ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Financial Statements
and Supplementary Schedules

December 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

ST. CHARLES HEALTH SYSTEM, INC.

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KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
St. Charles Health System, Inc.:

We have audited the accompanying consolidated financial statements of St. Charles Health System, Inc., which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, 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 auditors consider 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 St. Charles Health System, Inc. as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information included in schedules I and II is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Portland, Oregon
March 29, 2016

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2015 and 2014

Assets		2015	2014
Current assets:			
Cash and cash equivalents	$	55,796,000	28,082,000
Assets limited as to use, current portion		2,222,000	7,795,000
Patient accounts receivable, net of reserves for uncollectible accounts of $25,388,000 and $26,390,000 at December 31, 2015 and 2014, respectively		87,234,000	87,165,000
Other receivables, net		17,989,000	20,152,000
Supplies inventory		11,464,000	10,175,000
Prepaid expenses and other current assets		10,551,000	9,342,000
Total current assets		185,256,000	162,711,000
Assets limited as to use, net of current portion		369,808,000	395,830,000
Property and equipment, net		287,986,000	261,695,000
Other assets		7,687,000	9,380,000
Total assets	$	850,737,000	829,616,000
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	26,592,000	29,192,000
Accrued liabilities		50,696,000	50,960,000
Estimated third-party payor settlements payable, net		1,011,000	110,000
Deferred revenue		155,000	611,000
Current portion of long-term obligations		1,850,000	12,386,000
Total current liabilities		80,304,000	93,259,000
Long-term obligations, net of current portion		228,097,000	217,309,000
Other liabilities		11,903,000	10,628,000
Total liabilities		320,304,000	321,196,000
Net assets:			
Unrestricted, SCHS		520,042,000	499,004,000
Unrestricted, noncontrolling interests		4,664,000	4,528,000
Temporarily restricted		4,222,000	3,387,000
Permanently restricted		1,505,000	1,501,000
Total net assets		530,433,000	508,420,000
Total liabilities and net assets	$	850,737,000	829,616,000

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Operations

Years ended December 31, 2015 and 2014

	2015	2014
Operating revenues:		
Net patient service revenue prior to provision for bad debts	$ 593,218,000	560,772,000
Provision for bad debts	7,192,000	13,865,000
Net patient service revenue	586,026,000	546,907,000
Premium revenue	67,577,000	46,388,000
Other revenue	37,246,000	27,112,000
Total operating revenues	690,849,000	620,407,000
Expenses:		
Salaries and wages	277,083,000	250,370,000
Employee benefits	78,642,000	73,254,000
Professional fees and assessments	54,916,000	46,147,000
Depreciation and amortization	29,877,000	26,482,000
Interest	8,530,000	11,295,000
Medical supplies, drugs, and other	189,733,000	174,561,000
Total expenses	638,781,000	582,109,000
Excess of revenues over expenses from operations	52,068,000	38,298,000
Other income:		
Investment income, net	303,000	25,335,000
Loss on extinguishment of 2008 Bonds	(24,515,000)	—
Other, net	133,000	2,932,000
Total other (loss) income, net	(24,079,000)	28,267,000
Excess of revenue over expenses	27,989,000	66,565,000
Net assets released from restriction for capital	833,000	3,983,000
Capital contributions	268,000	1,014,000
Other transfers	(1,639,000)	(702,000)
Distributions	(6,277,000)	(6,203,000)
Increase in unrestricted net assets	$ 21,174,000	64,657,000

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Changes in Net Assets

Years ended December 31, 2015 and 2014

	Unrestricted – SCHS	Unrestricted noncontrolling interests	Temporarily restricted	Permanently restricted	Total
Net assets at December 31, 2013	$ 434,560,000	4,315,000	6,556,000	1,483,000	446,914,000
Excess of revenue over expenses	61,163,000	5,402,000	—	—	66,565,000
Restricted contributions	—	—	1,146,000	25,000	1,171,000
Net assets released from restriction	3,983,000	—	(5,110,000)	—	(1,127,000)
Other transfers	(719,000)	—	719,000	—	—
Distributions	—	(6,203,000)	—	—	(6,203,000)
Capital contributions	—	1,014,000	—	—	1,014,000
Other changes in net assets	17,000	—	76,000	(7,000)	86,000
Change in net assets	64,444,000	213,000	(3,169,000)	18,000	61,506,000
Net assets at December 31, 2014	499,004,000	4,528,000	3,387,000	1,501,000	508,420,000
Excess of revenue over expenses	21,567,000	6,422,000	—	—	27,989,000
Restricted contributions	—	—	835,000	—	835,000
Net assets released from restriction	833,000	—	(1,615,000)	—	(782,000)
Other transfers	(308,000)	—	258,000	50,000	—
Distributions	—	(6,277,000)	—	—	(6,277,000)
Capital contributions	268,000	—	—	—	268,000
Other changes in net assets	(1,322,000)	(9,000)	1,357,000	(46,000)	(20,000)
Change in net assets	21,038,000	136,000	835,000	4,000	22,013,000
Net assets at December 31, 2015	$ 520,042,000	4,664,000	4,222,000	1,505,000	530,433,000

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2015 and 2014

		2015	2014
Cash flows from operating activities:			
Increase in net assets	$	22,013,000	61,506,000
Adjustments to reconcile increase in net assets to net cash provided by operating activities:			
Depreciation and amortization		29,877,000	26,482,000
Net loss (gain) on investments		10,490,000	(13,384,000)
Loss (gain) on sale of property and equipment		257,000	(109,000)
Amortization and accretion of debt obligation		1,554,000	306,000
Loss from extinguishment of debt		24,515,000	—
Restricted contributions		(835,000)	(1,171,000)
Distributions to noncontrolling owners		6,277,000	6,203,000
Changes in certain operating assets and liabilities:			
Patient accounts receivable		(69,000)	2,054,000
Other receivables, net		2,163,000	(4,399,000)
Supplies inventory		(1,289,000)	130,000
Other assets		(2,814,000)	(4,296,000)
Accounts payable		(1,741,000)	1,351,000
Accrued liabilities		(264,000)	9,978,000
Estimated third-party payor settlements payable, net		901,000	(5,357,000)
Deferred revenue		(456,000)	245,000
Other liabilities		1,275,000	2,338,000
Net cash provided by operating activities		91,854,000	81,877,000
Cash flows from investing activities:			
Purchases of investments		(62,197,000)	(121,659,000)
Proceeds from sales and maturities of investments		83,302,000	47,856,000
Distributions received from joint ventures		4,632,000	5,203,000
Investment in joint ventures		(1,334,000)	—
Proceeds from sale of property and equipment		163,000	394,000
Purchases of property and equipment		(57,447,000)	(61,406,000)
Net cash used in investing activities		(32,881,000)	(129,612,000)
Cash flows from financing activities:			
Payments on long-term obligations		(138,383,000)	(3,591,000)
Proceeds from issuance of long-term obligations		112,566,000	75,000,000
Proceeds from restricted contributions		835,000	1,171,000
Distributions paid to noncontrolling owners		(6,277,000)	(6,203,000)
Net cash (used in) provided by financing activities		(31,259,000)	66,377,000
Net increase in cash and cash equivalents		27,714,000	18,642,000
Cash and cash equivalents at beginning of year		28,082,000	9,440,000
Cash and cash equivalents at end of year	$	55,796,000	28,082,000
Supplemental disclosures:			
Cash paid for interest, net of amounts capitalized	$	12,558,000	11,209,000
Noncash change in property and equipment in accounts payable		(859,000)	3,214,000

See accompanying notes to consolidated financial statements.

