KPMG

KALEIDA HEALTH

Consolidated Financial Statements

December 31, 2014 and 2013

(With Independent Auditors' Report Thereon)

KALEIDA HEALTH

Consolidated Financial Statements

December 31, 2014 and 2013

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KPMG LLP
12 Fountain Plaza, Suite 601
Buffalo, NY 14202

Independent Auditors' Report

The Board of Directors
Kaleida Health:

We have audited the accompanying consolidated financial statements of Kaleida Health (Kaleida), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kaleida Health as of December 31, 2014 and 2013, and the results of its operations and changes in net assets, and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

April 30, 2015

KALEIDA HEALTH

Consolidated Balance Sheets

December 31, 2014 and 2013

(Dollars in thousands)

Assets		2014	2013
Current assets:			
Cash and cash equivalents	$	95,658	58,567
Investments (notes 6 and 7)		171,560	157,525
Accounts receivable:			
Patient, less estimated allowance for doubtful accounts of $37,397 in 2014 and $35,271 in 2013		155,484	148,058
Other (note 15)		21,962	23,151
Estimated third–party payor receivables (note 4)		15,335	27,775
Inventories		26,182	26,246
Prepaid expenses and other current assets		14,489	14,224
Total current assets		500,670	455,546
Assets limited as to use (notes 5, 6, 7, and 10):			
Designated under debt agreements		38,153	36,184
Designated under self-insurance programs		115,074	124,561
Board designated and donor restricted		114,929	107,830
Other		1,946	2,046
		270,102	270,621
Property and equipment, less accumulated depreciation and amortization (notes 8 and 10)		444,192	467,241
Receivable for insurance recoveries (note 5)		4,661	4,644
Deferred financing costs, net		11,728	10,145
Other (note 9)		42,185	13,519
Total assets	$	1,273,538	1,221,716

See accompanying notes to consolidated financial statements.

Liabilities and Net Assets		2014	2013
Current liabilities:			
Accounts payable and other accrued expenses	$	92,577	90,325
Accrued payroll and related expenses		51,759	61,330
Estimated third-party payor settlements (note 4)		24,518	23,073
Current portion of long-term debt (note 10)		20,835	20,566
Other current liabilities		7,951	11,492
Total current liabilities		197,640	206,786
Long-term debt, less current portion (note 10)		288,137	290,140
Construction costs payable		5,194	145
Estimated self-insurance reserves (note 5)		165,774	163,755
Asset retirement obligations (note 13)		12,325	11,714
Pension and postretirement obligations (note 12)		279,638	195,059
Other long-term liabilities		12,265	15,643
		763,333	676,456
Total liabilities		960,973	883,242
Commitments (notes 8 and 11)			
Net assets:			
Unrestricted:			
Available for operations		451,440	424,697
Provision for future benefit costs (note 12)		(276,079)	(182,619)
Total unrestricted		175,361	242,078
Temporarily restricted (note 14)		121,724	80,996
Permanently restricted (note 14)		15,480	15,400
Total net assets		312,565	338,474
Total liabilities and net assets	$	1,273,538	1,221,716

KALEIDA HEALTH

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2014 and 2013

(Dollars in thousands)

		2014	2013
Operating revenue:			
Patient service revenue, net of contractual allowances and discounts (notes 3 and 4)	$	1,267,725	1,248,011
Less provision for bad debts		19,463	23,909
Net patient service revenue		1,248,262	1,224,102
Other operating revenue (notes 6 and 15)		35,853	35,014
Net assets released from restrictions for operations (note 14)		4,918	5,188
Total operating revenue		1,289,033	1,264,304
Operating expenses:			
Salaries and benefits		723,691	747,006
Purchased services and other		235,766	217,038
Medical and nonmedical supplies		233,797	229,235
Depreciation and amortization		65,355	70,438
Interest		15,188	15,886
Total operating expenses		1,273,797	1,279,603
Income (loss) from operations		15,236	(15,299)
Other income:			
Investment income (note 6)		7,062	6,190
Net realized gains on sales of investments (note 6)		5,266	2,656
Net change in unrealized gains on investments (note 6)		(2,361)	5,435
Total other income, net		9,967	14,281
Excess (deficiency) of revenue over expenses	$	25,203	(1,018)

See accompanying notes to consolidated financial statements.

KALEIDA HEALTH

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

Years ended December 31, 2014 and 2013

(Dollars in thousands)

		2014	2013
Unrestricted net assets:			
Excess (deficiency) of revenue over expenses	$	25,203	(1,018)
Pension and postretirement related changes other than net periodic cost (note 12)		(93,718)	85,214
Net assets released from restrictions for capital expenditures		1,317	607
Other, net		481	602
(Decrease) increase in unrestricted net assets		(66,717)	85,405
Temporarily restricted net assets:			
Contributions, bequests, and grants		44,793	5,918
Restricted investment gains		2,717	1,290
Net change in unrealized gains and losses on investments		(547)	4,447
Net assets released from restrictions for operations		(4,918)	(5,188)
Net assets released from restrictions for capital expenditures		(1,317)	(607)
Increase in temporarily restricted net assets		40,728	5,860
Permanently restricted net assets:			
Contributions		80	—
Restricted investment income		1,183	306
Net change in unrealized gains and losses on investments		(334)	1,571
Transfer to temporarily restricted net assets		(849)	(1,877)
Change in permanently restricted net assets		80	—
Change in net assets		(25,909)	91,265
Net assets, beginning of year		338,474	247,209
Net assets, end of year	$	312,565	338,474

See accompanying notes to consolidated financial statements.

KALEIDA HEALTH

Consolidated Statements of Cash Flows

Years ended December 31, 2014 and 2013

(Dollars in thousands)

		2014	2013
Operating activities:			
Change in net assets	$	(25,909)	91,265
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		65,355	70,438
Accretion expense		675	900
Restricted contributions, bequests, and grants		(17,579)	(2,882)
Change in interests in other investments		(2,513)	(1,463)
Net change in unrealized gains and losses on investments		2,908	(9,882)
Net realized gains and losses on investments		(9,166)	(4,252)
Provision for bad debts		19,463	23,909
Pension and postretirement related changes other than net periodic cost		93,718	(85,214)
Change in operating assets and liabilities:			
Patient accounts receivable		(26,889)	(24,374)
Estimated third-party payor receivables		12,440	(9,340)
Other receivables, inventories, and prepaid expenses		988	(4,247)
Receivable for insurance recoveries		(17)	4,264
Accounts payable, accrued expenses, and accrued payroll		(7,877)	24,277
Estimated third-party payor settlements		1,445	(3,217)
Other assets		(17,576)	230
Other liabilities		(14,103)	5,441
Net cash provided by operating activities		75,363	75,853
Investing activities:			
Additions to property and equipment, net of change in construction costs payable		(31,516)	(36,250)
Purchases of investments		(261,609)	(216,576)
Proceeds from sales of investments		241,127	213,526
Change in cash restricted for use		15,737	(12,319)
Capital contributions to joint venture		(11,090)	—
Net cash used in investing activities		(47,351)	(51,619)
Financing activities:			
Principal payments on debt and capital lease obligations		(20,709)	(25,036)
Proceeds from restricted contributions, bequests, and grants		17,579	2,882
Proceeds from long-term debt		14,786	1,696
Payments for deferred financing fees		(2,577)	(86)
Net cash provided by (used in) financing activities		9,079	(20,544)
Net increase in cash and cash equivalents		37,091	3,690
Cash and cash equivalents, beginning of year		58,567	54,877
Cash and cash equivalents, end of year	$	95,658	58,567
Supplemental disclosures on cash flow activities:			
Capital lease obligations	$	4,189	—
Interest paid		15,204	15,923
Capital acquisitions included in accounts payable		3,368	2,810

See accompanying notes to consolidated financial statements.

