PEACEHEALTH NETWORKS

Consolidated Financial Statements

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

PEACEHEALTH NETWORKS

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

Independent Auditors' Report

The Board of Directors
PeaceHealth Networks:

We have audited the accompanying consolidated financial statements of PeaceHealth Networks (a Washington not-for-profit corporation), which comprise the consolidated balance sheets as of June 30, 2016 and 2015, 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 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.

KPMG

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PeaceHealth Networks as of June 30, 2016 and 2015, and the results of its operations, changes in net assets, and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Portland, Oregon
September 30, 2016

PEACEHEALTH NETWORKS

Consolidated Balance Sheets

June 30, 2016 and 2015

(In thousands)

Assets		2016	2015
Current assets:			
Cash and cash equivalents	$	245,981	264,467
Short-term investments		341,426	351,437
Accounts receivable, net of allowance for doubtful accounts of $81,275 and $65,337		319,660	354,881
Other receivables		31,650	45,685
Inventory of supplies		44,061	42,398
Prepaid expenses and other		24,812	21,191
Assets whose use is limited that are required for current liabilities		25,468	40,015
Total current assets		1,033,058	1,120,074
Assets whose use is limited:			
Cash and investments		1,119,841	1,098,781
Investments in joint ventures and other		25,180	29,120
Total assets whose use is limited		1,145,021	1,127,901
Less current portion		(25,468)	(40,015)
Net assets whose use is limited		1,119,553	1,087,886
Property, plant, and equipment:			
Land and improvements		139,590	138,454
Buildings, fixed equipment, and other		1,725,642	1,706,188
Moveable equipment		853,862	715,169
Construction in progress		39,754	119,449
Total property, plant, and equipment		2,758,848	2,679,260
Less accumulated depreciation		(1,421,222)	(1,299,635)
Net property, plant, and equipment		1,337,626	1,379,625
Interest in net assets of related foundations		57,524	52,105
Other assets		43,639	44,513
Total assets	$	3,591,400	3,684,203

(Continued)

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Consolidated Balance Sheets

June 30, 2016 and 2015

(In thousands)

Liabilities and Net Assets		2016	2015
Current liabilities:			
Accounts payable	$	106,768	132,331
Accrued payroll, payroll taxes, and employee benefits		174,195	175,216
Accrued interest payable		4,605	4,776
Other current liabilities		56,856	60,377
Current portion of long-term debt		40,814	36,774
Total current liabilities		383,238	409,474
Other long-term liabilities		398,072	318,112
Long-term debt, net of current portion		994,519	1,037,785
Net assets:			
Unrestricted, controlling		1,730,006	1,846,087
Unrestricted, noncontrolling interest		4,466	3,989
Temporarily restricted		58,760	44,338
Permanently restricted		22,339	24,418
Total net assets		1,815,571	1,918,832
Total liabilities and net assets	$	3,591,400	3,684,203

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Operations

Years ended June 30, 2016 and 2015

(In thousands)

	2016	2015
Revenues:		
Net patient service revenue before provision for bad debts	$ 2,390,150	2,399,483
Provision for bad debts	(86,326)	(68,059)
Net patient service revenue	2,303,824	2,331,424
Other operating revenue	81,340	88,404
Total revenues	2,385,164	2,419,828
Expenses:		
Salaries and wages	1,203,902	1,110,977
Payroll taxes and benefits	232,893	238,213
Supplies	371,244	342,880
Purchased services	214,475	227,617
Other	195,538	174,651
Depreciation and amortization of other assets	145,645	133,607
Interest and amortization of deferred financing costs	31,280	30,686
Total expenses	2,394,977	2,258,631
(Loss) income from operations	(9,813)	161,197
Other income (loss):		
Investment income, net	7,265	21,923
Net change in interest rate swaps	(60,913)	(26,658)
Other	300	—
Total other income (loss):	(53,348)	(4,735)
(Deficit) excess of revenues over expenses from continued operations	(63,161)	156,462
Discontinued operations (Note 14)		
Loss from operations of Columbia United Providers (including gain on disposal of $16,069 in 2016)	(4,164)	(2,586)
Total loss on discontinued operations	(4,164)	(2,586)
(Deficit) excess of revenues over expenses	(67,325)	153,876
Net assets released from restrictions for property, plant, and equipment	2,544	2,990
Change in interest in net assets of related foundations	(8,237)	12
Change in pension liability	(41,426)	(21,850)
Other changes in unrestricted net assets	(1,160)	3,191
(Decrease) increase in unrestricted net assets	$ (115,604)	138,219

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2016 and 2015

(In thousands)

	Unrestricted controlling	Unrestricted noncontrolling interest	Temporarily restricted	Permanently restricted	Total
Net assets at June 30, 2014	$ 1,707,475	4,382	49,693	17,373	1,778,923
Excess of revenues over expenses	156,225	237	—	—	156,462
Other restricted contributions	—	—	2,990	—	2,990
Net assets released from restrictions	2,990	—	(3,970)	—	(980)
Change in interest in net assets of related foundations	12	—	289	3,841	4,142
Change in pension liability	(21,850)	—	—	—	(21,850)
Other changes in net assets	3,614	(423)	(4,664)	3,204	1,731
Change in net assets before discontinued operations	140,991	(186)	(5,355)	7,045	142,495
Discontinued operations (Note 14)	(2,379)	(207)	—	—	(2,586)
Change in net assets	138,612	(393)	(5,355)	7,045	139,909
Net assets at June 30, 2015	1,846,087	3,989	44,338	24,418	1,918,832
(Deficit) excess of revenues over expenses from continued operations	(63,971)	810	—	—	(63,161)
Other restricted contributions	—	—	2,555	—	2,555
Net assets released from restrictions	2,544	—	(2,107)	—	437
Change in interest in net assets of related foundations	(8,237)	—	16,122	(2,466)	5,419
Change in pension liability	(41,426)	—	—	—	(41,426)
Other changes in net assets	(1,160)	—	(2,148)	387	(2,921)
Change in net assets before discontinued operations	(112,250)	810	14,422	(2,079)	(99,097)
Discontinued operations (Note 14)	(3,831)	(333)	—	—	(4,164)
Change in net assets	(116,081)	477	14,422	(2,079)	(103,261)
Net assets at June 30, 2016	$ 1,730,006	4,466	58,760	22,339	1,815,571

See accompanying notes to consolidated financial statements.

PEACEHEALTH NETWORKS

Consolidated Statements of Cash Flows

Years ended June 30, 2016 and 2015

(In thousands)

	2016	2015
Cash flows from operating activities:		
Change in net assets	$ (103,261)	139,909
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	145,895	134,326
(Gain) loss on sale of land held for sale and property, plant, and equipment	(42)	799
Provision for bad debts	86,326	68,059
Change in pension liability	41,426	21,850
Restricted contributions	(2,555)	(2,990)
Net change in unrealized losses on investments	42,211	3,881
Realized gains on investments	(21,287)	(653)
Valuation adjustments on swap arrangements	46,611	11,855
Vesting of Premier Class B units	(5,689)	(7,364)
Increase in interest in net assets of related foundations	(5,419)	(4,142)
Distributions of earnings from joint ventures	7,625	8,948
Gain on sale of discontinued operations	(16,069)	—
Changes in operating assets and liabilities:		
Increase (decrease) in:		
Accounts receivable, net	(51,105)	(120,584)
Other assets	8,117	1,154
Increase (decrease) in:		
Accounts payable	(25,563)	5,344
Accrued payroll, payroll taxes, and employee benefits	(1,021)	17,727
Other liabilities	(11,770)	(1,397)
Net cash provided by operating activities	134,430	276,722
Cash flows from investing activities:		
Purchase of property, plant, and equipment	(102,489)	(186,473)
Proceeds from sale of discontinued operations	28,300	—
Proceeds from sale of land held for sale and property, plant, and equipment	143	21
Purchase of investments	(334,521)	(372,046)
Sales and maturities of investments	292,322	416,871
Net cash used in investing activities	(116,245)	(141,627)
Cash flows from financing activities:		
Proceeds from long-term borrowings	300	27,347
Principal payments on long-term debt	(39,526)	(46,391)
Proceeds from restricted contributions	2,555	2,990
Net cash used in financing activities	(36,671)	(16,054)
Net (decrease) increase in cash and cash equivalents	(18,486)	119,041
Cash and cash equivalents at beginning of year	264,467	145,426
Cash and cash equivalents at end of year	$ 245,981	264,467

See accompanying notes to consolidated financial statements.