(1) Business, Organization, and Summary of Significant Accounting Policies

(a) Business and Organization

St. Charles Health System, Inc. (SCHS or the Corporation) is an Oregon nonprofit corporation that operates a healthcare delivery system, which includes four hospitals in Central Oregon: St. Charles Bend, St. Charles Redmond, St. Charles Madras, and St. Charles Prineville, as well as several other lines of healthcare-related businesses. SCHS provides healthcare and healthcare-related services primarily to residents in Central, Southeastern, and Eastern Oregon. The Corporation contributes actuarially determined amounts to a self-insurance trust (the Trust) established to fund estimated ultimate losses related to professional and liability claims. SCHS is also the sole member of St. Charles Management Services Organization LLC (SCMSO), a limited liability company that previously provided billing services to physicians and medical clinics, but currently has no active business operations. These healthcare businesses and subsidiaries, along with the Corporation's home office, form the obligated group. The assets of any one are available for the satisfaction of debts of the others within the obligated group (subject to certain contractual limitations).

The St. Charles Foundation, Inc. (SCF), an Oregon nonprofit corporation, was established to engage in and conduct charitable, educational, and scientific activities and to raise funds in support of SCHS. The Corporation is the sole member of SCF, and SCF is included in the consolidated financial statements of SCHS but is not a member of the obligated group. The net assets of SCF are reported as unrestricted, temporarily restricted, or permanently restricted, according to donor or legal restrictions, in the accompanying consolidated financial statements.

SCHS also has a controlling interest in Cascade Medical Imaging, LLC (CMI). CMI is a limited liability corporation whose two members are SCHS (70% ownership interest) and Central Oregon Radiology Associates, P.C. (CORA) (30% ownership interest). CMI provides positron emission tomography (PET) scanning, computer-assisted tomography (CT) scanning, nuclear medicine, mammography, and picture archiving and communications system (PACS) services in Central, Southeastern, and Eastern Oregon. CMI has been consolidated into the financial statements of SCHS but is not part of the obligated group.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts and transactions of SCHS, the Trust, SCMSO, SCF, and CMI. All material intercompany accounts and transactions have been eliminated in consolidation.

(c) Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue, income, gains, expenses, and losses during the reporting period. Actual results could differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, third-party payor settlement liabilities, valuation of investments, and liabilities related to self-insurance programs.

(d) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and bank deposit money market accounts. Amounts held in demand bank accounts are often in excess of Federal Deposit Insurance Corporation (FDIC) coverage levels.

(e) Assets Limited as to Use

Assets limited as to use primarily consist of assets internally designated for future capital acquisitions and operating purposes (over which SCHS retains control and may, at its discretion, subsequently use for other purposes), assets held by a trustee under bond indenture agreements, and temporarily and permanently restricted funds held by SCF. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices in the accompanying consolidated financial statements.

The investment in the Oregon Community Foundation (OCF) represents a beneficial interest in a recipient organization. The investments are used solely to support the endowments of SCHS, and are recorded as a beneficial interest by SCHS in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-20, *Not-for-Profit Entities - Financially Interrelated Entities*, regarding financially interrelated not-for-profit entities. The investments, which represent an endowment fund that is legally owned by the OCF, primarily include equity securities and fixed-income investments. SCHS' investment in the OCF is recorded based on its initial contribution to the OCF, adjusted for changes in the value of the investment portfolio using a method that is similar to the equity method of accounting for investments in common stock. All earnings of the investments held by the OCF, less investment management fees charged by the OCF, are allocated by OCF and are recorded by SCHS as investment earnings in the consolidated statements of operations, within the appropriate category of net assets based on related donor restrictions. Earnings consist of interest, dividends, realized gains and losses, and changes in unrealized gains and losses. Funds held by OCF may be distributed once per quarter, subject to approval by the OCF board of directors.

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 of SCHS's investments. Furthermore, while SCHS believes that 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.

Investment income or loss (including interest, dividends, realized gains and losses, and unrealized gains and losses) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law.

Trading securities are debt and equity securities that are bought and held principally for the purpose of selling them in the near term. The Corporation classifies all of it investments in internally designated assets as trading securities, based on the nature of trading activity in its portfolio by the Corporation's investment manager.

As of December 31, 2015, the Corporation had investments in equity and fixed-income mutual funds, corporate obligations, cash surrender value of life insurance, and an interest in the OCF. Management believes that the Corporation's credit risk with respect to these investments is minimal due to the diversity of the individual investments and the financial strength of the entities, which have issued the securities or instruments. However, due to changes in economic conditions, interest rates, and common stock prices, the fair value of the Corporation's investments can be volatile. Consequently, the fair value of the Corporation's investments can significantly change in the near term as a result of such volatility.

(f) Patient Accounts Receivable, Allowance for Doubtful Accounts, and Other Receivables

The collection of receivables from third-party payors and patients is SCHS' primary source of cash and is critical to its operating performance. When SCHS provides care to patients, it does not require collateral; however, it maintains an estimated allowance for doubtful accounts. Additionally, SCHS adjusts accounts receivable balances to estimated collectible balances based on the terms of contracts in place with third-party payors. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (generally, deductibles and copayments) remain outstanding. The allowance for doubtful accounts is estimated based upon SCHS' historical collection experience, the age of the patient's account, management's estimate of the patient's economic ability to pay, and the effectiveness of collection efforts. Patient accounts receivable balances are routinely reviewed in conjunction with historical collection rates and other economic conditions that might ultimately affect the collectability of patient accounts when considering the adequacy of the amounts recorded in the allowance for doubtful accounts. Actual write-offs have historically been within management's expectations. Significant changes in payor mix, business office operations, economic conditions, or trends in federal and state governmental healthcare coverage could affect SCHS' collection of patient accounts receivable, cash flows, and results of operations.

SCHS' write-offs of accounts receivable for which patients have financial responsibility were $7,931,000 and $10,779,000 in fiscal 2015 and 2014, respectively. Total bad debt expense, which is a reduction in deriving net patient service revenue, for the years ended December 31, 2015 and 2014 was $7,192,000 and $13,865,000, respectively. The Corporation also maintains an allowance for doubtful accounts for third-party payors, which has been determined based on historical bad debt expense on those account types.

Significant concentrations of net patient service revenue prior to bad debt expense, excluding premium revenue, for the years ended December 31, 2015 and 2014 were approximately as follows:

	2015	**2014**
Medicare and Medicare managed care contracts	39%	38%
Medicaid and Oregon Health Plan (OHP), excluding premium revenue	10%	10%
Commercial and managed care insurance	50%	51%
Self-pay	1%	1%
	100%	100%

(g) Supplies Inventory

Supplies inventory is recorded at the lower of cost (first-in, first-out method) or market.

