially all of the System's contracts to procure fuel are designated as, and qualify as, normal purchases; accordingly, such contracts are not accounted for as derivative contracts.

(t) ***Excess of Revenue Over Expenses***

In the accompanying consolidated statements of operations and changes in net assets, excess of revenue over expenses is the performance indicator. Those gains and losses deemed by management to be closely related to ongoing operations are included in other revenue; other gains and losses from peripheral or incidental transactions, including the inherent contribution received in the LMC affiliation, are classified as nonoperating.

Contributions of, or restricted to, property, plant and equipment, and pension and other postretirement related changes other than net periodic benefit cost are excluded from the performance indicator, but are included in the change in net assets.

(u) ***Income Taxes***

Most entities within the System are not-for-profit corporations as described in Section 501(c)(3) of the Code, and are generally exempt from federal income taxes pursuant to Section 501(a) of the Code. Provisions for income taxes and deferred taxes, which are not material to the consolidated financial statements, have been made for the taxable entities listed above under the description of the System.

U.S. GAAP requires the System to evaluate tax positions taken or expected to be taken in the course of preparing the System's tax returns to determine whether the tax positions are "more-likely than-not" of being sustained by the applicable tax authority based upon the technical merits of the position. The System recognizes the effect of tax positions only if they are more-likely than-not of being sustained. This evaluation had no impact on the operations of the System as of and for the year ended September 30, 2016 and 2015.

(v) ***Operating Expenses***

Y-NHH records amounts received from the University, unrelated area hospitals, and other local health care providers for costs incurred on behalf of those organizations as reductions to expenses. These costs consist mainly of salaries and benefits. For the years ended September 30, 2016 and 2015, Y-NHH recorded approximately \$67.9 million and \$55.0 million, respectively, as reductions to expenses.

(w) ***Impairment of Assets***

The System reviews property, plant, and equipment, and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If such impairment indicators are present, the System recognizes a loss on the basis of

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whether these amounts are fully recoverable. There was no impairment charge recognized in 2016 and 2015.

**(x) *Reclassifications***

Certain reclassifications have been made to the year ended September 30, 2015, balances previously reported in the consolidated financial statements in order to conform with the year ended September 30, 2016, presentation.

**(y) *New Accounting Pronouncements***

In April, 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. ASU No. 2015-03 is intended to simplify the presentation of debt issuance costs, requiring them to be presented as a direct reduction from the carrying value of the related debt liability. This guidance is effective for fiscal years beginning after December 15, 2015. Management has adopted and applied ASU 2015-03 retrospectively to all periods presented.

In February, 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 will require a lessee to report most leases on their balance sheet, but recognize expenses on their income statement in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. This guidance is effective for fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of ASU No. 2016-02 on our consolidated financial statements.

In August, 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 is intended to improve the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance and cash flows. This guidance is effective for fiscal years beginning after December 15, 2017. Management is currently evaluating the impact of ASU No. 2016-14 on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Management is currently evaluating the impact of ASU 2014-09 on the financial statements.

**(2) *Accounts Receivable for Services to Patients and Net Patient Service Revenue***

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. The difference is accounted for as contractual allowances. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, fee-for-service,

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discounted charges, and per diem payments. Net patient service revenue is affected by the State of Connecticut Disproportionate Share program and is reported at the estimated net realizable amounts due from patients, third-party payors, 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 investigation.

Third-party payor receivables included in other current assets were \$5.9 million and \$5.0 million at September 30, 2016 and 2015, respectively. Third-party payor liabilities included in other current liabilities were \$82.6 million and \$76.2 million at September 30, 2016 and 2015, respectively. Third-party payor liabilities include in other long-term liabilities were \$78.4 million and \$70.5 million at September 30, 2016 and 2015, respectively.

The System has established estimates, based on information presently available, of amounts due to or from Medicare, Medicaid, and third-party payors for adjustments to current and prior year payment rates, based on System-specific data. Such amounts are included in the accompanying consolidated balance sheets. Additionally, certain payors' payment rates for various years have been appealed by the System.

Revenue from Medicare and Medicaid programs accounted for approximately 30% and 11%, respectively, of the System's consolidated net patient service revenue for the years ended September 30, 2016, and approximately 29% and 11%, respectively, of the System's consolidated net patient service revenue for the years ended September 30, 2015. Inpatient discharges relating to Medicare and Medicaid programs accounted for approximately 36% and 27%, respectively, for the years ended September 30, 2016 and 2015, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and are subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term.

The System believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing, except as disclosed in note 11. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on the System. Cost reports for the System's hospitals, which serve as the basis for final settlement with government payors have been settled by final settlement for various years ranging through 2013 for Medicare and through 2015 for Medicaid. Other years remain open for settlement.

The significant concentrations of accounts receivable for services to patients include 35% from Medicare, 13% from Medicaid, and 52% from nongovernmental payors at September 30, 2016 and 36% from Medicare, 16% from Medicaid, and 48% from nongovernmental payors at September 30, 2015.

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Patient service revenue for the years ended September 30, 2016 and 2015, net of contractual allowances and discounts (but before the provision for bad debts), recognized from these major payor sources based on primary insurance designation, is as follows:

	<u>2016</u>	<u>2015</u>
Commercial – Anthem Blue Cross	\$ 902,886	847,669
Commercial – other	109,824	138,583
Managed care	951,469	932,725
Medicaid	390,143	395,080
Medicare	835,782	793,950
Medicare managed care	269,013	258,704
Self-pay/Other	249,395	169,543
Total all payors	<u>\$ 3,708,512</u>	<u>3,536,254</u>

Net patient service revenue is comprised of the following for the years ended September 30, 2016 and 2015 (in thousands):

	<u>2016</u>	<u>2015</u>
Gross revenue from patients	\$ 12,552,069	12,259,499
Deductions:		
Contractual allowances	8,646,022	8,538,788
Charity and free care (at charges)	197,535	184,457
Provision for bad debts, net	105,031	81,528
Net patient service revenue	<u>\$ 3,603,481</u>	<u>3,454,726</u>

Deductibles and copayments under third-party payment programs within the third-party payor amount above are the patient's responsibility and the System considers these amounts in its determination of the provision for bad debts based on collection experience. Accounts receivable are also reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the System analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

The System's allowance for uncollectible accounts totaled approximately \$372.7 million and \$313.9 million at September 30, 2016 and 2015, respectively. The allowance for uncollectible accounts for self-pay patients was approximately 53% and 66.0% of self-pay accounts receivable as of September 30, 2016 and 2015, respectively. Substantially all write-offs are related to self-pay patients.

**(3) Uncompensated Care and Community Benefit Expense**

The System's commitment to community service is evidenced by services provided to the poor and benefits provided to the broader community. Services provided to the poor include services provided to



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persons who cannot afford health care because of inadequate resources, and/or who are uninsured or underinsured.

The System provides free care programs for qualifying patients. In accordance with the established policies of the System, during the registration, billing, and collection process, a patient's eligibility for free care funds is determined. For patients who were determined by the System to have the ability to pay but did not, the uncollected amounts are the provision for bad debts. For patients who do not avail themselves of any free care program, and whose ability to pay cannot be determined by the System, care given but not paid for is classified as charity care.

Together, charity care and provision for bad debts represent uncompensated care. The estimated cost of total uncompensated care is approximately \$178.1 million and \$154.7 million for the years ended September 30, 2016 and 2015, respectively. The estimated cost of uncompensated care is based on the ratio of cost to charges, as determined by claims activity.

The estimated cost of charity care provided was \$116.7 million and \$108.4 million for the years ended September 30, 2016 and 2015, respectively. The estimated cost of charity care is based on the ratio of cost to charges. The allocation between bad debt and charity care is determined based on management's analysis on the previous 12 months of hospital data. This analysis calculates the actual percentage of accounts written off or designated as bad debt versus charity care while taking into account the total costs incurred by the System for each account analyzed.

For the years ended September 30, 2016 and 2015, provision for bad debts, at charges, was \$105.0 million and \$81.5 million, respectively. For the years ended September 30, 2016 and 2015, provision for bad debt at cost was approximately \$61.4 million and \$46.3 million, respectively. The provision for bad debts is multiplied by the ratio of cost to charges for purposes of inclusion in the total uncompensated care amount identified above.

The Connecticut Disproportionate Share Hospital Program (CDSHP) was established to provide funds to hospitals for the provision of uncompensated care and is funded, in part, by an assessment on hospital net patient service revenue. During the years ended September 30, 2016 and 2015, the System received \$34.9 million and \$14.6 million, respectively, in CDSHP distributions, of which approximately \$24.1 million and \$10.4 million was related to charity care. The System made payments into the CDSHP of \$182.1 million and \$122.4 million for the years ended September 30, 2016 and 2015, respectively, for the assessment. These are recorded in net patient service revenue.

Additionally, the System provides benefits for the broader community which includes services provided to other needy populations that may not qualify as poor but need special services and support. Benefits include the cost of health promotion and education of the general community, interns and residents, health screenings and medical research. The benefits are provided through the community health centers, some of which service non-English speaking residents, disabled children and various community support groups. The System voluntarily assists with the direct funding of several City of New Haven programs, including an economic development program and a youth initiative program.

In addition to the quantifiable services defined above, the System provides additional benefits to the community through its advocacy of community service by employees. The System's employees serve

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numerous organizations through board representation, membership in associations and other related activities. The System also solicits the assistance of other health care professionals to provide their services at no charge through participation in various community seminars and training programs.