(1) Organization

Corporate Structure

PeaceHealth Networks is a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, which is the sole corporate member of PeaceHealth, which is also a Washington not-for-profit corporation, recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code, with its corporate office located in Vancouver, Washington. PeaceHealth Networks is not affiliated with the Roman Catholic Church, currently has no operations, and currently holds no financial assets in its own name (other than shares of stock in Columbia United Providers), however, it is the member corporation of PeaceHealth, which is a Private Pontifical Juridic Person according to the canon law of the Roman Catholic Church, does have extensive healthcare operations and holds substantial financial assets. Effective January 1, 2014, PeaceHealth Networks and PeaceHealth were reorganized so that the corporate membership relationship between them was reversed from what it had been for the three previous calendar years, as described hereafter. When PeaceHealth affiliated with Southwest Washington Health System in January 2011, PeaceHealth became the sole member of Southwest Washington Health System. In 2014, Southwest Washington Health System became the sole member of PeaceHealth and changed its name to PeaceHealth Networks. PeaceHealth Networks and its associated entities are collectively referred to herein as “the Corporation.” PeaceHealth Networks and PeaceHealth are the only members of the Corporation’s Obligated Group. At June 30, 2016, the following regional healthcare delivery systems and operating divisions were components of PeaceHealth:

Northwest Network:
- PeaceHealth Ketchikan Medical Center
- PeaceHealth St. Joseph Medical Center
- Peace Island Medical Center
- PeaceHealth United General Medical Center

Columbia Network:
- PeaceHealth St. John Medical Center
- PeaceHealth Southwest Medical Center

Oregon West Network:
- PeaceHealth Sacred Heart Medical Center at University District
- PeaceHealth Sacred Heart Medical Center at RiverBend
- PeaceHealth Cottage Grove Community Medical Center
- PeaceHealth Peace Harbor Hospital

Systemwide Organizations:
- PeaceHealth Medical Group
- PeaceHealth Laboratories
- PeaceHealth Self-insured Trusts

These regional healthcare delivery systems and operating divisions, provide inpatient, outpatient, primary and specialty care and home care services in Alaska, Washington and Oregon. These divisions

 (Continued)

primarily operate in Ketchikan, Alaska; Bellingham, Friday Harbor, Sedro Woolley, Longview, and Vancouver, Washington; Springfield, Eugene, Florence, and Cottage Grove, Oregon.

PeaceHealth Networks included the following controlled affiliates at June 30, 2016:

- PeaceHealth
- Health Ventures
- Pooled Income Funds (including Charitable Life Income Funds)
- PeaceHealth Southwest Medical Center Foundation
- Columbia United Providers (CUP) – owned 91.7%

The consolidated financial statements include the accounts of the Corporation. All significant intercompany transactions and balances have been eliminated.

(2) Summary of Significant Accounting Policies

(a) 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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, reimbursement settlements payable, valuation of alternative investments, interest rate swaps, pension obligations, and liabilities related to self-insurance programs.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and all highly liquid debt instruments purchased with an original maturity of three months or less other than those amounts included in assets whose use is limited by the board of directors. The Corporation held cash equivalents of approximately $120,083 and $191,028 as of June 30, 2016 and 2015, respectively.

The Corporation maintains cash and cash equivalents on deposit at various institutions, which, at times, exceed the insured limits of the Federal Deposit Insurance Corporation. This exposes the Corporation to potential risk of loss in the event the institution becomes insolvent.

(c) Short-Term Investments

Short-term investments consist primarily of certificates of deposit, U.S. government, and other investment-grade securities, which are carried at fair value. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(d) Inventory of Supplies

Inventory is valued on weighted average cost.

(e) Other Receivables

Other receivables primarily consist of amounts receivable from the federal government related to grants for electronic health record implementation, amounts receivable from excess insurance carriers and other miscellaneous amounts due.

(f) Assets Whose Use is Limited

Certain assets have been set aside by management of the Corporation for future capital improvements, self-insured liabilities and other purposes, over which management retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation have been reclassified as current in the consolidated balance sheets at June 30, 2016 and 2015. These items consist primarily of investments in marketable equity and fixed income securities, mutual funds, and investments in joint ventures. Money market funds and all marketable securities have readily determinable market values and are, therefore, carried at fair value. The investments in joint ventures and other are accounted for using the equity or cost method. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(g) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost at the date of acquisition or fair value at the date of donation. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed as they are incurred. When property, plant, and equipment is sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded. The Corporation assesses potential impairment of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amount. The loss recognized is the difference between the fair value and the carrying amount. No impairment losses related to property, plant, and equipment were recognized during the years ended June 30, 2016 and 2015.

In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over remaining lives. No adjustments were made in fiscal year 2016 and 2015.

The Corporation capitalized salary and wages along with related benefit costs in the amount of $5,775 and $11,174 during 2016 and 2015, respectively, related to the development of software for internal use.

(Continued)

(In thousands of dollars)

(h) Depreciation

Depreciation on property, plant, and equipment is computed using the straight-line method over the following estimated useful lives:

Land improvements	5–25 years
Buildings and improvements	5–80 years
Fixed equipment	10–75 years
Leasehold improvements	Shorter of remaining length of the lease or useful life
Moveable equipment	3–30 years

(i) Other Assets

Other assets include intangible assets, primarily deferred financing costs, trade names, and goodwill. The deferred financing costs are amortized over the lives of the related debt issuances using the effective interest method. Intangible assets with indefinite lives are evaluated annually for impairment. There were no impairment losses recognized during the years ended June 30, 2016 and 2015.

(j) Other Long-Term Liabilities

Other long-term liabilities consists primarily of the estimated fair value associated with the Corporation's interest rate swaps of $153,927 and $107,316 at June 30, 2016 and 2015, respectively; the liability for the PeaceHealth SWHS Frozen DB Pension Plan of $104,570 and $62,492 at June 30, 2016 and 2015, respectively; and the long-term portion of the liability for the self-insurance programs of $61,869 and $73,152 at June 30, 2016 and 2015, respectively. The remaining balance of other long-term liabilities includes gift annuities, environmental liability, and deferred compensation plan liability.

(k) Contributions and Grants

Contributions and grants are recognized as revenue upon receipt of the donor's pledge to contribute. Contributions and grants are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts pledged that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support. Unconditional promises to give that are silent as to the due date are presumed to be time restricted by the donor until received and are reported as temporarily restricted net assets.