(h) Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated property and equipment items are recorded on the basis of estimated fair value at the date of donation. Improvements and replacements of property and equipment are capitalized. Maintenance and repairs are charged to expense as incurred.

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Assets under capital lease obligations are amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation expense in the accompanying consolidated financial statements. Net interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Estimated useful lives are as follows:

Land improvements	5–25 years
Buildings and fixed equipment	5–40 years
Furniture and moveable equipment	3–20 years

Contributions of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports expirations of donor restrictions as support when the donated or acquired long-lived assets are placed in service.

(i) Long-Lived Assets

Management reviews property and equipment and other long-term assets, as appropriate, for possible impairment whenever events or circumstances indicate the carrying amount of such assets may not be recoverable. If there is an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over the remaining lives.

(j) Contributions and Grants

Unrestricted donations and grants are recorded as other operating revenue. Donor-restricted contributions and grants are recorded as additions to the appropriate class of restricted net assets. When capital expenditures are made consistent with the purpose intended by the donor, a transfer is made from temporarily restricted net assets to unrestricted net assets. If restricted amounts are expended for operations, the amounts are recorded as other revenues in the accompanying consolidated statements of operations.

(k) Other Assets

Other assets include SCHS' investments in various related entities, which are not consolidated. SCHS consolidates such investees if it owns a majority of the investee's stock, is the sole member of the investee, or controls a majority voting interest in the investee's board of directors and has an economic interest in such investee. If SCHS owns 50% or less of the voting stock of an investee and can exercise significant influence over the investee's operating and financial policies (generally presumed to be when SCHS owns more than 20% of the voting stock of the investee), SCHS accounts for such investments under the equity method of accounting, whereby SCHS records its proportionate share of the investee's income or loss in the consolidated statements of operations and records distributions received from the investee as a reduction in the related investment balance. If SCHS cannot exercise significant influence over the investee's operating and financial policies (generally presumed to be when SCHS owns less than 20% of the voting stock of the investee), SCHS accounts for such investments at cost and records dividends or distributions from the investee as other income when received.

(l) Unamortized Bond Discount

Unamortized bond discount, a component of long-term obligations, is amortized to interest expense over the term of the related bonds using the effective-interest method.

(m) Net Patient Service Revenue

SCHS has agreements with third-party payors that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, outpatient case rates, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts due and determined to be collectible from patients, third-party payors, and others for services rendered and includes estimates for potential retroactive revenue adjustments under reimbursement agreements with third-party payors. Such estimates are adjusted in future periods, as final settlements are determined.

A significant portion of SCHS' services are provided to Medicare, Medicaid, and Oregon Health Plan (OHP) patients under contractual arrangements. Inpatient acute care services rendered by SCHS to Medicare, Medicaid, and OHP program beneficiaries are generally reimbursed at prospectively determined rates per discharge, except for those paid based on capitated per member per month payment arrangements. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors (i.e., Medicare severity diagnosis-related groups or MS-DRGs). Such payments include a capital cost component and may be greater or less than the actual charges for services. Most outpatient services related to Medicare beneficiaries are reimbursed prospectively under the ambulatory payment classifications methodology. Home health services related to Medicare beneficiaries are reimbursed under a prospective payment system methodology. OHP outpatient services are reimbursed based on a percentage of charges, except for those paid based on capitated per member per month payment arrangements. SCHS is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after audits of SCHS' annual cost reports by the Medicare fiscal intermediary and Medicaid. St. Charles Bend's and St. Charles Redmond's cost reports have been audited and final settled by the Medicare fiscal intermediary and Medicaid through December 31, 2012 and 2013, respectively.

St. Charles Madras and St. Charles Prineville are "critical access hospitals" (CAH) for Medicare and Medicaid program purposes. As CAHs, St. Charles Madras and St. Charles Prineville cannot operate more than 25 beds, and the average length of stay for acute care patients cannot exceed 96 hours. As CAHs, St. Charles Madras and St. Charles Prineville are reimbursed for Medicare and Medicaid inpatient and outpatient services under a cost-reimbursement methodology. St. Charles Madras' and St. Charles Prineville's cost reports have been audited and final settled by the Medicare fiscal intermediary through December 31, 2014 and 2013, respectively, and Medicaid through December 31, 2013.

The 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 estimated third-party payor settlements payable, net, will change by a material amount in the near term. Net patient service revenue was increased by approximately $375,000 and $3,792,000 for the years ended December 31, 2015 and 2014, respectively, as a result of final settlements of prior years' cost reports and revisions of estimates for prior years' cost report settlements.

SCHS has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations to provide medical services to subscribing participants. The basis for payment to SCHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined fee schedules, and certain capitated per member per month payment arrangements. The capitated agreements are limited to services provided at SCHS facilities, and therefore, no unpaid claims liability is necessary. Amounts received under capitated agreements are shown in the consolidated statements of operations as premium revenue.

(n) Charity Care

SCHS provides services without charge, or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. SCHS' criteria for the determination of charity care include the patient's–or other responsible party's–annual household income, number of people in the home and claimed on taxes, assets, existing medical debt obligations, and other indicators of the patient's ability to pay. Generally, those individuals with an annual household income at or less than 250% of the Federal Poverty Guidelines (the Guidelines) qualify for charity care under SCHS' policy. In addition, SCHS provides discounts on a sliding scale to those individuals with an annual household income of between 251% and 400% of the Guidelines. When assistance available under SCHS's policy does not cover 100% of the gross charges for the services, the amounts charged to patients will not be more than amounts generally billed to patients having insurance with Medicare. Since SCHS does not pursue collection of amounts determined to qualify as charity care, those amounts are not reported as net patient service revenue. The cost of the services and supplies furnished under the charity care policy for the years ended December 31, 2015 and 2014, net of subsidies, was approximately $5,873,000 and $8,615,000, respectively. The Corporation uses a ratio of cost to charges based on the direct and indirect costs and gross charges of SCHS to estimate the cost of providing this charity care. The cost to charge ratio is developed separately for each facility by using certain analysis tools. The weighted average cost to charge ratio used in this determination was 46.5% and 46.2% for the years ended December 31, 2015 and 2014, respectively. The amount of subsidies received by SCHS for providing charity care for the years ended December 31, 2015 and 2014 was approximately $250,000 and $330,000, respectively.

(o) Consolidated Statements of Operations

For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenue and expenses. SCHS' income from investments in healthcare-related joint ventures recorded on the equity method of accounting is reported as other revenue. Peripheral or incidental transactions are reported as other income (losses).

The performance indicator for the accompanying consolidated statements of operations is excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses, consistent with industry practice, include the change in net assets released from restrictions used for purchases of property and equipment, contributions for property and equipment, distributions to noncontrolling interests, and net asset transfers.

