Consolidated Financial Statements and Supplemental Information

Catholic Health Initiatives
Years Ended June 30, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

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Building a better working world

Catholic Health Initiatives

Consolidated Financial Statements
and Supplemental Information

Years Ended June 30, 2016 and 2015

Contents

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Report of Independent Auditors

The Board of Stewardship Trustees
Catholic Health Initiatives

We have audited the accompanying consolidated financial statements of Catholic Health Initiatives 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 Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Catholic Health Initiatives at June 30, 2016 and 2015, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

September 23, 2016

Catholic Health Initiatives

Consolidated Balance Sheets
(In Thousands)

	June 30	
	2016	**2015**
Assets		
Current assets:		
Cash and equivalents	**$ 1,305,242**	$ 948,369
Net patient accounts receivable, less allowances for bad debts of $968,147 and $903,127 at June 30, 2016 and 2015, respectively	**2,161,237**	2,050,923
Other accounts receivable	**274,432**	323,739
Current portion of investments and assets limited as to use	**63,146**	61,220
Inventories	**296,647**	300,629
Assets held for sale	**223,285**	419,844
Prepaid and other	**152,230**	162,724
Total current assets	**4,476,219**	4,267,448
Investments and assets limited as to use:		
Internally designated for capital and other funds	**4,952,065**	5,461,568
Mission and Ministry Fund	**125,166**	135,808
Capital Resource Pool	**261,572**	330,678
Held by trustees	**113,235**	65,284
Held for insurance purposes	**841,048**	829,914
Restricted by donors	**264,949**	299,147
Total investments and assets limited as to use	**6,558,035**	7,122,399
Property and equipment, net	**9,452,010**	9,487,090
Investments in unconsolidated organizations	**1,263,506**	1,133,026
Intangible assets and goodwill, net	**462,838**	550,500
Notes receivable and other	**446,522**	442,829
Total assets	**$ 22,659,130**	$ 23,003,292

	June 30	
	2016	2015
Liabilities and net assets		
Current liabilities:		
Compensation and benefits	**$ 717,638**	$ 709,439
Third-party liabilities, net	**110,284**	127,884
Accounts payable and accrued expenses	**1,750,402**	1,608,644
Liabilities held for sale	**131,814**	248,097
Variable-rate debt with self-liquidity	**96,700**	163,300
Commercial paper and current portion of debt	**1,769,390**	1,246,559
Total current liabilities	**4,576,228**	4,103,923
Pension liability	**1,535,840**	732,580
Self-insured reserves and claims	**646,714**	617,824
Other liabilities	**1,262,068**	1,187,676
Long-term debt	**7,191,184**	7,399,274
Total liabilities	**15,212,034**	14,041,277
Net assets:		
Net assets attributable to CHI	**6,704,217**	8,150,235
Net assets attributable to noncontrolling interests	**423,424**	445,687
Unrestricted	**7,127,641**	8,595,922
Temporarily restricted	**224,524**	268,317
Permanently restricted	**94,931**	97,776
Total net assets	**7,447,096**	8,962,015
Total liabilities and net assets	**$ 22,659,130**	$ 23,003,292

See accompanying notes.

Catholic Health Initiatives

Consolidated Statements of Operations
(In Thousands)

	Year Ended June 30 2016	2015
Revenues:		
Net patient services revenues before provision for doubtful accounts	**$ 15,469,651**	$ 14,217,024
Provision for doubtful accounts	**(881,813)**	(850,531)
Net patient services revenues	**14,587,838**	13,366,493
Other operating revenues:		
Donations	**37,937**	38,522
Changes in equity of unconsolidated organizations	**132,909**	47,503
Gains on business combinations	**223,036**	436,340
Hospital ancillary revenues	**357,204**	324,587
Other	**603,582**	630,270
Total other operating revenues	**1,354,668**	1,477,222
Total operating revenues	**15,942,506**	14,843,715
Expenses:		
Salaries and wages	**6,477,482**	5,937,853
Employee benefits	**1,254,460**	1,127,638
Purchased services, medical professional fees, medical claims and consulting	**2,372,906**	1,998,211
Supplies	**2,783,100**	2,540,721
Utilities	**231,719**	222,369
Rentals, leases, maintenance and insurance	**938,476**	875,529
Depreciation and amortization	**878,594**	813,760
Interest	**300,094**	269,131
Other	**893,488**	851,607
Total operating expenses before restructuring, impairment and other losses	**16,130,319**	14,636,819
(Loss) income from operations before restructuring, impairment and other losses	**(187,813)**	206,896
Restructuring, impairment, and other losses	**295,503**	183,038
(Loss) income from operations	**(483,316)**	23,858
Nonoperating (losses) gains:		
Investment (losses) gains, net	**(15,337)**	198,910
Loss on defeasance of bonds	**(29,469)**	(20,184)
Realized and unrealized losses on interest rate swaps	**(154,816)**	(77,217)
Other nonoperating (losses) gains	**(16,490)**	4,052
Total nonoperating (losses) gains	**(216,112)**	105,561
(Deficit) excess of revenues over expenses	**(699,428)**	129,419
Excess of revenues over expenses attributable to noncontrolling interest	**3,779**	15,829
(Deficit) excess of revenues over expenses attributable to CHI	**$ (703,207)**	$ 113,590

See accompanying notes.

Catholic Health Initiatives

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Unrestricted Net Assets					
	Attributable to CHI	**Attributable to Noncontrolling Interests**	**Total**	**Temporarily Restricted Net Assets**	**Permanently Restricted Net Assets**	**Total Net Assets**
Balances, July 1, 2014	$ 8,289,188	$ 469,296	$ 8,758,484	$ 265,639	$ 92,772	$ 9,116,895
Excess of revenues over expenses	113,590	15,829	129,419	–	–	129,419
Net loss from discontinued operations	(109,286)	–	(109,286)	–	–	(109,286)
Change in pension funded status	(135,282)	(444)	(135,726)	–	–	(135,726)
Temporarily and permanently restricted contributions	–	–	–	40,946	630	41,576
Net assets released from restriction for capital	17,715	–	17,715	(17,715)	–	–
Net assets released from restriction for operations	–	–	–	(24,796)	–	(24,796)
Investment income	40	–	40	5,586	342	5,968
Temporarily and permanently restricted assets from acquisitions	–	–	–	7,760	2,387	10,147
Other changes in net assets	(25,730)	(38,994)	(64,724)	(9,103)	1,645	(72,182)
Net (decrease) increase in net assets	(138,953)	(23,609)	(162,562)	2,678	5,004	(154,880)
Balances, June 30, 2015	8,150,235	445,687	8,595,922	268,317	97,776	8,962,015
(Deficit) excess of revenues over expenses	**(703,207)**	**3,779**	**(699,428)**	**–**	**–**	**(699,428)**
Net loss from discontinued operations	**(30,667)**	**–**	**(30,667)**	**–**	**–**	**(30,667)**
Change in pension funded status	**(768,468)**	**(4,877)**	**(773,345)**	**–**	**–**	**(773,345)**
Temporarily and permanently restricted contributions	**–**	**–**	**–**	**39,276**	**3,487**	**42,763**
Net assets released from restriction for capital	**66,487**	**–**	**66,487**	**(66,487)**	**–**	**–**
Net assets released from restriction for operations	**–**	**–**	**–**	**(17,912)**	**–**	**(17,912)**
Investment income (losses)	**423**	**–**	**423**	**27**	**(378)**	**72**
Temporarily and permanently restricted assets from acquisitions	**–**	**–**	**–**	**11,672**	**2,531**	**14,203**
Temporarily and permanently restricted assets from dispositions	**–**	**–**	**–**	**(5,700)**	**(11,373)**	**(17,073)**
Distributions to noncontrolling owners	**–**	**(19,669)**	**(19,669)**	**–**	**–**	**(19,669)**
Noncontrolling ownership acquisitions	**–**	**9,275**	**9,275**	**–**	**–**	**9,275**
Other changes in net assets	**(10,586)**	**(10,771)**	**(21,357)**	**(4,669)**	**2,888**	**(23,138)**
Net decrease in net assets	**(1,446,018)**	**(22,263)**	**(1,468,281)**	**(43,793)**	**(2,845)**	**(1,514,919)**
Balances, June 30, 2016	**$ 6,704,217**	**$ 423,424**	**$ 7,127,641**	**$ 224,524**	**$ 94,931**	**$ 7,447,096**

See accompanying notes.

