CONSOLIDATED FINANCIAL STATEMENTS

Baystate Health, Inc. and Subsidiaries
Years Ended September 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

ERNST & YOUNG

Baystate Health, Inc. and Subsidiaries

Consolidated Financial Statements

Years Ended September 30, 2012 and 2011

Contents

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Report of Independent Auditors

The Board of Trustees
Baystate Health, Inc.

We have audited the accompanying consolidated statements of financial position of Baystate Health, Inc. and Subsidiaries (Baystate Health) as of September 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Baystate Health's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of Baystate Health's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Baystate Health's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Baystate Health, Inc. and Subsidiaries at September 30, 2012 and 2011, and the consolidated results of their operations, changes in their net assets and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

January 3, 2013

Baystate Health, Inc. and Subsidiaries

Consolidated Statements of Financial Position

(In Thousands)

	September 30 2012	September 30 2011
Assets		
Current assets:		
Cash and cash equivalents	**$ 140,460**	$ 123,615
Investments	**323,390**	299,523
Accounts receivable, patients, less allowance for uncollectible accounts of $29,996 in 2012 and $30,171 in 2011	**117,772**	108,968
Accounts receivable, other	**43,851**	38,997
Estimated final settlements receivable	**26,142**	25,483
Inventories	**19,230**	18,064
Prepaid expenses and other current assets	**11,547**	15,186
Total current assets	**682,392**	629,836
Long-term investments:		
Investments	**53,825**	50,440
Equity investment in unconsolidated affiliates	**2,744**	1,886
Notes receivable	**66,270**	65,504
Deferred expense and other long-term assets	**11,395**	9,384
Land, buildings, and equipment, net	**602,006**	533,761
	736,240	660,975
Assets whose use is limited:		
Board-designated funds:		
Cash and investments	**218,673**	198,836
Investments of captive insurance company	**95,333**	87,721
Investments held by trustee under debt agreements	**4,528**	36,724
Beneficial interest in perpetual trusts	**33,889**	30,077
	352,423	353,358
Total assets	**$1,771,055**	$ 1,644,169

	September 30 2012	September 30 2011
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 109,985**	$ 113,093
Medical claims payable	**45,114**	41,173
Accrued salaries and wages	**86,294**	74,843
Accrued interest payable	**2,439**	2,271
Estimated final settlements payable	**69,042**	68,571
Refundable advances	**707**	327
Short-term obligations	**-**	7,290
Deferred revenue	**8,853**	12,873
Current portion of long-term debt	**9,218**	5,837
Total current liabilities	**331,652**	326,278
Long-term debt	**454,548**	423,295
Pension liability	**180,442**	153,177
Insurance liability loss reserves	**103,767**	98,416
Other liabilities	**15,016**	17,348
Total liabilities	**1,085,425**	1,018,514
Net assets:		
Unrestricted:		
Operating	**865,790**	769,185
Pension adjustment	**(286,031)**	(247,379)
Total unrestricted	**579,759**	521,806
Temporarily restricted	**55,708**	57,574
Permanently restricted	**50,163**	46,275
Total net assets	**685,630**	625,655
Total liabilities and net assets	**$1,771,055**	$ 1,644,169

See accompanying notes.

Baystate Health, Inc. and Subsidiaries

Consolidated Statements of Operations

(In Thousands)

	Year Ended September 30	
	2012	**2011**
Operating revenues:		
Net patient service revenue	**$ 1,083,213**	$ 1,015,951
Premiums	**494,610**	452,817
Other revenue	**69,605**	70,242
Net assets released from restrictions for operations	**6,793**	5,126
Total operating revenues	**1,654,221**	1,544,136
Operating expenses:		
Salaries and wages	**637,110**	623,287
Supplies and expense	**539,970**	490,802
Medical claims and capitation	**343,398**	307,762
Depreciation and amortization	**54,385**	49,160
Bad debts	**23,210**	22,147
Interest expense	**9,476**	6,025
Total operating expenses	**1,607,549**	1,499,183
Income from operations before other expense	**46,672**	44,953
Other expense	**-**	3,861
Income from operations after other expense	**46,672**	41,092
Non-operating income (expense):		
Investment income	**6,687**	8,415
Net realized gain on investments	**5,257**	8,427
Net unrealized gain (loss) on investments	**45,732**	(19,605)
Equity gain in unconsolidated affiliates	**1,238**	1,047
Net interest cost on swap agreements	**(2,650)**	(2,816)
Change in fair value of swap agreements	**(279)**	(459)
Income taxes and other	**(10,137)**	(15,481)
Total non-operating income (expense)	**45,848**	(20,472)
Excess of revenues over expenses	**92,520**	20,620
Other changes in unrestricted net assets:		
Net assets released from restrictions for capital	**5,611**	3,893
Transfers to restricted net assets	**(381)**	(173)
Pension adjustment	**(38,652)**	(47,367)
Other	**(1,145)**	(183)
Increase (decrease) in unrestricted net assets	**$ 57,953**	$ (23,210)

See accompanying notes.

Baystate Health, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended September 30	
	2012	**2011**
Unrestricted net assets:		
Excess of revenues over expenses	**$ 92,520**	$ 20,620
Net assets released from restrictions for capital	**5,611**	3,893
Transfers to restricted net assets	**(381)**	(173)
Pension adjustment	**(38,652)**	(47,367)
Other	**(1,145)**	(183)
Increase (decrease) in unrestricted net assets	**57,953**	(23,210)
Temporarily restricted net assets:		
Restricted investment income	**185**	238
Net realized and unrealized gain on investments	**5,672**	202
Contributions	**4,451**	10,814
Transfers from unrestricted net assets	**381**	173
Net assets released from restrictions:		
For operations	**(6,793)**	(5,126)
For capital	**(5,611)**	(3,893)
Other	**(151)**	(64)
(Decrease) increase in temporarily restricted net assets	**(1,866)**	2,344
Permanently restricted net assets:		
Contributions	**76**	722
Change in value of perpetual trusts	**3,812**	(1,523)
Increase (decrease) in permanently restricted net assets	**3,888**	(801)
Increase (decrease) in net assets	**59,975**	(21,667)
Net assets at beginning of year	**625,655**	647,322
Net assets at end of year	**$ 685,630**	$ 625,655

See accompanying notes.