A donor restriction expires when an unconditional promise with an implied time restriction is collected or when the purpose for the restriction is accomplished. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the consolidated statements of operations as net assets released from restrictions. Restricted contributions received in the same year in which the restrictions are met are recorded as an increase in restricted support at the time of receipt and as net assets released from restrictions at the time restrictions are met.

(In thousands of dollars)

Permanently restricted net assets include the principal amount of contributions with the stipulation from the donor that the principal be maintained in perpetuity and only the income is available to be expended for purposes specified by the donor, if any.

(l) Interest in Net Assets of Related Foundations

The Corporation accounts for activities with its unconsolidated related foundations in accordance with applicable accounting guidance. That guidance requires the Corporation to recognize its interests in the net assets of these foundations on the consolidated balance sheets as the asset caption interest in net assets of related foundations, and the annual changes as shown in the consolidated statements of changes in net assets.

(m) Pooled Income Funds

The Corporation has created several pooled income funds. These funds are structured such that the Corporation sold and leased back certain properties. Donors make a contribution and receive annuity payments based on the associated rental income. Upon the annuity termination, the remaining interest is transferred to the Corporation. At June 30, 2016 and 2015, the Corporation has recorded the present value of the annuity payments of $14,972 and $14,828, respectively, as part of other long-term liabilities. The discount rate was 6.0% at June 30, 2016 and 2015.

(n) Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments of amounts different from established charges. The Corporation's net patient service revenue came from the following sources:

	2016	2015
Medicare	38%	33%
Medicaid	14	15
Commercial and other	47	51
Private pay	1	1
	100%	100%

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2016 and 2015:

	2016	2015
Medicare	28%	30%
Medicaid	14	13
Commercial and other	57	56
Private pay	1	1
	100%	100%

Reimbursement for inpatient and outpatient services rendered to Medicare recipients has been made principally under a prospective pricing system. Services to Medicaid patients are also reimbursed based on a combination of prospectively determined rates and cost reimbursement methodology. Continuation of these reimbursement programs at the present level, and on the present basis, is dependent upon future policies of federal and state governmental agencies. The Corporation operates five critical access hospitals that are reimbursed based on costs for inpatient and outpatient services rendered to Medicare and Medicaid program beneficiaries. Interim reimbursement to critical access hospitals is based upon tentative rates and retroactive adjustment is made to actual cost during final settlement by either the Medicare fiscal intermediary or the applicable state's Medicaid agency.

The Corporation has estimated payments for services rendered to Medicare and Medicaid patients during the year by applying the payment principles of the applicable governmental agencies and believes that an adequate provision has been made in the accompanying consolidated financial statements for final settlement. Estimates of final settlements due to and due from Medicare, Medicaid, and other third-party payors have been reflected net as reimbursement settlement payable in the accompanying consolidated balance sheets. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The net amount of adjustments from finalization and adjustment of prior years' cost reports and other third-party settlements resulted in an increase in net patient service revenue of approximately $6,400 and $5,000 in 2016 and 2015, respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretations. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term.

The Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per unit of service and discounts from established charges, as well as, risk sharing arrangements. Most arrangements provide for payment or reimbursement to the Corporation at amounts different than established rates. Contractual discounts represent the difference between established rates for services and amounts paid or reimbursed by these third-party payors. Risk sharing arrangements include incentive payments for specific quality outcomes, effective management of costs, and other measures and in some cases may result in a penalty.

The Corporation provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Corporation estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Corporation. Net bad debt write-offs during 2016 and 2015 were $70,387 and $80,915, respectively.

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(o) Premium Revenue and Accrued Healthcare Costs

PeaceHealth Networks' majority-owned subsidiary, CUP, receives premium revenue that consists of premiums paid by the state of Washington for healthcare services.

On December 31, 2013, CUP entered into an agreement with another health plan that had been awarded the contract from the state for the period January 1, 2014 through December 31, 2014. Under this contract, in return for receiving a defined premium amount from the other health plan, CUP was responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members assigned to CUP from the other plan. After the contract expired on December 31, 2014, CUP entered into a contract directly with the Health Care Authority (HCA) for the period January 1, 2015 through December 31, 2015. Under this contract, in return for receiving a defined premium amount from the HCA, CUP was responsible for providing medical, hospital, pharmaceutical, and related medical services to Apple Health members. Under the terms of this contract, CUP continued to perform most of the administrative services for its assigned members, such as claims payment and utilization management, that it performed under its contract with the state. As of January 1, 2015, CUP received this contract back from the HCA. On December 31, 2015, these members were sold to Molina, as described in Note 14. The results of CUP and the cash flows from discontinued operations are disclosed under discontinued operations for the year ended June 30, 2016 and the comparative results have been restated accordingly.

Under these contracts, PeaceHealth Networks recognized premium revenue of $71,516 and $138,879 for the years ended June 30, 2016 and 2015, respectively, which is included in discontinued operations in the accompanying consolidated statements of operations. The related medical expense recognized by CUP was $71,721 and $127,264 for the years ended June 30, 2016 and 2015, respectively, and is included in discontinued operations in the consolidated statements of operations. CUP is not part of the obligated group. Refer to Note 14 for disclosure of discontinued operations.

(p) Other Operating Revenue

Other operating revenue includes revenue from nonpatient care services, clinical space rental revenue, and contributions both unrestricted in nature and those released from restriction to support operating activities, grants from the federal government to help fund electronic health record implementation and other miscellaneous revenue.

(q) Hospital Transformation Performance Plan (HTPP)

The Hospital Transformation Performance Plan (HTPP) is a program through the Oregon Health Authority that uses quality metrics to show how well hospitals are advancing health system transformation, reducing costs, and improving patient safety. The Corporation received $13,326 and $15,400 related to the program for the years ended June 30, 2016 and 2015, respectively. The payment is classified in other operating revenue in the consolidated statement of operations.

(r) Income (loss) from Operations

Income or loss from operations excludes certain items that the Corporation deems outside the scope of its primary business such as investment income, change in valuation of interest rate swaps, changes in defined benefit plan expense, and other items.

(s) Excess (deficit) of Revenues over Expenses

Excess (deficit) of revenues over expenses includes results from the Corporation's operating and nonoperating investing activities. Investment income includes interest income, dividends, realized and unrealized investment gains and losses, and equity in earnings from joint ventures. Changes in unrestricted net assets not included in excess (deficit) of revenues over expenses include net assets released from restriction for the purchase of property, changes in the Corporation's interest in the net assets of noncontrolled foundations, and certain changes in funded status of the pension plan.

(t) Federal and State Income Taxes

PeaceHealth and PeaceHealth Networks have received determination letters from the Internal Revenue Service stating that they are exempt from federal and state income tax under Section 501(c)(3) of the Internal Revenue Code except for tax on unrelated business income. It is management's belief that none of its activities have produced material unrelated business income.

The Corporation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that exceeds a 50% probability of being realized. Changes in recognition or measurement are reflected in the period in which the change in estimate occurs.

Certain affiliated entities included in the consolidated financial statements may be subject to taxation. The tax expense and related provision for these entities are not material to the consolidated financial statements.

(u) Oregon State Provider Tax and Washington State Safety Net Assessment

Effective July 1, 2004, the state of Oregon instituted a provider tax on certain patient service revenue at qualifying hospitals. The state of Washington enacted the safety net program in 2009 involving Washington State hospitals to increase funding from other sources and obtain additional federal funds to support increased payments to providers for Medicaid services.