Catholic Health Initiatives

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2016	**2015**
Operating activities		
Decrease in net assets	**$ (1,514,919)**	$ (154,880)
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	**878,594**	813,760
Provision for bad debts	**881,813**	850,531
Changes in equity of unconsolidated organizations	**(132,909)**	(47,503)
Net gains on business combinations	**(223,036)**	(436,340)
Net gains on sales of facilities and investments in unconsolidated organizations	**(244,003)**	(112,047)
Noncash operating expenses related to restructuring, impairment and other losses	**143,977**	45,422
Loss on defeasance of bonds	**29,469**	20,184
Decrease in fair value of interest rate swaps	**116,327**	33,680
Increase in unfunded pension liability	**786,852**	95,553
Net changes in current assets and liabilities:		
Net patient and other accounts receivable	**(974,031)**	(862,485)
Other current assets	**35,815**	14,151
Current liabilities	**99,709**	46,462
Other changes	**21,344**	25,480
Net cash (used in) provided by operating activities, before net change in investments and assets limited as to use	**(94,998)**	331,968
Net decrease in investments and assets limited as to use	**703,181**	230,119
Net cash provided by operating activities	**608,183**	562,087
Investing activities		
Purchases of property, equipment, and other capital assets	**(885,054)**	(1,064,849)
Investments in unconsolidated organizations	**(62,670)**	(30,403)
Business acquisitions, net of cash acquired	**(2,453)**	7,982
Proceeds from asset sales	**750,266**	295,804
Distributions from investments in unconsolidated organizations	**65,411**	77,800
Net repayments of notes receivable	**16,575**	12,266
Other changes	**(12,711)**	22,507
Net cash used in investing activities	**(130,636)**	(678,893)
Financing activities		
Proceeds from issuance of debt and bank loans	**993,998**	832,109
Costs associated with issuance of debt	**(1,076)**	–
Repayment of debt	**(948,871)**	(763,590)
Swap cash collateral posted	**(164,725)**	(46,092)
Net cash (used in) provided by financing activities	**(120,674)**	22,427
Increase (decrease) in cash and equivalents	**356,873**	(94,379)
Cash and equivalents at beginning of period	**948,369**	1,042,748
Cash and equivalents at end of period	**$ 1,305,242**	$ 948,369
Supplemental disclosures of noncash investing activity		
Non cash purchases of property and equipment	**$ 77,983**	$ 56,415
Supplemental disclosures of cash flow information		
Cash paid during the year for interest, including amounts capitalized	**$ 324,799**	$ 321,211

See accompanying notes.

1. Summary of Significant Accounting Policies

Organization

Catholic Health Initiatives (CHI), established in 1996, is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI sponsors market-based organizations (MBO) and other facilities operating in 17 states and includes 103 hospitals, including four academic medical centers, and 30 critical access facilities; community health service organizations; accredited nursing colleges; home health agencies; and other facilities that span the inpatient and outpatient continuum of care. CHI also has an offshore captive insurance company, First Initiatives Insurance, Ltd. (FIIL).

The mission of CHI is to nurture the healing ministry of the Church, supported by education and research. Fidelity to the Gospel urges CHI to emphasize human dignity and social justice as CHI creates healthier communities.

Principles of Consolidation

CHI consolidates all direct affiliates in which it has sole corporate membership or ownership (Direct Affiliates) and all entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and equivalents, patient accounts receivable, investments and assets limited as to use, notes receivable and accounts payable. The carrying amounts reported in the consolidated balance sheets for these items, other than investments and assets limited as to use, approximate fair value. See Note 7, *Fair Value of Assets and Liabilities*, for a discussion of the fair value of investments and assets limited as to use.

Cash and Equivalents

Cash and equivalents include all deposits with banks and investments in interest-bearing securities with maturity dates of 90 days or less from the date of purchase. In addition, cash and equivalents include deposits in short-term funds held by professional managers. The funds

1. Summary of Significant Accounting Policies (continued)

generally invest in high-quality, short-term debt securities, including U.S. government securities, securities issued by domestic and foreign banks, such as certificates of deposit and bankers' acceptances, repurchase agreements, asset-backed securities, high-grade commercial paper, and corporate short-term obligations.

Net Patient Accounts Receivable and Net Patient Services Revenues

Net patient accounts receivable has been adjusted to the estimated amounts expected to be collected. These estimated amounts are subject to further adjustments upon review by third-party payors.

The provision for bad debts is based upon management's assessment of historical and expected net collections, taking into consideration historical business and economic conditions, trends in health care coverage, and other collection indicators. Management routinely assesses the adequacy of the allowances for uncollectible accounts based upon historical write-off experience by payor category. The results of these reviews are used to modify, as necessary, the provision for bad debts and to establish appropriate allowances for uncollectible net patient accounts receivable. After satisfaction of amounts due from insurance, CHI follows established guidelines for placing certain patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by each facility. The provision for bad debts is presented on the consolidated statement of operations as a deduction from patient services revenues (net of contractual allowances and discounts) since CHI accepts and treats all patients without regard to the ability to pay.

During fiscal year 2016 and 2015, CHI added approximately $93.3 million and $134.3 million, respectively, in net patient and other accounts receivable due to the acquisition of various new subsidiaries – see Note 4, *Acquisitions, Affiliations and Divestitures*.

1. Summary of Significant Accounting Policies (continued)

Details of CHI's allowance activity is as follows: (in thousands)

	Reserve for Contractual Allowance	Allowance for Bad Debt	Reserve for Charity	Total Accounts Receivable Allowances
Balance at July 1, 2014	$ (3,497,151)	$ (874,633)	$ (430,156)	$ (4,801,940)
Additions	(33,438,680)	(850,531)	(809,064)	(35,098,275)
Reductions	33,223,143	822,037	935,085	34,980,265
Balance at June 30, 2015	(3,712,688)	(903,127)	(304,135)	(4,919,950)
Additions	**(36,732,943)**	**(879,841)**	**(903,790)**	**(38,516,574)**
Reductions	**36,469,175**	**814,821**	**1,029,754**	**38,313,750**
Balance at June 30, 2016	**$ (3,976,456)**	**$ (968,147)**	**$ (178,171)**	**$ (5,122,774)**

CHI records net patient services revenues in the period in which services are performed. CHI has agreements with third-party payors that provide for payments at amounts different from its established rates. The basis for payment under these agreements includes prospectively determined rates, cost reimbursement and negotiated discounts from established rates, and per diem payments.

Net patient services revenues are reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations, and excluding estimated amounts considered uncollectible. The differences between the estimated and actual adjustments are recorded as part of net patient services revenues in future periods, as the amounts become known, or as years are no longer subject to such audits, reviews and investigations.

1. Summary of Significant Accounting Policies (continued)

Investments and Assets Limited as to Use

Investments and assets limited as to use include assets set aside by CHI for future long-term purposes, including capital improvements and self-insurance. In addition, assets limited as to use include amounts held by trustees under bond indenture agreements, amounts contributed by donors with stipulated restrictions and amounts held for Mission and Ministry programs.

CHI has designated its investment portfolio as trading as the portfolio is actively managed to achieve investment returns. Accordingly, unrealized gains and losses on marketable securities are reported within excess of revenues over expenses. In addition, cash flows from the purchases and sales of marketable securities are reported as a component of operating activities in the accompanying consolidated statements of cash flows.

Direct investments in equity securities with readily determinable fair values and all direct investments in debt securities have been measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

Investments in limited partnerships and limited liability companies are recorded using the equity method of accounting (which approximates fair value as determined by the net asset values of the related unitized interests) with the related changes in value in earnings reported as investment income in the accompanying consolidated financial statements.

Inventories

Inventories, primarily consisting of pharmacy drugs, and medical and surgical supplies, are stated at lower of cost (first-in, first-out method) or market.

Assets and Liabilities Held for Sale

A long-lived asset or disposal group of assets and liabilities that is expected to be sold within one year is classified as held for sale. For long-lived assets held for sale, an impairment charge is recorded if the carrying amount of the asset exceeds its fair value less costs to sell. Such valuations include estimates of fair values generally based upon firm offers, discounted cash flows and incremental direct costs to transact a sale (Level 2 and Level 3 inputs).

1. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at historical cost or, if donated or impaired, at fair value at the date of receipt or impairment. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings and improvements are depreciated over estimated useful lives of 5 to 84 years, equipment over 3 to 30 years, and land improvements over 2 to 25 years. For property and equipment under capital lease, amortization is determined over the shorter period of the lease term or the estimated useful life of the property and equipment.

Interest cost incurred during the period of construction of major capital projects is capitalized as a component of the cost of acquiring those assets. Capitalized interest of $17.5 million and $33.2 million was recorded in the years ended June 30, 2016 and 2015, respectively.

Costs incurred in the development and installation of internal-use software are expensed if they are incurred in the preliminary project stage or post-implementation stage, while certain costs are capitalized if incurred during the application development stage. Internal-use software is amortized over its expected useful life, generally between 2 and 15 years, with amortization beginning when the project is completed and the software is placed in service.

Investments in Unconsolidated Organizations

Investments in unconsolidated organizations are accounted for under the cost or equity method of accounting, as appropriate, based on the relative percentage of ownership or degree of influence over that organization. The income or loss on the equity method investments is recorded in the consolidated statements of operations as changes in equity of unconsolidated organizations.

Intangible Assets and Goodwill

Intangible assets are comprised primarily of trade names which are amortized over the estimated useful lives ranging from 10 to 25 years using the straight-line method. The weighted average useful life of the trade names is 16 years. Amortization expense of $12.8 million and $11.2 million was recorded in the years ended June 30, 2016 and 2015, respectively.

1. Summary of Significant Accounting Policies (continued)

Goodwill is not amortized but is subject to annual impairment tests during the third quarter of the fiscal year, as well as more frequent reviews whenever circumstances indicate a possible impairment may exist. Impairment testing of goodwill is done at the reporting unit level by comparing the fair value of the reporting unit's net assets against the carrying value of the reporting unit's net assets, including goodwill. Each MBO is defined as a reporting unit for purposes of impairment testing. The fair value of net assets is generally estimated based on quantitative analysis of discounted cash flows (Level 3 measurement). The fair value of goodwill is determined by assigning fair values to assets and liabilities, with the remaining fair value reported as the implied fair value of goodwill. As a result of its impairment testing during the third quarter of fiscal year 2016, CHI determined that $16.8 million of goodwill attributable to the discontinued operations of QualChoice Health was impaired. The impairment charge is reflected in discontinued operations within the consolidated statements of changes in net assets for fiscal year 2016.

Additionally, as of June 30, 2016, CHI revised the Houston MBO's projected cash flows due to operating results in the fourth quarter of fiscal year 2016 being below historical run rates. As a result of this update, CHI determined that $111.2 million of goodwill attributable to the Houston MBO operations was impaired. The impairment charge is reflected in the consolidated statement of operations for fiscal year 2016. No impairment of goodwill was identified in fiscal year 2015.

1. Summary of Significant Accounting Policies (continued)

The changes in the carrying amount of goodwill and intangibles is as follows (in thousands):

	2016	2015
Intangible assets, beginning of year	**$ 238,491**	$ 215,338
Current year acquisitions	**13,285**	23,153
Intangible assets, end of year	**251,776**	238,491
Accumulated amortization, beginning of year	**(38,140)**	(25,229)
Intangible amortization expense	**(12,783)**	(11,221)
Other adjustments	**243**	(1,690)
Accumulated amortization, end of year	**(50,680)**	(38,140)
Intangible assets, net	**201,096**	200,351
Goodwill, beginning of year	**350,149**	346,508
Current year acquisitions	**22,766**	3,641
Impairments	**(111,173)**	–
Goodwill, end of year	**261,742**	350,149
Total intangible assets and goodwill, net	**$ 462,838**	$ 550,500

Notes Receivable and Other Assets

Other assets consist primarily of notes receivable, pledges receivable, deferred compensation assets, long-term prepaid service contracts, deposits and other long-term assets. Notes receivable from related entities at June 30, 2016 and 2015, include balances from Bethesda Hospital, Inc. (Bethesda), the non-CHI joint operating agreement (JOA) partner in the Cincinnati, Ohio JOA.

1. Summary of Significant Accounting Policies (continued)

A summary of notes receivable and other assets is as follows as of June 30 (in thousands):

	2016	2015
Notes receivable		
From related entities	**$ 148,289**	$ 162,656
Other	**36,384**	16,518
Long-term pledge receivables	**36,324**	31,666
Reinsurance recoverable on unpaid losses and loss adjustment expense	**52,738**	49,839
Deferred compensation assets	**76,679**	77,355
Other long-term assets	**96,108**	104,795
Total notes receivable and other	**$ 446,522**	$ 442,829

Bethesda is a Designated Affiliate in the CHI credit group under the Capital Obligation Document (COD). As conditions of joining the CHI credit group, Bethesda has agreed to certain covenants related to corporate existence, insurance coverage, exempt use of bond-financed facilities, maintenance of certain financial ratios, and compliance with limitations on the incurrence of additional debt. Based upon management's review of the creditworthiness of Bethesda and its compliance with the covenants and limitations, no allowances for uncollectible notes receivable were recorded at June 30, 2016 and 2015.

Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity, including endowment funds. Temporarily restricted net assets and earnings on permanently restricted net assets, including earnings on endowment funds, are used in accordance with the donor's wishes primarily to purchase equipment, to provide charity care, and to provide other health and educational programs and services.

Unconditional promises to receive cash and other assets are reported at fair value at the date the promise is received. Conditional promises and indications of donors' intentions to give are reported at fair value at the date the conditions are met or the gifts are received. All unrestricted contributions are included in the excess of revenue over expenses as donation revenues. Other

1. Summary of Significant Accounting Policies (continued)

gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as donations revenue when restricted for operations or as unrestricted net assets when restricted for property and equipment.

Performance Indicator

The performance indicator is the excess of revenues over expenses, which includes all changes in unrestricted net assets other than changes in the pension liability funded status, net assets released from restrictions for property acquisitions, cumulative effect of changes in accounting principles, discontinued operations, contributions of property and equipment, and other changes not required to be included within the performance indicator under generally accepted accounting principles.

Operating and Nonoperating Activities

CHI's primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, long-term care, and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to CHI's primary mission are considered to be nonoperating. Nonoperating activities include investment earnings, gains/losses from bond defeasance, net interest cost and changes in fair value of interest rate swaps, and the nonoperating component of JOA income share adjustments. Any infrequent and nonreciprocal contribution that CHI makes to enter a new market community or to expand upon existing affiliations is also classified as nonoperating.

Charity Care

As an integral part of its mission, CHI accepts and provides medically necessary health care to all patients without regard to the patient's financial ability to pay. Services to patients are classified as charity care in accordance with standards established across all MBOs. Charity care represents services rendered for which partial or no payment is expected, and includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or

1. Summary of Significant Accounting Policies (continued)

who are uninsured or underinsured. CHI determines the cost of charity care on the basis of an MBO's total cost as a percentage of total charges applied to the charges incurred by patients qualifying for charity care under CHI's policy. This amount is not included in net patient services revenues in the accompanying consolidated statements of operations and changes in net assets. The estimated cost of charity care provided was $219.7 million and $211.9 million in 2016 and 2015, respectively, for continuing operations, and $0.8 million in 2015 for discontinued operations.

Other Operating Revenues

Other operating revenues include services sold to external health care providers, gains on acquisitions of subsidiaries, cafeteria sales, rental income, retail pharmacy and durable medical equipment sales, auxiliary and gift shop revenues, electronic health records incentive payments, gains and losses on the sales of assets, the operating portion of revenue-sharing income or expense associated with Direct Affiliates that are part of JOAs, premium revenues, and revenues from other miscellaneous sources.

Derivative and Hedging Instruments

CHI uses derivative financial instruments (interest rate swaps) in managing its capital costs. These interest rate swaps are recognized at fair value on the consolidated balance sheets. CHI has not designated its interest rate swaps related to CHI's long-term debt as hedges. The net interest cost and change in the fair value of such interest rate swaps is recognized as a component of nonoperating gains (losses) in the accompanying consolidated statements of operations. It is CHI's policy to net the value of collateral on deposit with counterparties against the fair value of its interest rate swaps in other liabilities on the consolidated balance sheets.