Baystate Health, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended September 30	
	2012	**2011**
Operating activities		
Change in net assets	**$ 59,975**	$ (21,667)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**54,385**	49,160
Pension adjustment	**38,652**	47,367
Net realized and unrealized (gain) loss on investments	**(56,383)**	11,435
Provision for bad debts	**23,210**	22,147
Change in beneficial interest of perpetual trusts	**(3,812)**	1,523
Restricted contributions	**(6,527)**	(11,536)
Changes in equity investment of affiliate	**(1,238)**	(1,047)
Increase in accounts receivable, patients	**(32,014)**	(25,183)
Net change in estimated final settlements	**(188)**	6,800
Change in accounts payable and accrued expenses	**8,511**	17,071
Change in accrued pension liability, net	**(11,387)**	(15,103)
Increase in medical claims payable	**3,941**	4,114
Increase in insurance liability loss reserves	**5,351**	8,219
Other	**(9,197)**	(6,960)
Net cash provided by operating activities	**73,279**	86,340
Investing activities		
Proceeds from sale and maturities of investments	**798,444**	498,636
Purchase of investments	**(764,285)**	(449,216)
Purchase of land, buildings, and equipment	**(123,693)**	(141,580)
Net cash used in investing activities	**(89,534)**	(92,160)
Financing activities		
Proceeds from restricted contributions	**6,527**	11,536
Increase in note receivable	**(766)**	(749)
Proceeds from debt issuance	**85,137**	
Repayments of debt	**(17,493)**	(6,539)
Defeasement of debt	**(40,305)**	
Net cash provided by financing activities	**33,100**	4,248
Net increase (decrease) in cash and cash equivalents	**16,845**	(1,572)
Cash and cash equivalents at beginning of year	**123,615**	125,187
Cash and cash equivalents at end of year	**$ 140,460**	$ 123,615

See accompanying notes.

1. Organization

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

Baystate Health currently includes the following:

- Baystate Medical Center, Inc. (BMC), located in Springfield, Massachusetts, is the largest of the three hospitals in the Baystate Health system. BMC, the leading health facility in western Massachusetts, is the only tertiary care referral medical center and Level I trauma center in the region. It is also home to western New England's only neonatal and pediatric intensive care units. BMC is a 716-bed, tax-exempt, not-for-profit, academic teaching hospital that serves as the western campus of Tufts University School of Medicine.

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

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

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

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

1. Organization (continued)

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

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

- Health New England, Inc. (HNE) is a for-profit, taxable health maintenance organization located in Springfield, Massachusetts, approximately 97% of which is owned by BH; the remaining 3% is owned by BH-affiliated physicians. HNE's service area in Massachusetts includes Franklin, Berkshire, Hampden, and Hampshire counties, and part of Worcester County. HNE also serves Hartford, Litchfield, and Tolland counties in Connecticut.

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

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

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

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

1. Organization (continued)

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

2. Significant Accounting Policies

Principles of Consolidation

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

Use of Estimates

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

Net Assets

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

2. Significant Accounting Policies (continued)

Unrestricted	Net assets that are not subject to donor-imposed stipulations. Net assets may be designated for specific purposes by action of the Board of Trustees, or may otherwise be limited by contractual agreements with outside parties.
Temporarily restricted	Net assets whose use by Baystate Health and its subsidiaries are subject to donor-imposed stipulations that can be fulfilled by actions of Baystate Health and its subsidiaries, or that expire by the passage of time. At September 30, 2012 and 2011, temporarily restricted net assets consist of amounts restricted as to spending for various purposes, such as education, research, clinical, and health care programs, as well as cumulative net appreciation of permanent endowment funds.
Permanently restricted	Net assets subject to donor-imposed stipulations that they be maintained permanently by Baystate Health and its subsidiaries. At September 30, 2012 and 2011, permanently restricted net assets consist of the original cost of permanent endowment gifts and beneficial interests in perpetual trusts.

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

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

2. Significant Accounting Policies (continued)

Cash and Cash Equivalents

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

Investments

Investments, including funds held by trustees under bond indenture agreements, are recorded at fair value in the consolidated statements of financial position. The fair value of investments is estimated using quoted market values. Interest and dividends on investments are included in other revenue or non-operating income in the statements of operations unless the income or loss is restricted by donor or law. Realized gains and losses and unrealized gains and losses on investments are included in non-operating income or temporarily restricted net assets, as applicable. Investment-related expense, such as custodial fees and investment fees, are netted against investment revenues and are immaterial for the year ended September 30, 2012.

Investments include mutual funds, fixed income and equity securities, as well as interests in limited partnerships, common-collective trusts, and limited liability corporations. Baystate Health has also entered into partnership agreements with limited partnerships, the majority of which are in private markets, whereby they have agreed to certain capital commitments. Baystate Health's policy is to record its ownership interest in these investments of less than 5% at the lower of cost or market. As of September 30, 2012, approximately $27,281,000 of total capital commitments, including those held within the pension plan assets discussed at Note 15, remain outstanding. Certain of the partnerships may hold some securities without readily determinable fair values and, consequently, the general partner may estimate fair value for such securities. These estimates may differ significantly from the values that would have been used had a ready market existed, and may also differ significantly from the values at which such investments may be sold, and the differences could be material. For those funds where the ownership interest is more than 5%, the ownership interests are reported using the equity method of accounting. Under the equity method, Baystate Health recognizes its share of the increase or the decrease of the investment's fair value in non-operating income.