In 2014, the state of Washington re-enacted legislation that provided for increased Medicaid payments to certain hospitals funded by assessments paid by these hospitals as well as matching federal funds (the safety net program). The safety net program covers the period from July 1, 2013 to June 30, 2017. Providers are assessed and reimbursed on a quarterly basis. During 2015, the state of Washington received approval from CMS related to the managed care portion of the program. Therefore, as of June 30, 2015, the fee-for-service and managed care portions of the program were both approved. In 2015, the Corporation recognized supplemental payments of $28,183 and assessments of $22,366 related to 2015 dates of service.

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In 2016 and 2015, with the States of Washington and Oregon programs, supplemental payments of $82,195 and $103,257, respectively, and assessments of $68,909 and $84,727, respectively, were recorded in net patient service revenue and other expenses, in the accompanying consolidated statements of operations and changes in net assets.

(v) Ownership in Group Purchasing Organization

The Corporation was an owner of several of the entities associated within a group purchasing organization (GPO), Premier. In October 2013, Premier restructured its business, including its initial public offering.

As part of the transaction, the Corporation received $6,053 in cash, and approximately 1,253,000 shares of Class B units in Premier in fiscal year 2014. These shares vest over the next seven years, as long as the Corporation remains a member of Premier. Upon each vesting date, the Corporation has the option to convert these shares into the publically traded securities of Premier or have them repurchased by Premier. The Corporation is recognizing the value of the shares over the vesting period, as a reduction of supplies expense. Upon the annual vesting date, October 31, the vested shares will be accounted for under the fair value option, whereby future changes in share price will be treated as nonoperating investment activity. In fiscal year 2016, 179,055 shares of Class B stock vested. In addition, the Corporation receives quarterly distributions associated with its purchasing volumes and tax benefits associated with the restructuring. These distributions are recognized as a reduction of supplies expense.

In 2016 and 2015, the Corporation recognized approximately $8,875 and $10,367, respectively, as a reduction of supplies expense associated with these transactions. The 2016 reduction comprised $5,689 related to Class B units and $3,186 in quarterly distributions. The 2015 reduction comprised $7,364 related to Class B units and $3,003 in quarterly distributions.

During 2016, the Corporation sold 358,110 shares of Class B units in Premier, which resulted in total proceeds of $11,728 and a gain on the sale of $340.

(w) Environmental Liability

Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Subtopic 410-30, *Environmental Obligations*, requires the fair value of a liability for a legal obligation associated with an asset retirement be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized. The Corporation had $18,905 and $18,051 recorded as other long-term liabilities as of June 30, 2016 and 2015, respectively. The Corporation recognized $805 and $794 in 2016 and 2015, respectively, related to amortization. Amortization is recognized over the life of the related asset.

(x) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation to more consistently present financial information between years.

(y) Recently Adopted or Newly Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (IFRS). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. The Corporation is currently evaluating the impact of ASU 2014-09, including the methods of implementation, which is effective for the fiscal year beginning on July 1, 2018.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize a lease liability and a right of use asset for all lease obligations with exception to short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right of use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The lease guidance also simplifies accounting for sale-leaseback transactions. The Corporation is currently evaluating the impact of ASU 2016-02, which is effective for the fiscal year beginning on July 1, 2019 with retrospective application to the earliest presented period.

In May 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-07, Fair Value Measurement (Topic 820) – Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), which eliminates the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value (NAV) per share, or its equivalent, using the practical expedient in the FASB's fair value measurement guidance. The Corporation has adopted the provision of this standard. The adoption of this ASU did not have a material impact on the Corporation's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities, to reduce diversity in reporting practice, reduce complexity, and enhance understandability of Not-for-Profit financial statements. This ASU contains the following key aspects: (A) Reduces the number of net asset classes presented from three to two: w*ith donor restrictions* and *without donor restrictions*; (B) Requires all NFPs to present expenses by their functional *and* their natural classifications in one location in the financial statements; (C) Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) Retains the option to present operating cash flows in the statement of cash flows using either the direct or indirect method. The Corporation is currently evaluating the impact of ASU 2016-14, including the methods of implementation, which is effective for the fiscal year beginning July 1, 2018.

(Continued)

(3) Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurement*, 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 three 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 measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Corporation uses a practical expedient for the estimation of the fair value of investments in funds for which the investment does not have a readily determinable fair value. The practical expedient used by the Corporation is the net asset value (NAV) per share, or its equivalent. In some instances, the NAV may not equal the fair value that would be calculated under fair value accounting standards. Valuations provided by fund administrators consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the exit price. Management reviews the valuations and assumptions provided by fund administrators for reasonableness and believes that the carrying amounts of these financial instruments are reasonable estimates of fair value. The initial valuation is adjusted when changes to inputs and assumptions are corroborated by evidence, such as transactions of similar securities, completed or pending third-party transactions in the underlying security or comparable entities, offerings in the capital markets, and changes in financial results, data, or cash flows. For positions that are not traded in active markets or are subject to notice provisions, valuations are adjusted to reflect such provisions, and such adjustments are generally based on available market evidence.

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. When available, quoted market prices are also used. The carrying value and fair value of bond debt, was approximately $1,012,825 and $1,037,483, respectively, as of June 30, 2016, and approximately $1,043,844 and $1,060,037, respectively, as of June 30, 2015. Remaining other debt of $22,508 and $30,715 as of June 30, 2016 and 2015, respectively, approximates carrying value.

Other financial instruments of the Corporation include cash and cash equivalents and other receivables. The carrying amount of these instruments approximates fair value because these items mature in less than one year. The carrying amount of other long-term investments approximates fair value.

(In thousands of dollars)

(4) Investments

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2016 is set forth in the following table:

			Fair value measurements at reporting date using		
		June 30, 2016	**Level 1**	**Level 2**	**Level 3**
Assets:					
Short-term investments:					
Fixed income:					
Government obligations	$	97,347	—	97,347	—
Corporate obligations		71,369	—	71,369	—
Mortgage-backed securities:					
Commercial		20,768	—	20,768	—
Residential		80,081	—	80,081	—
Municipal, foreign, and other fixed income		13,358	—	13,358	—
Mutual funds:					
Domestic debt securities		44,490	44,490	—	—
International debt securities		13,289	13,289	—	—
Other short-term investments		724	—	724	—
Total		341,426	57,779	283,647	—
Designated for capital acquisition:					
Cash and money market funds		58,422	58,422	—	—
Fixed income:					
Government obligations		95,873	—	95,873	—
Corporate obligations		74,746	—	74,746	—
Mortgage-backed securities:					
Commercial		8,116	—	8,116	—
Residential		54,276	—	54,276	—
Municipal, foreign, and other fixed income		23,247	—	23,247	—
Mutual funds:					
Fixed income		114,956	114,956	—	—
Domestic equities:					
Large capitalization		265,322	265,322	—	—
Medium-small capitalization		107,084	107,084	—	—
International equities:					
Foreign stock	$	118,545	118,545	—	—
Emerging markets		32,028	32,028	—	—
Real estate funds		31,263	31,263	—	—
Other long-term equity invest		3,973	3,973	—	—
Total		987,851	731,593	256,258	—

(In thousands of dollars)

		Fair value measurements at reporting date using		
	June 30, 2016	**Level 1**	**Level 2**	**Level 3**
Funds designated for 457 plans:				
Cash and short term	$ 1,379	1,379	—	—
Mutual funds:				
Equity	13,465	13,465	—	—
Fixed income	7,106	7,106	—	—
Target/blended/other	19,683	19,683	—	—
Total	41,633	41,633	—	—
Trustee-held funds:				
Cash and money market funds	2,339	2,339	—	—
Fixed income:				
Government obligations and other	290	—	290	—
Mortgage-backed securities:				
Residential	3,895	—	3,895	—
Mutual funds:				
Domestic equities:				
Large capitalization	14,432	14,432	—	—
Medium-small capitalization	8,564	8,564	—	—
International equities:				
Foreign stock and emerging markets	10,966	10,966	—	—
Domestic debt securities	35,779	35,779	—	—
Real estate funds	4,937	4,937	—	—
Total	81,202	77,017	4,185	—
Total assets at fair value	$ 1,452,112	908,022	544,090	—
Investments measured at NAV	9,155			
Total assets	$ 1,461,267			

