Foundation of the Massachusetts Eye and Ear Infirmary, Inc.

Combined Financial Statements and Supplementary Combining Schedules
September 30, 2016 and 2015

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Independent Auditor's Report

To the Board of Directors of the Foundation of
the Massachusetts Eye and Ear Infirmary, Inc.

We have audited the accompanying combined financial statements of the Foundation of the Massachusetts Eye and Ear Infirmary, Inc., (the "Foundation"), which comprise the combined balance sheets as of September 30, 2016 and 2015, and the related combined statements of operations, changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Combined Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Foundation's preparation and fair presentation of the combined 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 Foundation'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 combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Foundation and its subsidiaries at September 30, 2016 and 2015, and the changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining information is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position, results of operations and cash flows of the individual entities and is not a required part of the combined financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual companies.

PricewaterhouseCoopers LLP

Boston, Massachusetts
January 20, 2017

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combined Balance Sheets
September 30, 2016 and 2015

	2016	2015
Assets		
Current assets		
Cash and cash equivalents	$ 4,642,362	$ 8,012,889
Assets whose use is limited (Notes 2 and 3)	2,821,807	3,551,739
Patient accounts receivable, less allowance for doubtful accounts of $8,407,563 and $6,436,343 as of September 30, 2016 and 2015, respectively (Notes 10 and 16)	34,694,817	30,689,274
Other current assets	27,711,288	18,592,528
Total current assets	69,870,274	60,846,430
Assets whose use is limited (Notes 2 and 3)		
Special cash reserves	1,598,880	2,697,242
Under indenture agreement (Note 6)	7,064,382	7,246,350
Total assets whose use is limited	8,663,262	9,943,592
Investments (Notes 2, 3 and 6)	206,146,757	190,320,731
Pledges receivable, net (Notes 2 and 5)	5,830,014	5,261,431
Remainder interest in charitable trusts (Note 3)	484,361	451,826
Beneficial interest in trusts (Note 3)	15,891,307	15,128,979
Property, plant and equipment, net (Note 4)	187,714,055	177,464,053
Intangible assets, net of accumulated amortization of $3,073,045 and $2,111,507 as of September 30, 2016 and 2015, respectively	16,135,884	1,363,619
Deposits and other assets	16,195,662	15,567,662
Total assets	$ 526,931,576	$ 476,348,323
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt and capital lease obligations (Notes 6 and 9)	$ 9,294,576	$ 7,032,101
Accounts payable and accrued expenses	56,398,152	48,350,054
Accrued interest	558,146	778,221
Estimated third-party settlements (Note 10)	4,155,733	7,854,958
Total current liabilities	70,406,607	64,015,334
Long-term debt and capital lease obligations, less current portion (Notes 6 and 9)	120,331,875	86,035,526
Mass Devel. Finance Agency Revenue Bonds, Interest Swap Liability (Note 7)	4,036,706	-
Asset retirement obligation	-	-
Deferred QLT revenue (Note 15)	11,260,223	13,280,726
Other long-term liabilities (Notes 2 and 6)	11,708,168	12,162,134
Professional liability reserve (Note 14)	8,350,791	8,024,786
Accrued pension costs (Note 11)	54,586,319	55,512,094
Total liabilities	280,680,689	239,030,600
Commitments and contingencies (Notes 9 and 14)		
Unrestricted net assets		
Unrestricted for general operations	74,859,707	67,547,830
Board designated	48,167,360	48,282,744
Total unrestricted net assets	123,027,067	115,830,574
Temporarily restricted net assets (Notes 13 and 17)	46,700,163	49,262,806
Permanently restricted net assets (Notes 13 and 17)	76,523,657	72,224,343
Total net assets	246,250,887	237,317,723
Total liabilities and net assets	$ 526,931,576	$ 476,348,323

The accompanying notes are an integral part of these combined financial statements.

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combined Statements Of Operations
Years Ended September 30, 2016 and 2015

	2016	2015
Unrestricted revenue and gains (Note 10)		
Net patient service revenue (net of contractual allowances and discounts)	$ 292,755,225	$ 269,395,584
Provision for bad debts	(9,865,858)	(8,075,542)
Net patient service revenue less provision for bad debts	282,889,367	261,320,042
Research direct revenue	29,731,836	33,251,534
Research indirect revenue	13,938,619	13,953,988
Contributions	6,007,057	6,977,898
Investment income (Note 3)	2,175,773	2,225,227
Net assets released from restriction used for operations (Note 2)	14,545,656	15,036,071
QLT revenue (Note 15)	4,321,566	2,994,328
Other revenue and gains	47,901,922	60,940,815
Total unrestricted revenue and gains	401,511,796	396,699,903
Expenses (Note 8)		
Salaries and wages	157,848,004	149,070,600
Fringe benefits	37,034,224	35,976,351
QLT expenses (Note 15)	2,087,849	3,948,667
Supplies and other expenses	121,079,238	126,232,114
Depreciation	21,283,790	22,974,850
Interest	4,789,467	3,554,261
Research expenditures	51,069,021	47,607,917
Total expenses	395,191,593	389,364,760
Income from operations	6,320,203	7,335,143
Other gains		
Net realized gains on investments (Note 3)	160,771	1,782,773
Unrealized losses on interest rate swap agreements	(4,036,706)	-
Total other gains, net	(3,875,935)	1,782,773
Excess of revenues over expenses	2,444,268	9,117,916
Net assets released from restriction for the purchase of property, plant and equipment	(1,285,108)	365,186
Change in unrealized depreciation on investments (Note 2)	2,699,352	(2,386,496)
Pension and postretirement-related charges other than net periodic pension cost-Gain/Loss (Note 11)	3,337,981	(13,075,539)
Total increase (decrease) in unrestricted net assets	$ 7,196,493	$ (5,978,933)

The accompanying notes are an integral part of these combined financial statements.

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combined Statements of Changes in Net Assets
Years Ended September 30, 2016 and 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets at September 30, 2014	$ 121,809,507	$ 50,982,932	$ 72,878,901	$ 245,671,340
Excess of revenues over expenses	9,117,916	-	-	9,117,916
Contributions, grants and other income	-	15,357,589	472,461	15,830,050
Realized gain on investments	-	1,605,847	-	1,605,847
Investment loss, net	-	(852,513)	-	(852,513)
Net assets released from restriction for the purchase of property, plant and equipment	365,186	(924,093)	-	(558,907)
Change in unrealized depreciation on investments	(2,386,496)	(1,870,885)	-	(4,257,381)
Loss on beneficial interest in trusts	-	-	(1,127,019)	(1,127,019)
Net assets released from restriction used for operations	-	(15,036,071)	-	(15,036,071)
Pension and postretirement-related charges other than net periodic pension cost-loss	(13,075,539)	-	-	(13,075,539)
(Decrease) in net assets	(5,978,933)	(1,720,126)	(654,558)	(8,353,617)
Net assets at September 30, 2015	115,830,574	49,262,806	72,224,343	237,317,723
Excess of revenues over expenses	2,444,268	-	-	2,444,268
Contributions, grants and other income	-	10,708,686	3,536,987	14,245,673
Realized gain on investments	-	291,023	-	291,023
Investment loss, net	-	(944,011)	-	(944,011)
Net assets released from restriction for the purchase of property, plant and equipment	(1,285,108)	(690,935)	-	(1,976,043)
Change in unrealized depreciation on investments	2,699,352	2,618,250	-	5,317,602
Gain on beneficial interest in trusts	-	-	762,327	762,327
Net assets released from restriction used for operations	-	(14,545,656)	-	(14,545,656)
Pension and postretirement-related charges other than net periodic pension cost-gain	3,337,981	-	-	3,337,981
(Decrease) Increase in net assets	7,196,493	(2,562,643)	4,299,314	8,933,164
Net assets at September 30, 2016	$ 123,027,067	$ 46,700,163	$ 76,523,657	$ 246,250,887

The accompanying notes are an integral part of these combined financial statements.

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combined Statements of Cash Flows
Years Ended September 30, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Change in net assets	$ 8,933,164	$ (8,353,617)
Adjustments to reconcile change in net assets to cash flows provided by (used in) from operating activities		
Depreciation and amortization	21,046,981	23,084,835
Unrealized loss on interest rate swap agreements	4,036,706	
Net realized and unrealized gains(loss) on investments	(5,785,957)	868,761
Provision for doubtful accounts	9,865,858	8,075,542
Restricted contributions for long-term use	(8,166,102)	7,858,217
Noncash contributions received	(2,614,927)	(5,401,094)
Proceeds from sale of donated securities	36,162	108,326
Gain on beneficial interest in trusts	(762,328)	1,127,019
(Gain) Loss on remainder interest in trusts	(32,535)	57,851
Gain on disposal of property, plant and equipment	(23,638,446)	(39,756,621)
Change in asset retirement obligation	-	(30,723)
Pension and Postretirement-related charges other than net period pension costs	(3,337,981)	13,075,539
Effects of changes in operating assets and liabilities		
Accounts receivable	(13,871,401)	(12,011,279)
Pledges receivable	31,639	145,978
Other assets	(10,346,982)	(1,337,344)
Accounts payable and accrued expenses	7,679,937	12,845,648
Other long term liabilities	(453,966)	2,717,858
Estimated third-party settlements	(3,699,225)	3,942,098
QLT deferred fund liability	(2,020,503)	(1,014,446)
Professional liability reserve	326,005	493,262
Accrued pension costs	2,412,206	436,862
Cash provided by (used in) operating activities	(20,361,695)	6,932,672
Cash flows from investing activities		
Purchases of property, plant and equipment and intangible assets	(45,899,806)	(17,879,540)
Proceeds from sale of property, plant and equipment	23,638,446	39,756,621
Purchases of investments and assets whose use is limited	(130,733,635)	(139,895,584)
Sales of investments and assets whose use is limited	122,703,828	125,168,861
Cash (used in) provided by investing activities	(30,291,167)	7,150,358
Cash flows from financing activities		
Restricted contributions for long-term use	8,166,102	(7,858,217)
Proceeds from sale of donated securities restricted for endowment	2,578,765	5,292,768
Proceeds from issuance of Long-Term Debt	57,169,214	-
Proceeds from line of credit	1,250,000	-
Payments on line of credit	-	(500,000)
Principal payments on long-term debt and capital lease obligations	(21,881,746)	(6,253,873)
Cash used in financing activities	47,282,335	(9,319,322)
Increase (Decrease) in cash and cash equivalents	(3,370,527)	4,763,708
Cash and cash equivalents		
Beginning of year	8,012,889	3,249,181
End of year	$ 4,642,362	$ 8,012,889
Supplementary cash flow information		
Interest paid	$ 4,261,033	$ 4,095,276
Supplementary disclosure of noncash activities		
Acquisition of property, plant and equipment and intangible assets financed with a capital lease and debt	$ 15,513,756	$ 6,479,862
Donated Securities	2,614,927	5,401,094
Property plant and equipment included in AP and accrued expenses	212,019	63,933

The accompanying notes are an integral part of these combined financial statements.

1. Organization

The Foundation of the Massachusetts Eye and Ear Infirmary, Inc. (the "Foundation") is the parent corporation for a group of controlled organizations which consists of the Massachusetts Eye and Ear Infirmary (the "Infirmary"), Massachusetts Eye and Ear Associates, Inc. (the "Associates"), Schepens Eye Research Institute, Inc. ("Schepens"), Embankment Services, Inc. ("Embankment") and Circle Company, Inc. ("Circle").

The Foundation is a not-for-profit organization and was formed primarily as a fund-raising organization for the Infirmary, and to hold and manage the endowment and other investments of the Infirmary.

The Infirmary is a not-for-profit hospital located in downtown Boston, Massachusetts specializing in the treatment of, and teaching and research relating to, disorders of the eye, ear, nose, throat, head and neck. The Infirmary is the principal teaching hospital for ophthalmology and otolaryngology for Harvard Medical School.

The Associates is a not-for-profit corporation which provides physician services primarily to patients of the Infirmary. The Infirmary and Associates operate clinical practices in surrounding Massachusetts communities including Stoneham, Concord, East Bridgewater, Quincy, other suburban locations and in Providence Rhode Island.

Schepens, a not-for-profit corporation, conducts basic and clinical research and training of young scientists on the normal processes of vision and the diseases that affect sight.

Embankment, a not-for-profit corporation, was formed to engage in charitable activities and programs in support of the charitable purposes of the Foundation.

Circle, a not-for-profit corporation, was formed for the purpose of owning and developing real estate for the benefit of the Foundation and the Infirmary.

2. Summary of Significant Accounting Policies

Principles of Combination

The combined financial statements include the accounts of the above-named entities for the years ended September 30, 2016 and 2015. All significant inter-entity transactions have been eliminated. The assets of one or more of the entities in the combined group may not be available to satisfy the liabilities of others within the group.