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

2. Significant Accounting Policies (continued)

Inventories

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

Note Receivable

In December and May 2009, BMC loaned $31,186,783 and $32,617,500, respectively, to a third party relating to project costs of approximately $252,000,000 for the construction of a new hospital facility at 759 Chestnut Street, Springfield, Massachusetts. The loans are part of a financing arrangement that utilizes new markets tax credits (NMTC) to reduce cash required by BMC to construct this new facility. Each loan bears interest at 2.139% annually, with annual cash payments during the first seven years of the thirty-three-year term based on an interest rate of 1.00%. The notes are recorded as notes receivable in the statements of financial position as of September 30, 2012 and 2011.

Equity Investment in Unconsolidated Affiliates

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

Deferred Expenses and Other Long-Term Assets

Deferred expenses include unamortized bond issuance expenses, which are amortized over the weighted-average terms of the bonds, and deferred tax assets of HNE.

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

Assets Whose Use Is Limited

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

2. Significant Accounting Policies (continued)

Land, Buildings, and Equipment

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

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

Statements of Operations

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

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

Other Expenses

Other expenses are presented separately from the natural classification of expenses reported in the consolidated statements of operations. Other expenses are considered non-recurring and consist of severance and benefit costs resulting from a reduction in workforce.

2. Significant Accounting Policies (continued)

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts 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 investigations. Contracts, laws, and regulations governing Medicare, Medicaid, Blue Cross, and the Health Safety Net programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Blue Cross and other managed care plans have negotiated with Baystate Health and its subsidiaries various forms of contractual payment rates. The most common payment rates include discounted charges, per case, per diems, and fee schedules.

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

During 2012 and 2011, Baystate Health recorded adjustments to amounts accrued for settlements related to prior fiscal years. The net effect of such adjustments was to increase net patient service revenue by approximately $18,419,000 and $7,385,000 in 2012 and 2011, respectively.

Medicare and Medicaid Electronic Health Record (EHR) Program

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

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

Baystate Health has included approximately $10,589,000 and $10,676,000 in other revenue related to the program in fiscal years 2012 and 2011, respectively. The estimate is based on cost report data which is subject to audit and the amounts recognized are subject to change. Baystate Health's attestation of compliance with the meaningful use criteria is subject to audit by the federal or state government or its designee.

2. Significant Accounting Policies (continued)

Premium Revenue

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

Health Safety Net

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

The HSN reimburses hospitals for uncompensated care based on actual services provided at rates approximating the Medicare Prospective Payment System, subject to available funds. Like its predecessor, the Uncompensated Care Pool, the HSN is partially funded by acute hospitals through an assessment on gross charges billed to non-governmental payors.

Charity Care and Community Support

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

2. Significant Accounting Policies (continued)

The cost of charity care provided during the years ended September 30, 2012 and 2011, are as follows (in thousands):

	2012	2011
HSN assessment	**$ 5,229**	$ 5,412
HSN receipts	**(11,929)**	(10,227)
Bad debts	**23,210**	22,147
Free care (at cost)	**19,601**	19,603
Total	**$ 36,111**	$ 36,935

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

Income Taxes

All of Baystate Health's consolidated entities are recognized by the Internal Revenue Service as tax-exempt, not-for-profit organizations under Section 501(c)(3) of the Internal Revenue Code, except for BHIC, IC and its subsidiary, and HNE and its subsidiaries.

Recent Accounting Pronouncements

In August 2010, the FASB issued ASU 2010-24, Topic 954, *Presentation of Insurance Claims and Related Insurance Recoveries*. The amendments in this update clarify that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The amendments in this update permit retrospective application, and are effective for fiscal years beginning after December 15, 2010. The adoption of this standard did not have a material impact on Baystate Health's financial statements.

On October 1, 2011, Baystate Health adopted amendments to ASC 954, *Health Care Entities*, which changes the disclosure requirements around the measurement of charity care provided. The amendments require charity care to be measured at cost, defined as the direct and indirect

2. Significant Accounting Policies (continued)

cost of providing services. Companies may derive the cost of providing services directly from a cost accounting system or, in the absence of such a system, through reasonable estimation techniques. The method used to identify or estimate such costs must also be disclosed. The cost of charity care provided should not be reduced by any reimbursements received to offset or subsidize charity services provided, such as through government programs or private grants; rather, these amounts should be separately disclosed. Baystate Health has included the new charity care disclosures in its 2012 audited financial statements.

Recently Issued Accounting Standards Not Yet Adopted

In May 2011 the FASB issued ASU 2011-04 to amend ASC 820, *Fair Value Measurements*. The amendments in this update require an entity to disclose information that helps users of its financial statements assess (a) the valuation techniques and inputs used to develop measurements of fair value of assets and liabilities measured on a recurring or non-recurring basis, and (b) the effect of the measurements on changes in net assets for recurring fair value measurements using significant unobservable inputs (Level 3). The disclosure requirements of this update are effective for the annual period beginning October 1, 2012. Baystate Health is evaluating the impact on its financial statements.

In July 2011, the FASB issued ASU 2011-07, Topic 954, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The amendments in this update require an entity that recognizes significant amounts of patient service revenue at the time the services are rendered but does not assess whether patients are able to pay to reclassify its provision for bad debts from an operating expense to a deduction from patient service revenue, net of contractual allowances and discounts. The amendments further require enhanced disclosures surrounding revenue recognition policies, assessing bad debts, qualitative and quantitative information about changes in the allowance for doubtful accounts, and disclosure of patient service revenue, net of contractual allowances and discounts. The amendments in this update are effective for interim and annual periods beginning after December 15, 2012, for non-public entities.