(p) State of Oregon Provider Tax

Effective July 1, 2004, the State of Oregon instituted a provider tax on certain qualifying hospitals. SCHS recorded provider taxes of approximately $26,726,000 and $23,284,000 for the years ended December 31, 2015 and 2014, respectively, which are included in medical supplies, drugs, and other expense in the accompanying consolidated statements of operations. In addition, SCHS has entered into an agreement with the Oregon Association of Hospitals and Health Systems (OAHHS), which provides that all payments owed to SCHS related to beneficiaries of the Oregon Department of Medical Assistance Program (DMAP) are to be remitted directly to OAHHS. OAHHS aggregates these payments, returning a portion to SCHS. The remaining funds are pooled by OAHHS with like amounts received on behalf of other hospitals subject to the provider tax, and OAHHS redistributes such funds to qualifying hospitals on a quarterly basis. The estimate of the amount of receipts via the quarterly redistribution process from OAHHS for the years ended December 31, 2015 and 2014 matches the annual amounts of taxes paid, which is reflected as a component of net patient service revenue in the accompanying consolidated statements of operations.

(q) Income Taxes

The Corporation has received a determination letter from the Internal Revenue Service (IRS) stating that it is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. It is management's belief that none of its activities have produced material unrelated business income, and that SCHS continues to be operated in a manner that qualifies it for tax-exempt status.

Accounting principles generally accepted in the United States of America require SCHS' management to evaluate tax positions taken by the Corporation and recognize a tax liability (or asset) if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed tax positions taken by the Corporation and has concluded that as of December 31, 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Corporation's management believes it is no longer subject to income tax examinations for years prior to 2012.

(Continued)

(r) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

(2) Assets Limited as to Use

The composition of assets limited as to use as of December 31, 2015 and 2014 is set forth in the following table. The following breakout indicates management's methodology for managing their various investment portfolios, which does not necessarily directly follow net asset classification. Investments are carried at fair value.

	2015	2014
Internally designated for capital acquisitions:		
Equity mutual funds	$ 210,359,000	246,047,000
Fixed-income mutual funds	125,844,000	82,483,000
Total internally designated for capital acquisitions	336,203,000	328,530,000
Internally designated for operating purposes:		
Cash and cash equivalents	737,000	737,000
Equity mutual funds	3,987,000	3,941,000
Fixed-income mutual funds	1,039,000	805,000
Cash surrender value of life insurance	315,000	291,000
Total internally designated for operating purposes	6,078,000	5,774,000
Total internally designated	342,281,000	334,304,000
Held by trustee:		
Cash and cash equivalents	16,881,000	48,210,000
Equity mutual funds	2,769,000	2,526,000
Government agencies	—	10,032,000
Corporate obligations	2,651,000	2,260,000
Total held by trustee	22,301,000	63,028,000
Board-designated endowment:		
Investment in Oregon Community Foundation	2,409,000	2,533,000
Donor restricted – temporarily:		
Equity mutual funds	1,994,000	663,000
Fixed-income mutual funds	1,527,000	1,522,000
Donor restricted – permanently:		
Investment in Oregon Community Foundation	789,000	800,000
Cash and cash equivalents	20,000	46,000
Equity mutual funds	375,000	393,000
Fixed-income mutual funds	334,000	336,000
Total assets limited as to use	372,030,000	403,625,000
Less portion reported as current	(2,222,000)	(7,795,000)
Total assets limited as to use, net of current portion	$ 369,808,000	395,830,000

Investment income, net, consisted of the following for the years ended December 31, 2015 and 2014:

		2015	2014
Interest and dividend income	$	10,793,000	11,951,000
Realized (losses) gains on sales of securities, net		(109,000)	184,000
Unrealized (losses) gains on trading securities, net		(10,381,000)	13,200,000
Investment income, net	$	303,000	25,335,000

(3) Property and Equipment

Property and equipment consisted of the following at December 31, 2015 and 2014:

		2015	2014
Land and improvements	$	26,370,000	20,026,000
Buildings and fixed equipment		333,426,000	286,703,000
Furniture and movable equipment		192,966,000	174,675,000
		552,762,000	481,404,000
Less accumulated depreciation		(278,873,000)	(252,205,000)
		273,889,000	229,199,000
Construction in progress		14,097,000	32,496,000
Property and equipment, net	$	287,986,000	261,695,000

Construction in progress includes costs incurred in connection with various construction projects and costs incurred related to the acquisition and implementation of various software applications. As of December 31, 2015, management estimates that the remaining cost to complete the construction projects is approximately $32,031,000, the remaining cost to complete the software acquisitions and implementations is approximately $3,996,000, and the remaining cost to complete new equipment implementation is approximately $299,000.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component acquiring those assets. In 2015 and 2014, SCHS capitalized $2,386,000 and $1,879,000, respectively, of interest expense.

(4) Restricted Net Assets

Restricted net assets are held by SCF and are those whose use has been limited by donor-imposed restrictions to a specific time period and/or purpose. SCF also holds funds that are not donor restricted for a specific purpose and are distributed to SCHS in amounts and in periods determined by SCF's board of directors, which are included in unrestricted net assets. SCF's temporarily restricted net assets are distributed to SCHS or other recipients for the purposes specified by the donors. SCF's permanently restricted net assets consist of the principal amount of contributions accepted by SCF with the stipulation from donors that the principal be maintained in perpetuity and only the income from investments thereof be expended to support SCF's general activities or restricted purposes, as stipulated by the respective donors.

During 2015 and 2014, net assets were released from donor restrictions by SCHS incurring operating expenses satisfying the restricted purpose of approximately $782,000 and $1,127,000, respectively, and are included in other revenue. Further, approximately $833,000 and $3,983,000 were released from restriction to SCHS for capital expenditures made during 2015 and 2014, respectively.

Temporarily and permanently restricted net assets are available for the following purposes at December 31, 2015 and 2014:

		2015	2014
Temporarily restricted:			
Education and research	$	442,000	582,000
Indigent care		263,000	249,000
Patient care activities		2,606,000	2,203,000
Purchase of property and equipment		911,000	353,000
Net assets, temporarily restricted	$	4,222,000	3,387,000
Permanently restricted:			
Education and research	$	497,000	447,000
Patient care activities		25,000	25,000
Indigent care		983,000	1,029,000
Net assets, permanently restricted	$	1,505,000	1,501,000

SCF has adopted investment and spending policies for endowment assets to provide a predictable stream of funding to programs supported by its endowment and to maintain the value of the endowment assets. Asset allocation is reviewed annually with respect to: i) SCF's tolerance for risk based on its financial condition and need for cash from investments to support operations; ii) expected asset class return, risk, and correlation characteristics; and iii) changes in accounting guidance, tax law, or other restrictions.

SCF's spending practices are intended to comply with donor's wishes and meet all applicable laws and regulations. Spending must be for a purpose that is consistent with the documented intent of the donor, and may not exceed the amounts annually determined by the SCF's board of directors. Factors that are considered in addressing the annual spending allocation are: i) market value of the fund relative to the principal of the gift and ii) the level of spending in prior years.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or Uniform Prudent Management of Institutional Funds Act (UPMIFA) requires SCF to retain as a fund of perpetual duration. Deficiencies of this nature are reported as a reduction to unrestricted net assets and are excluded from the performance indicator.

SCF follows the guidance in the UPMIFA in determining the net asset classification of all donor-restricted endowment funds. In accordance with board policy, assets classified as permanent endowments in accordance with donor intent are only utilized for current period expenditures to the extent that earnings on the endowment exceed the original fair value of the donation. To the extent earnings on endowment funds exceed identified expenditures on which to apply those earnings, the earnings are classified as temporarily restricted net assets. As of December 31, 2015 and 2014, unspent earnings on endowment funds totaling $324,000 and $344,000, respectively, were included in temporarily restricted net assets.