**(4) Investments and Assets Limited as to Use**

The composition of investments, including investments held by the Trust, amounts on deposit with trustee in debt service fund, and assets limited as to use is set forth in the following table (in thousands):

	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Money market funds	\$ 115,334	130,047
U.S. equity securities	224,128	104,792
International equity securities <sup>(a)</sup>	242,852	105,476
Fixed income:		
U.S. government	519,820	417,835
International government <sup>(a)</sup>	86,065	97,707
Corporate bonds	23,362	4,945
Commodities <sup>(b)</sup>	5,486	1,595
Hedge funds:		
Absolute return <sup>(c)</sup>	60,126	21,909
Long/short equity <sup>(d)</sup>	5,674	6,936
Long only	12,153	—
Private equity	12,381	7,489
Real estate <sup>(e)</sup>	12,376	8,278
Interest in Yale University endowment pool <sup>(f)</sup>	946,457	855,264
Assets held in trusts by others	7,867	—
Perpetual trusts <sup>(g)</sup>	31,981	30,981
Total	\$ 2,306,062	1,793,254

<sup>(a)</sup> Investments with external international equity and bond managers that are domiciled in the United States. Investment managers may invest in American or Global Depository Receipts (ADR, GDR) or in direct foreign securities.

<sup>(b)</sup> Investments with external commodities futures manager.

<sup>(c)</sup> Investment with external multi-strategy fund of funds manager investing in publicly traded equity and credit holdings which may be long or short positions.

<sup>(d)</sup> Investment with an external long-short equity fund of funds manager with underlying portfolio investments consisting of publicly traded equity positions.

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- (e) Investments with external direct real estate managers and fund of funds managers. Investment vehicles include both closed end Real Estate Investment Trusts (REITs) and limited partnerships.
- (f) Yale University Endowment Pool maintains a diversified investment portfolio, through the use of external investment managers operating in a variety of investment vehicles, including separate accounts, limited partnerships, and commingled funds. The pool combines an orientation to equity investments with an allocation to nontraditional asset classes such as an absolute return, private equity, and real assets.
- (g) Investments consist of several domestic and international equity and fixed income mutual funds, REITs, commodities and money market funds. There is also an investment in a hedge fund of funds.

**(5) Property, Plant and Equipment**

Property, plant and equipment is as follows (in thousands):

	September 30	
	2016	2015
Land	\$ 76,886	53,293
Buildings and improvements	1,816,269	1,564,533
Equipment	1,414,349	1,264,862
Assets recorded under capital leases	145,800	57,345
	3,453,304	2,940,033
Less accumulated depreciation and amortization	1,721,967	1,551,286
Property, plant, and equipment, net	1,731,337	1,388,747
Construction in progress (note 8 (n))	125,131	157,101
	\$ 1,856,468	1,545,848

**(6) Endowment**

The System's endowment includes donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The System has interpreted the Connecticut Uniform Prudent Management of Institutional Funds Act (CUPMIFA) as requiring 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, the System classifies as permanently restricted net assets: (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment related to the System's beneficial interest in perpetual trusts made in accordance with the direction of the applicable donor gift instrument at the time of the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund

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that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed by CUPMIFA. In accordance with CUPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the System and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the System; and (7) the investment and spending policies of the System.

Changes in endowment net assets for the year ended September 30, 2016 are as follows (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets at beginning of year	\$ 44,714	75,276	93,356	213,346
Affiliation with LMC	11,101	16,193	7,411	34,705
Investment returns:				
Investment (loss) income	(516)	202	55	(259)
Net appreciation (realized and unrealized)	5,349	13,446	286	19,081
Total investment returns	4,833	13,648	341	18,822
Appropriation of endowment assets for expenditure	(2,976)	(7,776)	(171)	(10,923)
Transfers between donor classification	1,373	(1,337)	(36)	—
Other changes:				
Contributions	110	2,238	716	3,064
Change in value of beneficial interest trusts	—	—	291	291
Endowment net assets at end of year	\$ <u>59,155</u>	<u>98,242</u>	<u>101,908</u>	<u>259,305</u>

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Changes in endowment net assets for the year ended September 30, 2015 are as follows (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets at beginning of year	\$ 47,947	73,543	80,856	202,346
Investment returns:				
Investment (loss) income	(865)	151	—	(714)
Net appreciation (realized and unrealized)	<u>452</u>	<u>3,278</u>	<u>(1)</u>	<u>3,729</u>
Total investment returns	(413)	3,429	(1)	3,015
Appropriation of endowment assets for expenditure	(2,820)	(7,826)	(1,392)	(12,038)
Other changes:				
Contributions	—	6,130	15,175	21,305
Change in value of beneficial interest trusts	<u>—</u>	<u>—</u>	<u>(1,282)</u>	<u>(1,282)</u>
Endowment net assets at end of year	<u>\$ 44,714</u>	<u>75,276</u>	<u>93,356</u>	<u>213,346</u>

	<u>September 30</u>	
	<u>2016</u>	<u>2015</u>
	(In thousands)	
The portion of perpetual endowment funds subject to a time restriction under CUPMIFA:		
Without purpose restrictions	\$ 8,779	8,666
With purpose restrictions	<u>73,234</u>	<u>66,610</u>
Total endowment funds classified as temporarily restricted net assets	<u>\$ 82,013</u>	<u>75,276</u>

**(a) Return Objectives and Risk Parameters**

The System has adopted investment and spending policies for endowed assets that attempt to provide a predictable stream of funding to programs supported by its endowment. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under these policies, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that over time provide a rate of return that meets the spending policy objectives adjusted for inflation. Actual returns in any given year may vary from this amount.

**(b) Strategies Employed for Achieving Objectives**

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and

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current yield (interest and dividends). The System targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term rate of return objectives within prudent risk constraints.

**(c) Spending Policy and How the Investment Objectives Relate to Spending Policy**

BH and Y-NHH have a policy of appropriating for distribution each year based on a combination of the weighted average of the prior year spending adjusted for inflation and the amount that would have been spent using a predetermined percentage (5.25% for Y-NHH and 5.0% for BH) of the current market value of the endowment fund. In establishing this policy, BH and Y-NHH have considered the long-term expected return on its endowment.

GH has a policy of appropriating funds for distribution each year based on the greater of \$800,000 or 5% of the average market value of its investments for the prior 12 quarters. In establishing this policy, GH considered the long-term expected return on its endowment.

LMC has a policy in which spending is guided by several factors most important is the value of the portfolio. Generally, the LMC Board will approve a spending policy limiting annual expenditures for grants and operating expenses of to 4.5% of the value of the Funds' assets based on a 12 quarter rolling average for the endowment, and operating funds.

From time to time, the fair value of assets associated with permanently restricted endowment funds may fall below the level determined under Connecticut UPMIFA.

**(7) Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes (in thousands):

	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Specific hospital operations, teaching, research, indigent and free care, and training	\$ 154,971	125,467
Plant improvement and expansion	8,564	22,101
	<u>\$ 163,535</u>	<u>147,568</u>

Permanently restricted net assets of approximately \$110.0 million and \$93.4 million at September 30, 2016 and 2015, respectively, consist of donor restricted endowment principal and beneficial interests in perpetual trusts. The income generated from permanently restricted funds is expendable for purposes designated by donors, including research, free care, health care, and other services.

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During 2015, the Attorney General approved the transfer of certain philanthropic funds to Y-NHH from the Hospital of Saint Raphael and its Foundation related to Y-NHH's acquisition of the Hospital of Saint Raphael in FY 2012. The funds approved for transfer are included as contributions to temporarily restricted net assets totaling \$0.1 million and \$8.8 million for the year ended September 30, 2016 and 2015, respectively, and permanently restricted net assets totaling \$11.5 million for the year ended September 30, 2015. There were no permanently restricted net assets transferred for the year ended September 30, 2016.

**(8) Debt**

A summary of long-term debt and capital lease obligations is as follows (in thousands):

	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Revenue bonds financed with the State of Connecticut Health and Educational Facilities Authority (CHEFA):		
Tax-exempt		
Series C (Greenwich Hospital) maturing July 1, 2026 (variable interest rates with an average rate of approximately 3.22% for fiscal 2016) (a)	\$ 32,430	35,105
Series D (BH), maturing July 1, 2025, fixed interest ranging from 2.00% to 5.00% (b)	27,400	29,780
Series E (BH), 3.47% effective interest rate (c)	33,927	34,982
Series N (Y-NHH), 4.27% effective interest rate (d)	44,815	44,815
Series O (Y-NHH), 2.84% effective interest rate (d)	50,000	50,000
Series A (Y-NHH), 3.77% effective interest rate (e)	102,300	102,300
Series B (Y-NHH), 2.30% effective interest rate (e)	168,275	168,275
Series C (Y-NHH), 3.11% effective interest rate (f)	70,625	77,235
Series D (Y-NHH), 3.68% effective interest rate (f)	108,275	108,275
Series E (Y-NHH), 3.47% effective interest rate (c)	42,408	43,728
Series 2013 taxable bonds (Y-NHH), 4.37% effective rate (g)	132,000	132,000
Series 2014 taxable bonds (Y-NHH), 4.37% effective rate (h)	50,725	50,725
Series F (LMC) (o)		
Variable rate bonds	27,164	—
Term bonds due 2027 to 2031, 4.28% effective interest rate	9,487	—
Term bonds due 2032 to 2036, 4.95% effective interest rate	11,969	—
Series G (LMC), maturing (p)	29,727	—
Series H (LMC), maturing 2023-2034, variable rates (q)	21,405	—

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	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Loans payable:		
Note payable (Y-NHH), 5.4% effective interest rate (i)	\$ 8,156	8,309
Term loan – November 2010 (BH), 3.22% fixed interest rate (j)	3,010	3,674
Term loan June, 2012 (BH), 1.66% fixed interest rate (k)	854	1,977
Note payable (BH), 6.9% fixed interest rate (l)	1,611	2,101
Capital leases:		
Capital lease obligation at an imputed interest of 6.0% – November 2010, (Y-NHH) (m)	46,850	48,853
Capital lease obligation (BH), discount rate 6% (n)	98,097	60,774
Tax Exempt Lease (LMC) (r)	6,612	—
Capital lease obligation (LMC)	6	—
	1,128,128	1,002,908
Add premium	26,629	29,332
Less:		
Current portion	(35,464)	(18,931)
Deferred costs of issuance, net of accumulated amortization	(9,988)	(10,494)
	\$ 1,109,305	1,002,815