		Fair value measurements at reporting date using		
	June 30, 2016	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Interest rate swaps	$ 153,927	—	153,927	—
Total liabilities	$ 153,927	—	153,927	—

(Continued)

(In thousands of dollars)

The composition of cash and investments carried at fair value on a recurring basis at June 30, 2015 is set forth in the following table:

		Fair value measurements at reporting date using		
	June 30, 2015	**Level 1**	**Level 2**	**Level 3**
Assets:				
Short-term investments:				
Cash and money market funds	$ 2,667	2,667	—	—
Fixed income:				
Government obligations	107,769	—	107,769	—
Corporate obligations	86,430	—	86,430	—
Mortgage-backed securities:				
Commercial	27,215	—	27,215	—
Residential	72,834	—	72,834	—
Municipal, foreign, and other fixed income	14,931	—	14,931	—
Mutual funds:				
Domestic debt securities	29,497	29,497	—	—
International debt securities	9,293	9,293	—	—
Other short-term investments	801	—	801	—
Total	351,437	41,457	309,980	—
Designated for capital acquisition:				
Cash and money market funds	58,929	58,929	—	—
Fixed income:				
Government obligations	46,772	—	46,772	—
Corporate obligations	67,554	—	67,554	—
Mortgage-backed securities:				
Commercial	13,072	—	13,072	—
Residential	39,938	—	39,938	—
Municipal, foreign, and other fixed income	25,345	—	25,345	—
Mutual funds:				
Fixed income	96,376	96,376	—	—
Domestic equities:				
Large capitalization	224,233	224,233	—	—
Medium-small capitalization	103,057	103,057	—	—

(Continued)

(In thousands of dollars)

		Fair value measurements at reporting date using		
	June 30, 2015	**Level 1**	**Level 2**	**Level 3**
International equities:				
Foreign stock	$ 116,105	116,105	—	—
Emerging markets	35,669	35,669	—	—
Real estate funds	24,958	24,958	—	—
Commodities	14	—	14	—
Other long-term equity invest	11,477	—	11,477	—
Total	863,499	659,327	204,172	—
Funds designated for 457 plans:				
Cash and short term	1,357	1,357	—	—
Mutual funds:				
Equity	13,561	13,561	—	—
Fixed income	6,603	6,603	—	—
Target/blended/other	17,650	17,650	—	—
Total	39,171	39,171	—	—
Trustee-held funds:				
Cash and money market funds	3,706	3,706	—	—
Fixed income:				
Government obligations and other	5,277	—	5,277	—
Mortgage-backed securities:				
Residential	4,587	—	4,587	—
Mutual funds:				
Domestic equities:				
Large capitalization	36,864	36,864	—	—
Medium-small capitalization	18,235	18,235	—	—
International equities:				
Foreign stock and emerging markets	29,846	29,846	—	—
Domestic debt securities	76,753	76,753	—	—
International debt securities	293	293	—	—
Real estate funds	7,823	7,823	—	—
Total	183,384	173,520	9,864	—
Total assets at fair value	$ 1,437,491	913,475	524,016	—
Investments measured at NAV	12,412			
Total assets	$ 1,449,903			

(Continued)

(In thousands of dollars)

			Fair value measurements at reporting date using	
	June 30, 2015	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Interest rate swaps	$ 107,316	—	107,316	—
Total liabilities	$ 107,316	—	107,316	—

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2016 and June 30, 2015:

	2016	**2015**	**Unfunded Commitments**
Distressed Debt	$ 1,841	2,335	1,000
Private Equity	7,314	10,077	1,065
Total	$ 9,155	12,412	2,065

The Corporation holds investments in private equity limited partnerships where NAV is used as a practical expedient to measure fair value at June 30, 2016. These partnerships do not allow for periodic redemptions, but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investments are considered illiquid investments. At June 30, 2016, the Corporation held $9,155 of private equity and distressed debt limited partnerships that had termination dates that ranged from 2016 to 2022.

Investment income is comprises the following for the years ended June 30, 2016 and 2015:

	2016	**2015**
Interest and dividend income	$ 28,189	25,354
Net realized gains on sales of investments	21,287	653
Net change in unrealized gains on investments	(42,211)	(3,881)
Investment income, net	$ 7,265	22,126

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. PeaceHealth is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of the obligated group. The majority of these joint ventures are accounted for under the equity method. As of June 30, 2016 and 2015, the carrying value of the joint ventures was approximately $13,295 and $13,360, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from the joint ventures of $7,136 and $7,970 for the years ended June 30, 2016 and 2015, respectively, is included in other operating

(Continued)

(In thousands of dollars)

revenue. The assets, liabilities, and equity of these joint ventures accounted for under the equity method were $34,652, $9,522, and $25,130, respectively, at June 30, 2016 and $31,525, $5,706, and $25,819, respectively, at June 30, 2015.

Health Ventures has a controlling ownership of 54.05% in Riverbend Ambulatory Surgery Center, which is consolidated within Health Ventures.

(5) Charity Care

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

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies under its charity care policy. Estimated costs (based on the proportion of overall costs to charges foregone for charity care) for services and supplies furnished under the charity care policy for the years ended June 30, 2016 and 2015 were approximately $14,747 and $20,283, respectively.

(6) Long-Term Debt

Long-term debt at June 30 consisted of the following:

		2016	2015
Series 1995 Oregon Bonds, variable interest rate, paid off during fiscal year 2016.	$	—	1,295
Series 2008 Washington Bonds, Series A, fixed interest rate of 5% payable on each May 1 and November 1 through November 2018.		80,650	80,650
Series 2008 Oregon Bonds, Series A-B, variable interest rate (0.41% at June 30, 2016), principal payable each August, due in annual installments from 2030 to 2034 for Series A and B		145,975	145,975
Series 2009 Oregon Bonds, Series A, fixed interest rates of 3.25% to 5.00% payable each May and November, due in installments from 2013 to 2039		86,310	91,505
Series 2009 Washington Bonds, Series A, fixed interest rates of 3.0% to 5.0% payable each in May and November, due in installments through 2028		72,410	75,160
Series 2011 Oregon Bonds, Series A-B, variable interest rates (0.96% at June 30, 2016) principal payable each May, due in installments from 2036 to 2047		150,000	150,000

(In thousands of dollars)

		2016	2015
2011 Direct Note Obligation to Union Bank 2.46% payable monthly based on a ten-year amortization with remaining amount due November 2016	$	5,417	6,417
2012 Direct Note Obligation to Bank of America, fixed interest rate of 2.3%, due on December 1, 2022		37,889	43,181
2013 Washington Bonds, Series A, variable interest rate (1.01% at June 30, 2016), principal payable each September, in annual installments from 2013 to 2034		50,065	51,265
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.23%, due on October 2, 2023		38,218	42,753
2013 Direct Note Obligation to Bank of America, fixed interest rate of 3.92%, due on October 2, 2023		168,140	172,714
2013 Direct Note Obligation to US Bank, fixed interest rate of 3.43%, due on October 8, 2020		50,000	50,000
Series 2014 Washington Bonds, Series A, fixed interest rates of 2.0% to 5.0% payable each May and November, due in installments through 2028		36,620	38,610
Series 2014 Oregon Bonds, Series A, fixed interest rate of 5.0%, payable each May and November, due in installments from 2016 through 2029		66,060	66,060
2015 Direct Note Obligation to US Bank, variable interest rate (1.21% at June 30, 2016), due on June 30, 2020		8,080	10,100
Long-term debt at par value		995,834	1,025,685
Premium and other on long-term debt		16,991	18,159
Other long-term debt		22,508	30,715
Total long-term debt		1,035,333	1,074,559
Less amounts due within one year		(40,814)	(36,774)
Total long-term debt due after one year	$	994,519	1,037,785

PeaceHealth Networks and PeaceHealth are the sole members of the PeaceHealth Obligated Group. The assets of the Obligated Group are available for the satisfaction of debts of PeaceHealth and PeaceHealth Networks under the terms of its Master Trust Indenture.