3. Cash and Investments

The composition of cash and investments at September 30, 2012 and 2011, is as follows (in thousands):

	2012	2011
Cash and cash equivalents	**$ 151,032**	$ 164,230
Mutual funds	**271,260**	220,218
Common collective trusts	**91,452**	110,572
Fixed income securities	**165,365**	174,620
Limited partnership investments	**157,100**	127,219
	$ 836,209	$ 796,859

Cash and investments at September 30, 2012 and 2011, are included in the consolidated statements of financial position as follows (in thousands):

	2012	2011
Cash and cash equivalents	**$ 140,460**	$ 123,615
Investments	**323,390**	299,523
Long-term investments	**53,825**	50,440
Board-designated cash and investments	**218,673**	198,836
Investments of captive insurance company	**95,333**	87,721
Investments held by trustee	**4,528**	36,724
	$ 836,209	$ 796,859

	2012	2011
Investment income included in other revenue	**$ 9,665**	$ 7,890

4. Fair Value Measurements

Baystate Health calculates fair value as described in ASC 820-10 to value its financial assets and liabilities, when applicable. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a three-level valuation hierarchy that prioritizes observable and unobservables inputs used to measure fair value. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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

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

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

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, Baystate Health utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as consider counterparty credit risk in its assessment of fair value.

4. Fair Value Measurements (continued)

Financial assets and liabilities carried at fair value as of September 30, 2012 and 2011, are classified in the table below in one of the three categories described above (in thousands):

	Level 1	Level 2	Level 3	Total
Year ended September 30, 2012				
Assets:				
Cash equivalents	$ 151,032	$ -	$ -	$ 151,032
Mutual funds:				
Corporate bond fund	177,755	-	-	177,755
Other	86,930	6,575	-	93,505
Total mutual funds	264,685	6,575	-	271,260
Common collective trusts:				
International stock	-	6,434	-	6,434
Domestic equity index funds	-	64,083	-	64,083
Commodity fund	4,319	16,616	-	20,935
Total common collective trusts	4,319	87,133	-	91,452
Limited partnership investments:				
Emerging markets equity	4,005	9,786	-	13,791
International stock	-	35,402	-	35,402
Other	-	8,532	-	8,532
Total limited partnership investments	4,005	53,720	-	57,725
Fixed income securities:				
Corporate bond fund	143,294	-	-	143,294
U.S. government securities	22,071	-	-	22,071
Total fixed income securities	165,365	-	-	165,365
Beneficial interests in perpetual trusts	-	33,889	-	33,889
Total assets at fair value	$ 589,406	$ 181,317	$ -	770,723
Alternative investments				99,375
Financial assets, including alternatives				$ 870,098
Liabilities:				
Interest rate swap agreements	$ -	$ 10,704	$ -	$ 10,704

4. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Total
Year ended September 30, 2011				
Assets:				
Cash equivalents	$ 164,230	$ -	$ -	$ 164,230
Mutual funds:				
Corporate bond fund	168,794	-	-	168,794
Other	44,560	6,864	-	51,424
Total mutual funds	213,354	6,864	-	220,218
Common collective trusts:				
International stock	-	28,806	-	28,806
Domestic equity index funds	-	62,490	-	62,490
Commodity fund	3,895	15,381	-	19,276
Total common collective trusts	3,895	106,677	-	110,572
Limited partnership investments:				
Emerging markets equity	3,533	6,832	-	10,365
International stock	-	17,895	-	17,895
Other	-	6,157	-	6,157
Total limited partnership investments	3,533	30,884	-	34,417
Fixed income securities:				
Corporate bond fund	153,007	-	-	153,007
U.S. government securities	21,613	-	-	21,613
Total fixed income securities	174,620	-	-	174,620
Beneficial interest in perpetual trusts	-	30,077	-	30,077
Total assets at fair value	$ 559,632	$ 174,502	$ -	734,134
Alternative investments				92,802
Total				$ 826,936
Liabilities:				
Interest rate swap agreements	$ -	$ 10,424	$ -	$ 10,424

4. Fair Value Measurements (continued)

The following is a description of Baystate Health's valuation methodologies for assets measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers, and brokers. Level 3 assets consist of direct investments in hedge funds and hedge fund of funds that are not redeemable in the near term. The valuation for alternative investments included in Levels 2 and 3 is stated at fair value, as estimated in an unquoted market. Fair value for alternative investments is determined for each investment using net asset values as a practical expedient, as permitted by generally accepted accounting principles, rather than using another valuation method to independently estimate fair value.

The valuation methodologies for liabilities measured at fair value are determined using models that consider interest rates and credit spreads. The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Baystate Health believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. The amounts classified in the table above exclude assets invested in Baystate Health's defined benefit plan and limited partnership interests that Baystate Health has recorded at cost.

Level 3 investments, including direct investments in hedge funds and hedge fund of funds, utilize the investment strategies detailed by the fund managers and reported to Baystate Health on at least a quarterly basis. These investment strategies include investments designed to enhance returns with less correlation to traditional asset classes with less risk.

5. Pledges Receivable

Pledges receivable at September 30, 2012 and 2011, are as follows (in thousands):

	2012	2011
Receivable in less than one year	**$ 528**	$ 4,410
Receivable in one to five years	**8,551**	8,755
Receivable in more than five years	**225**	100
Total pledges receivable	**9,304**	13,265
Less allowance for uncollectible pledges	**(923)**	(1,331)
Net pledges receivable	**$ 8,381**	$ 11,934

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

6. Land, Buildings, and Equipment

Details of land, buildings, and equipment at September 30, 2012 and 2011, are as follows (in thousands):

	2012	2011
Land, land improvements, and leasehold improvements	**$ 37,920**	$ 35,894
Buildings	**655,292**	401,677
Fixed equipment	**95,324**	94,971
Moveable equipment	**472,556**	427,844
Assets under capital leases	**24,275**	10,009
Construction in progress	**55,961**	252,253
	1,341,328	1,222,648
Less accumulated depreciation and amortization	**(739,322)**	(688,887)
Total land, buildings, and equipment, net	**$ 602,006**	$ 533,761

Depreciation expense for the years ended September 30, 2012 and 2011, was $53,925,000 and $48,578,000, respectively.