- a) On May 6, 2008, CHEFA issued \$53.6 million of its Revenue Bonds on behalf of GH, Series C, consisting of variable rate demand bonds. The proceeds were utilized for the refunding of outstanding revenue bonds. Principal amounts related to the Series C revenue bonds mature annually each July 1 through fiscal 2026. The Series C bonds are required to be supported by a letter of credit, which has been executed with Bank of America. The letter of credit is scheduled to expire in May 2018.
- b) In May 2012, the BH Series D tax-exempt revenue bonds were issued through CHEFA under a Master Trust Indenture for approximately \$36.4 million, with coupons ranging from 2.0% to 5.0%, and a final maturity of July 2025. The proceeds, including a premium of approximately \$4.1 million, were held in an escrow account and used for the retirement of the outstanding tax-exempt revenue bonds, for Series A and C, and to pay for certain bond issuance costs of approximately \$0.8 million. The bond premium is being amortized using the effective interest method and is included in interest expense in the accompanying consolidated statement of operations and changes in net assets. Additionally, the Obligated Group has granted a collateral interest to CHEFA on its gross receipts.
- c) In June 2014, the Obligated Group issued Series E revenue bonds totaling approximately \$80.9 million. The Series E revenue bonds were issued as fixed rate bonds with an effective interest rate of 3.47%. The proceeds included a premium of approximately \$10.1 million. The proceeds were used to finance costs for the installation of machinery and equipment and various renovations and improvements to the infrastructures at BH and Y-NHH. Until completion of these projects, the premium was being amortized and included in capitalized interest. Upon completion, the bond



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premium is being amortized as interest expense in the consolidated statement of operations and changes in net assets. The Series E revenue bonds maturing on July 1, 2037 are payable in installments from 2016 to 2034 and July 1, 2037. Additionally, the Obligated Group has granted a collateral interest to CHEFA on its gross receipts.

- d) In January 2013, Y-NHH issued Series N and Series O revenue bonds totaling approximately \$100.0 million. The Series N revenue bonds were issued as fixed rate bonds with an effective interest rate of 4.27%. The Series O revenue bonds were issued as VRDBs with an effective interest rate of 2.84% at September 30, 2013. The proceeds, including a premium of approximately \$5.2 million for the Series N revenue bonds, were used to refinance a line of credit. The bond premium is being amortized as interest expense in the accompanying consolidated statements of operations and changes in net assets. The Series N revenue bonds maturing on July 1, 2036 are payable in installments from 2019 to 2036 and the Series N revenue bonds maturing on July 1, 2048 are payable in installments from 2044 to 2048. The Series O revenue bonds maturing on July 1, 2053 are payable in installments from 2049 to 2053. Additionally, the Obligated Group has granted a collateral interest to CHEFA on its gross receipts.
- e) In June 2014, the Obligated Group issued Series A revenue bonds totaling approximately \$102.3 million and Series B revenue bonds totaling approximately \$168.3 million. The Series A revenue bonds were issued as fixed rate bonds with an effective interest rate of 3.77% at September 30, 2016. The Series B revenue bonds were issued as floating rate notes with an effective interest rate of 2.30% at September 30, 2016. The proceeds from the Series A revenue bonds, including a premium of approximately \$14.8 million, and the proceeds from the Series B revenue bonds, were used to defease certain Y-NHH revenue bonds. The bond premium is being amortized as interest expense using the effective interest method in the consolidated statements of operations and changes in net assets. The Series A revenue bonds maturing on July 1, 2034 are payable in installments from 2026 to 2034. The Series B revenue bonds maturing on July 1, 2049 are payable in installments from 2037 to 2040 and from 2044 to 2049. Additionally, the Obligated Group has granted a collateral interest to CHEFA on its gross receipts.
- f) In June 2014, the Obligated Group issued Series C revenue bonds totaling approximately \$83.6 million and Series D revenue bonds totaling approximately \$108.3 million. The Series C revenue bonds were issued as VRDBs with an effective interest rate of 3.11% as of September 30, 2016. The proceeds from the Series C issuance were used to refund certain Y-NHH revenue bonds. The Series D revenue bonds were issued as VRDBs with an effective interest rate of 3.68% as of September 30, 2016. The proceeds from the Series D issuance were used to refund certain Y-NHH revenue bonds. The Series C revenue bonds maturing on July 1, 2025 are payable in installments from 2016 to 2025. The Series D revenue bonds maturing on July 1, 2048 are payable in installments from 2032 to 2036 and 2044 to 2048. Additionally, the Obligated Group has granted a collateral interest to CHEFA on its gross receipts.
- g) In January 2013, Y-NHH issued Series 2013 taxable bonds totaling approximately \$132.0 million. The Series 2013 taxable bonds were issued as fixed rate bonds with an effective interest rate of 4.37%. The proceeds were used to finance and refinance the costs of certain projects and activities in furtherance of Y-NHH's tax exempt purpose, including the refinancing of certain existing

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indebtedness. The Series 2013 taxable bonds maturing on July 1, 2043 are payable in installments from 2037 to 2043.

- h) In June 2014, the Obligated Group issued Series 2014 taxable bonds totaling approximately \$50.7 million. The Series 2014 taxable bonds were issued as fixed rate bonds with an effective interest rate of 4.37%. The proceeds were used to finance the costs of certain projects and activities in furtherance of the System's tax-exempt purpose.
- i) In connection with the May 2015 purchase of a parcel of real estate, Y-NHH assumed a note payable with an effective interest rate of 5.46%. The note payable had an original term of three years and matures in May 2017.
- j) In November 2010, BH obtained a \$6.6 million term loan from the CHEFA. The proceeds of the loan are to be used for the purchase and installation of energy savings equipment and various renovations and improvements to the infrastructure of BH. The loan is to be paid in monthly installments over ten years at a fixed interest rate of 3.22%.
- k) In June 2012, BH obtained a \$5.5 million term loan from CHEFA. The loan is to be paid in monthly installments over five years at a fixed rate of 1.66% with the proceeds to be used for medical and cafeteria equipment. The loan is secured by the equipment purchased with the proceeds of the loan.
- l) In December 2012, in connection with the purchase of a radiology practice, BH entered into a note payable with the seller in the amount of \$15.1 million. The note is to be repaid in monthly installments over five years.
- m) Y-NHH entered into a contract to lease space in a building adjacent to Y-NHH. Y-NHH's rental obligation commenced in November 2010. This capital lease has a term of 20 years from the commencement date with the option to extend the lease for four successive terms of ten years. Rental payments increase by 5% every five years. Y-NHH is also subject to additional rent for its share of expenses, as defined in the contract. Y-NHH has the option to purchase the property at the end of the fifth, tenth, or twentieth year or at the end of each of the first three ten-year extension periods.
- n) BH entered into an arrangement with a developer to construct a 120,000 square foot medical office building and adjacent garage in Fairfield County, CT. The arrangement contains provisions for BH to begin leasing the property for a 25-year period beginning in April 2016. Management has evaluated the terms of the arrangement and will be recording the project as a capital lease. Upon completion, the total estimated capital lease obligation will approximate \$102.0 million. At September 30, 2016 and 2015, construction costs totaled approximately \$0.0 million and \$38.2 million, respectively, and are included in construction in process in the accompanying consolidated balance sheet.
- o) On September 15, 2011 the Connecticut Health and Education Facilities Authority (CHEFA) issued \$58.9 million of Series F Bonds (the Series F Bonds) on behalf of the Lawrence + Memorial Hospital and Lawrence + Memorial Corporation (the L+M Obligated Group). The Series F Bonds are structured with a term bonds due at various dates through July 1, 2036, with annual sinking fund payments due each July 1st. Interest on the Series F Bonds is payable semiannually on the first

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business day of January 1 and July 1 which began on January 1, 2012. The bonds may be retired at an earlier date pursuant to terms of the master indenture. Payment of the bonds is collateralized by a pledge of the gross receipts, as defined and certain real property of L+M.

- p) On October 10, 2013 Series G was issued on behalf of the L+M Obligated Group in a private placement offering with Bank of America-Merrill Lynch and CHEFA in the amount of \$29.2 million with an interest rate of 3.20% until October 1, 2023 with an option to extend at a negotiated rate with a maturity date of July 1, 2038. The bonds may be retired at an earlier date pursuant to terms of the master indenture. Payment of the bonds is collateralized by a pledge of the gross receipts, as defined and certain real property of L+M.
- q) On November 5, 2013, Series H was issued on behalf of the L+M Obligated Group by CHEFA to refinance Series E. Series H was issued in the amount of \$21.4 million with a variable rate and a maturity date of July 1, 2034. This bond has a letter of credit guaranteed by T.D. Bank. Interest on the Series H Bonds accrues at the weekly rate and is payable on the first business day of each month commencing January 1, 2014. The bonds may be retired at an earlier date pursuant to terms of the master indenture. Payment of the bonds is collateralized by a pledge of the gross receipts, as defined and certain real property of L+M.
- r) The L+M Obligated Group tax exempt lease was obtained on June 27, 2013 in the principal amount of \$12.0 million. This is a seven year equipment lease on specific capital purchases that is administered through CHEFA and Bank of America-Merrill Lynch. This lease obligation will be amortized monthly through June 27, 2020 at a nominal annual interest rate of 1.759%.