(5) Debt Agreements

Long-term obligations consisted of the following at December 31, 2015 and 2014:

	2015	2014
2015 Senior Notes	$ 109,475,000	—
Hospital Facility Authority of Deschutes County Oregon (the Authority) Hospital Revenue Bonds Series 2014 (the 2014 Bonds)	75,000,000	75,000,000
The Authority Hospital Revenue Refunding Bonds Series 2008 (the 2008 Bonds)	—	100,570,000
The Authority Hospital Revenue Bonds Series 2005B (the 2005B Bonds)	43,650,000	44,675,000
Bank of the Cascades Secured Loan	1,178,000	—
Wells Fargo Bank and Wells Equipment Finance Notes Payable	670,000	1,170,000
Siemens Financial Services Equipment leases	194,000	353,000
Bend Ortho Building Associates Lease	—	9,094,000
Other	184,000	211,000
Less unamortized discount on bonds, net	(404,000)	(1,378,000)
Total long-term obligations	229,947,000	229,695,000
Less current portion	(1,850,000)	(12,386,000)
Long-term obligations, net of current portion	$ 228,097,000	217,309,000

In June 2015, the Corporation issued the 2015 Senior Notes (2015 Notes) in the amount of $111,750,000. The proceeds of the 2015 Notes were used to advance refund the 2008 Bonds. The 2015 Notes bear interest at a fixed rate of 4.420% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 (including mandatory redemptions) with a final payment in 2038. The principal payments range from $1,730,000 to $10,755,000.

In April 2014, the Authority issued the 2014 Bonds in the amount of $75,000,000. The proceeds from the 2014 Bonds are being used to finance certain capital additions and improvements at St. Charles Bend, St. Charles Madras, and to build a replacement hospital facility in Prineville, Oregon. The 2014 Bonds bear interest at a fixed rate of 2.420% payable monthly, until April 1, 2021, at which time the 2015 Bonds will be remarketed into another interest rate period. Principal payments will be subject to mandatory redemption on each January 1 beginning in 2039 with a final payment in 2044. The principal payments range from $11,800,000 to $13,025,000.

In December 2008, the Authority issued the 2008 Bonds in the amount of $103,460,000. The proceeds of the 2008 Bonds were primarily used to advance refund the 2005A Bonds, make the termination payment related to a swap agreement, and establish a debt service reserve fund. The 2008 Bonds bear interest at rates ranging from 5.500% to 8.250% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 (including mandatory redemptions) ranging from $1,570,000 in 2015 to $12,000,000 in 2038. The 2008 Bonds maturing on and after January 1, 2020 are subject to optional redemption prior to maturity, at the option of the Authority (such option shall be exercised at the request of the Corporation), at par, plus accrued interest. The 2008 bonds were defeased in June 2015, with a resulting loss on extinguishment of $24,515,000.

In December 2005, SCHS entered into agreements with the Authority, whereby the Authority issued the 2005B Bonds in the amount of $51,800,000. The proceeds from the 2005B Bonds were primarily used to finance certain capital additions and improvements at St. Charles Bend and St. Charles Redmond. The 2005B Bonds bear interest at rates ranging from 4.000% to 5.375% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 (including mandatory redemptions) ranging from $1,050,000 in 2016 to $7,150,000 in 2035.

The above described debt instruments are secured by gross receivables of SCHS. The Corporation has obtained bond insurance, which unconditionally guarantees payment of principal and interest on the 2005B Bonds.

The Bend Ortho Building Associates lease represented a lease of an approximately 30,000-square-foot building that expired on December 31, 2014, with two 5-year renewal options. Under this agreement, SCHS had the option to purchase the building on December 31, 2014 with a 30-day closing period allowed—or at the end of either of the subsequent renewal periods—at a price determined based on a formula that includes the net operating income of the building and a capitalization rate, all as defined in the lease agreement. In addition, the lessor had the right at any time during the lease term (including renewals) to require SCHS to purchase the building at a price using this same formula. Under the terms of the lease, SCHS was required to make monthly payments of approximately $68,000. SCHS exercised its right to purchase the building in January 2015 at the end of the initial term.

During 2015, CMI entered into a loan with Bank of the Cascades, which is secured by the equipment purchased with the loan proceeds. The loan is payable in monthly installments of $25,000, bears interest at a rate of 3.40%, and matures February 2020.

Notes and leases payable to Wells Fargo Bank, Wells Equipment Finance, Bank of the Cascades, and Siemens Financial Services represent various equipment financing arrangements, generally at CMI. The notes bear interest ranging from 3.50% to 5.25%, mature at various times from 2015 to 2018, and are secured by equipment.

The above-described debt instruments carry various financial covenants that the Corporation is required to measure on an annual basis.

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows:

	Long-term debt	Capital lease obligations
2016	$ 1,703,000	147,000
2017	4,637,000	44,000
2018	4,708,000	—
2019	4,819,000	—
2020	4,782,000	—
Thereafter	209,516,000	—
	$ 230,165,000	191,000
Less amount representing interest under capital lease obligations		(5,000)
		$ 186,000

As of December 31, 2015 and 2014, SCHS had a $30,000,000 and $3,000,000, respectively, line-of-credit agreement with U.S. Bank. There were no amounts outstanding under this line-of-credit agreement at December 31, 2015 or 2014. Borrowings outstanding under this line-of-credit agreement bear interest at the greater of LIBOR plus ranging from 0.60% to 1.15%. The line of credit expires on December 27, 2018.

Interest cost incurred net of interest capitalized during the years ended December 31, 2015 and 2014 was $8,530,000 and $11,295,000, respectively.

(6) Commitments and Contingencies

(a) Operating Leases

SCHS leases office space and equipment under operating lease agreements, which expire at various dates through 2026. Certain of these lease agreements contain renewal options. A portion of the leased office space has been subleased to unrelated third parties. As of December 31, 2015, future minimum rental commitments for the five years subsequent to and thereafter, under noncancelable operating lease agreements, that have initial or remaining lease terms in excess of a year were as follows:

2016	$ 4,262,000
2017	4,136,000
2018	4,026,000
2019	3,682,000
2020	3,181,000
Thereafter	17,583,000
Total minimum lease payments	36,870,000
Less total minimum sublease rentals	(231,000)
	$ 36,639,000

Certain of the leases above are with related entities. As of December 31, 2015, the total future minimum rental commitments expected to be paid on these related entity leases aggregate approximately $12,842,000.

Rent expense totaled $8,012,000 and $8,631,000 for the years ended December 31, 2015 and 2014, respectively, and is included in medical supplies, drugs, and other in the accompanying consolidated statements of operations.

(b) Medical Malpractice Insurance

Effective July 1, 2013, SCHS maintains a self-insurance program for malpractice and other general liability claims under which the Corporation contributes actuarially determined amounts to the Trust to fund estimated ultimate losses. SCHS purchases excess insurance for claims exceeding $500,000 per occurrence and $3,000,000 annual in aggregate.