Basis of Presentation

The financial statements of the Foundation have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Net Assets

Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets that have similar characteristics have been combined into similar categories as follows:

Permanently Restricted
Net assets subject to explicit donor-imposed stipulations that they be maintained by the Foundation in perpetuity are classified as permanently restricted. Generally, the donors of these assets permit the Foundation to use all or part of the investment return on these assets for general operations or specified purposes.

Temporarily Restricted
Net assets whose use by the Foundation is subject to explicit donor-imposed stipulations that can be fulfilled by either the incurrence of expenses by the Foundation pursuant to those stipulations or by the passage of time are classified as temporarily restricted. Temporarily restricted net assets also include amounts subject to legal restrictions such as portions of otherwise unrestricted capital appreciation on donor restricted funds which are restricted by Massachusetts law until appropriated by the Board of Directors.

Unrestricted
Net assets that are not subject to explicit donor-imposed stipulations are classified as unrestricted net assets. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. 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.

The Commonwealth of Massachusetts requires capital appreciation on donor restricted endowment funds to be considered as changes in temporarily restricted net assets until it has been appropriated for expenditure by the Board of Directors. When a donor restriction expires (i.e. when a stipulated time restriction ends or purpose restriction is met), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and of changes in net assets as either net assets released from restriction used for operations (for noncapital related items) or as net assets released from restriction for the purchase of property, plant and equipment (for capital related items).

Contributions, including unconditional promises to give, are recognized as revenues at the date the promise is received. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Unconditional promises to give are included in the financial statements as pledges receivable and revenue within temporarily restricted net assets due to implicit time restrictions. Pledges are recorded after discounting to the present value of the expected future cash flows and recording an allowance for unfulfilled pledges. Contributions restricted for the acquisition of land, buildings and equipment are reported as temporarily restricted support.

Assets Held With Outside Trustees
The Foundation is the beneficiary of several trust funds administered by outside trustees. Assets received include perpetual trusts and charitable remainder trusts and are recorded at fair value in the appropriate net asset category based on donor stipulations. Contributions related to perpetual trusts are recognized as revenue upon notification of the trusts' existence and are equal to the fair market value on that date. The related asset is adjusted on an annual basis to reflect changes in the fair value of the asset due to appreciation or depreciation in the trusts. The resulting unrealized gain or loss is included in the statement of changes in net assets. Contributions to charitable remainder trusts are recognized as revenue upon notification of the trusts' existence and are equal to the present value of the expected future cash flows to the Foundation.

Split-Interest Agreements

The Foundation has split-interest agreements consisting primarily of charitable gift annuities, and pooled income funds. Split-interest agreements, which are included in investment totals, amount to $1,957,633 (cost basis of $1,858,877) and $1,937,451 (cost basis of $1,969,502) as of September 30, 2016 and 2015, respectively. Contributions are recognized at the date the trusts are established net of a liability for the present value of the estimated future cash outflows to beneficiaries. The present value of payments is discounted with a rate of 7.5%. The liability of $633,264 and $676,777 as of September 30, 2016 and 2015, respectively, is adjusted during the term of the agreement for changes in actuarial assumptions. This number is included in the other long-term liabilities line on the Balance Sheet.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less. Amounts whose use is limited by Board designation, specific purpose, or other arrangements under trust agreements are reported in accordance with their intended use and are excluded from cash and cash equivalents.

The majority of the Foundation's banking activity, including cash and cash equivalents, is maintained with one bank and amounts on deposit exceed federal insurance limits. It is the Foundation's policy to monitor this bank's financial strength on an ongoing basis.

Research Grants and Contracts

The Foundation engages in research activities under grants and contracts with U.S. Government agencies and other organizations. Reimbursed costs, including overhead allowances, are subject to post-performance review and adjustment.

Revenues associated with research contracts and grants are recognized as the related costs or capital expenditures are incurred. Grant revenue used for the construction or acquisition of plant is recorded as changes in unrestricted net assets. The Foundation records reimbursement of facilities and administrative costs relating to government contracts and grants at authorized rates each year.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Donated items are recorded at fair value at the date of contribution. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Estimated useful lives range from 3 to 40 years. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization expense in the financial statements. Interest cost incurred on borrowed funds during the construction period of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted net assets. Absent explicit donor stipulations about how long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Intangible Assets
Intangible assets include deferred financing costs relating to bond financing. Deferred financing costs are amortized using the imputed interest method over the repayment period of the bonds.

Also included in intangible assets is the principal cost, less depreciation, of the sublicense of Partners Healthcare's Epic integrated electronic health record, clinical, and financial system that the Foundation implemented in Fiscal Year 2016.

The Foundation reviews its intangible and other long-lived assets annually to determine potential impairment. In performing the review, the Foundation estimates the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment is recognized.

Other Current Assets
Other current assets primarily include prepaid expenses, research receivables and inventories. Inventories are stated at average cost.

Investments and Investment Income
The Foundation records its investments in marketable securities at market value as determined by closing sale prices on national securities exchanges or closing bid prices on over the counter markets. The Foundation records its purchases and sales of investments on the trade date, and realized gains and losses are recorded by the Foundation using the average cost basis. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Investments in limited partnerships, limited liability corporations or common/collective trusts are recorded on the cost basis based on the Foundation's ownership share and rights of the investment. The Foundation does not own any interests in limited partnerships, limited liability corporations and common/collective trusts where the Foundation owns a significant portion of the total net assets of the portfolio or has significant influence. Since many of these investments are not readily marketable, the estimates of fair value involve assumptions and estimation methods which are uncertain, and therefore, the estimate could differ materially from actual results or if a ready market for the investment existed. The cost of these investments at September 30, 2016 and 2015 is $102,062,797 and $96,450,564, respectively. The estimated market value of these investments at September 30, 2016 and 2015 is $125,207,500 and $114,742,329, respectively.

The Foundation reviews the recoverability of investments quarterly in accordance with generally accepted accounting principles and reviews the carrying value of its investments held. Any impairment on unrestricted investments would be recognized in net realized gains (losses) rather than in the change in unrealized appreciation (depreciation) if a diminution in value considered to be other than temporary were to occur. Accordingly, the Foundation recorded a charge of $93,914 and $98,909 for the years ended September 30, 2016 and 2015, respectively, for the decline in fair value of investments considered to be other than temporary. These amounts have been included in net realized gains (losses) on investments on the combined statements of operations.

Assets Whose Use is Limited
Assets whose use is limited include assets set aside by the Board of Directors in a special cash reserve fund for future capital improvements or other purposes as designated by the Board of Directors, and assets held by trustees under indenture agreements. Also included are assets received from the QLT judgment and funding received from the Department of Defense for sponsored research.

Excess (Deficit) of Revenues Over Expenses
The statements of operations include excess (deficit) of revenues over expenses. Changes in unrestricted net assets which are excluded from excess (deficit) of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, changes in accrued pension costs other than net periodic pension costs, permanent transfers of assets to and from affiliates and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Derivative Instruments
The Foundation accounts for its interest rate swap agreement in accordance with Accounting for Derivative Instruments and Hedging Activities. Fair value of the interest rate swap agreement is the estimated amount that the Foundation would have received or paid, including accrued interest, to terminate the agreement on the date of the statement of financial position, taking into account the creditworthiness of the underlying party. The estimated fair value of the agreement is recorded as asset or liability within the consolidated statements of financial position. Changes in the estimated fair value are recorded in the consolidated statement of operations.

Net Patient Service Revenue
The Foundation has agreements with third-party payors that provide for payments to the Foundation at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments and fee schedules. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. These adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined (Note 10).

Charity Care
The Foundation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Foundation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The estimated costs of providing charity care services are determined using a ratio of costs of charges to the gross uncompensated charges associated with providing care to charity patients. The Associates estimated the cost of providing charity care based on the ratio of total expenses divided by gross revenue. For the Infirmary the ratio of costs to charges is calculated using a ratio of FY15 charity care costs to FY15 charity care gross charges. FY16 charity costs are derived from the hospital's internal cost accounting system, which is comprised of a step-down methodology for allocating hospital overhead that is similar to that used for the Medicare Cost Report. All indirect costs are allocated to patient care cost centers, teaching and research. Fully loaded patient care costs are allocated to patients using billed units, and unit costs and allocation algorithms specific to each cost center. Charity care includes the payment to the Health Safety Net (HSN).

Charity care of $3,381,052 and $2,902,944, measured at the Foundation's cost, was provided for the years ended September 30, 2016 and 2015, respectively. In FY16, the Infirmary received payments totaling $631,864 from the HSN pool, thus reducing the charity care figure.

Tax Status

The Foundation and its affiliates qualify as tax-exempt organizations under the Internal Revenue Code. The Foundation, Infirmary, Associates, Schepens and Embankment are tax-exempt under Section 501(c)(3) of the Internal Revenue Code and Circle is tax-exempt under 501(c)(25) of the Internal Revenue Code. Accordingly, no provision for income taxes has been made in the accompanying financial statements. Management has evaluated accounting for uncertainty in income tax position and there was no impact to the Foundation's financial statements for the year ended September 30, 2016.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of the financial statements including, but not limited to, recognition of net patient service revenue and patient accounts receivable, which includes contractual allowances and provision for bad debts, estimates for healthcare professional liabilities and estimated third-party liabilities. Management relies on historical experience and other assumptions believed to be reasonable relative to the circumstances in making judgments and estimates. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, a principles-based standard to recognize revenue from customer contracts. ASU 2014-09 is effective for the Foundation's fiscal year ending September 30, 2018. The Foundation is evaluating the impact that the ASU may have on its consolidated financial statements.

In April 2015, the Financial Accounting Standards Board ("FASB") issued guidance which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted and the Foundation has adopted and applied the guidance.

In May 2015, the FASB issued ASU 2015-07, Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). This guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. This guidance is effective for the Foundation's fiscal year ending September 30, 2018, however, this guidance can be early adopted. The Foundation has not early adopted and is evaluating the impact that this ASU may have on its current fair value disclosures.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The ASU is effective for the Foundation as of fiscal 2020; however, as permitted by the ASU, the Foundation has chosen to early adopt the provision to eliminate the requirement to disclose the fair value of financial instruments measured at cost (such as the fair value of debt). The Foundation is evaluating the remainder of the new guidance on the consolidated financial statements. The impact related to the early adoption of the provision of ASU 2016-01 was limited to the notes to the financial statements.

Subsequent Events

The Foundation has evaluated other subsequent events through January 20, 2017, the date of the financial statements issuance, and determined that subsequent events are properly reflected within the financial statements and notes.

3. Investments and Assets Whose Use is Limited

Investments consist of the following at September 30, 2016:

	On Cost Method	At Fair Value	Total
Cash and cash equivalents	$ -	$ 52,860,630	$ 52,860,630
Bonds	11,005,134	12,628,903	23,634,037
Equity securities	55,317,161	38,557,597	93,874,758
Investment in limited partnerships	34,650,502	-	34,650,502
Other	1,090,000	36,830	1,126,830
	$ 102,062,797	$ 104,083,960	$ 206,146,757

Investments consist of the following at September 30, 2015:

	On Cost Method	At Fair Value	Total
Cash and cash equivalents	$ -	$ 59,455,288	$ 59,455,288
Bonds	10,710,504	7,396,641	18,107,145
Equity securities	54,972,888	26,980,574	81,953,462
Investment in limited partnerships	29,917,172	-	29,917,172
Other	850,000	37,664	887,664
	$ 96,450,564	$ 93,870,167	$ 190,320,731

The cost of investments held at fair value at September 30, 2016 and 2015 is $99,288,689 and $94,410,890, respectively.

The Foundation is obligated to make capital investments in private equity funds. Gross commitments to private equity funds total $52,263,000. The Foundation had unfunded commitments of approximately $13,718,383 and $7,478,449 at September 30, 2016 and 2015, respectively.

Fair Value Measurements
The Foundation applies fair value accounting guidance which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset in an orderly transaction between market participants on the measurement data.

This fair value guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Foundation for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in the fair value accounting guidance. The three valuation techniques are as follows:

Market Approach
Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;

Cost Approach
Amount that would be required to replace the service capacity of an asset (i.e., replacement cost);

Income Approach
Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques).

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.