Required monthly payments on the revenue bonds by the System to a trustee are in amounts sufficient to provide for the payments of principal, interest, and sinking fund installments, as well as required payments to certain reserve funds held by the trustee, in accordance with the terms of the agreements, and certain other annual costs of CHEFA.

In May 2016, YNHHS entered into a syndicated line of credit with a consortium of banks in the amount of \$100.0 million. As of September 30, 2016, the System has not drawn on this line of credit and there is no outstanding balance. The line of credit allows repayment at any time during the term and requires that any remaining unpaid balance be repaid at the expiration date of May 5, 2019. This obligation bears interest at a rate equal to LIBOR plus 0.575% per annum.

Arbitrage rules apply to tax-exempt debt issued after August 31, 1986. The rules require that, in specified circumstances, earnings from the investment of tax-exempt bond proceeds which exceed the yield on the bonds must be remitted to the Federal government. There were no arbitrage liabilities at September 30, 2016 and 2015

The GH Series C, Y-NHH Series C, Y-NHH Series D, Y-NHH Series O and L+M Series H VRDBs are required to be supported by letter of credit facilities (LOCs) which have been executed with three financial institutions. These LOCs are scheduled to expire on May 7, 2018, December 31, 2017, June 23, 2019, February 14, 2018, and November 5, 2018, respectively.

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The Hospitals maintain the bank letters of credit to ensure the availability of funds to purchase any bonds tendered by bondholders that the remarketing agents are unable to remarket to new bondholders. Draws related to such tenders under the letters of credit will become Bank Bonds. As Bank Bonds, they can still be remarketed by the remarketing agents. If not remarketed successfully as Bank Bonds, the Hospitals will have the opportunity to refinance them, depending upon which bond series, during a period of from 90 to 367 days from initial draw date. If the Bank Bonds are not refunded and remain outstanding exceeding such period from initial draw date, GH will be required to make monthly payments over three years and Y-NHH will be required to make quarterly payments over five years. There were no draws under the letters of credit as of September 30, 2016 or 2015.

The terms of the various financing arrangements between CHEFA and the System, the financial institutions providing the LOCs and the System, and the bank and the System provide for financial covenants regarding the System's debt service coverage ratio, liquidity ratio, and debt to capitalization ratio, among others. Additionally, the Obligated Group and GH have granted a collateral interest to CHEFA on their gross receipts.

Assets recorded under the capital lease obligations totaled approximately \$156.1 million and \$118.1 million as of September 30, 2016 and 2015, respectively. Accumulated amortization for the capital lease obligations totaled approximately \$11.7 million and \$10.1 million at September 30, 2016 and 2015, respectively.

Under the terms of the trust indenture for the Series F, G and H Bonds, L+M's Obligated Group is required to meet certain financial covenants including a debt service coverage ratio and days cash on hand ratio. Members of L+M's Obligated Group are jointly and severally obligated to provide amounts sufficient to enable the Authority to pay principal and interest on the Series F, G and H Bonds. L+M's Obligated Group will make future debt service payments as required under the terms of the bonds.

The L+M Corporation had a line of credit with Bank of America-Merrill Lynch for \$13.8 million. This was obtained as a bridge loan prior to issuance of Series G private placement. The proceeds of Series G were used to pay off this line of credit on October 10, 2013. LMW Healthcare had a line of credit with Washington Trust for \$4.9 million. This line was reissued at time of closing but was paid off in November 2013.

Capitalized interest at September 30, 2016 and 2015 totaled approximately \$29.5 million and \$30.9 million, respectively.

For the years ended September 30, 2016 and 2015, the System paid approximately \$28.5 million and \$23.4 million, respectively, for interest related to long-term debt and capital lease obligations.

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Scheduled principal payments based on bond maturities and capital lease obligations, are as follows (in thousands):

	<b>Debt</b>	<b>Capital lease obligations</b>
Year ending September 30:		
2017	\$ 31,627	14,451
2018	21,745	14,481
2019	23,743	14,513
2020	24,222	14,575
2021	22,343	12,979
Thereafter	859,501	197,394
	\$ 983,181	268,393
Less interest		(116,828)
		\$ 151,565

The following table summarizes the System's interest rate swap agreements (in thousands):

Swap type	Expiration date	System receives	System pays	Notional amount at September 30	
				2016	2015
Obligated Group:					
Series O – fixed to floating	July 1, 2053	67% of LIBOR	2.84%	\$ 50,000	50,000
Series B – fixed to floating	July 1, 2049	67% of LIBOR	2.31	100,965	100,965
Series B – fixed to floating	July 1, 2049	LIBOR	2.29	67,310	67,310
Series C – fixed to floating	July 1, 2025	LIBOR	3.11	47,178	51,592
Series D – fixed to floating	July 1, 2036	LIBOR	3.68	44,505	44,505
Greenwich Hospital:					
Series C – fixed to floating	July 1, 2026	LIBOR	3.10	22,100	24,000
				\$ 332,058	338,372

The swap agreements set the interest rate at a level viewed as desirable by the System. Such agreements expose the System to credit risk in the event of nonperformance by the counterparties, some of the risk is collateralized. At September 30, 2016 and 2015, the fair value of the swap agreements based on current interest rates was approximately \$74.6 million and \$54.7 million, respectively, representing a payable to the counterparties (recorded in other long-term liabilities).

For the Y-NHH Series O swap, there was an unfavorable change in fair value of \$0.3 million and \$0.7 million for the years ended September 30, 2016 and 2015, respectively, which was recorded in excess of revenue over expenses. No collateral was required under the Series O swap agreement for the years ended September 30, 2016 and 2015.

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In June 2014, Y-NHHSC, on behalf of the Obligated Group, entered into LIBOR swap rate locks with two counter parties (the Series B swaps). For the Series B swaps, there was an unfavorable change in fair value of approximately \$15.0 million and \$13.2 for the years ended September 30, 2016 and 2015, respectively, which was recorded in excess of revenue over expenses. No collateral was required under the Series B swap agreements for the years ended September 30, 2016 and 2015.

For the Y-NHH Series C swap, there was a favorable change in fair value of approximately \$0.01 million and \$0.5 million, respectively, for the years ended September 30, 2016 and 2015 which was recorded in excess of revenue over expenses. No collateral was required under the Y- NHH Series C swap agreement for the years ended September 30, 2016 and 2015.

For the Y-NHH Series D swap, there was an unfavorable change in fair value of approximately \$5.6 million and \$4.2 million for the years ended September 30, 2016 and 2015, respectively, which was recorded in excess of revenue over expenses. No collateral was required under the Series D swap agreement for the years ended September 30, 2016 and 2015.

In connection with its Series C revenue bonds, GH entered into an interest rate swap agreement (the GH swap) with a financial institution. Under the terms of the GH swap, GH will receive variable interest payments and pay fixed interest payments on a notional value of approximately \$22.1 million.

For the GH swap, there was a favorable change in fair value of approximately \$0.04 million for the years ended September 30, 2016 and 2015 which was recorded in excess of revenue over expenses. The terms of the swap agreement have not required GH to collateralize funds to be held by the financial institution as of September 30, 2016 and 2015.

**(9) Pensions and Postretirement Benefits**

The System has qualified and nonqualified defined benefit pension plans covering substantially all employees and executives. The benefits provided are based on age, years of service, and compensation. The System's policy is to fund the pension benefits with at least the minimum amounts required by the Employee Retirement Income Security Act of 1974.

The System also sponsors contributory 403(b) plans and 401(k) plans covering substantially all employees. Employer contributions for certain 403(b), made to a matching 401(a) plan, and 401(k) plans are determined based on employee contributions and years of service. The System contributed approximately \$59.7 million and \$62.0 million for the years ended September 30, 2016 and 2015, respectively. Amounts due to the defined contribution plans amounted to \$29.9 million and \$28.7 million at September 30, 2016 and 2015, respectively, and is included in accrued expenses in the accompanying balance sheets.

Y-NHH maintains a Section 457 Nonqualified deferred compensation plan. Contributions are made on a pre-tax basis. The balances recorded at September 30, 2016 and 2015 in other assets and other long-term liabilities were approximately \$39.3 million and \$34.4 million, respectively.

On June 30, 2006, BH froze its defined benefit plan. On October 1, 2006, BH instituted a defined contribution plan.

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Effective as of December 31, 2006, GH amended its defined benefit pension plan to freeze benefits for employees who were under age 50 with less than five years of service. Effective January 1, 2007, GH began providing a matching contribution and a length of service contribution, in addition to its incentive contribution, for its defined contribution plan for all employees no longer accruing benefits under the defined benefit plan. Employees who were age 50 or older with five years of service continue to accumulate benefits under the defined benefit plan, and do not participate in the defined contribution plan.

On June 30, 1999, LMC froze its defined benefit plan. The benefits are based on years of service and the employee's compensation during the last five years of employment.

Effective September 30, 2013, the Y-NHH qualified defined benefit pension plan and the 401(a) plan were amended to reduce the percentage of compensation contributed by Y-NHH to the qualified defined benefit pension plan and to increase the percentage of compensation contributed by Y-NHH to the 401(a) plan for the plan years commencing after December 1, 2013.

Y-NHH and GH also provide certain health care and life insurance benefits upon retirement to substantially all their employees. Y-NHH's and GH's policy is to fund these annual costs as they are incurred from the general assets of Y-NHH and GH. The estimated cost of these postretirement benefits is actuarially determined and accrued over the employees' service periods.

The Hospital provides health care and life insurance benefits to its retired employees who meet certain eligibility requirements. The Hospital's policy is to fund the cost of postretirement benefits other than pensions as incurred. This plan was frozen to include only those employees who retired prior to May 1, 1994.