Functional Expenses

CHI provides healthcare services, including inpatient, outpatient, ambulatory, long-term care and community-based services to individuals within the various geographic areas supported by its facilities. Support services include administration, finance and accounting, information technology, public relations, human resources, legal, mission services and other functions that are supported centrally for all of CHI. Support services expenses as a percentage of total operating expenses were approximately 6.0% and 6.1% in 2016 and 2015, respectively.

1. Summary of Significant Accounting Policies (continued)

Restructuring, Impairment, and Other Losses

Restructuring, impairment, and other losses include charges relating to changes in business operations, severance costs, EPIC go-live support costs, goodwill and long-lived asset impairments, acquisition-related costs, and pension settlement activity. Changes in business operations include costs incurred periodically to implement reorganization efforts within specific operations, in order to align CHI's operations in the most strategic and cost-effective manner.

During the years ended June 30, 2016 and 2015, CHI recorded total charges of $321.0 million and $282.8 million, respectively. Of this amount, $295.5 million and $183.0 million were from continuing operations and reported in the consolidated statements of operations for 2016 and 2015, respectively, and included $143.6 million and $52.0 million for long-lived asset and goodwill impairments, respectively, $78.6 million and $78.2 million of changes in business operations, respectively, $43.2 million and $49.9 million of severance costs, respectively, and $30.1 million and $2.9 million of pension settlement activity, respectively. A total of $25.5 million and $99.8 million were reported as discontinued operations in the consolidated statements of changes in net assets for 2016 and 2015, respectively, and included $19.2 million and $97.1 million for asset and goodwill impairments, respectively, and $6.3 million and $2.7 million of severance costs, respectively.

Income Taxes

CHI is a tax-exempt Colorado corporation and has been granted an exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. CHI owns certain taxable subsidiaries and engages in certain activities that are unrelated to its exempt purpose and therefore subject to income tax. As of June 30, 2016, CHI has a deferred tax asset of $96.1 million related to net operating loss (NOL) carryforwards. CHI believes that most of the NOL carryforwards will expire unused and has established a valuation allowance of $91.6 million against the deferred tax asset associated with these NOL carryforwards.

Management reviews its tax positions annually and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated financial statements.

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could vary from the estimates.

Meaningful Use of Certified Electronic Health Record Technology Incentive Payments

Certain CHI hospitals and professionals have been receiving Medicare and Medicaid incentive payments beginning in 2011 as a result of implementing and achieving meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. CHI accounts for meaningful use incentive payments under the gain contingency model. Medicare EHR incentive payments are recognized as revenues when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenues when an eligible provider demonstrates meaningful use of certified EHR technology. CHI recognized $42.9 million and $75.1 million of Medicare meaningful use revenues and $15.1 million and $13.1 million of Medicaid meaningful use revenues in its consolidated statements of operations for fiscal year 2016 and 2015, respectively.

New Accounting Pronouncements and Adoption of New Accounting Standards

Revenue Recognition – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, 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. 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. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is not permitted. CHI is evaluating the guidance in ASU 2014-09 and the impact that the adoption of this update will have on its consolidated financial statements.

1. Summary of Significant Accounting Policies (continued)

Consolidation – In February 2015, the FASB issued ASU 2015-02, *Consolidation* (Topic 810), which requires a revaluation of whether certain legal entities, including limited partnerships, should be consolidated, and eliminates the presumption that a general partner should consolidate a limited partnership. ASU 2015-02 is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted, and had no impact upon CHI's accounting for its investments held within the CHI Investment Program, which is structured under a Limited Partnership Agreement with CHI as managing general partner – see Note 6, *Investments and Assets Limited to Use*.

Investments Calculated by Net Asset Value per Share – In May 2015, the FASB issued ASU 2015-07, *Disclosure for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, an update to ASC 820, *Fair Value Measurements and Disclosures*. ASU 2015-07 removed the requirement to categorize within the fair value hierarchy investments for which fair value is measured at net asset value (NAV) using the practical expedient. ASU 2015-07 is to be applied retrospectively and is effective for financial statements issued for fiscal years beginning after December 15, 2016, although early adoption is permitted. ASU 2015-07 provides disclosure guidance only and will have no impact on CHI's financial position or results of operations.

Leases – In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, to require a lessee to recognize a right-of-use asset and a lease liability for both operating and finance leases, whereas previous U.S. GAAP required the asset and liability be recognized only for capital leases. The amendment also requires qualitative and specific quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. CHI is evaluating the guidance of ASU 2016-02 and the impact that the adoption of this update will have on its consolidated financial statements.

Investments in Unconsolidated Organizations – In March 2016, the FASB ASU No. 2016-07, *Investments – Equity Method and Joint Ventures (Topic 323)*, to change the way an entity accounts for the transition of accounting for an investment from the cost method to the equity method as a result of an increase in the level of ownership or degree of influence. The amendment eliminates the requirement to retroactively adopt the equity method of accounting when transitioning from the cost method. ASU 2016-07 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted.

1. Summary of Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications were made to the fiscal year 2015 consolidated financial statement presentation to conform to the 2016 presentation. CHI reclassified $16.4 million of EPIC go-live support costs in fiscal year 2015 from salaries and wages into restructuring, impairment, and other losses as those costs are not anticipated to be on-going expense to CHI.

2. Community Benefit (Unaudited)

In accordance with its mission and philosophy, CHI commits substantial resources to sponsor a broad range of services to both the poor and the broader community. Community benefit provided to the poor includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. This type of community benefit includes the costs of traditional charity care; unpaid costs of care provided to beneficiaries of Medicaid and other indigent public programs; services such as free clinics and meal programs for which a patient is not billed or for which a nominal fee has been assessed; and cash and in-kind donations of equipment, supplies or staff time volunteered on behalf of the community.

Community benefit provided to the broader community includes the costs of providing services to other populations who may not qualify as poor but may need special services and support. This type of community benefit includes the costs of services such as health promotion and education, health clinics and screenings, all of which are not billed or can be operated only on a deficit basis; unpaid portions of training health professionals such as medical residents, nursing students and students in allied health professions; and the unpaid portions of testing medical equipment and controlled studies of therapeutic protocols.

2. Community Benefit (Unaudited) (continued)

A summary of the cost of community benefit provided to both the poor and the broader community is as follows (in thousands):

	2016	2015
Cost of community benefit:		
Cost of charity care provided	**$ 219,671**	$ 211,860
Unpaid cost of public programs, Medicaid and other indigent care programs	**577,485**	537,296
Nonbilled services	**35,739**	31,875
Cash and in-kind donations	**29,080**	4,031
Education research	**116,656**	110,319
Other benefit	**126,141**	73,256
Total cost of community benefit from continuing operations	**1,104,772**	968,637
Total cost of community benefit from discontinued operations	**–**	12,026
Total cost of community benefit	**1,104,772**	980,663
Unpaid cost of Medicare from continuing operations	**956,725**	721,141
Unpaid cost of Medicare from discontinued operations	**–**	24,760
Total unpaid cost of Medicare	**956,725**	745,901
Total cost of community benefit and the unpaid cost of Medicare	**$ 2,061,497**	$ 1,726,564

The summary above has been prepared in accordance with the Catholic Health Association of the United States (CHA) publication, *A Guide for Planning & Reporting Community Benefit*. Community benefit is measured on the basis of total cost, net of any offsetting revenues, donations or other funds used to defray cost. During fiscal year 2016 and 2015, CHI received $29.5 million and $0.8 million, respectively, in funds used to subsidize charity care provided.

The total cost of community benefit from continuing and discontinued operations was 6.5% and 6.3% of total operating expenses before restructuring, impairment and other losses in 2016 and 2015, respectively. The total cost of community benefit and the unpaid cost of Medicare from continuing and discontinued operations was 12.2% and 11.1% of total operating expenses before restructuring, impairment and other losses in 2016 and 2015, respectively.

3. Joint Operating Agreements and Investments in Unconsolidated Organizations

Joint Operating Agreements

CHI participates in JOAs with hospital-based organizations in three separate market areas. The agreements generally provide for, among other things, joint management of the combined operations of the local facilities included in the JOAs through a joint operating company (JOC). CHI retains ownership of the assets, liabilities, equity, revenues and expenses of the CHI facilities that participate in the JOAs. The financial statements of the CHI facilities managed under all JOAs are included in the CHI consolidated financial statements. Transfers of assets from facilities owned by the JOA participants generally are restricted under the terms of the agreements.