(1) Organization

Kaleida Health (Kaleida) is an integrated healthcare delivery system that provides acute, skilled nursing, rehabilitative, outpatient, and home healthcare services primarily to the residents of Western New York. The entities consolidated within Kaleida are the Hospital Corporation (Buffalo General Medical Center, Women and Children's Hospital, the Millard Fillmore Suburban Hospital, DeGraff Memorial Hospital, and two hospital based nursing facilities), Visiting Nursing Association of WNY, Inc., VNA Home Care Services, Inc., General Physician, P.C. and its subsidiaries, several other subsidiaries, and two charitable foundations that raise funds for Kaleida.

In 2006, the Commission on Health Care Facilities in the 21st Century (Berger Commission) created by the Governor and New York State Legislature issued recommendations on health care capacity and resources in New York State. The Berger Commission report discussed, among other things, the context and process under which the recommendations were made, the authority granted to the NYS Department of Health (DOH) to implement the recommendations, and how the implementation of these recommendations may be timed and funded. The Berger Commission's recommendations included consolidation, closures, conversions, and restructuring of hospital and nursing home systems throughout New York State, including at Kaleida.

In connection with the recommendations issued by the Berger Commission, Kaleida and Erie County Medical Center Corporation (ECMCC), have contractually subordinated certain planning activities and quality improvement programs to Great Lakes Health, a stand-alone not-for-profit 501(c)(3) corporation.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying consolidated financial statements of Kaleida are presented consistent with the Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 954, *Health Care Entities*, (ASC 954), which addresses the presentation of financial statements for health care entities. In accordance with the provisions of ASC 954, net assets and revenue, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, unrestricted net assets are amounts not subject to donor-imposed stipulations and are available for operations. Temporarily restricted net assets are restricted by donors and are reflected as net assets released from restrictions in unrestricted net assets to the extent utilized during the period. Permanently restricted net assets are subject to the restrictions of gift instruments requiring that the principal be maintained in perpetuity while permitting the income to be utilized for general and specific purposes.

The consolidated financial statements include the accounts of Kaleida and its wholly owned subsidiaries and those financial statements where Kaleida controls professional corporations in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 810, *Consolidation*. All significant intercompany transactions between Kaleida and its subsidiaries have been eliminated in consolidation.

Kaleida considers events or transactions that occur after the consolidated balance sheet date, but before the consolidated financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These consolidated financial

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statements were available to be issued on April 30, 2015 and subsequent events have been evaluated through that date.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The most significant areas which are affected by the use of estimates include the allowance for doubtful accounts, estimated third-party payor settlements, self-insurance reserves, valuation of certain alternative investments, and pension obligations. Actual results could differ from those estimates, and the differences in estimates from actual results could be significant.

(c) Cash and Cash Equivalents

Cash equivalents include amounts deposited in short-term interest-bearing accounts. For purposes of the consolidated statements of cash flows, cash equivalents exclude amounts maintained within investment portfolios and amounts classified as assets limited as to use.

Kaleida invests cash in money market securities and maintains cash balances in financial institutions in excess of federal deposit insurance limits. As discussed in note 2(n), cash equivalents available for operating purposes are stated at fair value and are considered a Level 1 financial asset.

(d) Charity Care and Provision for Bad Debts

Kaleida provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than their established rates. Because Kaleida does not anticipate collection of amounts determined to qualify as charity care, they are not reported as revenue.

Kaleida grants credit without collateral to patients, most of whom are local residents and are insured by commercial and government insurance plans. Additions to the estimated allowance for doubtful accounts are made by means of the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management’s assessment of historical and expected net collections, business and economic conditions, trends in Federal and State governmental healthcare coverage, and other collection indicators. The provision for bad debts primarily relates to patients without insurance and to those that are either underinsured or without the necessary resources to pay coinsurance and deductible balances.

(e) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue under certain third-party payor agreements is subject to audit and retroactive adjustment. Provision for estimated third-party payor settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as final settlements are determined. Net patient service revenue from Medicare and New York State Medicaid, and commercial insurance plans accounted for approximately 39%, 21% and 40%, respectively, of total net patient service revenue for the year ended December 31, 2014, and

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40%, 20% and 40%, respectively, of total net patient service revenue for the year ended December 31, 2013. Significant concentrations of patient accounts receivable at December 31, 2014 include 16% Medicare, 10% Medicaid, and 47% commercial insurance plans. Significant concentrations of patient accounts receivable at December 31, 2013 include 19% Medicare, 10% Medicaid, and 44% commercial insurance plans. Kaleida is dependent on these payors to carryout its operating activities.

(f) Investments and Investment Income

Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing participants at the measurement date. See notes 2(n) and 7 for a discussion of fair value measurements.

Participation units in pooled investment funds held within unrestricted, temporarily restricted, and permanently restricted net assets are determined monthly based on the fair value of the underlying investments at the calculation date. Income earned on pooled investments is allocated to participating funds based on their respective unit shares of the pool.

Investment income or loss (including interest, dividends, realized gains and losses on investments, change in interest in other investments, and change in unrealized gains and losses) is included in excess (deficiency) of revenue over expenses, unless the income is restricted by the donor or law. Further, investment income from funds designated for self-insurance programs and debt and lease agreements are recorded as a component of operating revenue.

(g) Inventories

Inventories consist principally of pharmaceutical and other medical supplies and are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

(h) Assets Limited as to Use

Assets limited as to use include investments maintained by a trustee under irrevocable self-insurance agreements and cash and investments held by trustees pursuant to debt agreements. Assets limited as to use also include investments set aside by the board of directors for specific purposes, as well as investments restricted by donors and grantors for a specific time period or purpose.

(i) Property and Equipment

Property and equipment are recorded at cost, except for donated items, which are recorded at fair market value at the date of donation. Cost includes interest incurred on related indebtedness during periods of construction. The costs of routine maintenance and repairs are charged to expense as incurred.

Kaleida monitors its long-lived assets for impairment indicators on an ongoing basis. If impairment indicators exist, Kaleida performs the required analysis and records impairment charges. In conducting its analysis, Kaleida compares the undiscounted cash flows expected to be generated from the long-lived assets to the related net book values. If the undiscounted cash flows exceed the net book value, the long-lived assets are considered not to be impaired. If the net book value exceeds the undiscounted cash flows, an impairment loss is measured and recognized based on the fair value of the asset, less costs to sell, or discounted cash flows compared to book value.