The 2008 Oregon Series A-B Variable Rate Demand Bonds, the Series 2011 Oregon Series A-B Direct Placement Bonds, and the Washington 2013(A) Direct Placement Bonds have variable interest rates that may bear interest at a daily, weekly, 28-day, monthly, semiannual, or annual rates. The rate determination mode may be changed upon request of PeaceHealth and PeaceHealth Networks. The bonds are subject to optional redemption by PeaceHealth and PeaceHealth Networks, in whole or in part at 100% of the principal amount plus accrued interest. The 2008 Oregon Variable Rate Demand Bonds are backed by letters of credit

(Continued)

in the amount of approximately $147,607. The letter of credit for Series A-B of the 2008 Oregon bonds will expire in June 2020. The 2011 Oregon bonds are held directly by two financial institutions subject to continuing covenant agreements, which contain substantially the same credit terms as the letters of credit, but which are not subject to the same remarketing and put risk as the 2008 bonds. The 2011 Oregon bonds and Washington 2013(A) bonds can be converted to publicly held variable rate demand bonds if PeaceHealth and PeaceHealth Networks chooses. The continuing covenant agreements for the Oregon 2011 Direct Placement Bonds expire in February 2019 for Series (A) and August 2020 for Series (B). The continuing covenant agreement for the Washington 2013(A) bonds expires February 2019, and requires a minimum two year notice period from the bank to PeaceHealth thereafter if the bank chooses to no longer hold the debt, provided that PeaceHealth is in compliance with financial covenants. With the exception of the WHCFA 2013(A) bonds, where subsequent to February 2019 the bank must give a two year notice if it wishes to terminate its holding of PeaceHealth's debt, the letters of credit and the continuing covenant agreements are extendable annually at the option of the bank upon request from PeaceHealth and PeaceHealth Networks for an additional year. The 2008, 2011 and 2013(A) bonds are matched to fixed payor swaps ranging between 3.60% and 4.10% for approximately their par value, the notional amounts of swaps amortizing proportionately to the bonds.

The Series 2008 Oregon variable rate demand bonds, which have long-term amortization periods, may be put back to the letter of credit bank on any interest rate reset date if the bonds fail to be remarketed. In the event of a failed remarketing, the letter of credit bank is obligated under the terms of the letter of credit agreement to buy the bonds. If the bonds continue to fail to be remarketed, and become a term loan from the letter of credit bank to the Corporation, the payments commence not less than 367 days after the purchase of the bonds by the letter of credit bank, and are payable in equal quarterly installments thereafter for a period of three years.

Other long-term debt includes $22,508 in capital leases and other debt.

(In thousands of dollars)

Scheduled principal payments of long-term debt, excluding the premium on bonds, as due according to their original long-term amortization schedule and other debt according to its original maturity schedule for the next five years and thereafter are as follows:

	Long-term debt	Capitalized leases and other	Total
Year ending June 30:			
2017	$ 34,364	7,267	41,631
2018	30,620	4,094	34,714
2019	103,570	3,518	107,088
2020	30,791	1,073	31,864
2021	80,993	631	81,624
Thereafter	715,496	8,889	724,385
Total	$ 995,834	25,472	1,021,306
Less amounts representing interest		(2,964)	(2,964)
Present value of net minimum capital lease payments		22,508	
Less current installments of obligations under capital leases		(6,450)	
Obligations under capital leases, excluding current installments		$ 16,058	
Total long-term debt			$ 1,018,342

The PeaceHealth Master Trust Indenture, the loan agreements and other contractual documents under which bonds were issued include covenants which, among others, obligate PeaceHealth and PeaceHealth Networks to: maintain net patient service revenue at levels sufficient to achieve specified debt service coverage ratios; meet certain financial tests before additional debt can be incurred; and meet certain financial tests before there can be any significant disposition of property.

Cash paid for interest totaled approximately $31,357 and $32,914 for the years ended June 30, 2016 and 2015, respectively. Interest totaling approximately $238 and $2,035 was capitalized in connection with construction projects during the years ended June 30, 2016 and 2015, respectively.

(7) Accounting for Derivative Instruments and Hedging Activities

In accordance with the policy adopted by the board of directors, the Corporation may use interest rate swap contracts to manage its net exposure to interest rate changes in attempting to reduce its overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Corporation accounts for its interest rate hedging transactions in accordance with FASB ASC 815, *Derivatives and Hedging*. That standard requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its estimated fair value. The interest rate swaps do not meet the criteria for hedge accounting and all changes in the valuation of the interest rate swaps are recognized in the consolidated statements of operations.

The Corporation has interest rate swap contracts outstanding as of June 30, 2016 and 2015, respectively, with a total current notional amount of approximately $384,075 and $427,600, which includes fixed payer swaps of approximately $384,075 and $387,600, which the Corporation uses to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 3.5% to 4.1% and a $40,000 basis swap outstanding as of June 30, 2015 where the Corporation received 81.9% of 30 day LIBOR and paid a 30 day tax‑exempt index rate which was terminated during fiscal 2016. The fixed payer interest rate swaps are associated with the variable rate bonds, but have not been integrated to any of the underlying debt for the purpose of hedge accounting.

Change in valuation of interest rate swaps consists of the non‑cash change in the liability primarily due to changes in market bond yields, as well as the cash payments and receipts associated with the swaps, and the amortization of the accumulated hedge effectiveness included in net assets. The non‑cash change in the fair value of the interest rate swaps, was an increase of $46,611 and $11,855 in the liability for the years ended June 30, 2016 and 2015, respectively. Net cash settlement cost for the interest rate swaps was $14,224 and $14,725, for the years ended June 30, 2016 and 2015, respectively. The amortization of the accumulated hedge effectiveness included in net assets was $78 for both years ended June 30, 2016 and 2015.

Derivative instruments are recorded at fair value taking into consideration the Corporation’s nonperformance risk and the respective counterparty’s nonperformance risk in the fair value measurements. The impact of taking into account the nonperformance risk on the estimated fair value of the interest rate swaps was a benefit of approximately $22,251 and $15,264, as of June 30, 2016 and 2015, respectively. Recording the interest rate swaps at fair value results in a total liability of $153,927 and $107,316 as of June 30, 2016 and 2015, respectively, in other long‑term liabilities in the accompanying consolidated balance sheets rather than the $176,178 and $122,580 that would be paid if all of the swaps were terminated as of June 30, 2016 and 2015, respectively. The inputs used to determine the impact of the counterparty nonperformance risk are Level 2 inputs; as such derivative liabilities have been recorded as Level 2 in the Corporation’s disclosure of fair value instruments, see note 4.