The following table presents the financial instruments carried at fair value as of September 30, 2016 by the valuation hierarchy defined above:

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Investments				
Cash and cash equivalents	$ 52,860,630	$ -	$ -	$ 52,860,630
Bonds	12,628,904	-	-	12,628,904
Equity securities	33,056,462	5,501,136	-	38,557,598
Other	-	-	36,830	36,830
Total investments	98,545,996	5,501,136	36,830	104,083,962
Remainder interest in charitable trusts	-	-	484,361	484,361
Beneficial interest in trusts	-	-	15,891,307	15,891,307
Assets whose use is limited	-	-	-	-
Cash and cash equivalents	11,485,070	-	-	11,485,070
Total assets whose use is limited	11,485,070	-	16,375,668	27,860,738
Total assets at fair value	110,031,066	5,501,136	16,412,498	131,944,700
Interest swap liability	-	4,036,706	-	4,036,706
	$ 110,031,066	$ 9,537,842	$ 16,412,498	$ 135,981,406

The following table presents the financial instruments carried at fair value as of September 30, 2015, by caption on the Balance Sheet by the valuation hierarchy defined above:

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Investments				
Cash and cash equivalents	$ 59,455,288	$ -	$ -	$ 59,455,288
Bonds	7,396,641	-	-	7,396,641
Equity securities	22,347,710	4,632,864	-	26,980,574
Other	-	-	37,664	37,664
Total investments	89,199,639	4,632,864	37,664	93,870,167
Remainder interest in charitable trusts	-	-	451,826	451,826
Beneficial interest in trusts	-	-	15,128,979	15,128,979
Assets whose use is limited				
Cash and cash equivalents	13,495,331	-	-	13,495,331
Total assets whose use is limited	13,495,331	-	15,580,805	29,076,136
Total assets at fair value	$ 102,694,970	$ 4,632,864	$ 15,618,469	$ 122,946,303

In addition to the investments noted above, the Foundation holds at September 30, 2016 and 2015 $102,062,797 and $96,450,564, respectively, in alternative investments using the cost method. These investments are not subject to fair value accounting. Please refer to Note 2.

Beneficial interests in perpetual trusts and assets in split interest agreements and charity remainder trusts are valued by the trustees of the agreements and are based on valuation of the underlying marketable securities or for those securities which do not have a readily determinable fair value by the trustee based on appraisals or other estimates which require judgment. These balances are included within Level 3. The primary unobservable inputs used in the fair value measurement of the perpetual trust assets are the underlying securities held by the trust. Significant fluctuation in the discount rates utilized in this calculation could result in a material change in fair value.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation 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 materially different estimate of fair value at the reporting date.

The following table is a roll-forward of the statement of financial position amounts for financial instruments classified by the Foundation within Level 3 of the fair value hierarchy defined above:

	Remainder Interest in Charitable Trusts	Beneficial Interest in Trusts	Other Investments	Total Level 3 Assets
Fair value at September 30, 2014	$ 509,677	$ 16,255,998	$ 37,864	$ 16,803,539
Purchases				
Sales	-	-	(574,049)	(574,049)
Realized gains, net	-	-	573,849	573,849
Change in value of charitable	-	-	-	-
remainder and perpetual trusts	(57,851)	(1,127,019)	-	(1,184,870)
Fair value at September 30, 2015	451,826	15,128,979	37,664	15,618,469
Purchases	-	-	-	-
Sales	-	-	(834)	(834)
Realized gains, net	-	-	-	-
Change in value of charitable	32,535	762,328	-	794,863
remainder and perpetual trusts	-	-	-	-
Fair value at September 30, 2016	$ 484,361	$ 15,891,307	$ 36,830	$ 16,412,498

All net realized gains in the table above are reflected in the accompanying Combined Statement of Operations. There were no unrealized gains (losses) associated with Level 3 investments at September 30, 2016 and 2015. The changes in value of charitable remainder trusts and perpetual trusts are reflected in the Statement of Changes in Net Assets.

Transfers from Level 3 to Level 2 typically would involve investments, or portions of investments, in investment vehicles recorded at fair value having redemption terms that provide for liquidity within the 6 months following the reporting period. The Foundation's policy is to recognize transfers as of the end of the year. As of September 30, 2016 and 2015, the Foundation did not record any transfers from Level 3 to Level 2.

As of September 30, 2016 and 2015, the Foundation did not record any transfers between Level 1 and Level 2.

In 1996, the Foundation invested in a start-up company. During 2016 and 2015, the Foundation realized net gains of $0 and $573,849, respectively, in its investment and received a cash payment representing the Foundation's share of the profits received from the sale of said technology by the inventor.

Assets whose use is limited consists of the following at September 30:

	2016		2015	
	Cost	Fair Value	Cost	Fair Value
Current asset designation				
Internally designated funds				
Special cash reserves	$ 1,654,006	$ 1,654,006	$ 1,468,186	$ 1,468,186
Externally limited funds				
Under indenture agreement	12	12	95,952	95,952
Construction funds	-	-	13	13
QLT judgment fund	92,927	92,927	676,982	676,982
Funds held for research	1,074,862	1,074,862	1,310,606	1,310,606
Total current assets whose use is limited	$ 2,821,807	$ 2,821,807	$ 3,551,739	$ 3,551,739
Long-term asset designation				
Internally designated funds				
Special cash reserves	$ 1,598,880	$ 1,598,880	$ 2,697,242	$ 2,697,242
	1,598,880	1,598,880	2,697,242	2,697,242
Externally limited funds				
Under indenture agreement	7,064,382	7,064,382	7,246,350	7,246,350
Construction funds	-	-	-	-
	7,064,382	7,064,382	7,246,350	7,246,350
Total long-term assets whose use is limited	$ 8,663,262	$ 8,663,262	$ 9,943,592	$ 9,943,592

Investment income is shown in the combined Statement of Operations net of expenses of $786,526 and $534,289 for the years ended September 30, 2016 and 2015, respectively.

4. Property, Plant and Equipment

Property, plant, and equipment consists of the following at September 30:

	2016	2015
Land and land improvements	$ 738,142	$ 899,134
Buildings and improvements	234,735,982	237,751,071
Fixed equipment	49,062,656	44,676,354
Major movable equipment	101,726,390	84,990,548
Minor movable equipment	29,568,601	15,814,145
Leasehold improvements	671,849	19,084,734
Construction in progress	18,644,592	10,365,418
	435,148,212	413,581,404
Less: Accumulated depreciation	(247,434,157)	(236,117,351)
	$ 187,714,055	$ 177,464,053

Included in property, plant and equipment as of September 30, 2016 and 2015 are assets under capital leases for major movable equipment with a cost of $8,626,447 and $8,782,659, respectively, and related accumulated amortization of $5,956,174 and $5,134,517, respectively.

Interest expense capitalized as a component of the cost of assets constructed is $3,865,852 and $3,301,071 for the years ended September 30, 2016 and 2015, respectively.

Depreciation expense for property, plant and equipment and amortization expense for intangible assets amounted to $21,283,790 and $22,974,850 for the years ended September 30, 2016 and 2015, respectively, of which $19,827,393 and $21,376,800 related to the Obligated Group (Note 4).

In July 2016 The Foundation sold the John Jeffries House property. Cash proceeds from the sale were $24,879,653. The subsequent gained recognized was $23,638,445; the gain is included in Other Revenue and Gains on the Statement of Operations.

5. Pledges Receivable

Unconditional promises to donate to the Foundation in the future are recorded as pledges receivable in the year promised at the present value of expected cash flows. Pledges receivable included in the financial statements at September 30 are expected to be realized as follows:

	2016	2015
One year or less (included in other current assets)	$ 6,257,751	$ 6,857,973
Between one and five years	6,573,117	5,876,831
More than five years	-	-
Less: Discount and allowance for uncollectible pledges	(743,102)	(615,400)
Pledges receivable	$ 12,087,766	$ 12,119,404

Due to uncertainties with regard to their realizability and valuation, bequest intentions and other conditional promises to give are not estimated by management and are recognized as assets only if and when the conditions upon which they depend are met. Conditional pledges at September 30, 2016 and 2015 are $3,125,000 and $2,481,603, respectively.

6. Long-Term Debt

Long-term debt consists of the following at September 30:

	2016	2015
Mass Development Finance Agency (MDFA) Series O-1 Pool Fund principal was refinanced in 2016 with the MDFA Series D Bond	$ -	$ 5,939,157
MDFA Series O-1 Pool Fund #2 principal was refinanced in 2016 with the MDFA Series D Bond	-	9,230,390
MDFA Bonds, Series C, with principal payments ranging from $1,785,000 in 2016 to $4,735,000 in 2035 with interest rates varying from 5.00% to 5.375%	58,585,000	60,370,000
MDFA Bonds, Series D, with principal payments ranging from $306,071 in 2016 to $719,125 in 2038	35,962,520	-
Citizens Bank Agreement with principal payments commencing in 2015 through 2020 with an interest amount equal to the Libor rate plus 1.5%	8,599,238	4,579,388
Series B Revenue Bond (Century Subsidiary Investments, Inc. III) commencing in 2010 through 2031 with an interest rate of 4.79%, collateralized by building, equipment and machinery	8,140,832	8,509,536
Mass General Hospital deferred credit construction loan with principal payments commencing in 2003 through 2017 with interest rate of 11.5%	1,739,460	2,871,160
Century Bank Line of Credit with prime interest rate of 3.25%	1,250,000	-
	114,277,050	91,499,631
Discount	(405,771)	(427,127)
Less: Current portion	(7,467,648)	(6,526,802)
	$ 106,403,631	$ 84,545,702

Aggregate maturities on long-term debt are as follows:

2017	$ 7,489,003
2018	5,567,528
2019	5,811,866
2020	5,795,623
2021	4,108,145
Thereafter	85,504,885
	$ 114,277,050

The MDFA Pools O-1 and O-1 #2 Bonds are variable rate demand bonds ("VRDBs") that are supported by two irrevocable letters of credit ("LOCs"). The LOCs are provided by a financial institution to secure bond repayment and interest obligations with an original maturity date of December 31, 2014. Prior to maturity of these LOCs, the Foundation extended their maturity to December 31, 2016. In the event that a VRDB cannot be remarketed, the bond may be "put" to the LOC provider, resulting in a loan to the Foundation to fund the redemption of the bond. As of September 30, 2016, the Foundation has used VRDBs backed by bank LOCs for a number of years during which time there have been no instances where a bond failed to be remarketed and was put back to the Foundation.

In September 2010, the Obligated Group issued $63,690,000 of MDFA bonds (the "Series C bonds"), for the purpose of financing capital projects. The bonds are collateralized by a mortgage on the Infirmary's main building located at 243 Charles Street, Boston.

The Obligated Group is jointly and severally liable for all obligations. Each member of the Obligated Group has granted a lien on all of its gross receipts, subject to certain limitations, to the master trustee. The indenture agreement contains a covenant against the creation of certain liens in favor of any party on certain property of the Obligated Group. The Master Trust places limits on additional borrowings and requires the Obligated Group to maintain a minimum debt service coverage ratio of 1.10. The Obligated Group is in compliance with this debt service ratio.

As of September 30, 2016 and 2015, the Foundation held $7,064,395 and $7,342,302 in various funds as required under the terms of the Master Trust Agreement and various bond documents. These funds are included in assets whose use is limited on the balance sheet.

In December 2015, The Foundation entered into a Loan and Security Agreement with Citizens Bank. The Massachusetts Development Finance Agency issued bonds which were purchased directly by three banks including Citizens Bank, whom will act as the sole Agent for all transactions with The Foundation. Under this agreement, The Foundation has access to borrow up to $55,000,000 for capital expenditures. The Foundation will pay interest only for the first three years, with the principal amortized over nineteen years. The bonds have variable interest rates, but were swapped at closing with an interest rate swap, synthetically fixing the interest rate 3.59%.

Under this agreement, the Foundation also refinanced the existing Pool-O loans. The Pool-O loans were refinanced for the amount of $15,394,000 which will be amortized over a period of 22 years using the swap rate of 3.59%. Also under the agreement with Citizens, the Foundation has access to $15,000,000 if needed, to fund future acquisitions or major capital expenditures.

In January of 2015 the Obligated Group entered into an agreement with Citizens Bank to borrow up to $8M. Subsequently, in December 2015 MEE received approval from Citizens to increase the available amount to $9.5M. The primary purpose of the agreement was to provide a source of funding for the PeopleSoft and Epic software projects and their related costs. The funds are intended to be used for costs including, but not limited to, equipment, software, consultants, temporary help, resource backfilling, and other related costs. The equipment and software purchased as part of the agreement, $9,499,306 as of September 30th, 2016, serves as collateral. The interest amount is equal to the LIBOR rate plus 1.50%. As of September 30th, 2016 the payback amount was $168,835 per month. The final due date of the agreement is July 1, 2020.