Depreciation is generally computed under the straight line method using date of service for buildings, fixtures and improvements, and the half-year convention for moveable equipment over the estimated useful lives of the assets. The estimated useful lives of assets generally follow American Hospital Association guidelines: land improvements, 10 years; buildings, fixtures, and improvements, 10 to 40 years; and movable equipment, 3 to 15 years. Assets recorded as capital leases are amortized over the lease term of the asset or its useful life, if shorter. Lease amortization is included within depreciation and amortization expense.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(j) Deferred Financing Costs

Kaleida has capitalized various costs associated with obtaining long-term financing. These costs are being amortized over the terms of related obligations.

(k) Self-Insured Programs

Certain divisions of Kaleida are partially self-insured for medical malpractice, general liability, and workers' compensation costs, with excess liability policies for exposures in excess of self-insurance retentions. Trusts have been established for the purpose of setting aside assets. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust.

Kaleida is also self insured for employee health and pharmaceutical coverage. Kaleida has recorded a provision for estimated claims which is based on Kaleida's own experience and includes the estimated ultimate cost of reported claims and claims incurred but not yet reported. To reduce its risk for catastrophic health claims, Kaleida has purchased stop loss coverage.

(l) Donor Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations limiting the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions and included as a component of total operating revenue, if for operations, or as an addition to unrestricted net assets, if for capital purposes. Contributions whose restrictions lapse, expire, or are otherwise met in the same reporting period as the contribution was received are recorded as unrestricted support and included as additions to unrestricted net assets.

(m) Endowment Funds

Kaleida's permanently restricted net assets consist of individual endowment funds established by donors to support a variety of purposes.

Kaleida classifies as permanently restricted net assets (a) the original value of gifts donated to an endowment fund, (b) the original value of subsequent gifts to that fund, and (c) accumulations to the fund made in accordance with the direction, if any, of the applicable donor gift instrument at the time the accumulation is added to the fund. Expendable portions of endowment gifts restricted by donors to specific purposes and any retained income and appreciation thereon is included as a component of temporarily restricted net assets. When the temporary restrictions on these assets have been met, the assets are reclassified to unrestricted net assets pursuant to Kaleida's spending policy.

(n) Fair Value Measurement of Financial Instruments

Kaleida estimates fair value based on a valuation framework that uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy as defined by ASC 820, *Fair Value Measurements and Disclosures*, are described below:

Level 1: Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities.

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly and fair value is determined through the use of models or other valuation methodologies.

Level 3: Unobservable inputs that are supported by little or no market activity and require significant management judgment or estimation in the determination of fair value.

Kaleida applies the accounting provisions of Accounting Standards Update (ASU) 2009-12, *Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalents) (ASU 2009-12)*. ASU 2009-12 allows for the estimation of the fair value of investments in certain investment companies for which the investment does not have a readily determinable value by using net asset value (NAV) per share or its equivalent as a practical expedient.

The carrying values of accounts receivable, prepaid expenses and other current assets, accounts payable and other accrued expenses, accrued payroll and related expenses and line of credit are reasonable estimates of their fair value due to the short-term nature of these financial instruments. Kaleida's long-term debt instruments are carried at cost. The estimated fair value of Kaleida's long-term debt as of December 31, 2014 and 2013 is approximately $340.1 million and $343.3 million, respectively. The value of debt was estimated by a discounted cash flow analysis using current borrowing rates for similar types of arrangements and is considered a Level 2 financial liability for disclosure purposes. Judgment is required in certain circumstances to develop the estimates of fair value, and the estimates may not be indicative of the amounts that could be realized in a current market exchange.

(o) Income Taxes

Kaleida and substantially all of its affiliates have been determined by the Internal Revenue Service to be organizations described in Internal Revenue Code (the Code) Section 501(c)(3) and, therefore, are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Kaleida recognizes income tax positions when it is more-likely than-not that the position will be sustainable based on the merits of the position. Management has concluded that there are no material uncertain tax positions that need to be recorded.

(p) Excess (Deficiency) of Revenue over Expenses

Kaleida's primary mission is meeting the healthcare needs of the people in the regions in which it operates. Kaleida is committed to providing a broad range of general and specialized healthcare services, including inpatient acute care, long-term care, home care, outpatient services, and other healthcare related services.

The consolidated statements of operations and changes in net assets include a performance indicator, excess (deficiency) of revenue over expenses. Changes in unrestricted net assets which are excluded from the excess (deficiency) of revenue over expenses consistent with industry practice include contributions of long-lived assets, and pension and postretirement related changes other than net periodic cost.

For purposes of display, transactions deemed by management to be recurring, major or central to the provision of healthcare services, including unrestricted contributions and interest and dividends from funds designated for self-insurance programs and debt agreements, are reported as operating revenue and expenses in the determination of Kaleida's operating results. Investment trading activities and peripheral transactions (i.e. nonrecurring restructuring charges and gains and losses related to disposal of fixed assets) are reported as other income or losses.

(q) Electronic Health Record Incentive Payments

The Health Information Technology for Economic and Clinical Health (HITECH) Act included in the American Recovery and Reinvestment Act (ARRA) provides incentives for the adoption and use of health information technology by Medicare and Medicaid providers and eligible professionals through 2016. To receive such incentives, providers are required to establish an electronic health record system and maintain its meaningful use status for a continuous 90-day period in year one and for 365-days in subsequent years.

Kaleida records revenue related to this program when management is reasonably assured that Kaleida has complied with the requirements of the program and has attested to these compliance requirements (see note 15).

(r) Concentration of Credit Risk

Financial instruments that potentially subject Kaleida to concentrations of credit risk consist primarily of accounts receivable and certain investments. Investments, which include government obligations, equity securities, other alternative investments funds, and fixed income mutual funds, are not concentrated in any corporation or industry.

Kaleida receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Medicaid, and various

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commercial insurance plans. Kaleida has not historically incurred any significant concentrated credit losses in the normal course of business.

(s) Reclassifications

Certain amounts in the 2013 consolidated financial statements have been reclassified to conform to 2014 presentation.

(3) Uncompensated Care

(a) Charity Care

Kaleida accepts all patients regardless of their ability to pay. A patient's care may be classified as charity care in accordance with certain established policies of Kaleida. Essentially, these policies define charity services as those services for which no payment is anticipated.

Kaleida utilizes a presumptive charity scoring system in order to determine charity care eligibility. The system uses demographic and public financial information to qualify patient accounts for charity care. The change was made to enhance and accelerate the charity care qualification process. In addition, Kaleida makes and receives payments to and from a statewide pool to support the delivery of charity care to patients throughout New York. These net payments are reported as a component of patient service revenue in the consolidated financial statements.

Kaleida's net cost of charity care, including payments to and receipts from the statewide pool was approximately $8 million in 2014 and $11 million in 2013 as follows:

		Year ended December 31	
		2014	**2013**
		(Dollars in thousands)	
Charity care at cost	$	3,579	6,871
Payments to statewide pool		7,643	7,398
Receipts from statewide pool		(3,711)	(3,462)
Cost of charity care, net	$	7,511	10,807

The cost of charity care provided was determined based on the application of the ratio of Kaleida's overall cost to patient charges.