The Corporation currently has four swap counterparties which minimize counterparty risk and collateral posting requirements. These swap agreements contain various credit thresholds that if breached by the Corporation would constitute an additional termination event whereby the swap counterparties could terminate the swap by either making a payment to, or receiving a payment from the Corporation, depending upon the termination value of the swaps as of the date of termination. The Corporation retains the right to terminate the swaps at any point, which would also require either making or receiving a payment depending on the termination value of the swap as of the termination date.

(In thousands of dollars)

(8) Benefit Plans

Defined Benefit Pension Plan

The Corporation sponsors a noncontributory defined benefit pension plan, the Southwest Washington Health System Retirement Plan, now known as PeaceHealth SWHS Frozen DB Pension Plan (the Plan) effective January 30, 2015, covering all employees at PeaceHealth Southwest Medical Center who meet requirements as specified in the Plan. The assets of the Plan are available to pay the benefits of all eligible employees of the Plan. The Plan has two benefit structures that include a cash balance and a final average pay structure. Effective December 31, 2010, the Plan was frozen. No new participants are admitted to the Plan after this date. This event did not terminate the Plan. Benefits earned before the plan was frozen will continue to be paid as participants qualify to receive benefits.

The following table sets forth disclosures related to the Plan in accordance with FASB ASC 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2016 and 2015:

	Years ended June 30	
	2016	**2015**
Change in projected benefit obligation:		
Projected benefit obligation (PBO) at beginning of period	$ 238,423	221,721
Service cost	1,565	1,094
Interest cost	10,070	9,040
Actuarial loss on PBO	27,462	14,005
Benefits and administrative expenses paid	(12,282)	(7,437)
Projected benefit obligation at June 30	$ 265,238	238,423

(In thousands of dollars)

		Years ended June 30	
		2016	2015
Change in fair value of plan assets:			
Fair value of assets at beginning of period	$	175,931	163,247
Actual return on plan assets		(2,982)	2,941
Employer contribution		—	17,180
Benefits paid		(10,828)	(6,390)
Administrative expenses		(1,454)	(1,047)
Fair value of assets at June 30	$	160,667	175,931
Reconciliation of funded status:			
Funded status	$	(104,570)	(62,492)
Net amount recognized	$	(104,570)	(62,492)
Amounts recognized in the consolidated balance sheets consist of:			
Accrued pension liability	$	104,570	62,492
Accumulated change in net assets		(77,911)	(36,813)

The accumulated benefit obligation for the Plan was $265,238 and $238,423 at June 30, 2016 and 2015, respectively.

Net periodic benefit cost for the years ended June 30, 2016 and 2015 included the following components and is included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets:

		2016	2015
Service cost	$	1,565	1,094
Interest cost		10,070	9,040
Expected return on plan assets		(12,668)	(11,976)
Amortization of loss		5,056	3,885
Net periodic pension cost	$	4,023	2,043

(a) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2016 and 2015, with measurement dates of June 30, 2016 and 2015:

	2016	2015
Discount rate	3.35%	4.30%

(Continued)

(In thousands of dollars)

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the years ended June 30, 2016 and 2015:

	2016	**2015**
Discount rate	4.30%	4.15%
Expected long-term rate of return on plan assets	7.25%	7.25%

This discount rate is based on a proprietary yield curve tool used by the Plan's actuary, which uses a composite of high-yield, investment-grade corporate bonds, and the projected payouts from the Plan to develop an equivalent yield rate to use in determining plan liabilities.

The expected long-term rate of return on plan assets was based on the asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The actual return on pension plan assets was approximately 1.2% loss and 1.8% gain during the years ended June 30, 2016 and 2015, respectively. In the calculation of pension plan expense, the expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a four-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns and expected returns based on the long-term rate of return assumptions.

(b) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2016 and 2015 is as follows:

		2016	**2015**
Equity securities	$	103,616	97,729
Debt securities		55,386	53,593
Other		1,665	24,609
Total	$	160,667	175,931

Pension plan assets are managed according to an investment policy adopted by the Plan's trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plan's trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities, and cash/other investments. The target allocations are 40% bonds and 60% stocks. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

(In thousands of dollars)

In accordance with FASB ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. These levels and the adoption of FASB ASC 820 are further discussed in note 4.

Following is a description of the valuation methodologies used for plan assets measured at fair value.

- Mutual Funds: Valued at the NAV of shares held by the Plan at year-end.
- Real Estate Investment Fund and Hedge Fund: Valued at the NAV of the underlying assets as supported by audited financial statements.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan 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.

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2016:

Assets	Total fair value	Level 1	Level 2	Level 3
Equity securities:				
Mutual funds:				
Large cap	$ 41,449	41,449	—	—
Mid cap	10,074	10,074	—	—
Small cap	6,861	6,861	—	—
Foreign stock and emerging markets	45,232	45,232	—	—
Total equity securities	103,616	103,616	—	—
Debt securities:				
Mutual funds:				
Fixed income	38,537	38,537	—	—
Global fixed income	16,849	16,849	—	—
Total debt securities	55,386	55,386	—	—
Total plan assets at fair value	$ 159,002	159,002	—	—
Investments at NAV	1,665			
Total plan assets	$ 160,667			

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2015:

Assets		Total fair value	Level 1	Level 2	Level 3
Equity securities:					
Mutual funds:					
Large cap	$	38,359	38,359	—	—
Mid cap		9,973	9,973	—	—
Small cap		6,660	6,660	—	—
Foreign stock and emerging markets		42,737	42,737	—	
Total equity securities		97,729	97,729	—	—
Debt securities:					
Mutual funds:					
Fixed income		43,579	43,579	—	—
Global fixed income		10,014	10,014	—	—
Total debt securities		53,593	53,593	—	—
Other:					
Cash and money markets		10,293	10,293	—	—
Total other		10,293	10,293	—	—
Total plan assets at fair value	$	161,615	161,615	—	—
Investments at NAV		14,316			
Total plan assets	$	175,931			

The following table provides information regarding redemption of investments where NAV has been used as a practical expedient at June 30, 2016 and June 30, 2015:

		2016	2015
Private Equity	$	1,665	1,998
Hedge Funds		—	12,318
Total	$	1,665	14,316

At June 30, 2016 and 2015, the Plan held $1,665 and $14,316, respectively, in alternative investments that are not actively marketed on an open exchange. These investments consist of shares or units in

(Continued)

(In thousands of dollars)

investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Due to the nature of these funds the NAV is used as a practical expedient to measure fair value at June 30, 2016. These partnerships do not allow for periodic redemptions, but rather liquidate upon the termination date as stated in the partnership agreement. Therefore, the private equity investment is considered an illiquid investment. At June 30, 2016 the Corporation held $1,665 of private equity limited partnerships that had a termination date of June 2019, but may be extended by up to three additional one-year periods.

(c) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts deemed appropriate. In the start of fiscal year 2017, the Corporation contributed $8,700 to the Plan for fiscal year 2017.

Benefit payments are expected to be paid as follows for the fiscal years ended June 30:

	Pension benefits
2017	$ 9,466
2018	10,061
2019	10,852
2020	11,531
2021	12,069
2022–2026	65,929

Expected benefit payments presented above are based on actuarial estimates. Actual benefit payments may vary significantly from these estimates.

Management is not aware of any settlements or curtailments that would require additional recognition during 2016.