Included in unrestricted net assets at September 30, 2016 and 2015 are the following amounts that have not yet been recognized in net periodic pension cost: unrecognized prior service credit of approximately \$18.5 million and \$20.4 million, respectively, and unrecognized actuarial losses of approximately \$459.0 million and \$350.1 million, respectively. The prior service credit and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ending September 30, 2017 are approximately \$1.9 million and \$15.4 million, respectively.

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The following table sets forth the change in benefit obligations, change in the plans' assets, and the reconciliation of underfunded status of the System's defined benefit plans and postretirement benefits plan as of September 30, 2016 and 2015 (in thousands):

	<b>Defined benefit pension plans</b>		<b>Postretirement benefits plan</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Change in benefit obligation:				
Benefit obligation at prior measurement date	\$ 922,289	908,910	69,581	78,136
Inclusion of benefit obligation from affiliation of LMC	161,859	—	754	—
Service cost	22,686	23,106	3,135	3,789
Interest cost	45,708	37,775	3,106	3,393
Actuarial loss (gain)	119,773	(5,176)	9,635	(14,067)
Employee contributions	42	—	—	—
Benefits paid	<u>(54,767)</u>	<u>(42,326)</u>	<u>(1,753)</u>	<u>(1,670)</u>
Benefit obligation at current measurement date	<u>1,217,590</u>	<u>922,289</u>	<u>84,458</u>	<u>69,581</u>
Change in plans' assets:				
Fair value of assets at prior measurement date	649,835	663,472	—	—
Inclusion of plan assets from affiliation of LMC	110,862	—	—	—
Actual return on plans' assets	61,231	(28,974)	—	—
Employee contributions	42	—	—	—
Employer contributions	77,005	57,663	1,753	1,670
Benefits paid	<u>(54,767)</u>	<u>(42,326)</u>	<u>(1,753)</u>	<u>(1,670)</u>
Fair value of plans' assets at current measurement date	<u>844,208</u>	<u>649,835</u>	<u>—</u>	<u>—</u>
Accrued benefit cost	<u>\$ (373,382)</u>	<u>(272,454)</u>	<u>(84,458)</u>	<u>(69,581)</u>



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The accrued benefit cost included in the consolidated balance sheets includes the following (in thousands):

	<b>Accrued pension and postretirement obligations</b>		<b>Fair value of plans' assets</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Y-NHH and Subsidiaries – accrued pension and postretirement obligations	\$ (261,071)	(230,944)	395,091	340,669
Bridgeport Hospital – accrued pension and postretirement obligations	(77,643)	(68,304)	159,594	142,986
Greenwich Hospital – accrued pension and postretirement obligations	(64,830)	(42,787)	173,781	166,180
Lawrence + Memorial - accrued pension and postretirement obligations	(54,296)	—	115,742	—
	<u>\$ (457,840)</u>	<u>(342,035)</u>	<u>844,208</u>	<u>649,835</u>

**Benefit Obligation and Assumptions**

The projected pension benefit obligation, accumulated pension benefit obligation, and fair value of the plans' assets were as follows (in thousands):

	<b>September 30</b>	
	<b>2016</b>	<b>2015</b>
Projected benefit obligation	\$ (1,217,590)	(922,289)
Accumulated benefit obligation	(1,136,565)	(919,111)
Fair value of plans' assets	844,208	649,835

As of September 30, 2016 and 2015, the underfunded status of the qualified defined benefit pension plans was approximately \$319.1 million and \$222.2 million, respectively, and that of the nonqualified defined benefit pension plan was approximately \$54.3 million and \$50.2 million, respectively. Additionally, there are assets limited as to use of approximately \$82.7 million and \$78.8 million, which are available to satisfy the obligations of the nonqualified defined benefit pension plan at September 30, 2016 and 2015, respectively.

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The net periodic benefit cost for the years ended September 30, 2016 and 2015 is as follows (in thousands):

	<b>Defined benefit pension plans</b>		<b>Postretirement benefits plan</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Service cost	\$ 22,686	23,106	3,135	3,788
Interest cost	45,708	37,775	3,106	3,393
Expected return on plan assets	(63,440)	(50,700)	—	—
Amortization of prior service cost	(1,907)	(1,951)	(96)	(37)
Recognized net actuarial loss	11,810	18,306	(488)	—
Net periodic benefit cost	<u>\$ 14,857</u>	<u>26,536</u>	<u>5,657</u>	<u>7,144</u>

Accumulated Other Comprehensive (income) loss (AOCI) for the years ended September 30, 2016 and 2015 is as follows (in thousands):

	<b>Defined benefit pension plans</b>		<b>Postretirement benefit plans</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
AOCI at prior fiscal year end	\$ 342,921	284,780	(13,134)	895
Inclusion of AOCI for affiliation for LMC	61,389	—	385	—
Amounts amortized during the year				
Net prior service credit	1,706	1,706	37	37
Net (loss)/gain	(10,178)	(17,191)	488	—
Occurring during the year				
Net prior service cost	(100)	—	—	—
Net loss/(gain)	109,174	73,626	9,635	(14,066)
AOCI at current fiscal year end	<u>\$ 504,912</u>	<u>342,921</u>	<u>(2,589)</u>	<u>(13,134)</u>

Weighted average assumptions used to determine benefit obligations at September 30, 2016 and 2015 are as follows:

	<b>Defined benefit pension plans</b>		<b>Postretirement benefits plan</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Discount rate, qualified plan	3.3-3.6	4.3-4.4%	3.6%	4.5%
Discount rate, nonqualified plans	3.6%	4.3%	—	—
Rate of compensation increase, qualified plans	2.5-4.0%	2.5-4.0%	—	—
Rate of compensation increase, nonqualified plans	5.00%	5.00%	—	—

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Weighted average assumptions used to determine net periodic benefit cost for the years ended September 30, 2016 and 2015 are as follows:

	Defined benefit pension plans		Postretirement benefits plan	
	2016	2015	2016	2015
Discount rate for determining net periodic benefit cost at year-end, qualified plan	4.10-4.40%	4.20-4.30%	5.00%	4.40%
Discount rate for determining net periodic benefit cost at year-end, nonqualified plan	4.50%	4.30-4.40%	—	—
Expected rate of return on plan assets	7.50-7.75%	6.75-7.75%	—	—
Rate of compensation increase qualified plan	2.50-4.00%	2.50-5.00%	—	—
Rate of compensation increase nonqualified plan	5.00%	5.00%	—	—

For measurement purposes relating to the postretirement benefits plans, a 4.0%–7.50% annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal 2016 and a 4.0% for annual rate of increase in the per capita cost of covered health care benefits was assumed for 2015. Rates are assumed to decline to 4.5%–5.0% through fiscal 2017.

Assumed health care cost trend rate assumptions have a significant effect on the amounts reported. A 1% change in the assumed health care cost trend rate would have the following effects (in thousands):

		1% increase	1% decrease
Effect on total of service and interest cost components	\$	1-51	(1)-(60)
Effect on postretirement benefit obligations		42-361	(38)-(419)

The asset allocation of the System's pension plans at September 30, 2016 and 2015, on a combined basis, was as follows:

Asset category	Target allocation	Percentage of assets	
	2017	2016	2015
Equity securities	42-46	44%	46%
Debt securities	17-21	23	22
Alternative investments	33-41	33	32
		100%	100%

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Financial assets, as of September 30, 2016, are classified in the following tables (see note 15 for description) (in thousands):

	<b>Investments measured at NAV</b>	<b>Investments classified in the fair value hierarchy Level 1</b>	<b>Total</b>
Money market funds	\$ —	43,423	43,423
U.S. equity securities	25,693	139,945	165,638
International equity securities	121,612	86,794	208,406
Fixed income funds:			
U.S. government	—	73,512	73,512
Corporate debt	4,731	41,659	46,390
International government	10,822	21,372	32,194
Commodities	10,623	1,319	11,942
Private equity	17,481	—	17,481
Hedge funds:			
Absolute return	193,838	—	193,838
Multi strategy/other	7,747	—	7,747
Long/short equity	17,020	—	17,020
Real estate	21,102	5,515	26,617
Total investments	\$ <u>430,669</u>	<u>413,539</u>	<u>844,208</u>

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Financial assets, as of September 30, 2015, are classified in the following tables (see note 15 for description) (in thousands):

	<b>Investments measured at NAV</b>	<b>Investments classified in the fair value hierarchy Level 1</b>	<b>Total</b>
Money market funds	\$ —	30,477	30,477
U.S. equity securities	75,363	68,016	143,379
International equity securities	96,995	58,733	155,728
Fixed income funds:			
U.S. government	28,183	36,989	65,172
Corporate debt	—	15,921	15,921
International government	10,776	30,504	41,280
Commodities	10,645	—	10,645
Private equity	17,043	—	17,043
Hedge funds:			
Absolute return	29,438	—	29,438
Multi strategy/other	113,206	—	113,206
Long/short equity	10,453	—	10,453
Real estate	17,093	—	17,093
Total investments	\$ 409,195	240,640	649,835

There are no pension investments that are measured at fair value based on Level 2 and Level 3 inputs at September 30, 2016 or 2015.

The following table is a summary of total investments as of September 30, 2016, with restrictions to redeem the investments at the measurement date, any unfunded capital commitments and investment strategies of the investees (in thousands):

Description of investment	Carrying value	Unfunded commitment	Redemption frequency	Notice period
U.S. equity securities	\$ 25,693	—	Monthly/Quarterly	30-60 days
International equity securities	121,612	—	Daily/Monthly	1-30 days
Fixed income funds	15,553	—	Daily/Monthly	1-30 days
Commodities	10,623	—	None-Quarterly	None and 45-90 days
Private equity	17,481	—	None	None
Hedge funds:				
Absolute return	193,838	—	Quarterly/Annual	30-95 days
Multi strategy/other	7,747	—	Quarterly	45-90 days
Long/short equity	17,020	—	Quarterly	30-45 days
Real estate	21,102	—	None	None

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The System's investment strategy for its pension assets balances the liquidity needs of the pension plans with the long-term return goals necessary to satisfy future pension obligations. The target asset allocation seeks to capture the equity premium granted by the capital markets over the long-term while ensuring security of principal to meet near term expenses and obligations through the fixed income allocation. The allocation of the investment pool to various sectors of the markets is designed to reduce volatility in the portfolio.