7. Short-Term Obligations and Commitments

Baystate Health's commercial paper borrowings at September 30, 2011, were $7,290,000 (no amounts were outstanding at September 30, 2012), at an average interest rate of 0.61%. The carrying value of these short-term obligations approximates fair value. The bank letter of credit committed to support commercial paper borrowings of Baystate Health amounted to $10,000,000 at September 30, 2011.

Baystate Health has a 50% ownership in Baycare Health Partners, Inc., a physician hospital organization. Baystate Health has provided an unconditional guarantee for a $1,000,000 line of credit from a financial institution. There were no amounts outstanding under the line of credit at September 30, 2012 and 2011.

8. Leases

Baystate Health and its subsidiaries lease certain real property and equipment under non-cancelable leases expiring at various dates through 2018 with varying renewal options. Rentals generally include insurance and maintenance costs.

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

Future minimum lease payments at September 30, 2012, are as follows (in thousands):

	Capital Leases	Operating Leases
Year Ending September 30		
2013	$ 3,351	$ 8,402
2014	3,351	5,754
2015	3,351	4,252
2016	3,173	3,764
2017	3,085	898
Thereafter	3,599	194
Total minimum lease payments	19,910	$ 23,264
Less amount representing interest	(1,369)	
Present value of net minimum lease payments	18,541	
Less current portion	(2,928)	
Long-term portion	$ 15,613	

8. Leases (continued)

Rental expense of operating leases amounted to approximately $12,602,000 and $10,480,000 for the years ended September 30, 2012 and 2011, respectively.

9. Long-Term Debt

BMC and BFMC have loan agreements with the MDFA (effective October 1, 2010, Massachusetts Health and Educational Facilities Authority (MHEFA) merged into MDFA) and with the MHEFA for construction projects and equipment.

Long-term obligations issued consist of the following (in thousands):

	Amount Outstanding September 30	
	2012	**2011**
MDFA and MHEFA issues:		
BMC Series M	**$ 40,137**	$ -
BMC Series L	**24,642**	-
BMC Series I	**63,380**	63,380
BMC Series J-1	**45,000**	45,000
BMC Series J-2	**45,000**	45,000
BMC Series K-1	**20,045**	20,045
BMC Series K-2	**26,365**	26,365
BMC Series M-2	**8,268**	8,782
BMC Series H	**6,222**	6,889
BFMC Series M-4A	**6,763**	7,141
BMC Series G	**52,910**	55,910
BMC Series F	**-**	41,290
BTHC NMTC debt	**107,550**	107,471
	446,282	427,273
Less original issue discount	**(1,057)**	(982)
Capital leases	**18,541**	2,841
Total long-term debt	**463,766**	429,132
Less current portion	**(9,218)**	(5,837)
Long-term debt, excluding current portion	**$ 454,548**	$ 423,295

9. Long-Term Debt (continued)

Summary information for each issue follows:

Series M Bonds

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

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

Series L Bonds

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

BMC Hospital Expansion MHEFA Bond Issuances

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

9. Long-Term Debt (continued)

Series I Bonds

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

Series J-1 Bonds

BMC issued Series J-1 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.17% at September 30, 2012. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2014.

Series J-2 Bonds

BMC issued Series J-2 MHEFA Revenue Bonds in the aggregate amount of $45,000,000. Interest on the bonds is variable and was 0.20% at September 30, 2012. Final maturity on the bonds is July 1, 2044. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates in January 2014.

Series K-1 Bonds

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

Series K-2 Bonds

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

9. Long-Term Debt (continued)

Series M-2

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

Series H Bonds

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

Series M-4A Bonds

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

Series G Bonds

On October 27, 2005, BMC issued Series G MHEFA Revenue Bonds in the aggregate principal amount of $71,740,000. Proceeds from the bonds were used to advance refund a portion of the outstanding Revenue Bonds, BMC Issue, Series E. The Series E bonds were issued to finance or refinance the following: (a) construction of a new 104,500 gross square foot Ambulatory Care Center; (b) construction of a new 100,000 gross square foot building to house the Ambulatory Surgery Center, Medical Library, and education space; (c) renovation of various existing spaces within BMC; and (d) acquisition of equipment for the new facilities. Bond proceeds were also used to finance routine capital construction, renovations, and equipping of various facilities of

9. Long-Term Debt (continued)

BMC. Interest on the bonds is variable, and resets every 35 days and was 0.22% at September 30, 2012. Final maturity of the bonds is July 1, 2026. The bonds are secured by an irrevocable letter of credit issued by a financial institution that terminates October 26, 2013.

New Markets Tax Credit Debt

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

In connection with the December and May 2009 financing arrangements, BMC loaned \$23,580,283 and \$32,617,500, respectively, to USBCDE Investment Fund XXXIII, LLC (the investment fund), a wholly owned subsidiary of U.S. Bancorp. The notes bear interest at 2.139% annually, with annual cash payments during the first seven years of each thirty-three-year term based on an interest rate of 1.00%. Also in connection with the December 2009 financing arrangement, BMC loaned \$7,606,500 to MHIC. The note bears interest at 1% annually, with no cash payments during the first seven years of the thirty-three-year term. The notes are recorded as notes receivable in the consolidated statements of financial position as of September 30, 2012 and 2011.