(b) Community Benefit

Kaleida offers numerous community benefit programs and services in community-based settings and in its campuses and facilities, in response to the needs of the communities it serves. They include community health fairs, health screenings, health education lectures and workshops for community groups and the general public, school health education programs, consumer health information, facilitated (insurance plan) enrollment services and clinical services such as city school-based health centers, outpatient clinics, adult and pediatric long-term care services, neonatal intensive care services and behavioral health services. Staff members of Kaleida also participate in community leadership efforts by donating significant hours of board service to other not-for-profit organizations. Kaleida supports graduate medical education and offers health professions education support for community members through continuing education programs and scholarships.

In addition, Kaleida serves the largest Medicaid and indigent patient population in Western New York whose healthcare service is only partially paid for by the Medicaid program. Kaleida provides service to Medicaid patients at reimbursement levels that are below the cost of care provided.

(4) Third-Party Reimbursement Agreements

Kaleida has agreements with third-party payors that provide for payments at amounts different from their established rates as follows:

(a) Inpatient Acute Care Services

Inpatient acute care services rendered are paid at prospectively determined rates per discharge in accordance with the Federal Prospective Payment System (PPS) for Medicare and generally at negotiated or otherwise pre-determined amounts under the provisions of the New York State All Patient Defined Diagnosis Related Groups (APR-DRGs) for Medicaid and other Non-Medicare payors. Inpatient nonacute services are paid at various rates under different arrangements with third-party payors, commercial insurance carriers, and health maintenance organizations. The basis for payment under these agreements includes prospectively determined per diem and per visit rates and fees, discounts from established charges, fee schedules, and reasonable cost subject to limitations. Medicare outpatient services are paid under a prospective payment system whereby services are reimbursed on a predetermined amount for each outpatient procedure, subject to various mandated modifications.

In addition, under New York State Public Health Law, all Non-Medicare payors are required to make surcharge payments for the subsidization of indigent care and other health care initiatives. The percentage amounts of the surcharge varies by payor and applies to a broader array of health care services. Also, certain payors are required to fund a pool for graduate medical education expenses through surcharges on payments to hospitals for inpatient services or through voluntary election to pay a covered lives assessment directly to the DOH.

(b) Skilled Nursing and Home Health Care Services

Net patient service revenue for skilled nursing services under the Medicaid program is based on a statewide pricing system using the Resource Utilization Group (RUGs) patient classification system. DOH calculates direct and indirect portions of Kaleida's rate by blending equally a statewide and a peer group component determined by DOH using 2007 filed cost report data as the base year for allowable costs. Capital and noncomparable costs are based on facility specific costs. Also, the direct portion of Kaleida's rate is adjusted twice annually for changes in the intensity of services provided to the nursing home residents. Medicare reimbursement for skilled nursing services are determined on a prospective payment system (PPS) basis. Under skilled nursing PPS, a single per diem rate is paid that covers all routine, ancillary, and capital related costs. The per diem payment is adjusted for each Medicare beneficiary, based on their care needs as measured by a patient assessment form.

Home health care services for Medicare are reimbursed under PPS which is based on a 60 day episode, case mix adjusted into one of the home health resource groups (HHRG). Adjustments exist for low and high utilization of services during a 60-day episode. Medicare will generally make an initial payment of 60% based on the submitted HHRG with the balance of the payment due at the end of the 60 day episode or at discharge, whichever occurs sooner. Effective May 1, 2012, Medicaid began reimbursing for certified home health care visits on a per episode basis similar to Medicare. For all other payors, the basis of payment includes prospectively determined per visit rates and fees, discount on charges, and fee schedules.

Kaleida is required to prepare and file various reports of actual and allowable costs annually. Provisions have been made in the consolidated financial statements for prior and current years' estimated final settlements. The difference between the amount provided and the actual final settlement is recorded as an adjustment to net patient service revenue as adjustments become known or as years are no longer subject to audits, reviews, and investigations. During 2014 and 2013, Kaleida recorded adjustments for estimated settlements with third-party payors, which resulted in increases to net patient service revenue of approximately $8.0 million and $17.0 million, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Kaleida receives regulatory inquiries and reviews in the normal course of business. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Kaleida believes it is in substantial compliance with all applicable laws and regulations.

As a result of the Affordable Care Act (ACA) federal healthcare reform legislation, substantial changes are taking place in the United States healthcare system. This legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursements of healthcare providers and the legal obligations of health insurers, providers, and employers. Many of these provisions are currently implemented with other provisions to be implemented. Kaleida Health recognizes those provisions impacting reimbursement as they become effective under the ACA. Kaleida Health also recognizes the potential consequences of the ACA on the healthcare industry and its impact on the delivery of healthcare services and is addressing these challenges as they arise.

(5) Self-Insurance Trusts and Estimated Self-Insurance Reserves

Kaleida is partially self-insured for medical malpractice, general liability, and workers' compensation costs, and excess liability policies are generally maintained for exposures in excess of self-insurance retentions. Trusts are established for the purpose of setting aside assets based on actuarial funding recommendations. Under the trust agreements, the trust assets can be used only for payment of losses, related expenses, and the costs of administering the trust. The estimated liability for both asserted and unasserted self-insurance claims for medical malpractice and general liability are discounted at 3.5% at December 31, 2014 and 2013, respectively. The estimated liability for self-insured workers' compensation is discounted at 3.0% at December 31, 2014 and 2013, respectively. Estimated self-insurance reserves are approximately $165.8 million and $163.8 million at December 31, 2014 and 2013, respectively. As of December 31, 2014 and 2013, $4.7 million and $4.6 million, respectively, is recoverable from Kaleida's excess liability policies. At December 31, 2014 and 2013, Kaleida has irrevocable secured letters of credit supporting the medical malpractice and workers compensation self-insurance programs totaling approximately $4.4 million and

(Continued)

$4.6 million, respectively. The annual fee for the letters of credit ranges between 75 and 85 basis points and they renew automatically unless the issuer notifies both parties in writing sixty days in advance. In addition, Kaleida has established additional security through collateral trust agreements on self-insured investments in the amount of $39.2 million and $34.9 million at December 31, 2014 and 2013, respectively.

At December 31, 2014 and 2013, there were various actions filed against Kaleida by former patients and others seeking compensatory and punitive damages.

Management believes current estimates for known and unknown claims reflected in the self-insurance accrual are adequate. If the ultimate costs differ from the estimates, such additional amounts will be accrued when known. Excess coverage retroactive to the date of Kaleida's formation has been obtained for incidents reported after December 31, 2000.