Based on an actuarial valuation, the Corporation has recorded estimated liabilities for incurred but not reported (IBNR) medical malpractice claims, which, along with deductibles on reported claims, aggregated $7,517,000 and $6,551,000 as of December 31, 2015 and 2014, respectively, and are included in other noncurrent liabilities in the accompanying consolidated balance sheets. These amounts are prior to expected insurance recoveries. Management believes that these estimated liabilities are adequate to cover actual ultimate expenses; however, the establishment of estimated liabilities for medical malpractice claims is an inherently uncertain process, and there can be no assurance that currently established liabilities will prove adequate. Subsequent actual experience could result in liabilities being too high or too low, which could positively or negatively impact the Corporation's reported consolidated operations in future periods.

(c) Self-Insurance

SCHS is self-insured for medical, dental, and vision benefits provided to its employees for claims up to $400,000 per employee. SCHS is also self-insured for state unemployment claims. SCHS recognizes self-insurance costs based on claims filed with its third-party administrators and estimates for IBNR claims. Management believes that the amounts accrued in the accompanying consolidated financial statements for the years ended December 31, 2015 and 2014 of $8,304,000 and $8,059,000, respectively, are adequate to cover any related potential losses.

(d) Risk Management

In the ordinary course of business, the Corporation is exposed to various risks of loss from theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. However, management believes that adequate commercial insurance coverage has been purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage for the years ended December 31, 2015 and 2014.

(e) Guaranties

As of December 31, 2015, SCHS is a guarantor of the following loans of certain related entities:

Entity		Loan balances outstanding at December 31, 2015	SCHS' guaranties	Loan expiration dates
Cascade Medical Buildings, LLC	$	22,078,000	11,039,000	March 2025
Heart Center of the Cascades, LLC		8,926,000	4,463,000	April 2025

In the opinion of management, the likelihood that SCHS will be required to make any payments under the guaranties is remote, and the estimated fair value of such guaranties is not significant to the accompanying consolidated financial statements; accordingly, no liability related to these guaranties has been recorded in the accompanying consolidated balance sheets.

(f) Regulations and Litigation

The healthcare industry is subject to various laws and regulations from federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has remained high with respect to investigations and allegations concerning possible violations by healthcare providers of regulations, which could result in the expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments of patient services previously billed and collected. Management believes that the Corporation is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations; however, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

In addition, the Corporation becomes involved in litigation and other regulatory investigations arising in the ordinary course of business. After consultation with legal counsel, management believes that these matters will be resolved without causing a material adverse effect on the Corporation's future consolidated financial position or results of operations.

(g) Collective Bargaining Agreements

Approximately 5% of SCHS employees, including nurses and certain professional employees, were covered under collective bargaining agreements at December 31, 2015 that will expire in 2016. An additional 21% are covered under contracts expiring beyond 2016.

(7) Retirement Plan

Substantially all employees of SCHS are eligible to participate in SCHS' defined-contribution retirement plan (the Plan). Under the Plan, SCHS matches each participant's contributions up to 6% of his or her salary. Employees are eligible to receive SCHS' matching contributions once they achieve at least 21 years of age, work 1,000 hours or more during the year, and have been continuously employed by SCHS for one year or more. SCHS' expense relating to the Plan during the years ended December 31, 2015 and 2014 was

$10,315,000 and $9,020,000, respectively, and is included in employee benefits in the accompanying consolidated statements of operations.

(8) Other Related-Party Transactions

The following is a summary of SCHS' primary unconsolidated related-party investments at December 31, 2015 and 2014:

Entity	Basis of accounting	Ownership as of December 31, 2015	Investment balance included in the accompanying consolidated balance sheets December 31 2015	Investment balance December 31 2014	SCHS' share of income (loss) included in the accompanying consolidated statements of operations 2015	SCHS' share of income (loss) 2014
CMB	Equity method	50%	$ (2,360,000)	(190,000)	(545,000)	296,000
CPH	Equity method	50	—	17,000	(17,000)	995,000
HCC	Equity method	50	(1,713,000)	(1,619,000)	66,000	95,000
CS	Equity method	50	686,000	484,000	1,936,000	1,776,000
SCAS	Equity method	49	—	—	—	—
COMRI	Equity method	33	884,000	800,000	1,186,000	1,162,000
SOLS	Equity method	28	685,000	646,000	—	—
PH	Equity method	14	1,499,000	666,000	(501,000)	—
IOC	Cost method	50	20,000	20,000	—	—
HF	Cost method	14	54,000	54,000	—	—

In addition to SCF, the Trust, SCMSO, and CMI, SCHS has investments in the following related entities:

(a) Cascade Medical Buildings, LLC (CMB)

CMB is a limited liability company whose two members are SCHS (50% ownership interest) and Deschutes Medical Buildings, LLC (50% ownership interest). CMB was formed to build, own, and manage a medical office building on land leased from SCHS. SCHS rents approximately 13,010 square feet in this building. During the years ended December 31, 2015 and 2014, SCHS received member distributions of $1,625,000 and $1,425,000, respectively, from CMB. During the years ended December 31, 2015 and 2014, SCHS earned rental income from CMB of approximately $212,000 and $184,000, respectively, under the land lease. During the years ended December 31, 2015 and 2014, SCHS incurred rent expense for facilities owned by CMB of $240,000 and $223,000, respectively.

(b) Cascade Property Holdings, LLC (CPH)

CPH is a limited liability company whose two members are SCHS (50% ownership interest) and Deschutes Medical Buildings, LLC (50% ownership interest). CPH owned bare land held for investment purposes in Bend, Oregon. The land was sold in 2014. In addition, as a result of the sale, CPH paid off a loan to CMB. CPH does not have any operating activities currently and was dissolved on December 31, 2015.

(c) Heart Center of the Cascades, LLC (HCC)

HCC is a limited liability company whose two members are SCHS (50% ownership interest) and four physicians with equal direct ownership interests (collectively a 50% ownership interest). The physicians are also employees of the Corporation. HCC was formed to build, own, and manage a medical building on land leased from SCHS. During the years ended December 31, 2015 and 2014, SCHS received member distributions of $160,000 and $0 from HCC, respectively. During the years ended December 31, 2015 and 2014, SCHS earned income from HCC of $356,000 and $350,000, respectively, under the land lease and from the provision of certain facility services. During the years ended December 31, 2015 and 2014, SCHS incurred rent expense related to a lease with HCC of $1,512,000 and $1,501,000, respectively.

HCC entered into an interest rate swap agreement in 2007 with KeyBank; the swap agreement was transferred to U.S. Bank in November 2010. The swap agreement is considered a cash flow hedge and has been deemed ineffective by management. As a result, the changes in fair value in the interest rate swap are included in excess of revenues over expenses. As of December 31, 2015 and 2014, HCC had a liability of $0 and $776,000, respectively, related to this swap agreement. SCHS recorded its share of the changes in the fair value of the swap agreement as a component of other, net in the accompanying consolidated statements of operations. HCC refinanced their loan into a fixed rate loan on May 1, 2015, eliminating the swap agreement.