Under the December 2009 financing arrangement, BTHC has borrowed \$37,692,500 from four CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp through the Investment Fund controls two of the CDEs and MHIC controls the other two. As of September 30, 2012, BTHC has outstanding loans of \$27,490,000 and \$10,202,500 due to U.S. Bancorp CDEs and MHIC CDEs, respectively, related to the December 2009 financing. The loans were issued in four tranches from each of the controlling entities. U.S. Bancorp loans were issued in tranches A, B, C, and D. The U.S. Bancorp CDEs A loan totaled \$19,886,783, the B loan \$2,653,217, the C loan \$3,693,500, and the D loan \$1,256,500. Each of the loans have a thirty-three-year term, and bear interest at rates ranging from .8911% to 1.8315% annually. MHIC loans were issued in tranches A, B, Series 2, and Series 4. The MHIC CDEs A loan totaled \$7,606,500, the B loan \$1,366,000, the Series 2 loan \$1,000,000, and the Series 4 loan \$230,000. Each of the loans have a thirty-three-year term, and bear interest at rates ranging from 1.00% to 1.935%.

9. Long-Term Debt (continued)

Under the May 2009 financing arrangement, BTHC has borrowed approximately $69,424,000 from CDEs established for the purpose of providing funds under the NMTC Program. U.S. Bancorp, through the Investment Fund, controls four of the CDEs and Banc of America controls the other CDE. As of September 30, 2011, BTHC has outstanding loans of approximately $43,340,000 and $26,084,000 due to U.S. Bancorp CDEs and Banc of America CDE, respectively. The loans were issued in two tranches, an A tranche and a B tranche. The A loans from the U.S. Bancorp CDEs totaled $32,617,500, have a thirty-three-year term, and bear interest at rates ranging from 0.816% to 1.00% annually. The B loans from the U.S. Bancorp CDEs totaled $10,722,500, have a thirty-three-year term, and bear interest at rates ranging from 0.5% to 1.2832% annually. The A loan from the Banc of America CDE of $20,000,000 has a seven-year term, and bears interest at 5.992% annually. The B loan from the Banc of America-controlled CDE of $6,084,000 has a seven-year term, and provides that if there has been no default, the principal balance will be forgiven at the end of the seven-year term. The B loan bears interest at 2.00% annually. Interest payments are due quarterly.

BMC recorded interest income of approximately $1,338,000 in 2012 and $1,318,000 in 2011, and BTHC recorded net interest capitalized of approximately $913,000 in 2012 and $2,164,000 in 2011, related to the financing arrangement agreements.

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

Significant Debt Covenants

The bond agreements include various financial covenants, the most restrictive of which are a pledge of revenues and the maintenance of a ratio of Net Revenue Available to Meet Debt Service to Total Principal and Interest Requirements of at least 1.1 (as defined by the agreement). Baystate Health was in compliance with those covenants during the fiscal years ended September 30, 2012 and 2011, except as noted below.

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

9. Long-Term Debt (continued)

The following funds and their balances at September 30, 2012 and 2011, have been established in accordance with these agreements (in thousands):

	2012	2011
Debt service fund	**$ 4,528**	$ 3,163
Construction fund	**-**	33,561
	$ 4,528	$ 36,724

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

2013	$ 9,218
2014	9,520
2015	9,845
2016	30,698
2017	12,912
Thereafter	392,630
	$ 464,823

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

The fair value of the bonds payable at September 30, 2012, approximates $471,652,000.

Interest paid was $13,297,000 and $10,791,000 for 2012 and 2011, respectively.

Interest Rate Swap Agreements

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

BMC entered into an interest rate swap agreement with a financial institution with an original notional amount of $67,470,000. The notional amount outstanding at September 30, 2012 and 2011, was $34,498,000 and $39,363,000, respectively. Under the terms of the agreement, BMC pays a fixed rate of 3.26%, and receives variable payments based upon the SIFMA Rate. The agreement, in effect, converts $39,363,000 of notional variable rate debt to fixed rate debt.

9. Long-Term Debt (continued)

In September 2005, BMC, in anticipation of the issuance of the Series G bonds, entered into an interest rate swap agreement with a financial institution with an original notional amount of $71,740,000. The notional amount outstanding at September 30, 2012 and 2011, was $52,910,000 and $55,910,000, respectively. The agreement provides for the financial institution to pay variable rate payments to BMC equal to 56.9% of one-month LIBOR plus 0.32%, and for BMC to pay the financial institution a fixed rate of 3.021%. The LIBOR was .22% and 0.23% at September 30, 2012 and 2011, respectively. The agreement, in effect, converts $55,910,000 of variable rate debt to a fixed rate of interest. There are termination provisions to this contract for each party.

The fair value of these agreements resulted in swap liabilities of approximately $10,704,000 and $10,425,000 at September 30, 2012 and 2011, respectively, and is included in other long-term liabilities in the consolidated statements of financial position.

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

10. Interest Expense

Baystate Health and its subsidiaries capitalize interest cost as part of the historical cost of acquiring certain significant qualifying assets. During the years ended September 30, 2012 and 2011, interest cost was as follows (in thousands):

	2012	2011
Total interest cost	**$ 13,481**	$ 10,662
Net interest cost capitalized	**(4,005)**	(4,637)
Net interest cost expensed	**$ 9,476**	$ 6,025

11. Insurance Liability Loss Reserves

BHIC, wholly owned by Baystate Health, insures the professional and general liability of substantially all of Baystate Health's subsidiaries, with the exception of HNE, on an indemnity basis. Baystate Health and certain of its subsidiaries have also purchased excess professional and general coverage from other insurers. In addition, BHIC insures the workers' compensation, employer's liability, excess workers' compensation, and long-term disability of certain of Baystate Health's subsidiaries.