(9) Defined Contribution Retirement Plans

PeaceHealth sponsors two defined contribution retirement plans, the Southwest Washington Health System Retirement Plan and the PeaceHealth Plan. These plans cover substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total defined contribution retirement plan costs charged to operations were approximately $68,215 and $70,111 for the years ended June 30, 2016 and 2015, respectively, which are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

PeaceHealth Deferred Compensation Plans

The estimated fair value associated with the plan assets of PeaceHealth's 457(b) and 457(f) postretirement savings plans, in the amount of approximately $41,633 and $39,171 at June 30, 2016 and 2015, respectively, is included in assets whose use is limited, cash and investments, with a corresponding amount included in other long-term liabilities. Contributions associated with these funds in 2016 and 2015 were $5,430 and $7,276, respectively, and included in payroll taxes and benefits in the accompanying consolidated statements of operations.

(In thousands of dollars)

(10) Restricted Net Assets

Restricted net assets are those whose use by the Corporation has been limited by donor-imposed restrictions to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

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

	2016	2015
Purchase of property, plant, and equipment	$ 4,854	15,021
Hospice and indigent care	13,138	2,544
Patient care	16,616	14,740
Other	24,152	12,033
	$ 58,760	44,338

The income from permanently restricted net assets is available for the following purposes at June 30:

	2016	2015
Purchase of property, plant, and equipment	$ —	1,442
Hospice and indigent care	3,396	5,536
Patient care operating activities	18,943	16,343
Other	—	1,097
	$ 22,339	24,418

Approximately $2,544 and $2,990 were released from restriction for capital expenditures made during 2016 and 2015, respectively.

Charitable Gift Annuities

PeaceHealth has been granted a license by the state of Washington, Office of Insurance Commissioner, to issue Charitable Gift Annuities in support of its charitable activities. The Corporation has delegated all its charitable fund raising activities to several fund-raising foundations whose net assets, held for the beneficial interest of PeaceHealth, are shown on the consolidated balance sheets of the Corporation. The liability for annuity contracts issued under the PeaceHealth license and the separately maintained reserve accounts are recorded on the books of PeaceHealth. As of June 30, 2016 and 2015, the following liabilities for annuity contracts issued under the PeaceHealth license and reserve account investments were recorded:

(In thousands of dollars)

		2016	2015
State of Washington gift annuity liabilities (other long-term liabilities)	$	613	792
Gift annuity reserve accounts (other assets whose use is limited, cash and investments)		685	1,052

(11) Commitments and Contingent Liabilities

(a) Litigation

Various laws and regulations of federal, state, and local governments govern the healthcare industry. These laws and regulations are subject to ongoing government review and interpretation, as well as regulatory actions unknown or unasserted at this time. The Corporation is also involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations.

(b) Operating Leases

The Corporation leases, for a nominal amount, the buildings and certain equipment for Ketchikan General Hospital from the City of Ketchikan, Alaska under a 10-year lease that expires in 2023.

The Corporation leases, from Skagit County Public Hospital District No. 304, the buildings and certain equipment for United General Medical Center in Sedro Woolley, Washington under a 30-year lease that expires in 2044.

Rent and lease expense future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2016 are as follows:

		Operating leases
Year ending June 30:		
2017	$	4,171
2018		753
2019		623
2020		489
2021		478
Later years, 2022 through 2026		12,384
Total minimum lease payments	$	18,898

Rent expense related to all operating leases was $24,167 and $25,497 during the years ended June 30, 2016 and 2015, respectively, and was included in supplies and other expenses in the consolidated statements of operations.

(c) Collective Bargaining Agreements

Approximately 41% and 34% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2016 and 2015, respectively. The Corporation's various collective bargaining agreements expire between September 2016 and June 2020.

(d) Construction Commitments

As of June 30, 2016, the Corporation entered into construction commitments for approximately $11,653 related to open projects at year-end.

(12) Insurance Coverages

The Corporation has a self-insurance program for hospital and physician professional and general liability claims under which the Corporation contributes actuarially determined amounts to a trust to fund estimated ultimate losses. In connection with the self-insurance program, the Corporation has accrued estimates for asserted and incurred but not reported claims, including both the expected liability under each claim and the cost to administer the claim. Self-insured professional and general liability retention in 2016 and 2015 was $5,000, per occurrence and $15,000, in aggregate. Individual general and professional liability claims in excess of the above self-insured retention levels are insured through claims-made excess insurance policy.

The Corporation also self-insures all or a portion of liabilities for medical and dental benefit plans, unemployment, and workers' compensation claims. Funding levels and liabilities are determined based on actuarial studies.

Based on actuarial studies, the Corporation has recorded a liability for all of the self-insurance programs of approximately $104,089 and $111,862 at June 30, 2016 and 2015, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately $42,221 and $38,710 at June 30, 2016 and 2015, respectively. Management has recorded amounts receivable from excess insurance carriers totaling approximately $6,332 and $8,027 as of June 30, 2016 and 2015, respectively, which is included in other receivables in the accompanying consolidated balance sheets.

The Corporation is a minority investor in American Excess Insurance Exchange (AEIX). AEIX is a risk retention group owned by a group of healthcare providers and provides them with excess professional liability insurance coverage. The Corporation accounts for its interest in AEIX on the equity method of accounting less mandatory withdrawal penalties and an estimated discount to present value. As of June 30, 2016 and 2015, the carrying value of AEIX was approximately $3,556 and $5,590, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets. Investment income from AEIX is recorded as an adjustment to supplies and other operating expenses in the accompanying consolidated statements of operations.

(In thousands of dollars)

(13) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

		2016	2015
Healthcare services	$	2,058,828	1,958,560
General and administrative		336,149	300,071
	$	2,394,977	2,258,631

(14) Discontinued Operations

PeaceHealth Networks’ majority-owned subsidiary, CUP, entered into an Asset Purchase Agreement to sell certain Medicaid assets to Molina Heath Care of Washington, Inc. on December 31, 2015. Molina purchased the right to assume CUP’s Medicaid membership in the state of Washington, as well as certain other rights and assets, including the assumption of CUP’s assignable provider contracts, related to the operation of the Medicaid business. As of December 31, 2015, CUP discontinued all of its Medicaid and Individual health care plan coverages, and subsequently discontinued all ASO services provided to local companies. CUP obtained approval from the Board of Directors and Shareholders to formally begin the dissolution process. Contractual obligations have been reviewed, and accruals recorded as appropriate.

The results of CUP from discontinued operations are disclosed under discontinued operations for the year ended June 30, 2016 and the comparative results have been restated accordingly. The significant impacts to cash flows from discontinued operations have been disclosed in the consolidated statement of cash flows. Total loss from operations of CUP were $4,164 and $2,586 for the years ended June 30, 2016 and 2015, respectively, including total gain on disposal of $16,069 for the year ended June 30, 2016.

The following is a reconciliation of the major classes constituting the loss from discontinued operations that is presented in the consolidated statement of operations.

		2016	2015
Operating revenues	$	72,369	140,021
Salaries and wages		6,246	8,850
Professional fees		3,846	1,624
Medical claims expenses		71,721	127,264
Taxes		4,537	(51)
Other expenses		6,435	5,123
Other income		183	203
Loss of discontinued operations related to major classes of loss		(20,233)	(2,586)
Gain on the disposal of the discontinued operation		16,069	—
Total loss on discontinued operations	$	(4,164)	(2,586)

(15) Subsequent Events

In connection with the preparation of the consolidated financial statements in accordance with FASB ASC Topic 855, *Subsequent Events*, the Corporation has evaluated subsequent events through September 30, 2016, which is the date the consolidated financial statements were issued.