(d) Cascade Surgicenter, LLC (CS)

CS is a limited liability company whose two members are SCHS (50% ownership interest) and Deschutes Surgicenter, LLC (50% ownership interest). CS was formed to own, operate, and manage an outpatient surgery center located in facilities owned by CMB. SCHS received member distributions of $1,734,000 and $1,818,000, respectively, from CS during the years ended December 31, 2015 and 2014. During the years ended December 31, 2015 and 2014, CS incurred rent expense for facilities owned by CMB of $792,000 and $778,000, respectively.

(e) St. Charles/AmSurg ASC Partners LLC (SCAS)

SCAS is a limited liability company, created in July 2013, whose two members are SCHS (49% ownership interest) and AmSurg Holdings, Inc. (51% ownership interest). SCAS was formed to acquire, develop, own, and/or operate ambulatory surgery centers or other facilities in Central Oregon. SCAS had no operating activities for the years ended December 31, 2015 and 2014.

(f) Central Oregon Magnetic Resonance Imaging, LLC (COMRI)

COMRI is a limited liability company, which is owned by SCHS, CORA, and certain physicians. SCHS owns a one-third interest in COMRI. COMRI owns and operates three magnetic resonance imaging machines located in Bend and Redmond, Oregon. During the years ended December 31, 2015 and 2014, SCHS received member distributions of $1,102,000 and $901,000, respectively, from COMRI. During the years ended December 31, 2015 and 2014, SCHS charged COMRI $348,000 and $326,000, respectively, for certain staffing services, rent, and supplies. In addition, during the years ended December 31, 2015 and 2014, SCHS incurred professional fees expense of $3,538,000 and $2,994,000, respectively, for services rendered by COMRI. Included in accounts payable in the accompanying consolidated balance sheets are amounts due to COMRI for these services of $264,000 and $15,000, as of December 31, 2015 and 2014, respectively.

(g) Southern Oregon Linen Service (SOLS)

SOLS is an Oregon cooperative corporation that provides laundry, linen, and uniform services to members of the cooperative. SCHS owns 28% of the outstanding common stock of SOLS, and St.

Charles Bend, St. Charles Redmond, St. Charles Madras, and St. Charles Prineville utilize the laundry and linen services provided by this cooperative. SCHS received member distributions of $11,000 and $9,000, respectively, from SOLS during the years ended December 31, 2015 and 2014. SCHS incurred laundry and linen expense with SOLS of $1,314,000 and $1,474,000, for the years ended December 31, 2015 and 2014, respectively.

(h) Propel Health (PH)

PH is a limited liability company formed to further the charitable and statutory mission of the eight member nonprofit corporations. SCHS owns approximately 14% of PH and invested an additional $1,334,000 in fiscal 2015. PH's purpose is to deliver the tools, methods, and support necessary for optimal health management in the communities served by the participating organizations.

(i) Institute of the Cascades (IOC)

IOC is a limited liability company whose two members are SCHS (50% ownership interest) and The Neuromusculoskeletal Center of the Cascades PC (NCC) (50% ownership interest). IOC provides administration and marketing to promote CMB, CS, NCC, and SCHS.

(j) Health Futures (HF)

HF is a limited liability company whose members participate in centralized administrative services in Oregon. SCHS owns approximately 14% of HF. Primarily, SCHS benefits from group purchasing agreements. SCHS receives distributions from time to time that are treated as a reduction to purchases and not a return of capital, as they are the result of group purchasing agreements.

(9) Functional Classification of Expenses

Expenses on a functional basis for the years ended December 31, 2015 and 2014 were as follows:

		2015	2014
Healthcare services	$	502,281,000	453,834,000
General and administrative		136,500,000	128,275,000
	$	638,781,000	582,109,000

(10) Fair Value Measurements

The Corporation applies the provisions of FASB ASC Topic 820, *Fair Value Measurement* (ASC 820) for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

The following table presents assets that are measured at fair value on a recurring basis at December 31, 2015:

	Fair value measurements at reporting date			
	December 31, 2015	**(Level 1)**	**(Level 2)**	**(Level 3)**
Assets:				
Assets limited as to use:				
Cash and cash equivalents	$ 17,638,000	17,638,000	—	—
Equity mutual funds:				
Medium cap blend	8,711,000	8,711,000	—	—
Medium cap value	19,000	19,000	—	—
Medium cap growth	21,000	21,000	—	—
Small cap blend	355,000	355,000	—	—
Small cap value	55,000	55,000	—	—
Small cap growth	8,295,000	8,295,000	—	—
Large cap growth	19,799,000	19,799,000	—	—
Large cap balanced	58,005,000	58,005,000	—	—
Large cap value	19,787,000	19,787,000	—	—
Large cap blend	3,219,000	3,219,000	—	—
International growth	14,126,000	14,126,000	—	—
International value	14,433,000	14,433,000	—	—
International large cap	64,000	64,000	—	—
International balance	28,072,000	28,072,000	—	—
Market neutral	16,934,000	16,934,000	—	—
REIT sector	27,589,000	27,589,000	—	—
Fixed-income mutual funds:				
Treasury intermediate	51,215,000	51,215,000	—	—
Inv grade corp interm	26,569,000	26,569,000	—	—
Inv grade corp short	25,655,000	25,655,000	—	—
International bond	25,305,000	25,305,000	—	—
Corporate obligations	2,651,000	—	2,651,000	—
Cash surrender value of life insurance	315,000	—	315,000	—
	$ 368,832,000	365,866,000	2,966,000	—

The following table presents assets that are measured at fair value on a recurring basis at December 31, 2014:

	Fair value measurements at reporting date			
	December 31, 2014	(Level 1)	(Level 2)	(Level 3)
Assets:				
Assets limited as to use:				
Cash and cash equivalents	$ 48,993,000	48,993,000	—	—
Equity mutual funds:				
Medium cap blend	10,350,000	10,350,000	—	—
Medium cap value	21,000	21,000	—	—
Medium cap growth	22,000	22,000	—	—
Small cap blend	338,000	338,000	—	—
Small cap value	50,000	50,000	—	—
Small cap growth	10,178,000	10,178,000	—	—
Large cap growth	24,425,000	24,425,000	—	—
Large cap balanced	68,275,000	68,275,000	—	—
Large cap value	23,061,000	23,061,000	—	—
Large cap blend	3,151,000	3,151,000	—	—
International growth	15,708,000	15,708,000	—	—
International value	15,656,000	15,656,000	—	—
International large cap	62,000	62,000	—	—
International balance	30,891,000	30,891,000	—	—
Market neutral	16,108,000	16,108,000	—	—
REIT sector	35,275,000	35,275,000	—	—
Fixed-income mutual funds:				
Treasury intermediate	33,858,000	33,858,000	—	—
Inv grade corp interm	17,520,000	17,520,000	—	—
Inv grade corp short	16,731,000	16,731,000	—	—
International bond	17,036,000	17,036,000	—	—
Corporate obligations	2,260,000	—	2,260,000	—
U.S. government agencies	10,032,000	—	10,032,000	—
Cash surrender value of life insurance	291,000	—	291,000	—
	$ 400,292,000	387,709,000	12,583,000	—

The fair value of long-term obligations is estimated using current market activity and discounted cash flow analysis and is considered a Level 2 measurement under ASC 820. The fair value and carrying amount of long-term obligations at December 31, 2015 and 2014 were as follows:

	2015		2014	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term obligations	$ 229,947,000	236,962,000	229,695,000	253,241,000

(11) Recent Accounting Pronouncements

On May 28, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles when it becomes effective. The new standard is effective for SCHS on January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The new standard also requires additional disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. The Corporation has neither selected a transition method nor determined the effect of the standard on its ongoing financial reporting.