(6) Investments and Assets Limited as to Use

The components of investments and assets limited as to use, stated at fair value, at December 31 are summarized as follows:

	2014	2013
	(Dollars in thousands)	
Current investments:		
Cash and cash equivalents	$ 12,845	15,295
Equity and fixed income mutual funds	46,199	39,701
Equity securities	59,725	51,545
Other investments	52,791	50,984
	171,560	157,525
Assets limited as to use:		
Designated under debt agreements:		
Cash and cash equivalents	2,435	2,298
U.S. government obligations	35,718	33,886
	38,153	36,184
Designated under self-insurance programs:		
Cash and cash equivalents	47,340	46,369
U.S. government obligations	9	312
Equity and fixed income mutual funds	14,217	17,471
Equity securities	26,301	29,253
Other investments	27,207	31,156
	115,074	124,561

		2014	2013
		(Dollars in thousands)	
Board designated and donor restricted:			
Cash and cash equivalents	$	28,433	26,370
U.S. government obligations		259	259
Equity and fixed income mutual funds		20,787	18,204
Equity securities		34,889	32,100
Other investments		30,561	30,897
		114,929	107,830
Other:			
Cash and cash equivalents		1,946	2,046
		270,102	270,621
Total investments and assets limited as to use	$	441,662	428,146

The components of investment return include the following for the years ended December 31:

		2014	2013
		(Dollars in thousands)	
Other operating revenue:			
Interest and dividends	$	2,187	2,380
Other income:			
Investment income:			
Interest and dividends	$	4,549	4,727
Change in interests in other investments		2,513	1,463
	$	7,062	6,190
Net realized gains on sales of investments	$	5,266	2,656
Net change in unrealized gains and losses on investments		(2,361)	5,435

(7) Fair Value Measurements

The following is a description of the valuation methodologies used by Kaleida for its assets measured at fair value on a recurring basis:

Cash equivalents: Cash equivalents are valued at the NAV reported by the financial institution.

Equity and fixed income securities: Kaleida's equity and fixed income portfolios consist of direct investment in individual equity and fixed income securities and U.S. government obligations that are valued based on quoted market prices (Level 1 measurements). If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or, if necessary, matrix pricing from a third party pricing vendor to determine fair value (Level 2 measurements). Matrix prices are based on quoted prices for fixed income securities with similar coupons, ratings and maturities, rather than on specific bids and offers for a designated security.

In addition, Kaleida's equity and fixed income portfolios include investments in actively traded mutual funds valued at the closing price on the active market in which the individual funds are traded (Level 1 measurements) and pooled/commingled investment funds where Kaleida owns shares, units, or interests of pooled funds rather than the underlying securities in the fund. The pooled/commingled funds are measured at fair value based on the nature of the underlying investments, timing of the pricing of the fund's NAV and liquidity restrictions for the funds (Level 2 measurements).

Other investments: Other investments consist of private, domestic and global equities, real assets, fixed income, and hedge funds. Other investments are typically redeemable with the fund at NAV under the original terms of the partnership agreement and/or subscription agreements. The estimation of fair value of other investments for which the underlying securities do not have a readily determinable value is made using the NAV per share or its equivalent as a practical expedient. Kaleida owns interests in these funds rather than in securities or assets underlying each fund and, therefore, is generally required to consider such investments as Level 2 or Level 3, even though certain underlying securities may not be difficult to value or may be readily marketable.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although Kaleida believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. Also, because the use of NAV as a practical expedient to estimate fair value of certain investments, the level in the fair value hierarchy in which each fund's fair value measurement is classified is based primarily on Kaleida's ability to redeem its interest in the fund at or near the date of the consolidated balance sheet. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes are not necessarily an indication of the risk associated with investing in those investments.

The following tables present Kaleida's investments at December 31, 2014 and 2013 that are measured at fair value on a recurring basis as well as their redemption frequency and notification provisions. The financial assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurements (dollars in thousands):

	2014					
	Total	**Level 1**	**Level 2**	**Level 3**	**Redemption frequency**	**Days notice**
Investments:						
Cash and cash equivalents	$ 92,999	92,999	—	—	Daily	Same day
U.S. government obligations	35,986	—	35,986	—	Daily	Same day
Equity securities:						
Large-cap securities	67,920	55,503	12,417	—	Daily – monthly	Same day – 9 days
International securities	52,995	—	52,995	—	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	81,203	81,203	—	—	Daily	Same day
Other investments:						
Hedge funds	16,864	—	12,339	4,525	Monthly – see (a) below	20 days – See (a) below
Private equity	13,082	—	9,000	4,082	Quarterly – see (a) below	60 days – See (a) below
Global equity	48,075	—	48,075	—	Monthly	3 – 15 days
Domestic equity	29,932	—	16,853	13,079	Monthly – annually	30 – 60 days
Real assets	2,606	—	—	2,606	See (a) below	See (a) below
	$ 441,662	229,705	187,665	24,292		

	2013					
	Total	**Level 1**	**Level 2**	**Level 3**	**Redemption frequency**	**Days notice**
Investments:						
Cash and cash equivalents	$ 92,378	92,378	—	—	Daily	Same day
U.S. government obligations	34,457	—	34,457	—	Daily	Same day
Equity securities:						
Large-cap securities	63,338	53,417	9,921	—	Daily – monthly	Same day – 9 days
International securities	49,560	—	49,560	—	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	75,376	75,376	—	—	Daily	Same day
Other investments:						
Hedge funds	25,346	—	21,336	4,010	Monthly – see (a) below	20 days – See (a) below
Private equity	1,556	—	—	1,556	See (a) below	See (a) below
Global equity	52,841	—	52,841	—	Monthly	3 – 15 days
Domestic equity	30,201	—	17,217	12,984	Monthly – annually	30 – 60 days
Real assets	3,093	—	—	3,093	See (a) below	See (a) below
	$ 428,146	221,171	185,332	21,643		

(a) Certain investments include noncontrolling shares or interests in funds where the controlling general partner serves as the investment manager. Such shares are typically not eligible for redemption from the fund or general partner, but are typically sold to third party buyers in private transactions that typically can be completed in approximately 90 days. It is the intent of Kaleida to hold these investments until the fund has fully distributed all proceeds to the limited partners and the term of the partnership agreements expire.

Under the terms of certain agreements, Kaleida has committed to contribute a specified level of capital over a defined period of time. Through December 31, 2014, Kaleida has committed to contribute approximately $11.6 million to such investments, of which Kaleida has contributed approximately $10.3 million and has outstanding commitments of $1.3 million.

There were no significant transfers into or out of Level 1 and Level 2 fair value measurements during the years ended December 31, 2014 and 2013.

The following tables present additional information about the changes in Level 3 assets measured at fair value for the years ended December 31 (dollars in thousands):

	2014				
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**
Balance, beginning of year	$ 21,643	3,093	4,010	1,556	12,984
Purchases	8,672	33	4,191	2,948	1,500
Sales	(8,796)	(108)	(4,191)	(747)	(3,750)
Realized gains	5,933	43	191	423	5,276
Realized losses	(373)	(373)	—	—	—
Change in unrealized gains and losses	(2,787)	(82)	324	(98)	(2,931)
Balance, end of year	$ 24,292	2,606	4,525	4,082	13,079

	2013				
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**
Balance, beginning of year	$ 14,498	3,302	—	1,763	9,433
Purchases	4,210	210	4,000	—	—
Sales	(1,256)	(777)	—	(479)	—
Realized gains	416	44	—	372	—
Change in unrealized gains and losses	3,775	314	10	(100)	3,551
Balance, end of year	$ 21,643	3,093	4,010	1,556	12,984

Liquidity

The following presents the fair value of Kaleida's investments as of December 31 by redemption period:

		2014	2013
Investments redemption period:			
Daily	$	291,462	279,477
Semi – monthly		8,288	7,840
Monthly		107,370	108,743
Quarterly		10,250	10,442
Annual		13,079	12,984
Illiquid		11,213	8,660
Total	$	441,662	428,146

The limitation and restrictions on Kaleida's ability to redeem or sell these investments vary by investment and range from required notice periods for certain investments and hedge funds, to specified terms at inception. Based upon the terms and conditions in effect at December 31, 2014, redemption periods expire at various times through 2016.