The System's pension portfolios return assumption of 7.50%-7.75% is based on the targeted weighted-average return of comparative market indices for the asset classes represented in the portfolio and adjusted for pension related expenses.

The future cash flows of the System relative to retirement benefits are expected to be as follows (in thousands):

	<u>Defined benefit pension plans</u>	<u>Postretirement benefit plan</u>
Estimated benefit payments related to years ending September 30:		
2017	\$ 55,906	2,358
2018	58,459	2,688
2019	61,251	2,863
2020	65,585	3,092
2021	69,120	3,364
2022 to 2026	383,135	22,248

The System expects to make contributions of approximately \$57.0 million for pension benefits and approximately \$2.3 million for postretirement benefits in fiscal 2017.

**(10) Professional Liability Insurance**

In 1978, Y-NHH and a number of other unrelated academic medical centers formed The Medical Centre Insurance Company Ltd. (the Captive) to insure for professional and comprehensive general liability risks. In 1997, the Captive formed MCIC Vermont, Inc. (MCIC) to write direct insurance for the professional and general liability risks of the shareholders. Since 1997, the Captive has acted as a reinsurer for varying levels of per claim limit exposure. MCIC has reinsurance coverage from outside reinsurers for amounts above the per claim limits. In addition, the insurance structure includes a layer where the Hospitals are self-insured for claims. Premiums are based on claims made coverage, and are actuarially determined based on actual experience of the System, the Captive, and MCIC.

Y-NHH controls less than 20% of the Class A stock of MCIC; however, for accounting purposes the investment in the insurance companies is recorded on the equity method because of contractual agreements. This investment is recorded in other long term assets and is approximately \$75.3 million and \$74.9 million for the years ended September 30, 2016 and 2015, respectively.

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The System's entities of GH, BH, and NEMG participate in the Y-NHH insurance program as additional insureds. These entities initially pay premiums to Y-NHHSC. Y-NHHSC generally assumes the responsibility for ensuring that all the System members pay all premiums owed by them to MCIC. Y-NHHSC manages MCIC's operations for all other System members.

MCIC's policy is to establish retrospective-related premiums for its shareholders equivalent to estimated losses and general and administrative expenses, less estimated investment income, so that its results of operations are breakeven each year. The System accrues premiums as incurred.

LMC purchases claims made professional and general liability insurance to cover medical malpractice claims from L&M Indemnity Ltd, a wholly owned subsidiary of the LMC. Lawrence + Memorial Hospital, Westerly Hospital, LMPA and VNA have adopted the policy of self-insuring the tail portion of its malpractice insurance coverage. Management accrues its best estimate of losses as incidents which give rise to potential losses occur.

The estimate for claims-made professional liabilities and the estimate for incidents that have been incurred but not reported aggregated approximately \$194.7 million and \$180.4 million at September 30, 2016 and 2015, respectively, for the System. The undiscounted estimate for incidents that have been incurred but not reported aggregated approximately \$78.9 million and \$69.1 million for the System at September 30, 2016 and 2015, respectively, and is included in professional insurance liabilities in the accompanying consolidated balance sheets at the actuarially determined present value of approximately \$71.5 million and \$63.0 million, respectively, based on a discount rates of approximately 2.0% for the years ended September 30, 2016 and 2015.

The System has recorded related insurance recoveries receivable of approximately \$123.2 million and \$117.6 million at September 30, 2016 and 2015, respectively, in consideration of the expected insurance recoveries for the total discounted claims-made insurance. The current portion of professional liabilities and the related insurance receivable represents an estimate of expected settlements and insurance recoveries over the next 12 months.

Lukan, the Y-NHH sponsored professional liability program, continues to manage all incidents and claims reported to Lukan prior to the acquisition of HSR, as well as extending professional liability coverage for post-acquisition risks to certain affiliated community clinicians.

Prior to the 2012 acquisition of HSR, Caritas provided excess professional liability and general liability insurance to HSR and their employed clinicians. Caritas continued to manage all incidents and claims reported prior to the acquisition of HSR and are included in the amounts above.

In October 2014, Y-NHH disposed of its interest in Caritas and Lukan (the Captives) through a novation agreement with Medical Centre Insurance Company, Ltd (MCIC) for a total price of approximately \$40.2 million. The novation agreement assigns and transfers all of the Captives' past, present and future rights, risks, liabilities and obligations, and transfers substantially all of the assets of the Captives to MCIC. Y-NHH dissolved the Captives in the fiscal year ended September 30, 2015.

The System's estimates for professional insurance liabilities are based upon complex actuarial calculations which utilize factors such as historical claims experience for the System and related industry factors,

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trending models, estimates for the payment patterns of future claims and present value discount factors. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Revisions to estimated amounts resulting from actual experience differing from projected expectations are recorded in the period the information becomes known or when changes are anticipated.

**(11) Commitments and Contingencies**

**(a) Leases**

The System leases various equipment and properties under several noncancelable operating leases that range in terms. The System is responsible for operating expenses, as defined, during the lease terms. Future minimum lease payments under these leases are as follows (in thousands):

2017	\$	44,817
2018		40,441
2019		38,295
2020		32,563
2021		30,047
Thereafter		<u>303,570</u>
	\$	<u><u>489,733</u></u>

The System incurred rent expense under these leases of approximately \$52.0 million and \$51.3 million for the years ended September 30, 2016 and 2015, respectively.

**(b) Cancer Hospital**

YNHH has a shared facilities and services agreement with the University in connection with the Cancer Hospital. YNHH and the University both contributed to the development of a comprehensive cancer treatment facility. Funds were contributed by the University to YNHH and were recorded as deferred revenue at YNHH. Deferred revenue, from this agreement, at September 30, 2016 and 2015, was \$41.5 million and \$42.7 million, respectively and is amortized over the life of the agreement.



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**(c) Inpatient Rehabilitation Unit Agreement**

During September 2014, the Hospital entered into an agreement with another health care provider to provide a framework for implementing programs in a manner that is consistent with the charitable mission of each organization and the communities they serve. Under the terms of the agreement the Hospital will utilize beds at the health care provider's location under a lease arrangement to provide inpatient rehabilitation services to its patients. The term of lease agreement is five years and provides the Hospital with two five year renewal options at the end of each term. In addition, Y-NHH furnished an \$8.0 million term loan to the health care provider. The term loan bears interest of 6.5% annually that is payable monthly. The loan is collateralized by certain property owned by a subsidiary of the health care provider.

**(d) Litigation**

Various lawsuits and claims arising in the normal course of operations are pending, or are in progress against the System. Such lawsuits and claims are either specifically covered by insurance as explained in note 10, or are deemed immaterial. While the outcomes of the lawsuits and claims cannot be determined at this time, management believes that any loss which may arise from these actions will not have a material adverse effect on the consolidated financial position or changes in net assets of the System.

The System has received requests for information from certain governmental agencies relating to, among other things, patient billings. These requests cover several prior years relating to compliance with certain laws and regulations. Management is cooperating with those governmental agencies in their information requests and ongoing investigations. The ultimate results of those investigations, including the impact on the System, cannot be determined at this time.

**(12) Functional Expenses**

The System provides general acute health care services to residents within its geographic areas. Net expenses related to providing these services are as follows (in thousands):

	<b>Year ended September 30</b>	
	<b>2016</b>	<b>2015</b>
Health care services	\$ 2,735,309	2,589,819
General and administrative	940,358	852,805
	<u>\$ 3,675,667</u>	<u>3,442,624</u>

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**(13) Other Revenue**

Other revenue consisted of the following (in thousands):

	<b>Year ended September 30</b>	
	<b>2016</b>	<b>2015</b>
Cafeteria and vending	\$ 15,746	14,673
Contributions	2,817	3,406
Parking income	10,124	9,241
Net assets released from restrictions for operations	19,865	21,196
Net assets released from restrictions for clinical programs	6,378	1,477
Grants	26,900	20,168
Rental income	6,422	3,304
Electronic health records incentive payment	2,624	3,973
Foundation distributed income	2,976	2,820
Pharmacy sales	72,589	37,959
IT Services	5,351	—
Other	36,189	29,337
	\$ 207,981	147,554

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2012 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. In subsequent years, providers must demonstrate meaningful use of such technology to qualify for additional Medicaid incentive payments. Hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

The System uses a grant accounting model to recognize revenue for the Medicare and Medicaid EHR incentive payments. Under this accounting policy, EHR incentive payment revenue is recognized when the System is reasonably assured that the EHR meaningful use criteria for the required period of time were met and that the grant revenue will be received. Medicare EHR incentive payment revenue was approximately \$2.6 million and \$4.0 million for the years ended September 30, 2016 and 2015, respectively. The System did not receive Medicaid EHR incentive payments for the year ended September 30, 2015 or 2016. EHR incentive payment revenue is included in other revenue in the accompanying consolidated statements of operations and changes in net assets. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Additionally, the System's attestation of compliance with the meaningful use criteria is subject to audit by the federal government.