As of June 30, 2016 and 2015, CHI has investment interests of 65%, 50%, and 50% in JOCs based in Colorado, Iowa, and Ohio, respectively. CHI's interests in the JOCs are included in investments in unconsolidated organizations and totaled $351.9 million and $199.0 million at June 30, 2016 and 2015, respectively. CHI recognizes its investment in all JOCs under the equity method of accounting. The JOCs provide varying levels of services to the related JOA sponsors, and operating expenses of the JOCs are allocated to each sponsoring organization. The JOCs had total assets of $907.2 million and $651.7 million at June 30, 2016 and 2015, respectively, and net assets of $607.9 million and $359.7 million, respectively.

In March 2016, CHI amended the existing Iowa JOA to among other items, allow for the Iowa JOC to acquire health care systems in Iowa and contiguous markets, which would be owned equally between CHI and the existing JOC partner. In May 2016, the Iowa JOC acquired Wheaton Franciscan Healthcare and recorded a business combination gain on the acquisition. As a result, CHI recognized $89.1 million of its proportionate share of the gain, which is reflected in the consolidated statements of operations as changes in equity of unconsolidated organizations for the year ended June 30, 2016.

Investments in Unconsolidated Organizations

CHI holds noncontrolling interests in various organizations, accounted for under the cost or equity method of accounting, as appropriate. Significant investments are described below.

3. Joint Operating Agreements and Investments in Unconsolidated Organizations (continued)

Conifer Health Solutions (Conifer) – As of June 30, 2016 and 2015, CHI holds a 23.8% equity method investment in Conifer totaling $570.7 million and $535.3 million, respectively. The investment in Conifer was acquired as part of a multi-year agreement with Conifer where Conifer provides revenue cycle services and health information management solutions for CHI acute care operations. Since CHI was granted incremental shares in Conifer in conjunction with the multi-year agreement with Conifer, CHI also has a deferred income balance related to the Conifer agreement as of June 30, 2016 and 2015, of $458.9 million and $486.7 million, respectively, reported in other liabilities on the consolidated balance sheets, which is being amortized on a straight line basis over the remaining agreement term expiring in January 2033, offsetting revenue cycle services fees paid to Conifer which are reported in purchased services expense on the consolidated statements of operations.

As a result of CHI recording its incremental equity ownership in Conifer at fair value, the carrying value of its equity method investment in Conifer was $261.8 million and $272.3 million greater than CHI's equity interest in the underlying net assets of Conifer as of June 30, 2016 and 2015, respectively, due to basis differences in the carrying amounts of the tangible and intangible assets of $195.1 million and $205.6 million, respectively, and of goodwill of $66.7 million in both periods. Goodwill is not amortized but is subject to annual impairment tests during the third quarter of the fiscal year, as well as more frequent reviews whenever circumstances indicate a possible impairment may exist. No impairment of goodwill was identified as of June 30, 2016 and 2015. The basis differences of the tangible and intangible assets are being amortized over the average useful lives of the underlying assets, ranging from 8 to 25 years, as a reduction of CHI's equity earnings in Conifer.

Preferred Professional Insurance Corporation (PPIC) – Effective in September 2014, CHI sold its investment in PPIC, an unconsolidated affiliate of CHI, which provided professional liability insurance and other related services to preferred physician and other health care providers associated with its owners. Gross proceeds on the sale were $48.9 million, plus the distribution of a $21.5 million extraordinary dividend, which resulted in a gain on sale of approximately $10.0 million reflected in the consolidated statement of operations for the year ended June 30, 2015.

3. Joint Operating Agreements and Investments in Unconsolidated Organizations (continued)

MedSynergies Inc., (MSI) – Effective in October 2014, CHI sold its ownership in MSI, a national physician management services organization, for gross proceeds of $121.1 million, which resulted in a gain of $69.0 million reported in other revenue in the consolidated statement of operations for the year ended June 30, 2015.

Other Entities – The summarized financial positions and results of operations for the other entities accounted for under the equity method of accounting as of and for the periods ended June 30, excluding the investments described above, are as follows (in thousands):

	2016							
	Medical Office Buildings	Outpatient and Diagnostic Services	Ambulatory Surgery Centers	Physician Practices	Hospital Based Services	ACO/ CCO/ CIN	Other Investees	Total
Total assets	**$ 8,416**	**$ 325,839**	**$ 61,443**	**$ 8,621**	**$ 184,497**	**$ 128,069**	**$ 176,054**	**$ 892,939**
Total debt	**1,241**	**50,495**	**14,028**	**1**	**18,775**	**–**	**59,848**	**144,388**
Net assets	**6,013**	**220,849**	**31,488**	**8,197**	**146,959**	**78,961**	**104,998**	**597,465**
Net patient services revenues	**–**	**312,518**	**98,850**	**6,271**	**156,264**	**–**	**116,540**	**690,443**
Total revenues, net	**1,889**	**419,513**	**100,251**	**6,628**	**156,373**	**179,066**	**161,319**	**1,025,039**
Excess of revenues over expenses	**10,012**	**41,496**	**30,364**	**105**	**32,531**	**7,091**	**6,399**	**127,998**

	2015							
	Medical Office Buildings	Outpatient and Diagnostic Services	Ambulatory Surgery Centers	Physician Practices	Hospital Based Services	ACO/ CCO/ CIN	Other Investees	Total
Total assets	$ 9,069	$ 291,568	$ 67,281	$ 8,696	$ 374,186	$ 133,151	$ 149,985	$ 1,033,936
Total debt	5,525	25,612	12,393	442	60,536	–	29,962	134,470
Net assets	3,089	215,065	46,062	8,265	260,905	73,329	77,343	684,058
Net patient services revenues	–	299,131	134,147	12,142	357,598	–	133,954	936,972
Total revenues, net	1,853	403,537	133,515	15,645	309,403	85,514	193,431	1,142,898
Excess of revenues over expenses	291	70,871	36,937	1,734	44,215	5,448	10,582	170,078

4. Acquisitions, Affiliations, and Divestitures

The following table is a summary of the business combinations and affiliations that occurred in fiscal year 2016 (in thousands):

	Trinity	Brazosport	LUH	Other	Total
Fiscal year 2016					
Purchase consideration:					
Cash	$ –	$ –	$ –	$ 17,225	$ 17,225
Noncontrolling interest	–	–	–	9,275	9,275
Business combination gains	72,717	21,293	111,551	17,475	223,036
	72,717	21,293	111,551	43,975	249,536
Equity interest in Trinity	72,392	–	–	–	72,392
	$ 145,109	$ 21,293	$ 111,551	$ 43,975	$ 321,928
Fiscal year 2016					
Purchase price allocation:					
Cash and investments	$ 133,349	$ 18,650	$ 70,416	$ 5,420	$ 227,835
Patient and other A/R	40,363	22,191	25,346	5,443	93,343
Other current assets	6,373	3,200	9,775	786	20,134
Property and equipment	57,598	36,292	111,609	16,970	222,469
Intangible assets	210	–	–	19,848	20,058
Other assets	8,962	144	13,276	–	22,382
Current liabilities	(26,246)	(18,777)	(17,455)	(2,994)	(65,472)
Pension liability	(16,408)	–	–	–	(16,408)
Other liabilities	(9,818)	(671)	–	–	(10,489)
Debt	(40,069)	(38,450)	(97,765)	(1,437)	(177,721)
Restricted assets	(9,205)	(1,286)	(3,651)	(61)	(14,203)
	$ 145,109	$ 21,293	$ 111,551	$ 43,975	$ 321,928

Trinity Health System – Effective February 1, 2016, CHI became the sole owner of Trinity Health System (Trinity) based in Steubenville, Ohio, when it acquired the remaining 50% ownership in Trinity. The other 50% ownership in Trinity was held by Sylvania Franciscan Health (Sylvania), which CHI acquired in November 2014; the re-measurement of Sylvania's investment in Trinity resulted in an immaterial gain on Sylvania's 50% equity ownership. Trinity owns and operates Trinity Medical Center East, Trinity Medical Center West, Tony Teramana Cancer Center, and numerous outpatient clinics located in eastern Ohio. The transaction resulted in the recognition of a $72.7 million gain calculated as the fair value of identifiable assets acquired and liabilities assumed, determined based upon Level 3 inputs, including estimated

4. Acquisitions, Affiliations, and Divestitures (continued)

future cash flows and probability-weighted performance assumptions. Excluding the business combination gain, Trinity reported $103.7 million in operating revenues and $13.0 million of excess of revenues over expenses in the CHI consolidated results of operations for the period from February 1, 2016 through June 30, 2016.