(8) Property and Equipment

A summary of property and equipment at December 31 follows:

		2014	2013
		(Dollars in thousands)	
Land and land improvements	$	26,140	26,135
Buildings, fixtures, and improvements		810,801	804,178
Movable equipment		597,125	586,320
		1,434,066	1,416,633
Less accumulated depreciation and amortization		1,039,028	980,177
		395,038	436,456
Construction in progress		49,154	30,785
	$	444,192	467,241

During 2014, Kaleida began construction of the John R. Oishei Children's Hospital on the Buffalo Niagara Medical Campus. The hospital is being financed through mortgage proceeds (note 10), philanthropy, equipment financing, grant awards and hospital equity, and will be completed in late 2017. Total estimated cost for the project is approximately $266 million with commitments outstanding at December 31, 2014 of approximately $238 million.

Commitments outstanding at December 31, 2014, for routine capital projects totaled approximately $14.7 million.

Net property and equipment includes approximately $5.5 million and $8.1 million applicable to capital leases at Decembers 31, 2014 and 2013, respectively.

No interest expense was capitalized in 2014 and 2013.

(9) Other Assets

		2014	2013
		(Dollars in thousands)	
Long term pledges receivable, net (a)	$	18,407	1,930
Note receivable		5,000	5,000
Equity investments in joint ventures (b)		18,365	6,176
Other		413	413
	$	42,185	13,519

(a) Long term pledges receivable include donor contributions that are not expected to be collected within one year. These amounts are reported at their present value and consisted of the following at December 31:

		2014	2013
		(Dollars in thousands)	
Gross pledges receivable	$	18,688	2,073
Less discount and reserve		(281)	(143)
	$	18,407	1,930

Total pledges receivable, which includes $9.9 million of current pledges receivable included within other receivables on the consolidated balance sheet at December 31, 2014, are expected to be realized in the following periods:

		2014	2013
		(Dollars in thousands)	
Less than one year	$	10,617	773
One year to five years		16,630	1,007
More than five years		1,083	150
	$	28,330	1,930

(b) Investments in partnerships and joint ventures in which Kaleida owns more than 20% but less than 80% are accounted for using the equity method of accounting. Kaleida recognizes its proportionate share of income or loss from their partnership and joint venture investments in the current period and records this income or loss as an increase or decrease in the related investment.

(10) Long-Term Debt

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

	2014	2013
	(Dollars in thousands)	
Mortgage notes payable for GVI in monthly installments of $668,000, including interest at 6.35%, through February 1, 2037. (a)	$ 91,427	93,253
Mortgage notes payable for HighPointe SNF in monthly installments of $325,000, including interest at 5.73%, through February 1, 2037. (a)	48,990	50,058
Mortgage payable for BGMC in monthly installments of $545,000, including interest at 2.44% through August 1, 2023. (a)	51,067	56,295
Mortgage payable for MFH in monthly installments of $514,000, including interest at 3.29% through November 1, 2017 and $314,000, including interest at 3.29% through April 1, 2020. (a)	25,072	30,317
Mortgage notes payable for MFS in monthly installments of $338,000, including interest at 5.05%, through October 1, 2033. (a)	49,162	50,688
Mortgage notes payable for BGMC Cath Lab in monthly installments of $107,000, including interest at 5.05%, through February 1, 2032. (a)	14,784	15,312
Mortgage notes payable for John R. Oishei Children's Hospital with interest only payments at 4.18% through October 2017. Thereafter, monthly installments of $645,000, including interest at 4.18% through October 1, 2042. (a)	14,786	—
Capital lease obligations, less imputed interest of $766,673 and $137,709 at December 31, 2014 and 2013, respectively. (b)	7,026	4,702
Equipment notes payable (c)	4,419	6,683
Other	2,239	3,398
	308,972	310,706
Less current maturities	20,835	20,566
	$ 288,137	290,140

(a) Mortgages Payable

The mortgages payable, which are insured by the U.S. Department of Housing and Urban Development (HUD), are secured by essentially all assets of the respective borrowing entities.

On December 4, 2009, Kaleida secured a loan commitment of approximately $100.3 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment were used to finance the cost of constructing and equipping the Gates Vascular Institute (GVI). The mortgage note has a 25 year term, fixed monthly payments and an annual interest rate of 6.35%.

On December 7, 2010, Kaleida secured a loan commitment of approximately $51.9 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment were used to finance the cost of constructing and equipping Highpointe SNF. The mortgage note has a 25 year term, fixed monthly payments and an annual interest rate of 5.73%.

On September 19, 2012, Kaleida refinanced the existing mortgage of $62.2 million maturing in August 2023 related to improvements made to the Buffalo General Medical Center. Although the principal amount refinanced and mortgage term remained the same, the interest rate and monthly payment were modified.

On December 9, 2014, Kaleida secured a loan commitment of approximately $120 million by entering into a new mortgage note and building loan agreement. The proceeds from the loan commitment will be used to finance the cost of the construction of a children's hospital (John R. Oishei Children's Hospital) adjacent to the Buffalo General Medical Center. The facility will replace the Women and Children's Hospital of Buffalo currently located on Bryant Street. The mortgage note, when fully drawn, will have a 25 year term, fixed monthly payments and an annual interest rate of 4.18%. The mortgage note is insured by HUD. At December 31, 2014, Kaleida has drawn $14.8 million for costs related to the John R. Oishei Children's Hospital project.

Kaleida has entered into Regulatory Agreements with HUD, which set forth certain provisions and requirements. Among these requirements are certain performance indicators, financial ratios, and reporting requirements. Also among these requirements is the funding of a Mortgage Reserve Fund (Mortgage Reserve) as established by the Mortgage Reserve Fund Agreement, dated May 20, 2004, as amended September 21, 2006, December 4, 2009, December 7, 2010, September 19, 2012 and December 9, 2014. As required under the Mortgage Reserve Fund Agreement, Kaleida is required to maintain a certain balance either through deposits or investment earnings. Failure to comply with these requirements may result in oversight activities by HUD. At December 31, 2014 and 2013, Kaleida was in compliance with all applicable debt agreement provisions.

Under the terms of the borrowing agreements, Kaleida established certain bank trustee accounts which include the Mortgage Reserve Fund. Included in the accompanying consolidated financial statements, classified as assets limited as to use, is Kaleida's balance in this fund at December 31 as follows:

	2014	**2013**
	(Dollars in thousands)	
Mortgage reserve fund	$ 38,153	36,184

(b) Capital Leases

The majority of the capital lease obligations represent arrangements entered into with a bank to finance acquisitions of various pieces of equipment. These arrangements are either administered by the Dormitory Authority of the State of New York (DASNY) as part of their Tax-Exempt Leasing Program (TELP) or by the private banking institution.