On December 30, 2010, Schepens issued $10,000,000 of revenue bonds, Series B (2010) (the Bonds). The Bonds have an interest rate of 4.79%. Bond principal and interest payments are made monthly to the bond purchaser, Century Subsidiary Investments, Inc. III. The Bonds mature on July 1, 2031. The Bonds are secured by collateral consisting of building, equipment, and machinery. The Bond proceeds have been used to refinance the January 15, 1999 issued Series A revenue bonds. Initially, the Bonds Master Trust Indenture provided for the maintenance of a minimum debt service coverage ratio of 1.10, however, in 2015 Century Bank executed an amendment that eliminated the requirement of a debt service ratio.

In 2003, Schepens entered into an agreement with the Davis Company, now Massachusetts General Hospital, (the Landlord) where the Landlord provided $10,000,000 to Schepens which was used to renovate the building at 20 Staniford Street. The $10,000,000 has an interest rate of 11.5% and the last payment is due in January of 2018.

Schepens entered into a line of credit arrangement with Century Bank & Trust Company which carries a maximum possible balance of $3,000,000. The line of credit has a variable interest rate that is equal to the Bank's designated prime rate, but not less than 3.25%. As of September 30, 2016 and 2015 Schepens has drawn down $1,250,000 and $0 of their line of credit. Collateral used to secure the loan is building, equipment and machinery. The line of credit was renewed in FY16 with an expiration date of March 31, 2017.

7. Interest Rate Swap

The Foundation has one interest rate swap agreement with a financial institution counterparty. The purpose of the agreement is to effectively convert the variable rate on the MDFA, Series 2015 Revenue Bonds to a fixed rate of 3.59%. The swap agreement expires at the maturity of each bond and the notional principal amount will decrease as the bonds mature.

Interest rates swaps are valued using both observable and unobservable inputs, such as quotations received from the counterparty, dealers or brokers, whenever available and considered reliable. In instances where models are used, the value of the interest rate swap depends on the contractual terms of, and specific risks inherent in the instrument, as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, assumptions for nonperformance risk, and correlations of such inputs. Certain of the interest rate swap arrangements have inputs which can generally be corroborated by market data and are therefore classified as Level 2.

Although these financial instruments involve counterparty credit exposure, the counterparty for the agreement is a major financial institution that meets the Foundation's criteria for financial stability and creditworthiness at September 30, 2016. The Foundation entered into this agreement to manage the cash flows attributed to interest payments and does not use such instrument for speculative purposes.

The swap agreements' fair value and change therein, is reported in the consolidated financial statement. The fair value of the swap agreement represents the estimated cost to the Foundation to cancel the agreement as of the reporting date, and is based on option pricing models that consider risks and other market factors.

The following table summarizes the Foundation's derivative activity as presented in the consolidated financial statement as of September 30:

Fair Values of Derivative Instruments on the Combined Statements of Financial Position.

Derivatives not designated as hedging instruments	Combined Balance Sheet Location	Fair Value of Derivatives 2016	Fair Value of Derivatives 2015
Interest rate swap contracts	Interest rate swap liability	$ 4,036,706	$ -

Effective of Derivative Instruments on the Combined Statement of Operations

Derivatives not designated as hedging instruments	Combined Statement of Operations Location	Fair Value of Derivatives 2016	2015
Interest rate swap contracts	Unrealized (losses) gains on interest rate swap agreements	$ (4,036,706)	$ -
	Less: Operating expenses	-	-
	Net impact	$ (4,036,706)	$ -

8. Functional Expenses

Expenses of the Foundation are functionalized as follows at September 30:

	2016	2015
Patient care and clinical	$ 239,040,383	$ 230,901,682
General and administrative	87,051,424	94,185,871
Research	61,592,876	58,034,857
Fundraising	2,641,774	2,167,420
Education	4,865,136	4,074,930
	$ 395,191,593	$ 389,364,760

9. Lease Obligations

The following is a schedule of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments at September 30, 2016:

2017	$ 2,537,976
2018	2,705,547
2019	2,148,483
2020	2,122,173
Thereafter	9,753,520
	19,267,699
Interest	(3,512,526)
	$ 15,755,173

The Infirmary and Associates have entered into operating lease agreements for facility space and equipment. Future minimum rent payments under operating leases are as follows:

2017	$ 8,434,668
2018	7,198,225
2019	6,285,176
2020	5,558,732
2021	5,342,595
Thereafter	61,039,534
	$ 93,858,930

Total rental expense for the years ended September 30, 2016 and 2015 was $9,097,459 and $8,675,319, respectively.

10. Patient Service Revenue and Accounts Receivable

Patient service revenue is reported net of contractual allowances and the provision for bad debt as follows for the years ended September 30, 2016 and 2015:

	2016	2015
Gross patient service revenue	$ 676,728,163	$ 627,579,270
Less: Contractual allowances	(383,972,938)	(358,183,686)
Less: Provision for bad debt	(9,865,858)	(8,075,542)
Net patient service revenue	$ 282,889,367	$ 261,320,042

Patient service revenue (net of contractual allowance before bad debt) by major payors are summarized as follows for the years ended September 30, 2016 and 2015:

Major Payor	2016	2015
Medicare	$ 84,182,674	$ 77,189,033
Blue Cross	73,936,107	65,500,556
Other Third Party	61,285,196	54,864,511
Harvard and Tufts	52,078,209	42,320,572
Self-Pay	9,832,114	11,361,861
Medicaid	7,333,086	7,354,968
Other	4,107,839	10,804,083
	$ 292,755,225	$ 269,395,584

Accounts Receivable, prior to adjustment for doubtful accounts, are summarized as follows for the years ended September 30, 2016 and 2015:

Receivables	2016	2015
Patients	$ 5,371,956	$ 5,447,830
Third party	37,736,077	30,566,019
Nonpatient	447,345	1,081,768
	$ 43,555,378	$ 37,095,617

Accounts receivable are reduced by an allowance for doubtful accounts. The Foundation uses a trend analysis and a look back approach to estimate the appropriate amount of the provision for bad debt and the reserve for doubtful accounts. The provision for bad debts is established based on a review of the current year's volume, payor, case mix and collectability trends. The amount of the provision is adjusted as required during the year, and a thorough analysis is conducted at year end. The sufficiency of the year-end reserve for doubtful accounts is reviewed by analyzing prior year and current year collection experience by payor. The previous year's bad debt experience is reviewed using a look-back analysis. For the look back, a ratio is computed of the amount of bad debts written off from the previous years' accounts receivable to the amount of accounts receivable of the prior year. Any current year accounts receivable older than 365 days is added to the bad debt allowance. The ratio is applied to year-end accounts receivable net of contractual adjustments. Six month accounts receivable is also reviewed, since an increase in the proportion of six month accounts receivable might indicate a change in collectability compared to the prior year, necessitating an increase to the reserve. The amount and ageing of self-pay accounts receivable compared with prior years is also reviewed. Self-pay accounts receivable includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill. Management regularly reviews contractual adjustment allowances, denials and bad debt reserve requirements at a payor level to ensure that changes in payor mix, co-pays and deductibles and other collectability assumptions are conservatively reserved for.

The Infirmary and Associates have agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare
Inpatient acute care services rendered to Medicare program recipients are paid at a prospectively determined rate per discharge. These rates, which are based on the diagnosis-related group (DRG), vary according to the intensity of service required by the patient. Medicare reimburses most hospital outpatient services based on a prospectively determined rate per ambulatory service.

Professional services provided by the Associates to program recipients are paid according to a fee schedule. These fees are based on Current Procedural Terminology ("CPT") codes, which describe the medical, surgical and diagnostic services provided.

NonMedicare
The Infirmary and Associates have entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Infirmary under these agreements includes prospectively determined rates per case, per diem and discounts from established charges and prospectively determined daily rates. The basis for payment to Associates under these agreements include discounts from established charges and prospectively determined fee schedules based on CPT codes.

Health Safety Net Pool
The Commonwealth of Massachusetts operates a Health Safety Net Pool (the "Pool"), which is funded by an assessment on acute care hospitals based on the amount of private sector charges. Each hospital's liability is adjusted for the cost of caring for Health Safety Net (HSN) patients. Beginning in fiscal year 2008, the value of HSN services was determined through a prospectively determined rate per discharge (inpatient) or encounter (outpatient).

Blue Cross
The Infirmary renegotiated its three year Blue Cross managed care contract in 2011, with an effective date of October 1, 2011. The contract pays the Infirmary for inpatient services based on a DRG methodology and for outpatient services on the basis of a fee schedule for certain services or at a discount from charges. The basis for payment to the Associates under its Blue Cross arrangement is a fee schedule based on CPT codes.

Included in the statement of operations is a decrease/increase in net patient service revenue due to changes in prior years estimated settlements of $(371,390) and $(447,763) for the years ended September 30, 2016 and 2015, respectively.

11. Pension Plan

The Infirmary had a noncontributory defined benefit pension plan covering substantially all of its employees. The plan was amended February 1, 2004.

The benefits under the plan are based on years of service and the participant's compensation during the final five years of service. The Infirmary's policy is to fund the minimum required contributions under the plan in order to cover all present and future obligations of the plan. Contributions are intended to provide not only for benefits attributed to services to date but also for those expected to be earned in the future. The assets of the plan are invested in a broad range of common stocks, government securities, corporate bonds, limited partnerships and mutual funds.

The plan was amended on February 1, 2004, whereby, benefits for nongrandfathered active participants consist of (i) the frozen accrued benefit as of January 31, 2004, plus (ii) cash balance accruals for service on and after February 1, 2004 (with a zero initial cash balance; an "A plus B" approach). An additional minimum benefit formula applies for nongrandfathered active participants. Grandfathered active participants continued to earn benefits under the prior plan provisions until January 31, 2009, and then moved into the cash balance plan, which does not have a minimum benefit formula. The midyear amendment was adopted in fiscal year 2004.

The following table sets forth the plan's change in benefit obligation and change in plan assets for the years ended September 30:

	2016	2015
Change in benefit obligation		
Benefit obligation at beginning of year	$ 133,526,701	$ 122,637,557
Service cost	5,881,344	5,288,886
Interest cost	5,278,125	4,859,841
Actuarial loss	262,420	7,082,293
Benefits paid	(5,592,521)	(6,341,876)
Benefit obligation at end of year	139,356,069	133,526,701
Change in plan assets		
Fair value of plan assets at beginning of year	78,014,607	80,637,864
Actual (loss)/return on plan assets	3,615,660	(4,950,718)
Employer contribution	8,732,004	8,669,337
Benefits paid	(5,592,521)	(6,341,876)
Fair value of plan assets at end of year	84,769,750	78,014,607
Funded status		
Funded status	$ (54,586,319)	$ (55,512,094)
Amounts recognized in balance sheet		
Current liability	$ -	$ -
Noncurrent liability	(54,586,319)	(55,512,094)
Net amount recognized	(54,586,319)	(55,512,094)
Pension cost recognized in operations net of contributions	(54,586,319)	(55,512,094)
Accrued pension costs on the combined balance sheet	$ (54,586,319)	$ (55,512,094)

Funded Status

The Infirmary accounts for these benefits in accordance with authoritative guidance for employers' accounting for pensions, defined benefit pension and other postretirement plans. The Foundation recognizes a benefit liability for an underfunded plan and a benefit asset for an overfunded plan, with offsetting impacts to unrestricted net assets. At September 30, 2016, the Foundation's pension plan had an unfunded status of $54,586,319. Additionally, please note the following amounts recognized in unrestricted net assets:

	2016	2015
Net actuarial loss	$ 44,106,080	$ 47,444,061
Unrestricted net assets	$ 44,106,080	$ 47,444,061

Other changes in plan assets and benefit obligations recognized in unrestricted net assets are as follows:

	2016	2015
New actuarial loss	$ 1,991,014	$ 17,591,900
Amortization of net loss in unrestricted net assets	(5,328,995)	(4,516,361)
Total pension-related charges other than net periodic pension cost	$ (3,337,981)	$ 13,075,539

The amounts expected to be recognized as components of net periodic cost in the following year are as follows:

Amortization of net actuarial loss	$ 5,100,000
Amounts to be recognized in the following year	$ 5,100,000

The Infirmary expects to contribute $9,698,000 to the plan in fiscal year 2017.

Included in the table below is additional year-end information for the pension plan and benefit obligations in excess of plan assets at the actuarial valuation date of September 30.