Brazosport Regional Health System – Effective February 1, 2016, a consolidated subsidiary of CHI signed an affiliation agreement with Brazosport Regional Health System (Brazosport) in Lake Jackson, Texas, to become part of CHI. Brazosport is a nonprofit health care organization that includes a 158-bed hospital that operates the only Level III trauma center in Brazoria County. The transaction resulted in the recognition of a $21.3 million gain calculated as the fair value of identifiable assets acquired and liabilities assumed, determined based upon Level 3 inputs, including estimated future cash flows and probability-weighted performance assumptions. Excluding the business combination gain, Brazosport reported $33.7 million in operating revenues and $(1.3) million of deficit of revenues over expenses in the CHI consolidated results of operations for the period from February 1, 2016 through June 30, 2016.

Longmont United Hospital – Effective August 1, 2015, a direct affiliate of CHI entered into a Joint Operating and Management Agreement with Longmont United Hospital (LUH) to become the sole and exclusive agent to manage and operate the LUH business for a period of 99 years. The transaction resulted in the recognition of a $111.6 million gain calculated as the fair value of identifiable assets acquired and liabilities assumed, determined based upon Level 3 inputs, including estimated future cash flows and probability-weighted performance assumptions. Excluding the business combination gain, LUH reported $160.9 million in operating revenues and $(8.6) million of deficit of revenues over expenses in the CHI consolidated results of operations for the period from August 1, 2015 through June 30, 2016.

The following table is a summary of the business combinations that occurred in fiscal year 2015 (in thousands):

	St. Alexius	Sylvania	Total
Fiscal year 2015			
Purchase consideration:			
Cash	$ 10,000	$ 74,375	$ 84,375
Other liabilities	1,436	–	1,436
Business combination gains	153,803	282,537	436,340
	$ 165,239	$ 356,912	$ 522,151

4. Acquisitions, Affiliations, and Divestitures (continued)

	St. Alexius	Sylvania	Total
Fiscal year 2015			
Purchase price allocation:			
Cash and investments	$ 95,065	$ 340,746	$ 435,811
Patient and other accounts receivable	46,033	88,271	134,304
Other current assets	8,118	12,273	20,391
Property and equipment	127,956	351,327	479,283
Intangible assets	–	13,350	13,350
Other assets	23,491	89,586	113,077
Current liabilities	(27,087)	(49,714)	(76,801)
Pension liability	–	(140,670)	(140,670)
Other liabilities	(1,347)	(50,584)	(51,931)
Debt	(104,227)	(290,289)	(394,516)
Restricted net assets	(2,763)	(7,384)	(10,147)
	$ 165,239	$ 356,912	$ 522,151

St. Alexius Medical Center – Effective October 1, 2014, St. Alexius Medical Center (St. Alexius), located in Bismarck, ND, became a direct affiliate of CHI. In conjunction with this affiliation, CHI contributed $10.0 million to an endowment fund with a third-party as consideration for the transaction. The transaction resulted in the recognition of a $153.8 million gain calculated as the fair value of assets acquired and liabilities assumed, less purchase consideration determined based upon Level 3 inputs including estimated future cash flows and probability-weighted performance assumptions. St. Alexius is a 306-bed, acute medical center offering a full line of inpatient and outpatient services. Besides the main campus in Bismarck, North Dakota, St. Alexius also owns and operates hospitals and clinics in Garrison, North Dakota, and Turtle Lake, North Dakota. Excluding the business combination gain, St. Alexius reported $332.7 million and $243.1 million in operating revenues, respectively, and $(8.7) million and $0.3 million of (deficit) excess of revenues over expenses, respectively, to the CHI consolidated results of operations for fiscal year ended June 30, 2016, and for the period October 1, 2014 through June 30, 2015, respectively.

4. Acquisitions, Affiliations, and Divestitures (continued)

Sylvania Franciscan Health – Effective November 1, 2014, CHI paid $74.4 million to become the sole sponsor of Sylvania Franciscan Health (Sylvania). The transaction resulted in the recognition of a $282.5 million gain calculated as the fair value of assets acquired and liabilities assumed, less purchase consideration determined based upon Level 3 inputs including estimated future cash flows and probability-weighted performance assumptions. Sylvania's hospitals and facilities in Texas and Ohio provide comprehensive primary and critical care services, while the long-term care facilities in Texas, Kentucky, and Ohio provide both residential and rehabilitation services. Excluding the business combination gain, Sylvania reported $487.6 million and $334.7 million in operating revenues, respectively, and $18.2 million and $36.2 million of excess of revenues over expenses to the CHI consolidated results of operations for the fiscal year ended June 30, 2016, and the period November 1, 2014 through June 30, 2015, respectively.

Had CHI owned Trinity, Brazosport, LUH, St. Alexius, and Sylvania as of the beginning of each fiscal year, CHI's unaudited pro forma results, excluding business combination gains, for the years ended June 30 would have been as presented below (in thousands):

	2016 Pro Forma Total CHI	**2015 Pro Forma Total CHI**
Operating revenues	**$ 15,935,455**	$ 15,183,298
Operating (loss) before restructuring	**(431,761)**	(230,456)
Deficit of revenues over expenses	**(841,125)**	(304,271)

Unaudited pro forma information is not necessarily indicative of the historical results that would have been obtained had the transaction actually occurred on those dates, nor of future results.

Discontinued Operations

In May 2016, CHI approved a plan to sell or otherwise dispose of certain entities of QualChoice Health, Inc. (QualChoice Health), a consolidated CHI subsidiary, whose primary business is to develop, manage and market commercial and Medicare Advantage health insurance programs, as well as a wide range of products and administrative services. The sale of the operations is being actively marketed and is anticipated to close no later than the end of the next fiscal year.

4. Acquisitions, Affiliations, and Divestitures (continued)

Effective in fiscal year 2016, CHI sold the operations of the Reading, Pennsylvania MBO and the Denville, New Jersey MBO, for total gross proceeds of $206.0 million. The Reading MBO sales proceeds were $110.0 million and were received on June 30, 2015, in advance of the closing. The Denville MBO sale also included $20.9 million of working capital settlements. A final settlement of the Reading MBO working capital settlements is expected in fiscal year 2017.

CHI has been reflecting the Reading and Denville MBOs as discontinued operations and held for sale as of June 30, 2015, in accordance with Accounting Standards Codification (ASC) No. 205-20, *Discontinued Operations*, and ASC No. 360-10, *Impairment and Disposal of Long-Lived Assets.* The QualChoice Health operations are also reflected as discontinued operations and held for sale as of June 30, 2016 and 2015, in accordance with ASU No. 2014-08, *Reporting Discontinued Operations and Disclosure of Disposals of Components of an Entity*, as the operations held for sale are deemed to represent a strategic shift in CHI's operations which will have a major effect on its financial results. The results of operations of QualChoice Health, and the Reading and Denville MBOs are reported in the consolidated statements of changes in net assets as discontinued operations.

A reconciliation of major classes of assets and liabilities of the discontinued operations is presented below as of June 30 (in thousands):

	2016	2015
Net patient accounts receivable	**$ 810**	$ 65,029
Other accounts receivable	**75,769**	25,070
Investments held for insurance purposes	**116,950**	84,740
Property and equipment, net	**12,598**	218,444
Other assets	**10,171**	26,561
Total major classes of assets of the discontinued operations	**216,298**	419,844
Other assets classified as held for sale	**6,987**	–
Total assets classified as held for sale	**$ 223,285**	$ 419,844
Accounts payable and accrued expenses	**$ 37,995**	$ 60,415
Debt	**–**	12,061
Self-insured reserves	**74,629**	63,434
Other liabilities	**19,190**	112,187
Total major classes of liabilities of the discontinued operations classified as held for sale	**$ 131,814**	$ 248,097

4. Acquisitions, Affiliations, and Divestitures (continued)

The $7.0 million of other assets classified as held for sale as of June 30, 2016, represent real estate assets which are scheduled to be sold in fiscal year 2017, measured at the lower of their carrying amount or fair value less cost to sell.