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**(14) Nonoperating Gains and Losses, Net**

Nonoperating gains and losses consisted of the following (in thousands):

	<b>Year ended September 30</b>	
	<b>2016</b>	<b>2015</b>
Income from investments, donations and other, net	\$ 15,884	5,099
Income attributable to noncontrolling interest	(2,470)	(5,522)
Contribution received in affiliation with LMC	241,106	—
Change in unrealized gains on investments, net	97,402	14,536
Change in fair value of swap, including counterparty payments	(30,160)	(29,678)
	<u>\$ 321,762</u>	<u>(15,565)</u>

**(15) Fair Values of Financial Instruments**

In determining fair value, the System utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The System also considers nonperformance risk in the overall assessment of fair value.

ASC 820-10, *Fair Value Measurements – Overall*, establishes a three-tier valuation hierarchy for fair value disclosure purposes. This hierarchy is based on the transparency of the inputs utilized for the valuation. The three levels are defined as follows:

*Level 1:* Quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities. This established hierarchy assigns the highest priority to Level 1 assets.

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

*Level 3:* Unobservable inputs that are used when little or no market data is available. The inputs are assigned the lowest priority.

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Financial assets carried at fair value as of September 30, 2016 are classified in the following table by level within the fair value hierarchy as described above (in thousands):

	<b>September 30</b>			
	<b>Investments measured at NAV</b>	<b>Investments classified in the fair value hierarchy</b>		<b>Total</b>
		<b>Level 1</b>	<b>Level 2</b>	
Cash and cash equivalents	\$ —	188,272	—	188,272
Money market funds	—	115,334	—	115,334
U.S. equity securities	18,777	205,351	—	224,128
International equity securities	112,195	130,657	—	242,852
Fixed income funds:				
U.S. government	—	519,820	—	519,820
International government	32,668	53,397	—	86,065
Corporate bonds		23,362	—	23,362
Commodities	4,258	1,228	—	5,486
Hedge Funds:				
Absolute return	60,126	—	—	60,126
Long/short equity	5,674	—	—	5,674
Long only equity	12,153			12,153
Private equity	12,381	—	—	12,381
Real estate	7,635	4,741	—	12,376
Interest in Yale University endowment pool	946,457	—	—	946,457
Assets held in trusts by others	7,867	—	—	7,867
Perpetual trusts	31,981	—	—	31,981
Beneficial interest in remainder trust	1,626	—	—	1,626
Total investments	<u>\$ 1,253,798</u>	<u>1,242,162</u>	<u>—</u>	<u>2,495,960</u>
Liabilities:				
Interest rate swaps	\$ —	—	(74,680)	(74,680)

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Financial assets carried at fair value as of September 30, 2015 are classified in the following table by level within the fair value hierarchy as described above (in thousands):

	<b>September 30</b>			
	<b>Investments measured at NAV</b>	<b>Investments classified in the fair value hierarchy</b>		<b>Total</b>
		<b>Level 1</b>	<b>Level 2</b>	
Cash and cash equivalents	\$ —	194,946	—	194,946
Money market funds	—	130,047	—	130,047
U.S. equity securities	31,174	73,618	—	104,792
International equity securities	47,463	58,013	—	105,476
Fixed income funds:				
U.S. government	288,508	129,327	—	417,835
Corporate bonds	—	4,945	—	4,945
International government	42,470	55,237	—	97,707
Commodities	1,595	—	—	1,595
Hedge Funds:				
Absolute return	21,909	—	—	21,909
Long/short equity	6,936	—	—	6,936
Private equity	7,489	—	—	7,489
Real estate	8,241	37	—	8,278
Interest in Yale University endowment pool	855,264	—	—	855,264
Perpetual trusts	32,649	—	—	32,649
Total investments	<u>\$ 1,343,698</u>	<u>646,170</u>	<u>—</u>	<u>1,989,868</u>
Liabilities:				
Interest rate swaps	\$ —	—	(54,707)	(54,707)

The amounts reported in the tables as detailed above do not include assets invested in the System's defined benefit pension plan. The beneficial interest in remainder trust listed in the above tables are included in other assets. The interest rate swaps listed above are classified in the accompanying consolidated balance sheets as other long-term liabilities at September 30, 2016 and 2015. There are no assets or liabilities that are measured at fair value based on Level 3 inputs at September 30, 2016 or 2015.

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

The following is a summary of total investments as of September 30, 2016, with restrictions to redeem the investments at the measurement date, any unfunded capital commitments and investment strategies of the investees (in thousands):

Description of investment	Carrying value	Unfunded commitments	Redemption frequency	Notice period	Funds availability
U.S. equity securities	18,777	None	Monthly/Quarterly	30-60 days	30-60 days
International equity securities	112,195	None	Daily /Monthly/Quarterly	1-30 Days	1-30 Days
Fixed income funds:					
International government	32,668	None	Daily/Monthly	1-10 Days	1-10 Days
Commodities	4,258	None	None/Quarterly	None -90 days	None -90 days
Hedge Funds:					
Absolute return	60,126	None	None	None	None
Long/short equity	5,674	None	None	None	None
Long only equity	12,153	None	30 days	1 years	1 years
Private equity	12,381	3,203	None	None	None
Real estate	7,635	2,267	None	None	None
Interest in Yale University endowment pool	946,457	None	*	*	*
Assets held in trusts by others	7,867	None	*	*	*
Perpetual trusts	31,981	None	*	*	*
Beneficial interest in remainder trust	1,626	None	*	*	*
	<u>1,253,798</u>				

\*see note 1 for descriptions

The fair value of long-term debt was approximately \$1025.4 million and \$934.5 million at September 30, 2016 and 2015, respectively. The fair value of the capital leases was approximately \$150.4 million and \$112.5 million at September 30, 2016 and 2015, respectively. The fair value of long-term debt and capital leases are classified as Level 2 in the fair value hierarchy as it uses a combination of quoted market prices and valuation based on current market rates. The carrying value of all other financial instruments approximates fair value.

**(16) Subsequent Events**

Management has evaluated subsequent events through December 22, 2016, which is the date the consolidated financial statements were issued. No other events have occurred that require disclosure or adjustment to the consolidated financial statements.

## **SUPPLEMENTARY INFORMATION**

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidating Balance Sheet

September 30, 2016

(In thousands)

Assets	Yale-New Haven Health Services Corporation	NEMG	Yale-New Haven Hospital and Subsidiaries	Bridgeport Hospital and Subsidiaries	Eliminations	Obligated Group	Greenwich Hospital and Subsidiaries	Other Non-Obligated Entities	Eliminations	Total	L+M	Eliminations	Total
Current assets:													
Cash and cash equivalents	\$ 45,754	505	74,073	26,616	—	146,948	22,272	1,846	(1,587)	169,479	18,793	—	188,272
Short-term investments	40,379	—	1,121,276	94,053	—	1,255,708	116,197	—	—	1,371,905	156,035	—	1,527,940
Accounts receivable for services to patients, less allowance for uncollectible accounts	—	17,744	260,416	53,543	—	331,703	39,165	4,924	(4,924)	370,868	45,801	—	416,669
Professional liabilities insurance recoveries receivable	—	—	21,003	5,893	—	26,896	6,837	—	—	33,733	—	—	33,733
Other assets	100,304	18,227	120,549	23,267	(162,113)	100,234	18,123	9,138	(32,255)	95,240	17,898	(693)	112,445
Assets limited as to use – debt service fund	—	—	4,913	715	—	5,628	—	—	—	5,628	1,307	—	6,935
<b>Total current assets</b>	<b>186,437</b>	<b>36,476</b>	<b>1,602,230</b>	<b>204,087</b>	<b>(162,113)</b>	<b>1,867,117</b>	<b>202,594</b>	<b>15,908</b>	<b>(38,766)</b>	<b>2,046,853</b>	<b>239,834</b>	<b>(693)</b>	<b>2,285,994</b>
Assets limited as to use	—	—	102,373	1,144	—	103,517	83,216	—	—	186,733	49,085	—	235,818
Long-term investments	10,098	—	392,424	61,697	—	464,219	73,974	—	—	538,193	—	—	538,193
Investment in LMC	277,307	—	—	—	—	277,307	—	—	—	277,307	—	(277,307)	—
Professional liabilities insurance recoveries receivable	—	—	56,000	20,486	—	76,486	12,930	—	—	89,416	—	—	89,416
Other assets	964,129	372	154,884	18,774	(929,293)	208,866	9,824	11,514	(15,861)	214,343	9,304	—	223,647
Property, plant, and equipment, net	110,655	5,139	984,132	262,791	—	1,362,717	257,933	5,263	(5,263)	1,620,650	235,818	—	1,856,468
Goodwill	52,050	267	44,767	17,217	—	114,301	—	—	—	114,301	11,864	—	126,165
<b>Total assets</b>	<b>\$ 1,600,676</b>	<b>42,254</b>	<b>3,336,810</b>	<b>586,196</b>	<b>(1,091,406)</b>	<b>4,474,530</b>	<b>640,471</b>	<b>32,685</b>	<b>(59,890)</b>	<b>5,087,796</b>	<b>545,905</b>	<b>(278,000)</b>	<b>5,355,701</b>



**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidating Balance Sheet, continued

September 30, 2016

(In thousands)