	2016	2015
Accumulated benefit obligation	$ 129,941,633	$ 126,870,050

The following table sets forth the plan's components of net periodic benefit cost for the years ended September 30:

	2016	2015
Service cost	$ 5,881,344	$ 5,288,886
Interest cost	5,278,125	4,859,841
Expected return on plan assets	(5,344,254)	(5,558,889)
Unrecognized net loss	5,328,995	4,516,361
Net periodic benefit cost	$ 11,144,210	$ 9,106,199

Actuarial assumptions used in determining the benefit obligation and net periodic benefit cost were as follows as of and for the years ended September 30:

	2016	2015
Benefit obligation at September 30		
Discount rate	3.83 %	4.00 %
Salary increase	3.50 %	3.50 %
Net periodic benefit cost for the year ended September 30		
Discount rate	4.00 %	4.00 %
Salary increase	3.50 %	3.50 %
Expected long-term rate of return	6.90 %	6.90 %

Expected benefit payments, net of participant contributions are as follows:

2017	$ 10,251,000
2018	10,138,000
2019	8,521,000
2020	10,364,000
2021	9,645,000
2022–2026	44,437,000

The Projected Benefit Obligation was derived by projected cash flows using the Ryan Select High-End Curve for September 30, 2016. The Projected Benefit Obligation was determined as of October 1, 2015 and projected to fiscal year-end using generally accepted actuarial principles. The Service Cost used in the projection was also derived by discounting projected cash flows using the Ryan Select High-End Curve for September 30, 2016. The Interest Cost was derived by applying spot-rates to the discounted cash flows.

In selecting the long-term rate of return on assets, the Foundation considered the plan's target allocation to each of the major asset classes in the fund and the expected future earnings on these asset classes. Earnings assumptions were long-term in nature and were based on historical risk premiums, current valuation levels, and expected future inflation rates. The historical risk premiums were evaluated over various cumulative and rolling time periods. This basis is consistent with prior years.

The goal of the investment strategy is to achieve a rate of return equal to or better than a benchmark comprised of the asset classes with weightings as defined below. The Foundation believes that the diversification of these investments will keep risk levels within a tolerable range.

The following lists the plan's asset allocation at September 30, 2016 and 2015:

	2016	2015	Target Percentages
Asset category			
Equity securities	31 %	31 %	30 %
Alternative investments	38	45	50
Fixed income	31	24	20
	100 %	100 %	100 %

The hierarchy and inputs to valuation techniques to measure fair value of the Plan's assets are the same as outlined in Note 3. The following table sets forth the Foundation Plans' investments that were accounted for at fair value as of September 30, 2016 and 2015:

	Assets at Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Mutual funds				
Short-term bonds	$ 10,678,765	$ -	$ -	$ 10,678,765
Equity energy funds	-	-	-	-
Diversified emerging markets	-	-	-	-
	10,678,765	-	-	10,678,765
Equity securities	12,817,929	3,932,970		16,750,899
Private equity and senior loan funds				
Senior loan fund	-	-	8,397,151	8,397,151
Real estate	-	-	1,411,579	1,411,579
Emerging market smaller companies	2,063,019	-	3,113,661	5,176,680
Diversified international funds	-	-	12,811,291	12,811,291
	2,063,019	-	25,733,682	27,796,701
Limited partnerships				
Diversified international	-	-	10,762,901	10,762,901
Diversified domestic	-	-	1,989,076	1,989,076
Domestic equity	-	-	2,768,075	2,768,075
Fund of funds	-	-	-	-
Mid cap growth	-	-	3,993,685	3,993,685
	-	-	19,513,737	19,513,737
Money market funds	10,029,648	-	-	10,029,648
Total plan assets at fair value	$ 35,589,361	$ 3,932,970	$ 45,247,419	$ 84,769,750

	Assets at Fair Value as of September 30, 2015			
	Level 1	Level 2	Level 3	Total
Mutual funds				
Short-term bonds	$ 8,464,359	$ -	$ -	$ 8,464,359
Equity energy funds	-	-	-	-
Diversified emerging markets	959,141	-	-	959,141
	9,423,500	-	-	9,423,500
Equity securities	9,006,248	2,940,162	-	11,946,410
Private equity and senior loan funds				
Senior loan fund	-	-	7,956,497	7,956,497
Real estate	-	-	1,236,628	1,236,628
Emerging market smaller companies	1,737,402	-	2,646,624	4,384,026
Diversified international funds	-	-	11,894,540	11,894,540
	1,737,402	-	23,734,289	25,471,691
Limited partnerships				
Diversified international	-	-	7,469,322	7,469,322
Diversified domestic	-	-	2,021,724	2,021,724
Domestic equity	-	-	2,939,641	2,939,641
Fund of funds	-	-	-	-
Mid cap growth	-	-	3,711,077	3,711,077
	-	-	16,141,764	16,141,764
Money market funds	15,031,242	-	-	15,031,242
Total plan assets at fair value	$ 35,198,392	$ 2,940,162	$ 39,876,053	$ 78,014,607

The table below sets forth a summary of changes in the fair value of Plan's Level 3 assets for the year ended September 30, 2016:

	Private Equity Funds	Limited Partnerships
Balances at beginning of year	$ 23,734,289	$ 16,141,764
Realized gains	223,152	29,171
Unrealized gains	1,254,129	478,473
Gross purchases	602,145	3,000,000
Gross Sales	(80,033)	(135,670)
Balances at end of year	$ 25,733,682	$ 19,513,738

The table below sets forth a summary of changes in the fair value of Plan's Level 3 assets for the year ended September 30, 2015:

	Private Equity Funds	Limited Partnerships
Balances at beginning of year	$ 19,412,546	$ 19,077,342
Realized gains	608	237,699
Unrealized gains	(1,838,542)	(313,420)
Gross purchases	6,216,880	(2,859,857)
Gross Sales	(57,203)	-
Balances at end of year	$ 23,734,289	$ 16,141,764

Transfers from Level 3 to Level 2 typically would involve investments, or portions of investments, in investment vehicles recorded at fair value having redemption terms that provide for liquidity within the six months following the reporting period. The Foundation's policy is to recognize transfers as of the end of the year. There are no known transfers between levels to recognize for the year ended September 30, 2016.

The following table presents liquidity information for the Pension Plan investments Asset Value as of September 30, 2016:

Investment Type	Fair Value	Redemption Frequency	Notice Period
Mutual funds	$ 10,678,765	Daily	1
Equity securities	16,750,899	Daily to monthly	1
Private equity and senior loan funds	27,796,701	Monthly to 30 months	8–90 days
Limited partnerships	19,513,737	Monthly to 37 months	7–60 days
Money market	10,029,648	Daily	1
	$ 84,769,750		

12. Defined Contribution Retirement Plans

The Associates maintains a defined contribution retirement plan covering physicians, research associates, and optometrists employed by the Associates and the Infirmary. Subject to certain limitations, the plan provides for employer contributions ranging from 11% to 20% of participants' earnings. Vesting occurs after one year of service. Contributions to the plan for the years ended September 30, 2016 and 2015 totaled $4,978,402 and $4,692,936, respectively.

In prior years, Schepens made contributions to a qualified defined-contribution retirement plan for full-time employees with at least two years of service. Contributions to the plan were made monthly and were based upon the compensation of the participants. Participants were fully vested immediately upon admission to the plan. As of Dec 31, 2014, no further contributions were made to the Schepens plan. Participants in this plan were moved to either the Mass Eye and Ear plan or to the Associate's plan based upon the plan's eligibility requirements.

13. Temporarily and Permanently Restricted Net Assets

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

	2016	2015
Realized gains from donor restricted funds	$ 10,414,543	$ 13,502,849
Research	25,577,158	26,355,855
Other	3,820,657	4,535,463
Unrealized gains from donor restricted funds	3,743,338	1,994,823
Educational	2,196,820	2,058,896
Patient care	947,647	814,920
	$ 46,700,163	$ 49,262,806

Permanently restricted net assets are restricted as to the following at September 30:

	2016	2015
Investments to be held in perpetuity, the income of which is expendable for patient care, teaching and research activities of the Infirmary, Schepens and Associates	$ 60,632,350	$ 57,095,364
Beneficial interest in trusts	15,891,307	15,128,979
	$ 76,523,657	$ 72,224,343

14. Commitments and Contingencies

The Foundation participates with other Harvard-affiliated medical institutions in the operation of a captive insurance company, Controlled Risk Insurance Company, Ltd. (CRICO). The Foundation currently maintains an internal risk management program and carries claims-made malpractice insurance coverage. The Foundation purchases its malpractice and general liability insurance through the Controlled Risk Insurance Company of Vermont, Inc. ("CRICO"), a Risk Retention Group based in Burlington, VT at rates determined annually. Currently, CRICO provides primary coverage of $5,000,000 per claim and a $10,000,000 annual aggregate for professional liability for each individual insured, and $5,000,000 per claim with no annual aggregate for general liability. CRICO retains liability under this coverage of $3,000,000 per claim for professional liability and general liability. Excess coverage is provided with limits of $105,000,000 per claim and $105,000,000 annual aggregate. These excess limits are reinstated once over the $3,000,000 primary coverage. In addition, each year CRICO issues a policy to extend the current tail liability coverage (unasserted claims) related to physicians who have left the Foundation or the Infirmary. Total amounts accrued under these programs as long-term liabilities approximate $8,350,791 and $8,024,786 at September 30, 2016 and 2015, respectively. Amounts recognized as insurance receivables are measured on the same basis and are included in other assets on the combined balance sheet. The Foundation recognized insurance receivables of $6,780,229 and $6,422,844 at September 30, 2016 and 2015, respectively. In determining the ultimate cost, the Foundation has used a 4.0% and 4.0% discount rate at September 30, 2016 and 2015, respectively.

In April 2012, the Foundation entered into an Affiliation Agreement with the Joslin Diabetes Center. Both the Foundation and Joslin are committed to providing the highest quality ophthalmology and related care to their patients with or at risk for diabetes and have shared clinical, teaching and research goals. The organizations will collaborate with respect to their individual areas of expertise in order to benefit patients with or at risk for diabetes who have ophthalmology related illness. The Foundation has committed to providing fees of $450,000 per year for professional services, goods, facilities, and licensing arrangements. The organizations will share in the financial risks and rewards of the arrangement in a manner consistent with the collaborative nature of the agreement. The agreement has an initial period that terminates September 30, 2021 with options for additional renewal periods.

In 2013 the Foundation agreed to pay a $1,500,000 fine to the Department of Health and Human Services (HHS) to address allegations that the Foundation failed to comply with certain requirements of the Health Insurance Portability and Accountability Act (HIPAA) standards that govern the security of electronic individually identifiable health information (the "Security Rule"). The review of the Foundation by the U.S. Department of Health and Human Services (HHS) was triggered by the hospital's proactive self-reporting of a doctor's unencrypted laptop being stolen while he was traveling abroad in 2010. The Foundation has no indication that any patients were harmed by this isolated incident. As a result of that incident, the Foundation cooperated extensively with HHS as HHS conducted an investigation of the hospital's compliance with the federal standards under the Health Insurance Portability and Accountability Act (HIPAA.) The agreement with HHS requires the Foundation to enter into a Corrective Action Plan (CAP), which includes a risk assessment, the review and revision of policies and procedures, and the provision of training to staff. The Foundation has implemented many of the elements of the CAP as part of ongoing programs to safeguard the health information of patients. The fine was paid over a 3-year period with the final installment of $500,000 completed in October 2014.

The health care industry is subjected to numerous laws and rules of federal, state and local governments. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of billing rules. Such investigations and reviews may or may not result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Compliance with such laws and rules can be subject to future government review and interpretations as well as regulatory actions unknown or unasserted at this time.

15. QLT Judgment

The Foundation continues to recognize revenue and deferred revenue from the QLT, Inc. Judgment. In the fiscal year 2016, the Infirmary used $2,237,123 from the resources for the institution's academic and research programs and consequently recognized this amount as revenue. At September 30, 2016 and 2015, the balance of deferred revenue was $11,260,223 and $13,280,726, respectively. The related assets are included in Investments on the Combined Balance Sheets as of September 30, 2016 and 2015 (Note 3).

16. Concentrations of Credit Risk

The Foundation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The Foundation has not historically incurred any significant credit losses outside the normal course of business.

The mix in patient accounts receivable as of September 30, 2016 and 2015, before allowances for doubtful accounts, consisted of the following:

	2016	2015
Managed care	44 %	44 %
Medicare and Medicaid	37	32
Other	8	10
Self-pay patients	6	8
Commercial insurance	5	6
	100 %	100 %

The following table categorizes payors into seven groups and their respective percentages of gross patient service revenue for the years ended September 30, 2016 and 2015:

Major Payor	2016	2015
Medicare	33 %	34 %
Blue Cross	23	24
Other third party	21	21
Harvard & Tufts	15	14
Medicaid	5	4
Other	1	2
Self-Pay	2	1
	100 %	100 %

17. Components of Net Assets and Endowment

Endowments

The Foundation's endowment consists of approximately 206 individual donor restricted endowment funds and 21 board-designated endowment funds for a variety of purposes plus the following where the assets have been designated for endowment: pledges, receivables, split interest agreements, and other net assets. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. The net assets associated with endowment funds including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

The Board of Directors of the Foundation has interpreted the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) as requiring the preservation 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 Foundation 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 fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure of the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate endowment funds:

(1) The duration and preservation of the fund.