Operating results of discontinued operations are reported in the accompanying consolidated statements of changes in net assets and are summarized as follows for the years ended June 30 (in thousands):

	2016	2015
Revenues:		
Net patient service revenues	**$ 86,286**	$ 502,236
Insurance premium revenues	**516,844**	376,400
Gain on sale	**69,776**	2,871
Other revenues	**73,846**	33,013
Total revenues	**746,752**	914,520
Expenses:		
Salaries, wages, and employee benefits	**(152,929)**	(323,913)
Medical claims	**(482,402)**	(278,907)
Depreciation	**(2,631)**	(6,671)
Other expenses	**(117,480)**	(317,135)
Total operating expenses	**(755,442)**	(926,626)
Restructuring, impairment and other losses	**(25,508)**	(99,314)
Nonoperating income	**3,531**	2,134
Deficit of revenues over expenses	**$ (30,667)**	$ (109,286)

Total operating revenues in fiscal year 2016 include a gain of $59.6 million on the sale of the Denville MBO's long-term care operations in May 2016. Restructuring and other losses for fiscal year 2015 include an impairment loss of $46.0 million recognized at the Reading MBO to adjust the carrying value of property and equipment to its net realizable value, and an impairment loss of $51.1 million at the Denville MBO to adjust the carrying value of property and equipment to its net realizable value due to a modification in the sales agreement to remove the long-term care assets from the original sales agreement.

4. Acquisitions, Affiliations, and Divestitures (continued)

During fiscal year 2016 and 2015, the discontinued operations reported $0.7 million and $4.1 million in capital expenditures.

5. Net Patient Services Revenues

Net patient services revenues are derived from services provided to patients who are either directly responsible for payment or are covered by various insurance or managed care programs. CHI receives payments from the federal government on behalf of patients covered by the Medicare program, from state governments for Medicaid and other state-sponsored programs, from certain private insurance companies and managed care programs, and from patients themselves. A summary of payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and certain outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or procedure. These rates vary according to patient classification systems based on clinical, diagnostic and other factors.

Certain CHI facilities have been designated as critical access hospitals and, accordingly, are reimbursed their cost of providing services to Medicare beneficiaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are primarily paid under the traditional Medicaid plan at prospectively determined rates per discharge. Certain outpatient services are reimbursed based on a cost reimbursement methodology, fee schedules or discounts from established charges.

Other – CHI has also entered into payment agreements with certain managed care and commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to CHI under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

5. Net Patient Services Revenues (continued)

CHI's Medicare, Medicaid and other payor utilization percentages, based upon net patient services revenues before provision for doubtful accounts, are summarized as follows:

	2016	2015
Medicare	**32%**	33%
Medicaid	**13**	11
Managed care	**38**	40
Self-pay	**4**	5
Commercial and other	**13**	11
	100%	100%

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimated settlements related to Medicare and Medicaid of $108.4 million and $124.5 million at June 30, 2016 and 2015, respectively, are included in third-party liabilities. Net patient services revenues from continuing operations increased by $102.4 million in fiscal year 2016 and $56.0 million in fiscal year 2015 due to favorable changes in estimates related to prior-year settlements.

6. Investments and Assets Limited as to Use

CHI's investments and assets limited as to use as of June 30 are reported in the accompanying consolidated balance sheets as presented in the following table (in thousands):

	2016	2015
Cash and equivalents	**$ 185,325**	$ 271,927
CHI Investment Program	**5,266,787**	5,835,141
Marketable equity securities	**342,327**	288,449
Marketable fixed-income securities	**802,382**	763,332
Hedge funds and other investments	**24,360**	24,770
	6,621,181	7,183,619
Less current portion	**(63,146)**	(61,220)
	$ 6,558,035	$ 7,122,399

6. Investments and Assets Limited as to Use (continued)

Net unrealized gains in investments and assets limited to use at June 30, 2016 and 2015, were $120.1 million and $459.3 million, respectively.

CHI attempts to reduce its market risk by diversifying its investment portfolio using cash equivalents, fixed-income securities, marketable equity securities and alternative investments. Most of the U.S. Treasury, money market funds and corporate debt obligations as well as exchange-traded marketable securities held directly by CHI and by the CHI Investment Program (the Program) have an actively traded market. However, CHI also invests in commercial paper, mortgage-backed or other asset-backed securities, alternative investments (hedge funds, private equity investments, real estate funds, funds of funds, etc.), collateralized debt obligations, municipal securities and other investments that have potential complexities in valuation based upon the current conditions in the credit markets. For some of these instruments, evidence supporting the determination of fair value may not come from trading in active primary or secondary markets. Because these investments may not be readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had an active market for such investments existed. Such differences could be material. However, management reviews the CHI investment portfolio on a regular basis and seeks guidance from its professional portfolio managers related to U.S. and global market conditions to determine the fair value of its investments. CHI believes the carrying amount of these financial instruments in the consolidated financial statements is a reasonable estimate of fair value.

The majority of all CHI long-term investments are held in the Program. The Program is structured under a Limited Partnership Agreement with CHI as managing general partner and numerous limited partners, most sponsored by CHI. The partnership provides a vehicle whereby virtually all entities associated with CHI, as well as certain other unrelated entities, can optimize investment returns while managing investment risk. Entities participating in the Program that are not consolidated in the accompanying financial statements have the ability to direct their invested amounts and liquidate and/or withdraw their interest without penalty as soon as practicable based on market conditions but within 180 days of notification. The Limited Partnership Agreement permits a simple-majority vote of the noncontrolling limited partners to terminate the partnership. Accordingly, CHI recognizes only the unitized portion of Program assets attributable to CHI and its direct affiliates. Program assets attributable to CHI and its Direct Affiliates represented 89% and 88% of total Program assets at June 30, 2016 and 2015, respectively.

6. Investments and Assets Limited as to Use (continued)

The Program asset allocation at June 30 is as follows:

	2016	2015
Equity securities	**44%**	46%
Fixed-income securities	**32**	30
Alternative investments	**23**	22
Cash and equivalents	**1**	2
	100%	100%

The CHI Finance Committee (the Committee) of the Board of Stewardship Trustees is responsible for determining asset allocations among fixed-income, equity, and alternative investments. At least annually, the Committee reviews targeted allocations and, if necessary, makes adjustments to targeted asset allocations. Given the diversity of the underlying securities in which the Program invests, management does not believe there is a significant concentration of credit risk.

The Program allocation to alternative investments is based upon contractual commitment levels to various funds. These commitments are drawn by the fund managers as opportunities arise to invest the capital. As of June 30, 2016, the Program had committed to invest $775.0 million in 38 funds, of which $662.7 million had been invested. The remaining $112.4 million will be invested when, and if, requested by the funds. Alternative investments within the Program have limited liquidity. As of June 30, 2016, illiquid investments not available for redemption totaled $417.0 million, and investments available for redemption within 180 days at the request of the Program totaled $739.0 million.

6. Investments and Assets Limited as to Use (continued)

Investment income is comprised of the following for the years ended June 30 (in thousands):

	2016	2015
Dividend and interest income	**$ 149,999**	$ 134,131
Net realized gains	**170,100**	275,054
Net unrealized losses	**(335,436)**	(210,275)
Total investment (losses) income from continuing operations	**(15,337)**	198,910
Total investment income from discontinued operations	**3,531**	2,134
Total investment (losses) income	**$ (11,806)**	$ 201,044

Direct expenses of the Program are less than 0.4% of total assets. Fees paid to the alternative investment managers are not included in the total expense calculation as they are not a direct expense of the Program.

7. Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs 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 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.

7. Fair Value of Assets and Liabilities (continued)

Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

Certain of CHI's alternative investments are made through limited liability companies (LLC) and limited liability partnerships (LLP). These LLCs and LLPs provide CHI with a proportionate share of the investment gains (losses). CHI accounts for its ownership in the LLCs and LLPs under the equity method. CHI also accounts for its ownership in the Program under the equity method. As such, these investments are excluded from the scope of ASC 820.