Liabilities and Net Assets	Yale-New Haven Health Services Corporation	NEMG	Yale-New Haven Hospital and Subsidiaries	Bridgeport Hospital and Subsidiaries	Eliminations	Obligated Group	Greenwich Hospital and Subsidiaries	Other Non-Obligated Entities	Eliminations	Total	L+M	Eliminations	Total
Current liabilities:													
Accounts payable and accrued expenses	\$ 103,939	30,890	403,770	67,321	(58,639)	547,281	39,860	1,481	(18,385)	570,237	56,908	(693)	626,452
Current portion of long-term debt	8,207	—	16,363	6,744	(8,207)	23,107	2,790	—	—	25,897	5,730	—	31,627
Current portion of capital lease obligation	—	—	2,126	1,711	—	3,837	—	—	—	3,837	—	—	3,837
Professional liabilities	—	—	21,003	5,893	—	26,896	6,837	—	—	33,733	—	—	33,733
Other liabilities	—	—	53,114	15,141	—	68,255	16,749	1,013	(1,013)	85,004	14,589	—	99,593
Total current liabilities	112,146	30,890	496,376	96,810	(66,846)	669,376	66,236	2,494	(19,398)	718,708	77,227	(693)	795,242
Long-term debt, net of current portion	802,325	—	773,528	64,747	(802,325)	838,275	29,280	—	—	867,555	100,640	—	968,195
Long-term capital lease obligations, net of current portion and deferred financing costs	—	—	44,724	96,386	—	141,110	—	—	—	141,110	—	—	141,110
Accrued pension and postretirement benefit obligations	8,447	—	258,936	77,644	(8,447)	336,580	64,829	—	—	401,409	55,452	—	456,861
Professional liabilities	—	—	96,479	36,990	—	133,469	21,129	—	—	154,598	6,326	—	160,924
Other liabilities	223,453	6,767	285,901	30,580	(213,788)	332,913	19,525	8,794	(19,354)	341,878	30,906	—	372,784
Deferred revenue	—	—	41,482	—	—	41,482	—	—	—	41,482	—	—	41,482
Total liabilities	1,146,371	37,657	1,997,426	403,157	(1,091,406)	2,493,205	200,999	11,288	(38,752)	2,666,740	270,551	(693)	2,936,598
Net assets:													
Unrestricted	418,104	4,597	1,235,948	117,604	—	1,776,253	371,040	21,397	(21,138)	2,147,552	239,153	(241,106)	2,145,599
Temporarily restricted	20,497	—	56,203	42,302	—	119,002	44,533	—	—	163,535	20,497	(20,497)	163,535
Permanently restricted	15,704	—	47,233	23,133	—	86,070	23,899	—	—	109,969	15,704	(15,704)	109,969
Total net assets	454,305	4,597	1,339,384	183,039	—	1,981,325	439,472	21,397	(21,138)	2,421,056	275,354	(277,307)	2,419,103
Total liabilities and net assets	\$ 1,600,676	42,254	3,336,810	586,196	(1,091,406)	4,474,530	640,471	32,685	(59,890)	5,087,796	545,905	(278,000)	5,355,701

See accompanying notes to consolidated financial statements.

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)

Consolidating Statement of Operations and Changes in Net Assets

Year ended September 30, 2016

(In thousands)

	<b>Yale New Haven Health Services Corporation and Subsidiaries</b>	<b>NEMG</b>	<b>Yale New Haven Hospital and Subsidiaries</b>	<b>Bridgeport Hospital and Subsidiaries</b>	<b>Eliminations</b>	<b>Obligated Group</b>	<b>Greenwich Hospital and Subsidiaries</b>	<b>Other Non-Obligated Entities</b>	<b>Eliminations</b>	<b>Total</b>	<b>L+M</b>	<b>Eliminations</b>	<b>Total</b>
<b>Operating revenue:</b>													
Net patient service revenue	\$ —	200,185	2,610,532	488,431	—	3,299,148	384,207	16,169	(16,169)	3,683,355	25,157	—	3,708,512
Less provision for bad debts, net	—	(8,848)	(63,352)	(15,692)	—	(87,892)	(16,192)	—	—	(104,084)	(947)	—	(105,031)
Net patient service revenue, less provision for bad debts	—	191,337	2,547,180	472,739	—	3,211,256	368,015	16,169	(16,169)	3,579,271	24,210	—	3,603,481
Other revenue	515,139	120,399	145,705	41,059	(554,844)	267,458	15,716	9,150	(84,691)	207,633	1,036	(688)	207,981
Total operating revenue	515,139	311,736	2,692,885	513,798	(554,844)	3,478,714	383,731	25,319	(100,860)	3,786,904	25,246	(688)	3,811,462
<b>Operating expenses:</b>													
Salaries and benefits	254,141	197,793	1,096,282	203,955	6,560	1,758,731	148,862	8,761	(8,751)	1,907,603	17,827	—	1,925,430
Supplies and other expenses	159,458	146,923	1,335,988	222,898	(485,021)	1,380,246	172,765	9,350	(74,600)	1,487,761	8,438	(688)	1,495,511
Depreciation and amortization	50,198	2,529	126,391	32,496	(40,224)	171,390	24,802	447	(5,095)	191,544	1,843	—	193,387
Insurance	29,702	7,313	25,111	8,537	(36,159)	34,504	2,893	153	(5,804)	31,746	481	—	32,227
Interest	—	—	22,464	5,480	—	27,944	968	—	—	28,912	200	—	29,112
Total operating expenses	493,499	354,558	2,606,236	473,366	(554,844)	3,372,815	350,290	18,711	(94,250)	3,647,566	28,789	(688)	3,675,667
Income (loss) from operations	21,640	(42,822)	86,649	40,432	—	105,899	33,441	6,608	(6,610)	139,338	(3,543)	—	135,795
<b>Nonoperating gains (losses), net:</b>													
Income from investments, donations and other, net	(536)	—	100,987	6,144	—	106,595	3,029	(3,453)	3,453	109,624	1,192	—	110,816
Contribution received in affiliation with LMC	241,106	—	—	—	—	241,106	—	—	—	241,106	—	—	241,106
Change in fair value of swap, including counter party payments	—	—	(29,091)	—	—	(29,091)	(1,069)	—	—	(30,160)	—	—	(30,160)
Excess (deficiency) of revenue over expenses	262,210	(42,822)	158,545	46,576	—	424,509	35,401	3,155	(3,157)	459,908	(2,351)	—	457,557
<b>Unrestricted net assets:</b>													
Other changes in net assets	—	—	(4)	1,336	—	1,332	(1,183)	(169)	168	148	398	—	546
Transfer to (from) NEMG, net	—	43,288	(9,244)	(21,684)	—	12,360	(12,360)	—	—	—	—	—	—
Net assets released from restrictions for purchases of fixed assets	—	—	45,588	140	—	45,728	1,535	—	—	47,263	—	—	47,263
Pension related changes other than net periodic benefit cost	—	—	(63,316)	(20,470)	—	(83,786)	(26,976)	—	—	(110,762)	—	—	(110,762)
Increase (decrease) in unrestricted net assets	262,210	466	131,569	5,898	—	400,143	(3,583)	2,986	(2,989)	396,557	(1,953)	—	394,604

**YALE-NEW HAVEN HEALTH SERVICES CORPORATION**  
(d/b/a Yale New Haven Health System and Subsidiaries)  
Consolidating Statement of Operations and Changes in Net Assets, continued  
Year ended September 30, 2016  
(In thousands)

	<b>Yale New Haven Health Services Corporation and Subsidiaries</b>	<b>NEMG</b>	<b>Yale New Haven Hospital and Subsidiaries</b>	<b>Bridgeport Hospital and Subsidiaries</b>	<b>Eliminations</b>	<b>Obligated Group</b>	<b>Greenwich Hospital and Subsidiaries</b>	<b>Other Non-Obligated Entities</b>	<b>Eliminations</b>	<b>Total</b>	<b>L+M</b>	<b>Eliminations</b>	<b>Total</b>
Temporarily restricted net assets:													
Income from investments	\$ —	—	265	55	—	320	—	—	—	320	—	—	320
Net realized and unrealized gains on investments	—	—	7,231	4,586	—	11,817	3,280	—	—	15,097	—	—	15,097
Bequests and contributions	—	—	38,724	10,020	—	48,744	6,325	—	—	55,069	—	—	55,069
Net assets released from restrictions for purchases of fixed assets	—	—	(45,588)	(140)	—	(45,728)	(1,535)	—	—	(47,263)	—	—	(47,263)
Net assets released from restrictions for operations	—	—	(8,992)	(5,568)	—	(14,560)	(5,305)	—	—	(19,865)	—	—	(19,865)
Net assets released from restrictions for clinical programs	—	—	(6,378)	—	—	(6,378)	—	—	—	(6,378)	—	—	(6,378)
Contribution received in affiliation with LMC	20,497	—	—	—	—	20,497	—	—	—	20,497	—	—	20,497
Other changes in net assets	—	—	—	(1,496)	—	(1,496)	(14)	—	—	(1,510)	—	—	(1,510)
Increase (decrease) in temporarily restricted net assets	20,497	—	(14,738)	7,457	—	13,216	2,751	—	—	15,967	—	—	15,967
Permanently restricted net assets:													
Bequests and contributions	—	—	57	257	—	314	241	—	—	555	—	—	555
Net assets released from restrictions for purchases of fixed assets	—	—	—	—	—	—	—	—	—	—	—	—	—
Net realized and unrealized on investments	—	—	—	—	—	—	145	—	—	145	—	—	145
Contribution received in affiliation with LMC	15,704	—	—	—	—	15,704	—	—	—	15,704	—	—	15,704
Changes in beneficial interest in perpetual trusts	—	—	290	—	—	290	—	—	—	290	—	—	290
Other changes in net assets	—	—	—	—	—	—	(81)	—	—	(81)	—	—	(81)
Increase in permanently restricted net assets	15,704	—	347	257	—	16,308	305	—	—	16,613	—	—	16,613
Increase (decrease) in net assets	298,411	466	117,178	13,612	—	429,667	(527)	2,986	(2,989)	429,137	(1,953)	—	427,184
Net assets at beginning of year	155,894	4,131	1,222,206	169,427	—	1,551,658	439,999	18,411	(18,149)	1,991,919	—	—	1,991,919
Net assets at end of year	\$ 454,305	4,597	1,339,384	183,039	—	1,981,325	439,472	21,397	(21,138)	2,421,056	(1,953)	—	2,419,103

See accompanying notes to consolidated financial statements.