(c) Equipment Notes Payable

In March 2010, Kaleida Health entered into an equipment financing agreement with High Street Developments, LLC. The maximum aggregate principal amount of credit that can be extended under the agreement is $10 million. There was approximately $4.4 million and $6.7 million of borrowings on the financing agreement at December 31, 2014 and 2013, respectively, which represents two 5 year notes which bear interest at approximately 1.3% payable monthly through October 2016.

Future annual principal payments of long-term debt for the next five years as of December 31, 2014 are as follows (dollars in thousands):

2015	$	20,835
2016		21,008
2017		18,616
2018		16,304
2019		16,815

Line of Credit

In October 2009, Kaleida entered into a Revolving Credit Loan Agreement (Loan Agreement) with a financial institution. The Loan Agreement, which was renewed in October 2013 for a two year term, requires Kaleida to payoff the outstanding balance annually for a period of twenty business days. The maximum aggregate principal amount of credit that can be extended under the Loan Agreement is $20 million. Interest is payable monthly and is calculated at the greater of the one day LIBOR rate plus a margin of 2.25% or the one month LIBOR rate plus a margin of 2.25%. Kaleida also pays monthly an unused facility fee equal to 20 basis points per year on the average unused daily balance. DASNY and HUD agreed to subordinate their security interest in the first $30 million worth of patient accounts receivable to the bank as collateral for borrowings on the Loan Agreement. No borrowings were outstanding at December 31, 2014 and 2013.

(11) Lease Commitments

Kaleida leases various equipment and facilities under noncancelable operating leases expiring at various dates in the future. Rental expense for all operating leases was approximately $29.7 million and $26.5 million in 2014 and 2013, respectively. Future minimum payments under noncancelable operating leases as of December 31, 2014 having lease terms in excess of one year are as follows (dollars in thousands):

2015	$	19,083
2016		15,686
2017		14,900
2018		14,794
2019		13,516

(12) Pension and Other Postretirement Benefits

(a) Pension Plans

Defined Benefit Plan – Kaleida sponsors a defined benefit plan (the Plan) covering substantially all of its eligible employees. The Plan provides benefits based upon years of service and the employee's compensation. Kaleida's funding policy is to contribute amounts required by the Employee Retirement Income Security Act (ERISA). The amount to be funded is subject to annual review by management and Kaleida's consulting actuary.

The following table sets forth the defined benefit pension plan's projected benefit obligation and fair value of plan assets at December 31:

		2014	2013
		(Dollars in thousands)	
Change in projected benefit obligation:			
Benefit obligation at beginning of year	$	656,272	694,042
Service cost		24,730	27,112
Interest cost		32,920	29,414
Actuarial losses (gains)		78,767	(72,352)
Benefits paid		(22,267)	(21,944)
Benefit obligation at end of year	$	770,422	656,272
Change in plan assets:			
Fair value of plan assets at beginning of year	$	466,425	431,341
Actual return on plan assets		20,956	31,027
Employer contributions		35,100	26,001
Benefits paid		(22,267)	(21,944)
Fair value of assets at end of year	$	500,214	466,425

The funded status of the plan and amounts recognized in the consolidated balance sheets at December 31, are as follows:

		2014	2013
		(Dollars in thousands)	
Funded status at end of year:			
Fair value of plan assets	$	500,214	466,425
Projected benefit obligation		770,422	656,272
Pension obligation recognized in the consolidated balance sheets at end of year	$	(270,208)	(189,847)
Amount recorded in unrestricted net assets at end of year for future pension cost:			
Net actuarial loss	$	(267,376)	(177,544)
Prior service costs		(541)	(795)
	$	(267,917)	(178,339)

The estimated prior service cost and net actuarial loss that will be amortized from unrestricted net assets in 2014 as a component of net periodic pension cost are approximately $255,000 and $9.7 million, respectively.

The accumulated benefit obligations at the Plan's measurement date for 2014 and 2013 was approximately $709 million and $593 million, respectively.

The components of net periodic pension cost for the years ended December 31 is as follows:

		2014	2013
		(Dollars in thousands)	
Service cost	$	24,730	27,112
Interest cost		32,920	29,414
Expected return on plan assets		(41,674)	(36,830)
Amortization of net prior service cost		255	265
Amortization of actuarial loss		9,652	17,884
Net periodic pension cost	$	25,883	37,845

The weighted average assumptions used to determine pension cost and benefit obligations at the Plan's measurement date (December 31):

	2014	2013
Discount rate for benefit obligations	4.20%	5.10%
Discount rate for net pension cost	5.10	4.30
Rate of compensation increase for benefit obligations	3.00	4.00
Rate of compensation increase for net pension cost	4.00	4.00
Expected long-term rate of return on plan assets	8.50	8.50

The investment policy specifies the type of investment vehicles appropriate for the plan, asset allocation guidelines, criteria for selection of investment managers, procedures to maintain overall investment performance, as well as investment manager performance. The expected long-term rate of return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of returns expected to be available for reinvestment. Rates of return were evaluated based on current capital market assumptions and investment allocations.

The range of target investment allocation percentages at December 31, 2014 are listed below:

Cash	0 – 5%
Equity securities:	
Domestic	0 – 10%
International	5 – 16%
Fixed income securities:	
Diversified bonds	4 – 20%
High yield	0 – 8%
Emerging market	0 – 8%
Other:	
Global asset	10 – 22%
Risk parity	9 – 21%
Hedge funds	0 – 18%
Private equity	0 – 22%
Real assets	4 – 16%
Opportunistic funds	0 – 12%

(Continued)

The following tables present Kaleida's defined benefit pension plan's assets at December 31, 2014 and 2013 that are measured at fair value on a recurring basis. The hierarchy and inputs to valuation techniques to measure fair value of the plan's assets are the same as outlined above in note 7 of the consolidated financial statements (dollars in thousands):

	2014					
	Total	**Level 1**	**Level 2**	**Level 3**	**Redemption frequency**	**Days Notice**
Investments:						
Cash and cash equivalents	$ 11,807	11,807	—	—	Daily	Same day
Insurance contract	2,598	—	2,598	—	Daily	Same day
Equity securities:						
Large-cap securities	30,393	20,275	10,118	—	Daily – monthly	Same day – 9 days
International securities	81,926	—	81,926	—	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	105,024	105,024	—	—	Daily	Same day
Other investments:						
Hedge funds	60,136	—	47,938	12,198	Monthly – See note 7(a)	20 days – See note 7(a)
Private equity	82,342	—	14,000	68,342	Quarterly - See note 7(a)	60 days - See note 7(a)
Global equity	75,079	—	75,079	—	Monthly	3 – 15 days
Domestic equity	31,532	—	19,601	11,931	Monthly – annually	30 – 60 days
Real assets	14,142	—	—	14,142	See note 7(a)	See note 7(a)
Fixed income	5,235	—	—	5,235	Annually	180 days
	$ 500,214	137,106	251,260	111,848		

	2013					
	Total	**Level 1**	**Level 2**	**Level 3**	**Redemption frequency**	**Days Notice**
Investments:						
Cash and cash equivalents	$ 15,481	15,481	—	—	Daily	Same day
Insurance contract	2,968	—	2,968	—	Daily	Same day
Equity securities:						
Large-cap securities	36,033	27,271	8,762	—	Daily – monthly	Same day – 9 days
International securities	80,700	—	80,700	—	Daily – monthly	2 – 30 days
Equity and fixed income mutual funds	80,978	80,978	—	—	Daily	Same day
Other investments:						
Hedge funds	78,883	—	68,807	10,076	Monthly – See note 7(a)	20 days – See note 7(a)
Private equity	42,553	—	—	42,553	See note 7(a)	See note 7(a)
Global equity	74,675	—	74,675	—	Monthly	3 – 15 days
Domestic equity	29,533	—	19,306	10,227	Monthly – annually	30 – 60 days
Real assets	16,023	—	—	16,023	See note 7(a)	See note 7(a)
Fixed income	8,598	—	—	8,598	Annually	180 days
	$ 466,425	123,730	255,218	87,477		

The insurance contract held within Kaleida's defined benefit plan is recorded at contract value which approximates fair value.