(2) The purposes of the Foundation 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 Foundation.

(7) The investment policies of the Foundation.

The Foundation had the following endowment activities during the year ended September 30, 2016 delineated by net asset class and donor-restricted versus Board-designated funds:

Changes in endowment net assets for the year ended September 30, 2016:

	Board-Designated Unrestricted	Donor-Restricted Endowment Temporarily Restricted	Donor-Restricted Endowment Permanently Restricted	Total
Endowment net assets at beginning of year	$ 3,658,456	$ 15,497,672	$ 53,457,046	$ 72,613,174
Investment return				
Investment income	5,758	184,691	-	190,449
Net appreciation (realized and unrealized)	129,410	2,408,995	-	2,538,405
Total investment return	135,168	2,593,686	-	2,728,854
Gifts and pledges	-	-	1,960,347	1,960,347
Net releases from restriction	(908,241)	(3,933,478)	-	(4,841,719)
Endowment net assets at end of year	$ 2,885,383	$ 14,157,880	$ 55,417,393	$ 72,460,656

Changes in endowment net assets for the year ended September 30, 2015:

	Board-Designated Unrestricted	Donor-Restricted Endowment Temporarily Restricted	Donor-Restricted Endowment Permanently Restricted	Total
Endowment net assets at beginning of year	$ 4,895,458	$ 21,388,187	$ 52,228,006	$ 78,511,651
Investment return				
Investment income	13,217	299,921	-	313,138
Net appreciation (realized and unrealized)	(30,357)	(557,247)	-	(587,604)
Total investment return	(17,140)	(257,326)	-	(274,466)
Gifts and pledges	-	-	1,229,040	1,229,040
Net releases from restriction	(1,219,862)	(5,633,189)	-	(6,853,051)
Endowment net assets at end of year	$ 3,658,456	$ 15,497,672	$ 53,457,046	$ 72,613,174

Description of Amounts Classified as Permanently Restricted Net Assets and Temporarily Restricted Net Assets (Endowments Only).

Permanently Restricted Net Assets

The portion of perpetual endowment funds that is required to be retained permanently by explicit donor stipulation:

	2016	2015
Restricted for general use	$ 13,323,660	$ 13,303,660
Restricted for research	26,041,388	25,555,662
Restricted for department use	7,480,829	6,066,556
Restricted for patient care	5,921,685	5,915,062
Restricted for education	2,649,832	2,616,106
	$ 55,417,394	$ 53,457,046

Temporarily Restricted Net Assets

	2016	2015
Term endowment funds		
Restricted for general use	$ (507,112)	$ (346,012)
Restricted for research	9,447,812	10,351,318
Restricted for department use	3,057,105	3,217,250
Restricted for patient care	2,174,459	2,284,878
Restricted for education	(14,384)	(9,763)
	$ 14,157,880	$ 15,497,671

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits of this nature reported in unrestricted net assets were $196,112 and $631,022 as of September 30, 2016 and 2015, respectively. These deficits resulted from unfavorable market fluctuations that occurred shortly after the investment of newly established endowments, and authorized appropriation that was deemed prudent.

The Foundation has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against a blended index, based on the endowment's target allocation applied to the appropriate individual benchmarks. The Foundation expects its endowment funds over time, to provide an average rate of return of approximately 5% plus inflation annually. Actual returns in any given year may vary from this amount.

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

The Board of Directors of the Foundation determines the method to be used to appropriate endowment funds for expenditure. Calculations are performed for individual endowment funds at a rate of 5% of the rolling 12 quarter average market value. The corresponding calculated spending allocations are distributed in equal quarterly installments on the first day of each quarter from the current net total or accumulated net total investment returns for individual endowment funds. In establishing this policy, the Board considered the expected long-term rate of return on its endowment. Accordingly, over the long term, the Foundation expects the current spending policy to allow its endowment to grow at least by the rate of inflation annually, consistent with its intention to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts.

Supplementary Combining Schedules

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Balance Sheet
September 30, 2016

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Assets										
Current assets										
Cash and equivalents	$ 187,882	$ 1,194,722	$ 3,293,658	$ -	$ 4,676,262	$ (63,213)	$ 2,904	$ 26,409	$ -	$ 4,642,362
Assets whose use is limited	-	2,821,714	-	-	2,821,714	-	93	-	-	2,821,807
Patient accounts receivable, less allowance for doubtful accounts of $8,407,563	-	24,099,867	10,594,950	-	34,694,817	-	-	-	-	34,694,817
Other current assets	6,257,751	16,435,501	1,161,153	-	23,854,405	3,856,883	-	-	-	27,711,288
Due from affiliates	16,378,920	101,766,589	75,540,746	(193,686,255)	-	29,007,844	3,038,886	1,324,849	(33,371,579)	-
Total current assets	22,824,553	146,318,393	90,590,507	(193,686,255)	66,047,198	32,801,514	3,041,883	1,351,258	(33,371,579)	69,870,274
Assets whose use is limited										
Construction fund	-	-	-	-	-	-	-	-	-	-
Special cash reserves and capital reserves	-	1,598,880	-	-	1,598,880	-	-	-	-	1,598,880
QLT judgment funds	-	-	-	-	-	-	-	-	-	-
Under indenture agreement	-	6,297,480	-	-	6,297,480	766,902	-	-	-	7,064,382
Total assets whose use is limited	-	7,896,360	-	-	7,896,360	766,902	-	-	-	8,663,262
Investments	203,944,949	-	36,830	-	203,981,779	2,164,978	-	-	-	206,146,757
Pledges receivable, net	5,830,014	-	-	-	5,830,014	-	-	-	-	5,830,014
Remainder interest in charitable trusts	436,613	-	-	-	436,613	47,748	-	-	-	484,361
Beneficial interest in trust	15,891,307	-	-	-	15,891,307	-	-	-	-	15,891,307
Property, plant and equipment, net	15,470,847	152,903,737	1,021,202	-	169,395,786	18,318,269	-	-	-	187,714,055
Other assets										
Investment interest in Foundation	-	232,540,445	-	(232,540,445)	-	-	-	-	-	-
Investment interest in Schepens	19,367,256	-	-	-	19,367,256				(19,367,256)	-
Intangible assets, net of accumulated amortization of $3,073,045	-	16,135,884	-	-	16,135,884	-	-	-	-	16,135,884
Deposits and other assets	3,000,000	7,556,917	5,036,511	-	15,593,428	602,234	-	-	-	16,195,662
Total assets	$ 286,765,539	$ 563,351,736	$ 96,685,050	$ (426,226,700)	$ 520,575,625	$ 54,701,645	$ 3,041,883	$ 1,351,258	$ (52,738,835)	$ 526,931,576

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Statement of Operations
Year Ended September 30, 2016

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Unrestricted revenue and gains										
Net patient service revenue (net of contractual allowances and discounts)	$ -	$ 185,328,882	$ 107,426,343	$ -	$ 292,755,225	$ -	$ -	$ -	$ -	$ 292,755,225
Provision for bad debts		(4,236,650)	(5,629,208)		(9,865,858)					(9,865,858)
Net patient service revenue less provision for bad debts	-	181,092,232	101,797,135	-	282,889,367	-	-	-	-	282,889,367
Research direct revenue	-	21,431,232	-	-	21,431,232	8,300,604	-	-	-	29,731,836
Research indirect revenue	-	7,731,293	-	-	7,731,293	6,207,326	-	-	-	13,938,619
Contributions	1,386,689	3,840,210	(199)	-	5,226,700	780,357	-	-	-	6,007,057
Investment income	2,021,839	82,059	24,613	-	2,128,511	46,023	1,239	-	-	2,175,773
Institutional Support	-	5,607,488	17,947,568	(23,555,056)	-	2,837,308	-	-	(2,837,308)	-
Net assets released from restriction used for operations	12,758,729	9,604,370	255,522	(9,859,892)	12,758,729	2,438,303	-	-	(651,376)	14,545,656
QLT revenue	-	4,321,566	-	-	4,321,566	-	-	-	-	4,321,566
Other revenue and gains	23,637,968	18,464,342	3,947,063	(117,126)	45,932,247	1,915,683	628,097	1,252,165	(1,826,270)	47,901,922
Total unrestricted revenue	39,805,225	252,174,792	123,971,702	(33,532,074)	382,419,645	22,525,604	629,336	1,252,165	(5,314,954)	401,511,796
Expenses										
Salaries and wages	517,424	71,116,933	83,691,899	-	155,326,256	1,835,516	93,264	592,968	-	157,848,004
Fringe benefits	157,597	19,741,392	17,002,330	-	36,901,319	(95,927)	30,145	198,687	-	37,034,224
QLT expenses	-	2,087,849	-	-	2,087,849	-	-	-	-	2,087,849
Supplies and other expenses	1,862,786	95,091,185	20,593,739	(117,126)	117,430,584	4,423,643	287,075	764,206	(1,826,270)	121,079,238
Institutional support	20,841,263	14,915,073	1,137,677	(36,894,013)	-	9,619	-	-	(9,619)	-
Depreciation and amortization	625,085	19,128,859	73,449	-	19,827,393	1,194,906	261,491	-	-	21,283,790
Interest	-	4,032,830	73,575	-	4,106,405	683,062	-	-	-	4,789,467
Research and other expenditures	-	34,452,004	-	-	34,452,004	16,617,017	-	-	-	51,069,021
Total expenses	24,004,155	260,566,125	122,572,669	(37,011,139)	370,131,810	24,667,836	671,975	1,555,861	(1,835,889)	395,191,593
income (loss) from operations	15,801,070	(8,391,333)	1,399,033	3,479,065	12,287,835	(2,142,232)	(42,639)	(303,696)	(3,479,065)	6,320,203
Other gains (losses)										
Net realized gains on investments	105,991	49,783	-	-	155,774	4,997	-	-	-	160,771
Unrealized losses on interest rate swap agreements	-	(4,036,706)	-	-	(4,036,706)	-	-	-	-	(4,036,706)
Change in interest of Foundation	-	9,274,864	-	(9,274,864)	-	-	-	-	-	-
Change in interest of Schepens	(1,844,916)	-	-	-	(1,844,916)	-	-	-	1,844,916	-
Total other gains, net	(1,738,925)	5,287,941	-	(9,274,864)	(5,725,848)	4,997	-	-	1,844,916	(3,875,935)
Excess (deficit) of revenues over expenses	14,062,145	(3,103,392)	1,399,033	(5,795,799)	6,561,987	(2,137,235)	(42,639)	(303,696)	(1,634,149)	2,444,268
Other support										
Transfer from (to) affiliate, net	(5,478,216)	7,805,203	87,651	-	2,414,638	-	(2,735,704)	321,066	-	-
Net assets released from restriction for the purchase of property, plant and equipment	690,935	-	-	-	690,935	-	(1,976,043)	-	-	(1,285,108)
Change in unrealized (depreciation) appreciation on investments	1,956,640	2,407,033	-	(1,956,640)	2,407,033	292,319	-	-	-	2,699,352
Adjustment for pension and postretirement-related charges other than net periodic pension cost	-	3,337,981	-	-	3,337,981	-	-	-	-	3,337,981
Total increase (decrease) in unrestricted net assets	$ 11,231,504	$ 10,446,825	$ 1,486,684	$ (7,752,439)	$ 15,412,574	$ (1,844,916)	$ (4,754,386)	$ 17,370	$ (1,634,149)	$ 7,196,493

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Balance Sheet
September 30, 2016