11. Insurance Liability Loss Reserves (continued)

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

12. Medical Claims and Capitation Expense

Medical claims and capitation expense include the following components for the years ended September 30, 2012 and 2011 (in thousands):

	2012	2011
Physician and other outpatient specialty services	**$ 172,464**	$ 166,329
Inpatient care and same day surgery	**63,321**	59,272
Pharmacy	**73,148**	62,296
Primary care capitation	**4,166**	3,418
Other medical services	**21,467**	11,543
Coordination of benefits	**(406)**	(456)
Net reinsurance losses (recoveries)	**1,381**	(921)
	335,541	301,481
Provider risk-sharing, net	**7,857**	6,281
Total medical claims and capitation expense	**$ 343,398**	$ 307,762

13. Income Taxes

Income tax (benefit) expense for the years ended September 30, 2012 and 2011, for HNE and its subsidiaries, was approximately ($367,000) and $10,904,000, respectively. Net federal and state deferred tax assets totaled approximately $4,724,000 and $3,473,000 as of September 30, 2012 and 2011, respectively. There is no valuation allowance recorded.

There was no income tax expense for the year ended September 30, 2012, for IC and its subsidiary. Income tax expense was approximately $7,000 for the year ended September 30, 2011. As of September 30, 2012, operating loss carryforwards for federal income tax purposes totaled approximately $1,090,000 and $14,625,000 for IC and BMC, respectively, which expire in various years ranging from 2013 to 2031. This results in a deferred tax asset; however, because utilization of these net operating losses is not reasonably assured, IC and BMC have recorded a full valuation allowance offsetting this deferred tax asset.

14. Funds Held in Trust by Others

Baystate Health and its subsidiaries are beneficiaries of certain perpetual trusts (the Trusts), from which they receive unrestricted income. Appreciation or depreciation in the value of the Trusts is recorded as an increase or decrease to permanently restricted net assets. During fiscal years 2012 and 2011, Trust distributions of approximately $1,032,000 and $1,037,000, respectively, are included in operating revenue.

15. Pension Plans

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

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

ASC 715 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, postretirement benefit plans) to recognize the funded status of their postretirement benefit plans in the statement of financial position, measure the fair value of the assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. ASC 715 requires Baystate Health to measure defined benefit plan assets and obligations as of September 30, the date of its fiscal year-end statement of financial position.

15. Pension Plans (continued)

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

	2012	2011
Change in pension obligation		
Pension obligation at beginning of year	**$ 792,839**	$ 700,166
Service cost	**31,150**	28,839
Interest cost	**41,656**	39,946
Actuarial loss	**151,257**	51,035
Benefits paid	**(29,467)**	(27,147)
Plan amendments	**(81,322)**	-
Pension obligation at end of year	**906,113**	792,839
Change in plan assets		
Fair value of plan assets at beginning of year	**638,888**	578,634
Actual return on plan assets	**75,324**	47,401
Employer contributions	**40,000**	40,000
Benefits paid	**(29,467)**	(27,147)
Fair value of plan assets at end of year	**724,745**	638,888
Funded status		
Funded status of the plan	**(181,368)**	(153,951)
Pension liability	**$ (181,368)**	$ (153,951)
Amounts recognized in unrestricted net assets consist of		
Net actuarial loss	**$ 395,896**	$ 279,672
Prior service credit	**(108,577)**	(31,224)
Pension adjustment	**$ 287,319**	$ 248,448

Exclusive of other ownership interest, the underfunded status of the plan at September 30, 2012, is $180,442,000, the change in the pension adjustment is $38,652,000 and the total pension adjustment is $286,031,000.

15. Pension Plans (continued)

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

- The Plan's fixed annuity conversion factors will be replaced with variable annuity factors, based on 417(e) (3) interest and mortality, for benefits accrued on or after January 1, 2013.
- The age 65 requirement for eligibility to receive a lump sum distribution on benefits accrued after 2004 is removed.
- Participants will become eligible to make separate lump sum and annuity elections on benefits earned prior to 2013 and after 2012.

The net actuarial loss and prior service credit expected to be recognized in benefit cost in 2013 is approximately $30,046,000 and $12,765,000, respectively.

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

	2012	2011
Measurement date	**September 30, 2012**	September 30, 2011
Discount rate	**4.10%**	5.20%
Rate of compensation increase	**3.25%**	3.25%

The accumulated benefit obligation was approximately $863,642,000 and $696,502,000 at September 30, 2012 and 2011, respectively.

Net Periodic Pension Cost

Net pension cost for the defined benefit plan for the years ended September 30, 2012 and 2011, includes the following components (in thousands):

	2012	2011
Service cost	**$ 31,150**	$ 28,839
Interest cost	**41,656**	39,946
Expected return on plan assets	**(54,566)**	(50,385)
Amortization of prior service credit	**(3,969)**	(3,969)
Recognized net actuarial loss	**14,275**	10,394
Net pension cost	**$ 28,546**	$ 24,825

15. Pension Plans (continued)

The assumptions used to determine net pension cost for the years ended September 30, 2012 and 2011, are as follows:

	2012	2011
Discount rate	**5.20%**	5.60%
Expected return on plan assets	**7.75%**	7.75%
Rate of compensation increase	**3.25%**	3.25%

Plan Assets

The plan's investment objectives are to achieve long-term growth in excess of inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets. In order to minimize risk, the plan attempts to minimize the variability in yearly returns. The plan diversifies its holdings among sectors, industries, and companies. The target allocations of assets at September 30, 2012, were equities 30%, fixed income 40%, and other 30%.