Under the terms of certain agreements, Kaleida has committed to contribute a specified level of capital over a defined period of time. Through December 31, 2014, Kaleida has committed to contribute approximately $166.7 million to such investments, of which Kaleida has contributed approximately $111.3 million and has outstanding commitments of $55.4 million.

The following tables present additional information about the changes in Level 3 assets measured at fair value for the years ended December 31 follows (dollars in thousands):

	2014					
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**	**Fixed income**
Balance, beginning of year	$ 87,477	16,023	10,076	42,553	10,227	8,598
Purchases	53,299	994	12,015	38,940	—	1,350
Sales	(38,019)	(3,148)	(10,950)	(18,859)	—	(5,062)
Realized gains	11,584	1,042	198	5,706	3,984	654
Realized losses	—	—	—	—	—	—
Change in unrealized gains and losses	(2,493)	(769)	859	2	(2,280)	(305)
Balance, end of year	$ 111,848	14,142	12,198	68,342	11,931	5,235

	2013					
	Total	**Real assets**	**Hedge funds**	**Private equity**	**Domestic equity**	**Fixed income**
Balance, beginning of year	$ 63,162	15,363	—	36,312	7,219	4,268
Purchases	32,679	2,413	10,051	16,615	—	3,600
Sales	(17,897)	(3,637)	—	(14,260)	—	—
Realized gains	5,543	823	—	4,720	—	—
Realized losses	—	—	—	—	—	—
Change in unrealized gains and losses	3,990	1,061	25	(834)	3,008	730
Balance, end of year	$ 87,477	16,023	10,076	42,553	10,227	8,598

Contributions – For the plan year ended December 31, 2014, Kaleida has contributed $35.1 million. Expected contributions for the plan year ending December 31, 2014 will be made at a level recommended by Kaleida's consulting actuary and in accordance with ERISA funding requirements.

Estimated Future Benefit Payments – The following benefit payments, which reflect expected future service, are as follows for the Plan (dollars in thousands):

2015	$	23,770
2016		25,654
2017		28,072
2018		30,903
2019–2023		245,549

The expected benefits are based on the same assumptions used to measure Kaleida's benefit obligations at December 31, 2014 and include future employee service.

Other Pension Benefit Plans – In addition, Kaleida contributes to a multi-employer defined benefit pension plan as required by union contracts from which benefits are paid to certain union employees. Additionally, Kaleida provides an employer-matched Tax Sheltered Annuity program (403(b) Plan) for nonunion employees. Total expense under these plans was approximately $2.7 million and $2.6 million for 2014 and 2013, respectively.

(b) Retiree Health and Life Insurance Plan

Kaleida also maintains a contributory retiree health and life insurance plan covering only certain eligible employees of DeGraff Memorial Hospital (DeGraff). The following table sets forth the funded status and amounts recognized in the consolidated balance sheets at December 31:

		2014	2013
		(Dollars in thousands)	
Accumulated postretirement obligation at end of year	$	8,162	4,280
Fair value of plan assets at end of year		—	—
Postretirement obligation recognized at end of year included as a component of pension and postretirement obligations	$	(8,162)	(4,280)

Net postretirement benefit cost was approximately $56,000 and $38,000 for the years ended December 31, 2014 and 2013, respectively. The weighted average assumptions used to determine postretirement benefit cost and obligations at the Plan's measurement date (December 31):

	2014	2013
Discount rate for benefit obligations	3.80%	4.70%
Discount rate for net postretirement cost	4.70	3.80

For measurement purposes, 2014 increases in the per capita cost of covered health care benefits were assumed for medical and prescription drugs at 7.22%. The rate is assumed to decrease gradually on an annual basis. A one-percentage point change in assumed healthcare cost trend rates would not have a material impact on the future cost or benefit obligation.

(c) Collective Bargaining Agreements

A significant portion of Kaleida employees work under collective bargaining agreements which were renegotiated in 2014. The new agreements have a duration of three years and will expire in May 2016.

(13) Asset Retirement Obligations

Kaleida has asset retirement obligations (AROs) to perform certain asset retirement activities in the event they renovate or demolish buildings in the future. The liability was initially measured at fair value and subsequently is adjusted for accretion expense and changes in the amount or timing of the estimated cash flows. The following table presents the activity for the AROs for the years ended December 31:

		2014	2013
		(Dollars in thousands)	
Balance at beginning of year	$	11,714	13,621
Net obligations settled in current period		(64)	(2,807)
Accretion expense		675	900
Balance at end of year	$	12,325	11,714

(14) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at December 31 are available for the following purposes:

		2014	2013
		(Dollars in thousands)	
Capital expansion and improvements	$	47,908	10,053
Advancement of medical education and research and healthcare services		73,816	70,943
	$	121,724	80,996

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

	2014	2013
	(Dollars in thousands)	
Funds to be held in perpetuity, the income from which is expendable to support healthcare services, including medical research	$ 10,824	10,824
Funds to be held in perpetuity, the income from which is expendable to support pediatric healthcare services	4,656	4,576
	$ 15,480	15,400

In 2014 and 2013, net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes of operating expenses of approximately $4.9 million and $5.2 million, respectively, and capital expenditures of $1.3 million and $0.6 million, respectively.

(Continued)

(15) Other Operating Revenue

Components of other operating revenue for the years ended December 31 are as follows:

		2014	2013
		(Dollars in thousands)	
Grant revenue	$	9,999	9,321
Unrestricted contributions		2,576	3,026
Rental revenue		3,620	3,431
Rebate and other miscellaneous revenue		3,504	4,363
Pharmaceutical discount program revenue		13,710	11,365
HITECH incentive funds (a)		2,444	3,508
	$	35,853	35,014

(a) HITECH Incentive Funds

During the years ended December 31, 2013 and 2014, Kaleida attested to Medicare and Medicaid that it met the required elements meaningful use and therefore qualified to receive incentive funds under the HITECH Act for Medicare and Medicaid. The amount due from Medicare and Medicaid is recorded in other accounts receivable in the consolidated balance sheets.

(16) Functional Expenses

Kaleida provides general healthcare services to residents within its geographic location. Expenses related to these services are as follows for the years ended December 31:

		2014	2013
		(Dollars in thousands)	
Healthcare services	$	1,147,054	1,150,850
General and administrative		126,743	128,753
	$	1,273,797	1,279,603