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Liabilities and Net Assets										
Current liabilities										
Current portion of long-term debt and capital lease obligations	$ -	$ 6,397,327	$ -	$ -	$ 6,397,327	$ 2,897,249	$ -	$ -	$ -	$ 9,294,576
Accounts payable and accrued expenses	40,879	48,270,963	3,686,182	-	51,998,024	4,400,128	-	-	-	56,398,152
Accrued interest	-	524,400	-	-	524,400	33,746	-	-	-	558,146
Estimated third-party payors settlements	-	4,155,733	-	-	4,155,733	-	-	-	-	4,155,733
Due to affiliates	53,611,555	79,372,618	70,712,511	(193,686,255)	10,010,429	18,968,009	3,041,883	1,351,258	(33,371,579)	-
Total current liabilities	53,652,434	138,721,041	74,398,693	(193,686,255)	73,085,913	26,299,132	3,041,883	1,351,258	(33,371,579)	70,406,607
Long-term debt and capital lease obligations, less current portion	-	112,098,832	-	-	112,098,832	8,233,043	-	-	-	120,331,875
Mass Development Finance Agency Rev Bonds Interest Swap Liability	-	4,036,706	-	-	4,036,706	-	-	-	-	4,036,706
Asset retirement obligation	-	-	-	-	-	-	-	-	-	-
Deferred QLT revenue	-	11,260,223	-	-	11,260,223	-	-	-	-	11,260,223
Other long term liabilities	572,660	10,333,294	-	-	10,905,954	802,214	-	-	-	11,708,168
Professional liability reserve	-	3,006,550	5,344,241	-	8,350,791	-	-	-	-	8,350,791
Accrued pension costs	-	54,586,319	-	-	54,586,319	-	-	-	-	54,586,319
Total liabilities	54,225,094	334,042,965	79,742,934	(193,686,255)	274,324,738	35,334,389	3,041,883	1,351,258	(33,371,579)	280,680,689
Net assets										
Unrestricted for general operations	76,910,567	59,892,447	14,967,260	(76,910,567)	74,859,707	479,922	-	-	(479,922)	74,859,707
Board designated	32,406,058	46,192,504	1,974,856	(32,406,058)	48,167,360	-	-	-	-	48,167,360
Total unrestricted net assets	109,316,625	106,084,951	16,942,116	(109,316,625)	123,027,067	479,922	-	-	(479,922)	123,027,067
Temporarily restricted	46,700,163	46,700,163	-	(46,700,163)	46,700,163	6,875,616	-	-	(6,875,616)	46,700,163
Permanently restricted	76,523,657	76,523,657	-	(76,523,657)	76,523,657	12,011,718	-	-	(12,011,718)	76,523,657
Total net assets	232,540,445	229,308,771	16,942,116	(232,540,445)	246,250,887	19,367,256	-	-	(19,367,256)	246,250,887
Total liabilities and net assets	$ 286,765,539	$ 563,351,736	$ 96,685,050	$ (426,226,700)	$ 520,575,625	$ 54,701,645	$ 3,041,883	$ 1,351,258	$ (52,738,835)	$ 526,931,576

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Balance Sheet
September 30, 2015

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Assets										
Current assets										
Cash and equivalents	$ 1,874,227	$ 1,824,021	$ 2,654,792	$ -	$ 6,353,040	$ 34,671	$ 1,285,600	$ 339,578	$ -	$ 8,012,889
Assets whose use is limited	-	3,551,739	-	-	3,551,739	-	-	-	-	3,551,739
Patient accounts receivable, less allowance for doubtful accounts of $6,436,343	-	20,851,137	9,838,137	-	30,689,274	-	-	-	-	30,689,274
Other current assets	6,857,973	9,259,070	728,893	-	16,845,936	1,646,069	12,098	88,425	-	18,592,528
Due from affiliates	-	22,160,534	6,292,242	(23,027,698)	5,425,078	17,631,515	-	-	(23,056,593)	-
Total current assets	8,732,200	57,646,501	19,514,064	(23,027,698)	62,865,067	19,312,255	1,297,698	428,003	(23,056,593)	60,846,430
Assets whose use is limited										
Construction fund	-	-	-	-	-	-	-	-	-	-
Special cash reserves and capital reserves	-	2,334,500	-	-	2,334,500	-	362,742	-	-	2,697,242
QLT judgment funds	-	-	-	-	-	-	-	-	-	-
Under indenture agreement	-	6,480,219	-	-	6,480,219	766,131	-	-	-	7,246,350
Total assets whose use is limited	-	8,814,719	-	-	8,814,719	766,131	362,742	-	-	9,943,592
Investments	187,591,657	-	37,664	-	187,629,321	2,691,410	-	-	-	190,320,731
Pledges receivable, net	5,261,431	-	-	-	5,261,431	-	-	-	-	5,261,431
Remainder interest in charitable trusts	375,026	-	-	-	375,026	76,800	-	-	-	451,826
Beneficial interest in trust	15,128,979	-	-	-	15,128,979	-	-	-	-	15,128,979
Property, plant and equipment, net	16,095,932	137,847,296	1,094,651	-	155,037,879	19,319,814	3,106,360	-	-	177,464,053
Other assets	-	-	-	-	-	-	-	-	-	-
Investment interest in Foundation	-	219,572,271	-	(219,572,271)	-	-	-	-	-	-
Investment interest in Schepens	22,279,331	-	-	-	22,279,331	-	-	-	(22,279,331)	-
Intangible assets and other assets, net of accumulated amortization of $2,111,507	-	1,363,619	-	-	1,363,619	-	-	-	-	1,363,619
Deposits and other assets	3,000,000	6,949,986	5,071,738	-	15,021,724	545,938	-	-	-	15,567,662
Total assets	$ 258,464,556	$ 432,194,392	$ 25,718,117	$ (242,599,969)	$ 473,777,096	$ 42,712,348	$ 4,766,800	$ 428,003	$ (45,335,924)	$ 476,348,323

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Balance Sheet
September 30, 2015

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Liabilities and Net Assets										
Current liabilities										
Current portion of long-term debt and capital lease obligations	$ -	$ 5,531,702	$ -	$ -	$ 5,531,702	$ 1,500,399	$ -	$ -	$ -	$ 7,032,101
Accounts payable and accrued expenses	38,539	40,093,840	4,753,515	-	44,885,894	3,137,317	6,287	320,556	-	48,350,054
Accrued interest	-	778,221	-	-	778,221	-	-	-	-	778,221
Estimated third-party payors settlements	-	7,854,958	-	-	7,854,958	-	-	-	-	7,854,958
Due to affiliates	38,251,902	2,327,706	79,605	(23,027,698)	17,631,515	5,294,134	6,127	124,817	(23,056,593)	-
Total current liabilities	38,290,441	56,586,427	4,833,120	(23,027,698)	76,682,290	9,931,850	12,414	445,373	(23,056,593)	64,015,334
Long-term debt and capital lease obligations, less current portion	-	76,155,230	-	-	76,155,230	9,880,296	-	-	-	86,035,526
Asset retirement obligation	-	-	-	-	-	-	-	-	-	-
Deferred QLT revenue	-	13,280,726	-	-	13,280,726	-	-	-	-	13,280,726
Other long term liabilities	601,844	10,939,419	-	-	11,541,263	620,871	-	-	-	12,162,134
Professional liability reserve	-	2,595,221	5,429,565	-	8,024,786	-	-	-	-	8,024,786
Accrued pension costs	-	55,512,094	-	-	55,512,094	-	-	-	-	55,512,094
Total liabilities	38,892,285	215,069,117	10,262,685	(23,027,698)	241,196,389	20,433,017	12,414	445,373	(23,056,593)	239,030,600
Net assets										
Unrestricted for general operations	66,948,884	49,330,238	13,480,576	(66,948,884)	62,810,814	1,828,262	4,754,386	(17,370)	(1,828,262)	67,547,830
Board designated	31,136,238	46,307,888	1,974,856	(31,136,238)	48,282,744	496,576	-	-	(496,576)	48,282,744
Total unrestricted net assets	98,085,122	95,638,126	15,455,432	(98,085,122)	111,093,558	2,324,838	4,754,386	(17,370)	(2,324,838)	115,830,574
Temporarily restricted	49,262,806	49,262,806	-	(49,262,806)	49,262,806	7,942,775	-	-	(7,942,775)	49,262,806
Permanently restricted	72,224,343	72,224,343	-	(72,224,343)	72,224,343	12,011,718	-	-	(12,011,718)	72,224,343
Total net assets	219,572,271	217,125,275	15,455,432	(219,572,271)	232,580,707	22,279,331	4,754,386	(17,370)	(22,279,331)	237,317,723
Total liabilities and net assets	$ 258,464,556	$ 432,194,392	$ 25,718,117	$ (242,599,969)	$ 473,777,096	$ 42,712,348	$ 4,766,800	$ 428,003	$ (45,335,924)	$ 476,348,323

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Combining Statement of Operations
September 30, 2015

	Foundation	Infirmary	Associates	Eliminations and Reclassifications	Obligated Group	Schepens	Circle	Embankment	Eliminations and Reclassifications	Combined
Unrestricted revenue and gains										
Net patient service revenue (net of contractual allowances and discounts)	$ -	$ 167,332,489	$ 102,304,300	$ (241,205)	$ 269,395,584	$ -	$ -	$ -	$ -	$ 269,395,584
Provision for bad debts	-	(3,810,922)	(4,264,620)	-	(8,075,542)	-	-	-	-	(8,075,542)
Net patient service revenue less provision for bad debts	-	163,521,567	98,039,680	(241,205)	261,320,042	-	-	-	-	261,320,042
Research direct revenue	-	25,032,444	-	(558,480)	24,473,964	9,433,289	-	-	(655,719)	33,251,534
Research indirect revenue	-	7,428,909	-	-	7,428,909	6,525,079	-	-	-	13,953,988
Contributions	1,375,746	3,468,726	-	-	4,844,472	2,133,426	-	-	-	6,977,898
Investment income	2,050,353	104,141	-	-	2,154,494	69,329	1,404	-	-	2,225,227
Institutional Support	-	7,137,871	16,690,715	(23,828,586)	-	3,064,228	-	-	(3,064,228)	-
Net assets released from restriction used for operations	13,118,713	6,562,753	278,778	(6,841,531)	13,118,713	2,847,326	-	-	(929,968)	15,036,071
QLT revenue	-	2,994,328	-	-	2,994,328	-	-	-	-	2,994,328
Other revenue and gains	39,756,621	13,533,509	3,743,061	(16,814)	57,016,377	641,060	1,726,862	3,011,504	(1,454,988)	60,940,815
Total unrestricted revenue	56,301,433	229,784,248	118,752,234	(31,486,616)	373,351,299	24,713,737	1,728,266	3,011,504	(6,104,903)	396,699,903
Expenses										
Salaries and wages	588,125	71,324,373	73,900,641	-	145,813,139	2,059,738	100,361	1,097,362	-	149,070,600
Fringe benefits	146,474	19,552,036	15,730,565	-	35,429,075	206,988	26,182	314,106	-	35,976,351
QLT expenses	-	3,948,667	-	-	3,948,667	-	-	-	-	3,948,667
Supplies and other expenses	4,956,718	89,053,882	27,131,146	(258,019)	120,883,727	4,531,536	664,794	1,607,045	(1,454,988)	126,232,114
Institutional support	20,996,616	12,718,992	948,705	(30,670,117)	3,994,196	-	-	-	(3,994,196)	-
Depreciation and amortization	625,083	20,663,247	88,470	-	21,376,800	1,251,019	347,031	-	-	22,974,850
Interest	-	2,768,171	-	-	2,768,171	786,090	-	-	-	3,554,261
Research and other expenditures	-	32,755,033	-	(558,480)	32,196,553	16,067,083	-	-	(655,719)	47,607,917
Total expenses	27,313,016	252,784,401	117,799,527	(31,486,616)	366,410,328	24,902,454	1,138,368	3,018,513	(6,104,903)	389,364,760
(Loss) income from operations	28,988,417	(23,000,153)	952,707	-	6,940,971	(188,717)	589,898	(7,009)	-	7,335,143
Other gains (losses)										
Net realized gains on investments	1,401,988	378,395	-	-	1,780,383	2,390	-	-	-	1,782,773
Change in interest of Foundation	-	25,554,496	-	(25,554,496)	-	-	-	-	-	-
Change in interest of Schepens	(614,699)	-	-	-	(614,699)	-	-	-	614,699	-
Total other gains, net	787,289	25,932,891	-	(25,554,496)	1,165,684	2,390	-	-	614,699	1,782,773
(Deficit) excess of revenues over expenses	29,775,706	2,932,738	952,707	(25,554,496)	8,106,655	(186,327)	589,898	(7,009)	614,699	9,117,916
Other support										
Transfer from (to) affiliate, net	(5,127,908)	5,568,952	(41,044)	-	400,000	-	(400,000)	-	-	-
Net assets released from restriction for the purchase of property, plant and equipment	906,698	-	-	-	906,698	17,395	(558,907)	-	-	365,186
Change in unrealized (depreciation) appreciation on investments	(1,447,521)	(1,940,729)	-	1,447,521	(1,940,729)	(445,767)	-	-	-	(2,386,496)
Adjustment for pension and postretirement-related charges other than net periodic pension cost	-	(13,075,539)	-	-	(13,075,539)	-	-	-	-	(13,075,539)
Total (decrease) increase in unrestricted net assets	$ 24,106,975	$ (6,514,578)	$ 911,663	$ (24,106,975)	$ (5,602,915)	$ (614,699)	$ (369,009)	$ (7,009)	$ 614,699	$ (5,978,933)

1. Basis of Presentation

The accompanying supplemental combining information includes the combined balance sheets and statement of operations of the Foundation of Massachusetts Eye and Ear. Significant inter-affiliate accounts and transactions have been eliminated. The combining information presented is prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America consistent with the combined financial statements. The combining information is presented for the purpose of additional analysis of the combined financial statements and is not required as part of the basic financial statements.