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

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

	2012	2011
Common and preferred equity securities	**31%**	26%
U.S. government and domestic fixed income securities	**40**	46
Other investments	**29**	28
	100%	100%

15. Pension Plans (continued)

Pension Disclosure

Financial assets invested in Baystate Health's defined benefit pension plan (the Plan) are classified in the table below in one of the three categories described previously as of September 30, 2012 and 2011 (in thousands):

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

15. Pension Plans (continued)

Pension Disclosure (continued)

	Assets at Fair Value as of September 30, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Money market	$ 1,571	$ 2,952	$ -	$ 4,523
Mutual funds:				
Corporate bond fund	4,898	-	-	4,898
Other	24,960	-	-	24,960
Total mutual funds	29,858	-	-	29,858
Closed end real estate funds	-	-	12,000	12,000
Common-collective trusts:				
International stock	31,324	-	-	31,324
Domestic equity index funds	73,705	-	-	73,705
Commodity fund	20,175	-	-	20,175
Total common-collective trusts	125,204	-	-	125,204
Limited partnership investments:				
Private equity funds	-	-	35,288	35,288
Real estate fund	-	-	8,402	8,402
Hedge funds	-	-	98,840	98,840
Emerging markets equity	12,162	-	9,424	21,586
International stock	16,371	-	-	16,371
Total limited partnership investments	28,533	-	151,954	180,487
Fixed income securities:				
Corporate bond fund	-	143,658	-	143,658
US government securities	-	130,028	-	130,028
Total fixed income securities	-	273,686	-	273,686
Total assets, at fair value	$ 185,166	$ 276,638	$ 163,954	625,758
Pension assets, at contract value				13,130
Total pension plan assets				$ 638,888

15. Pension Plans (continued)

The following table sets forth a summary of changes in the fair value of the Plan's Level 3 assets for the years ended September 30, 2012 and 2011 (in thousands):

	Level 3 Assets Year Ended September 30, 2012	Level 3 Assets Year Ended September 30, 2011
Balance at beginning of year	$ 163,954	$ 134,898
Unrealized gains relating to investments still held at the reporting date	15,790	6,417
Purchases	6,403	24,087
Sales	(1,924)	(1,448)
Balance at end of year	$ 184,223	$ 163,954

The following is a summary of investments (by major class) that have restrictions on the Plan's ability to redeem its investment at the measurement date and any unfunded capital commitments as of September 30, 2012 (in thousands):

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

Contributions

Baystate Health expects to contribute approximately $40,000,000 to its pension plan in 2013.

15. Pension Plans (continued)

Estimated Future Benefit Payments

The following approximate benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next ten calendar years (in thousands):

Calendar Year	Pension Benefits
2013	$ 66,700
2014	54,600
2015	56,300
2016	57,800
2017	65,600
Years 2018 – 2022	308,000

Defined Contribution Plans

Baystate Health and certain of its consolidated subsidiaries and other ownership interest participate in a defined contribution retirement plan which covers all employees hired after December 31, 2004. Under this plan, Baystate Health contributes up to 7.5% of the employee's compensation based on age and years of service. Total expense under this plan was approximately $10,240,000 in 2012 and $8,980,000 in 2011.

HNE provides a 401(k) Retirement Plan (the Plan). Each year, employees may contribute up to 20% of pretax annual compensation, as defined in the Plan document. HNE matches 100% of the first 6% of employee contributions to the Plan. Additional contributions may be made by HNE at its discretion. Contributions and compensation levels are subject to certain limitations under the Internal Revenue Code. The Plan expense amounted to approximately $1,674,000 and $1,365,000 in 2012 and 2011, respectively.

16. Concentrations of Credit Risk

Baystate Health and its subsidiaries grant credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2012 and 2011, are as follows:

	2012	2011
Medicare	**18%**	16%
Medicaid	**18**	13
Blue Cross	**1**	2
Health maintenance organizations	**37**	40
Commercial	**12**	14
Self-pay patients	**14**	15
	100%	100%

17. Functional Expenses

Baystate Health and its subsidiaries provide general health care services to residents within its geographic location. Expenses related to providing these services for the years ended September 30, 2012 and 2011, are as follows (in thousands):

	2012	2011
Health care services	**$ 1,511,003**	$ 1,442,068
General and administrative	**96,546**	57,115
	$ 1,607,549	$ 1,499,183

18. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2012 and 2011 (in thousands):

	2012	2011
Research and education	**$ 12,079**	$ 12,058
Patient care services	**43,629**	45,516
Total	**$ 55,708**	$ 57,574

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

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

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

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

18. Temporarily and Permanently Restricted Net Assets (continued)

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

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

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

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

18. Temporarily and Permanently Restricted Net Assets (continued)

For the year ended September 30, 2011, Baystate Health had the following endowment-related activities (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at October 1, 2010	$ 20,200	$ 32,670	$ 15,476	$ 68,346
Investment return:				
Investment income	260	620	-	880
Net appreciation	101	190	-	291
Total investment return	361	810	-	1,171
Contributions	71	-	722	793
Net asset reclassifications	-	107	-	107
Amounts appropriated for expenditures	(1,089)	(2,668)	-	(3,757)
Total change in endowment funds	(657)	(1,751)	722	(1,686)
Endowment net assets at September 30, 2011	$ 19,543	$ 30,919	$ 16,198	$ 66,660

Baystate Health's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Baystate Health must hold in perpetuity or for a donor-specified term. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that will generate an 8% total return annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, Baystate Health relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Baystate Health targets a diversified asset allocation that consists of equities, fixed income, and alternative investments.

Baystate Health has a policy of appropriating for distribution each year, no more than 5.0% of its endowment funds' current fair value. In establishing this policy, Baystate Health considered the long-term expected return on its endowments.

18. Temporarily and Permanently Restricted Net Assets (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires Baystate Health to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were $254,000 as of September 30, 2011. There was no deficiency at September 30, 2012.

19. State Surplus Revenue Retention

Through September 30, 2012, BMC had no surplus in excess of the Commonwealth of Massachusetts regulations governing the excess of state revenues over expenses for not-for-profit organizations. The total deficit attributable to state contracting for BMC was approximately $54,000 (2011 – $70,000). As of September 30, 2012, the cumulative deficit attributable to state contracting of approximately $6,180,000 is included in the unrestricted net assets of BMC.

20. Events Subsequent to September 30, 2012

Subsequent events have been evaluated for potential recognition in the financial statements through January 3, 2013, which is the date the financial statements were issued.

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