On April 7, 2015, the FASB issued ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30)*. The new guidance changes the presentation of debt issuance costs in the financial statements to present such costs as a direct deduction from the related debt liability rather than as an asset. Amortization of debt issuance costs will be reported as interest expense. This standard is effective for SCHS on January 1, 2016. The Corporation does not expect the adoption to have a material impact on the consolidated financial position, and will have no impact on results of operations or cash flows.

On February 25, 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires that lease arrangements longer than 12 months result in an entity recognizing an asset and liability. The new guidance is effective for SCHS on January 1, 2019. Early adoption of the update is permitted. The Corporation is evaluating the impact of the adoption of this update on the consolidated financial statements and related disclosures.

(12) Subsequent Events

The Corporation has performed an evaluation of subsequent events through March 29, 2016, which is the date these consolidated financial statements were issued.

SUPPLEMENTARY SCHEDULES

Schedule I

ST. CHARLES HEALTH SYSTEM, INC.

Supplementary Schedule – Balance Sheet Information

December 31, 2015 and 2014

Assets	Obligated group	Nonobligated group excluding St. Charles Foundation, Inc.	St. Charles Foundation, Inc.	Eliminating and reclassifying entries	2015	2014
Current assets:						
Cash and cash equivalents	$ 53,187,000	1,598,000	1,011,000	—	55,796,000	28,082,000
Assets limited as to use, current portion	2,222,000	—	—	—	2,222,000	7,795,000
Patient accounts receivable, net of allowance	83,388,000	3,846,000	—	—	87,234,000	87,165,000
Other receivables, net	16,878,000	96,000	1,376,000	(361,000)	17,989,000	20,152,000
Supplies inventory	11,464,000	—	—	—	11,464,000	10,175,000
Prepaid expenses and other current assets	10,425,000	126,000	—	—	10,551,000	9,342,000
Total current assets	177,564,000	5,666,000	2,387,000	(361,000)	185,256,000	162,711,000
Assets limited as to use, net of current portion	360,603,000	722,000	8,483,000	—	369,808,000	395,830,000
Property and equipment, net	283,250,000	4,736,000	—	—	287,986,000	261,695,000
Other assets	29,597,000	9,214,000	—	(31,124,000)	7,687,000	9,380,000
Total assets	$ 851,014,000	20,338,000	10,870,000	(31,485,000)	850,737,000	829,616,000
Liabilities and Net Assets						
Current liabilities:						
Accounts payable	$ 26,092,000	500,000	—	—	26,592,000	29,192,000
Accrued liabilities	50,692,000	4,000	—	—	50,696,000	50,960,000
Estimated third-party payor settlements, net	1,011,000	—	—	—	1,011,000	110,000
Deferred revenue	516,000	—	—	(361,000)	155,000	611,000
Current portion of long-term obligations	1,077,000	773,000	—	—	1,850,000	12,386,000
Total current liabilities	79,388,000	1,277,000	—	(361,000)	80,304,000	93,259,000
Long-term obligations, net of current portion	226,828,000	1,269,000	—	—	228,097,000	217,309,000
Other liabilities	11,838,000	—	65,000	—	11,903,000	10,628,000
Total liabilities	318,054,000	2,546,000	65,000	(361,000)	320,304,000	321,196,000
Net assets:						
Unrestricted, SCHS	527,233,000	13,128,000	2,430,000	(22,749,000)	520,042,000	499,004,000
Unrestricted, noncontrolling interests	—	4,664,000	—	—	4,664,000	4,528,000
Temporarily restricted	4,222,000	—	4,467,000	(4,467,000)	4,222,000	3,387,000
Permanently restricted	1,505,000	—	3,908,000	(3,908,000)	1,505,000	1,501,000
Total net assets	532,960,000	17,792,000	10,805,000	(31,124,000)	530,433,000	508,420,000
Total liabilities and net assets	$ 851,014,000	20,338,000	10,870,000	(31,485,000)	850,737,000	829,616,000

See accompanying independent auditors' report.

Schedule II

ST. CHARLES HEALTH SYSTEM, INC.

Supplementary Schedule – Statement of Operations Information

Years ended December 31, 2015 and 2014

	Obligated group	Nonobligated group excluding St. Charles Foundation, Inc.	St. Charles Foundation, Inc.	Eliminating and reclassifying entries	2015	2014
Operating revenue:						
Net patient service revenue prior to bad debt adjustments	$ 578,950,000	37,794,000	—	(23,526,000)	593,218,000	560,772,000
Bad debt adjustments	7,192,000	—	—	—	7,192,000	13,865,000
Net patient service revenue	571,758,000	37,794,000	—	(23,526,000)	586,026,000	546,907,000
Premium revenue	67,577,000	—	—	—	67,577,000	46,388,000
Other revenue	55,659,000	—	2,048,000	(20,461,000)	37,246,000	27,112,000
Total operating revenue	694,994,000	37,794,000	2,048,000	(43,987,000)	690,849,000	620,407,000
Expenses:						
Salaries and wages	270,142,000	6,941,000	492,000	(492,000)	277,083,000	250,370,000
Employee benefits	80,106,000	—	156,000	(1,620,000)	78,642,000	73,254,000
Professional fees and assessments	78,427,000	—	65,000	(23,576,000)	54,916,000	46,147,000
Depreciation	28,804,000	1,073,000	—	—	29,877,000	26,482,000
Interest	8,449,000	81,000	—	—	8,530,000	11,295,000
Medical supplies, drugs, and other	184,156,000	8,291,000	540,000	(3,254,000)	189,733,000	174,561,000
Total expenses	650,084,000	16,386,000	1,253,000	(28,942,000)	638,781,000	582,109,000
Operating income	44,910,000	21,408,000	795,000	(15,045,000)	52,068,000	38,298,000
Other income (losses):						
Investment income, net	305,000	—	26,000	(28,000)	303,000	25,335,000
Loss on extinguishment of debt	(24,515,000)	—	—	—	(24,515,000)	—
Other, net	133,000	—	—	—	133,000	2,932,000
Total other income, net	(24,077,000)	—	26,000	(28,000)	(24,079,000)	28,267,000
Excess of revenue over expenses	20,833,000	21,408,000	821,000	(15,073,000)	27,989,000	66,565,000
Increase (decrease) in interest in net assets of St. Charles Foundation, Inc.	2,767,000	—	—	(2,767,000)	—	—
Net assets released from restriction for use	833,000	—	—	—	833,000	3,983,000
Capital contributions	268,000	—	—	—	268,000	1,014,000
Transfers to affiliated organizations	(1,617,000)	(9,000)	(13,000)	—	(1,639,000)	(702,000)
Distributions	—	(20,923,000)	—	14,646,000	(6,277,000)	(6,203,000)
Increase in unrestricted net assets	$ 23,084,000	476,000	808,000	(3,194,000)	21,174,000	64,657,000

See accompanying independent auditors' report.