Schedule of Expenditures of Federal Awards

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

Federal Program	CFDA	Direct	Pass Through	Pass-Through Entity	Pass Through-Entity Sponsor Number	Total Expenditures	Passed through to Subrecipients
Research and Development Cluster							
Department of Health and Human Services							
National Institute of Health							
Oral Diseases and Disorders Research	93.121		23,202	Tufts University	R21DE025295	23,202	
Human Genome Research	93.172		730	Broad Institute	UM1HG008900	730	
Research Related to Deafness & Other Communication Disorders	93.173	8,802,749				8,802,749	394,956
Research Related to Deafness & Other Communication Disorders	93.173		41,832	Brigham & Women's Hospital	U01DC010811	41,832	
Research Related to Deafness & Other Communication Disorders	93.173		75,724	Draper Laboratory	R01DC006848	75,724	
Research Related to Deafness & Other Communication Disorders	93.173		184,636	Draper Laboratory	R01DC013909	184,636	
Research Related to Deafness & Other Communication Disorders	93.173		113,371	Tufts University	R01DC014217	113,371	
Research Related to Deafness & Other Communication Disorders	93.173		37,985	University of Michigan	R01DC004820	37,985	
Research Related to Deafness & Other Communication Disorders	93.173		15,930	Physical Sciences, Inc.	R43DC013923	15,930	
Research Related to Deafness & Other Communication Disorders	93.173	118,403				118,403	-
Mental Health Research Grants	93.242		51,264	McLean Hospital	R01MH091348	51,264	
Discovery and Applied Research for Technological Innovations to Improve Human Health	93.286	615,987				615,987	503,600
Trans-NIH Research Support	93.310		164,795	University of Pennsylvania	DP1EY023177	164,795	
Research Infrastructure Programs	93.351		(5,462)	Harvard University	UL1TR001102	(5,462)	
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847		183	Joslin Diabetes Center	DP3DK10174	183	
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847		183	Massachusetts General Hospital	DP3DK101074	183	
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	175,545				175,545	
Allergy and Infectious Diseases Research	93.855	3,397,130				3,397,130	1,549,326
Biomedical Research and Research Training	93.859	83,755				83,755	
Aging Research	93.866	271,769				271,769	
Aging Research	93.866		8,329	Rhode Island Hospital	R03AG046472	8,329	
Vision Research	93.867	15,676,871				15,676,871	1,352,778
Vision Research	93.867		106,741	AfaSci Inc.	R41EY025913	106,741	
Vision Research	93.867		63,171	Columbia University	R01EY024091	63,171	
Vision Research	93.867		43,236	EyePhone LLC	R43EY025902	43,236	
Vision Research	93.867		20,647	Jaeb Center for Health Research	U10EY014231	20,647	
Vision Research	93.867		1,388	Johns Hopkins Bloomberg School	U10EY024527	1,388	
Vision Research	93.867		30,068	Massachusetts General Hospital	R01EY025454	30,068	
Vision Research	93.867		20,212	Oklahoma University Health School	R01EY023568	20,212	
Vision Research	93.867		19,985	Oklahoma University Health School	R21EY025256	19,985	
Vision Research	93.867		96,093	Scripps Research	R01EY026202	96,093	
Vision Research	93.867		55,353	University of Illinois at Chicago	R01EY022651	55,353	
Vision Research	93.867		308,826	University of Pennsylvania	R01EY023682	308,826	
Vision Research	93.867		6,698	University of Pennsylvania	U10EY022879	6,698	
Research Related to Deafness & Other Communication Disorders	93.867	47,028				47,028	-
Research Related to Deafness & Other Communication Disorders	93.867	633,287				633,287	188,784
Research Related to Deafness & Other Communication Disorders	93.867	196,008				196,008	-
Research Related to Deafness & Other Communication Disorders	93.867		36,886	Schepens Eye Research Institute	T32EY007145	36,886	-
Vision Research	93.867		33,837	Children's Hospital Boston	R01EY025794	33,837	
		30,018,531	1,555,846			31,574,377	3,989,646

The accompanying note is an integral part of this schedule.

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

Federal Program	CFDA	Direct	Pass Through	Pass-Through Entity	Pass Through-Entity Sponsor Number	Total Expenditures	Passed through to Subrecipients
Department of Defense							
US Army Medical Research Acquisition Activity	12.420	4,303,072				4,303,072	212,840
US Army Medical Research Acquisition Activity	12.420		19,655	Environmental Tectonics Corporation	144942	19,655	
US Army Medical Research Acquisition Activity	12.420		16,047.00	Boston Children's Hospital	W81XWH-12-1-0155	16,047.00	
Office of Naval Research	12.300	(2,944)				(2,944)	
		4,300,128	35,702			4,335,831	212,840
National Aeronautics & Space Admin							
Basic Research, Educational Outreach, or Training Opportunities in the area of Science	43.001	13,673	-			13,673	
National Space and Biomedical Research Institute	43.009		101,492	Baylor University	NCC-9-58-231	101,492	
		13,673	101,492			115,165	
Total Research and Development Cluster		$ 34,332,333	$ 1,693,040			$ 36,025,373	$ 4,202,487
Total Federal Expenditures		$ 34,332,333	$ 1,693,040			$ 36,025,373	$ 4,202,487

The accompanying note is an integral part of this schedule.

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the combined federal grant activity of the Foundation of the Massachusetts Eye and Ear Infirmary, Inc. (the "Foundation") for the year ended September 30, 2016 presented on the accrual basis of accounting. The information presented in the Schedule is presented in accordance with the Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements*, *Cost Principles*, and *Audit Requirements for Federal Awards* (Uniform Guidance). Amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the combined financial statements. Expenditures for federal awards are recognized as disbursed and are determined using the cost accounting principles and procedures set forth in OASC-3, *A Guide for Hospitals -Cost Principles and Procedures for Establishing Indirect Cost and Patient Care Rates for Grants and Contracts with the Department of Health, Education and Welfare*. Under these cost principles, certain expenditures are not allowable or are limited as to reimbursement. Negative amounts represent adjustments or credits to amounts reported as expenditures in prior years. CFDA and passthrough numbers are presented when available.

The Foundation applies its predetermined approved facilities and administrative rate when charging indirect costs to federal awards rather than the 10% de minimis cost rate as described in Section 200.414 of the Uniform Guidance.

Part II–Reports on Internal Controls and Compliance

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Directors of The Foundation of the
Massachusetts Eye and Ear Infirmary Inc.

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the combined financial statements of the Massachusetts Eye and Ear Infirmary Inc. (the "Foundation") , which comprise the combined balance sheet as of September 30, 2016 and the related combined statement of operations and changes in net assets and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 20, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Foundation's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Foundation's internal control. Accordingly, we do not express an opinion on the effectiveness of Foundation's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Foundation's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Foundation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Foundation's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Foundation's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PricewaterhouseCoopers LLP

Boston, Massachusetts
January 20, 2017

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Report of Independent Auditors on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with the OMB Uniform Guidance

To the Board of Directors of
The Foundation of the Massachusetts Eye and Ear Infirmary Inc.

Report on Compliance for Each Major Federal Program

We have audited the Foundation of the Massachusetts Eye and Ear Infirmary Inc.'s (the "Foundation") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Foundation's major federal programs for the year ended September 30, 2016. The Foundation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Foundation's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Foundation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Foundation's compliance.

Opinion on Each Major Federal Program

In our opinion, the Foundation complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2016.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as items 2016-001 and 2016-002. Our opinion on each major federal program is not modified with respect to these matters.

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The Foundation's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs and corrective action plan. The Foundation's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the Foundation is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Foundation's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Foundation's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

PricewaterhouseCoopers LLP

Boston, Massachusetts
January 20, 2017

Part III–Audit Findings and Questioned Costs

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Schedule of Findings and Questioned Costs
September 30, 2016

I Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unmodified
Internal control over financial reporting	
Material weakness (es) identified?	No
Significant deficiency (ies) identified that are not considered to be material weakness (es)?	None reported
Noncompliance material to financial statements	No

Federal Awards

Internal control over major programs	
Material weakness (es) identified?	No
Significant deficiency (ies) identified that are not considered to be material weakness (es)?	None reported
Type of auditor's report issued on compliance for major programs	Unmodified
Audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)	Yes

Identification of major program

CFDA Number	Name of Federal Program or Cluster
Various	Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs	$750,000
Auditee qualified as low-risk auditee?	Yes

II. Financial Statement Findings

None noted

III. Federal Award Findings and Questioned Costs

Finding 2016-001 – Period of Performance

Cluster: Research and Development
Grantor: National Institutes of Health
Award Year: 10/1/15 - 9/30/16
Award Name: Drug-Eluting Stapes Prosthesis for the Prevention of Sensorineural Hearing Loss
Award number: 5 R01 DC009837-05
CFDA#: 93.173

Condition
Through our testing of period of performance, it was noted that the Foundation had 10 awards that commenced during fiscal year 2016 and 35 awards that ended during fiscal year 2016. We obtained the detailed expenditure listings for these awards and noted that 4 transactions totaling $1,200, related to the award above, were charged to the grant in August through September 2016, which was after the budget period for the award ended on February 29, 2016.

Criteria
A non-Federal entity may charge to the Federal award only allowable costs incurred during the period of performance and any costs incurred before the Federal awarding agency or pass-through entity made the Federal award that were authorized by the Federal awarding agency or pass-through entity (2 CFR section 200.309). Unless the Federal awarding agency or pass-through entity authorizes an extension, a non-Federal entity must liquidate all obligations incurred under the Federal award not later than 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the Federal award (2 CFR section 200.343(b)).

Cause
During fiscal year 2016, the Foundation implemented a new general ledger system and the Office of Research Finance was restructured, which altered certain review roles and responsibilities. As a result, certain grant administrators were not able to complete the input of their grant expenses during the implementation of the new accounting system, resulting in a backlog of expenses to be approved by the Office of Research Finance once the system was implemented. The combination of the reduction in review personnel, the delayed submission of expenses to the Office of Research Finance and a period of lack of familiarization with the new accounting software created a lag in the posting of expenses to the new general ledger system.

Effect
The lag in the input of grant expenses into the general ledger and review of grant expenses, resulted in requesting reimbursement from the federal government in excess of 90 calendar days after the end date of the period of performance of the grant.

Questioned Costs
$1,200

Recommendation
We recommend that the Foundation implement policies and procedures to ensure the close-out of awards in timely manner and additionally, implement a reconciliation at the time of close-out to ensure the completeness and accuracy of grant expenses. This will allow management to close out an award timely and to make any final reimbursement requests within the 90-day allowed period after the end date of the period of performance.

Management's Views and Corrective Action Plan
Management's views and corrective action plan is included at the end of this report after the summary schedule of prior audit findings and status.

2016-002 – Equipment Dispositions

Cluster: Research and Development
Grantor: National Institute of Deafness & Other Communicable Disorders
Award Year: 10/1/15 - 9/30/16
Award Name: Micromechanical Device for Intracochlear Drug Delivery
Award number: 5 R01 DC000235-20
CFDA#: 93.173

Condition
Through our testing of dispositions of federal equipment at the Foundation, it was noted that 1 selection out of 4 tested (100% of the population), was improperly included on the disposition listing. This asset totaling, $47,005, was still in use by the Foundation and thus had not been disposed of.

Criteria
Property records must be maintained that include a description of the property, a serial number or other identification number, the source of funding for the property (including the FAIN), who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the project costs for the Federal award under which the property was acquired, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property. (2 CFR section 200.313(d).

Cause
In fiscal year 2016, the Foundation converted from a manual equipment registry to an automated registry located within a new Peoplesoft ERP system. Due to the manual input of the equipment into Peoplesoft, this asset was inappropriately excluded from the system and thus identified as a disposal when compared to the previous system of record.

Effect
The Foundation may improperly exclude a piece of equipment from the federal equipment list and fail to use the equipment for properly approved purposes. Additionally, the Foundation may remove the equipment from service or dispose of the equipment without obtaining the proper approvals from the funding agency.

Questioned Costs
None noted.

Recommendation
We recommend that the Foundation complete a final reconciliation between the new Peoplesoft system and the legacy system to ensure the completeness and accuracy of the current federal equipment inventory listing. Additionally, we recommend the Foundation perform a reconciliation periodically between equipment purchased and disposed of and the amount within Peoplesoft to ensure the continuing completeness and accuracy of the equipment inventory listing.

Management's Views and Corrective Action Plan
Management's views and corrective action plan is included at the end of this report after the summary schedule of prior audit findings and status.

Foundation of the Massachusetts Eye and Ear Infirmary, Inc.
Summary Schedule of Prior Audit Findings and Status
September 30, 2016

There are no findings from prior year which require an update.