Financial assets and liabilities measured at fair value on a recurring basis were determined using the market approach based upon the following inputs at June 30 (in thousands):

	2016			
	Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of June 30	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	**$ 185,325**	**$ 183,641**	**$ 1,684**	**$ –**
Equity securities	**342,327**	**342,327**	**–**	**–**
Fixed-income securities	**802,382**	**143,263**	**659,119**	**–**
Other investments	**428**	**–**	**–**	**428**
Deferred compensation assets:				
Cash and short-term investments	**8,248**	**8,248**	**–**	**–**
	$ 1,338,710	**$ 677,479**	**$ 660,803**	**$ 428**
Liabilities				
Interest rate swaps	**$ 416,277**	**$ –**	**$ 416,277**	**$ –**
Contingent consideration	**207,204**	**–**	**–**	**207,204**
Deferred compensation liability	**8,248**	**8,248**	**–**	**–**
	$ 631,729	**$ 8,248**	**$ 416,277**	**$ 207,204**

7. Fair Value of Assets and Liabilities (continued)

	2015			
		Fair Value Measurements at Reporting Date Using		
		(Level 1)	(Level 2)	(Level 3)
	Fair Value as of June 30	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Assets limited as to use:				
Cash and short-term investments	$ 271,927	$ 192,265	$ 79,662	$ –
Equity securities	288,449	288,449	–	–
Fixed-income securities	763,332	138,204	625,128	–
Other investments	2,456	–	–	2,456
Deferred compensation assets:				
Cash and short-term investments	12,969	12,969	–	–
	$ 1,339,133	$ 631,887	$ 704,790	$ 2,456
Liabilities				
Interest rate swaps	$ 299,984	$ –	$ 299,984	$ –
Contingent consideration	255,227	–	–	255,227
Deferred compensation liability	12,969	12,969	–	–
	$ 568,180	$ 12,969	$ 299,984	$ 255,227

The fair values of the securities included in Level 1 were determined through quoted market prices. Level 1 instruments include money market funds, mutual funds and marketable debt and equity securities. The fair values of Level 2 instruments were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves and referenced credit spreads; estimated prepayment rates, where applicable, are used for valuation purposes and are provided by third-party services where quoted market values are not available. Level 2 instruments include corporate fixed-income securities, government bonds, mortgage and asset-backed securities, and interest rate swaps. The fair values of Level 3 securities are determined primarily through information obtained from the relevant counterparties for such investments. Information on which these securities' fair values are based is generally not readily available in the market. The fair value of the contingent consideration

7. Fair Value of Assets and Liabilities (continued)

liability was determined based on estimated future cash flows and probability-weighted performance assumptions, discounted to net present value. The contingent consideration liability balance was adjusted to reflect $36.0 million of payments made since June 30, 2015, and to reflect a $12.0 million reduction for changes in payment assumptions.

8. Property and Equipment

A summary of property, equipment, and software is as follows as of June 30 (in thousands):

	2016	2015
Land and improvements	**$ 725,933**	$ 729,824
Buildings and improvements	**7,538,717**	7,592,041
Equipment	**5,632,380**	5,170,098
Software	**1,154,569**	959,135
	15,051,599	14,451,098
Less accumulated depreciation and amortization	**(6,700,455)**	(6,055,130)
	8,351,144	8,395,968
Construction in progress	**1,100,866**	1,091,122
	$ 9,452,010	$ 9,487,090

CHI evaluates whether events and circumstances have occurred that indicate the remaining useful life of property, equipment and certain other intangible assets may not be recoverable. Management determined there were impairment issues in both 2016 and 2015, to the extent that the undiscounted cash flows estimated to be generated by certain assets were less than the underlying carrying value, or due to a project being discontinued. CHI recorded $32.8 million and $44.4 million in impairment losses in continuing operations for 2016 and 2015, respectively, resulting from charges related to estimated fair value deficiencies (based upon projected discounted cash flows) at various MBOs.

CHI incurs a variety of direct and indirect costs to develop internal-use software. In order for software to be considered internal use, it must be acquired, internally developed or modified solely to meet CHI's needs and no plan exists or is being developed to sell the software externally during the software's development or modification. Unamortized software costs at June 30, 2016 and 2015, were $914.2 million and $845.4 million, respectively. For the fiscal

8. Property and Equipment (continued)

years ended June 30, 2016 and 2015, CHI recorded $126.1 million and $76.9 million, respectively, related to amortization of internal-use software. Amortization of internal-use software begins when the software is placed in service, and is based on the expected useful life of the software, which is generally between 2 and 15 years.

In April 2016, CHI entered into an agreement to sell approximately 50 real estate assets across the enterprise as part of a long-term effort to improve the mix of owned and leased assets. In conjunction with the sale, CHI entered into 10-year operating lease agreements with the buyer, and in accordance with ASC 840-40 – *Leases – Sale-Lease Back Transactions*, certain of the gains on the sale of the real estate assets were deferred and will be amortized to lease expense over the life of the operating leases.

The majority of the real estate portfolio totaling 46 properties closed in fiscal year 2016 for gross proceeds of $601.7 million and a total net book value of $332.3 million. As a result of the real estate sale, CHI recognized a $59.4 million gain on sale in the consolidated statements of operations for the year ended June 30, 2016, as well as $20.1 million in short-term deferred gains in accrued expenses and $180.6 million in long-term deferred gains in other long-term liabilities reflected on the consolidated balance sheet as of June 30, 2016.

9. Debt Obligations

The following is a summary of debt obligations as of June 30 (in thousands):

	Maturity Date	Interest Rates at June 30, 2016	2016	2015
Debt secured under the CHI COD				
Variable-rate bonds:				
CHI Series 2000B	–	–%	**$ –**	$ 21,400
CHI Series 2002B	–	–	**–**	91,400
CHI Series 2004B	2044	1.25	**54,200**	180,700
CHI Series 2004C	2039	0.6–0.61	**96,700**	163,300
CHI Series 2008A	2037	1.05	**120,175**	120,175
CHI Series 2008C	2040	1.56	**52,990**	50,000
CHI Series 2011B	2046	1.21–1.81	**158,155**	158,155
CHI Series 2011C	2046	1.31	**118,000**	119,000
CHI Series 2013B	2035	1.41–1.81	**200,000**	200,000
CHI Series 2013C	2046	1.82	**100,000**	100,000
CHI Series 2013E Taxable	2046	1.86	**125,000**	125,000
CHI Series 2013F Taxable	2046	1.73	**75,000**	75,000
CHI Series 2015-1	2032	1.06	**38,400**	–
CHI Series 2015-2	2027	1.07	**73,700**	–
CHI Series 2015A	2032	1.21–1.27	**69,500**	–
CHI Series 2015B	2042	1.21	**50,000**	–
Fixed-rate bonds:				
CHI Series 2002A	2017	5.50	**920**	1,790
CHI Series 2004A	2034	4.75–5.0	**140,985**	146,285
CHI Series 2006A	2042	4.0–5.0	**270,635**	270,635
CHI Series 2006C	–	–	**–**	300,000
CHI Series 2008C	–	–	**–**	55,000
CHI Series 2008D	2039	5.0–6.38	**452,065**	465,965
CHI Series 2009A	2040	4.0–5.25	**672,050**	699,725
CHI Series 2009B	2040	1.88–5.25	**217,720**	217,720
CHI Series 2011A	2041	3.25–5.25	**451,270**	467,570
CHI Series 2012A	2036	3.54–5.0	**264,170**	266,620
CHI Series 2012 Taxable	2043	1.6–4.35	**1,500,000**	1,500,000
CHI Series 2013A	2045	5.0–5.75	**600,600**	600,600
CHI Series 2013D Taxable	2024	2.6–4.2	**540,000**	540,000
Madonna Manor Series 2010	2040	7.00	**27,990**	–
St. Clare Commons Series 2012A	2042	3.17	**31,720**	–

9. Debt Obligations (continued)

	Maturity Date	Interest Rates at June 30, 2016	2016	2015
Debt secured under the CHI COD (continued)				
St. Joseph Manor Series 1997B	2028	5.38%	**$ 13,895**	$ –
St. Joseph Regional Health Center Series 1993B	2019	6.00	**8,760**	–
St. Joseph Regional Health Center Series 1997A	2028	5.38	**45,017**	–
St. Joseph Regional Health Center Series 2014	2032	2.84	**25,255**	–
Bank lines of credit	2016-2017	1.3	**450,000**	200,000
Bank loan	2016	1.6	**333,741**	–
Commercial paper	2016	0.8	**815,519**	741,085
Unamortized debt premium and discount, net			**31,580**	27,882
Unamortized debt issuance costs			**(31,295)**	(38,141)
Total debt secured under the CHI COD			**8,194,417**	7,866,866
Other debt				
St. Leonard Master Trust Indenture	2040	6.0–6.63	**41,892**	42,727
Sylvania Master Trust Indenture	–	**–**	**–**	98,492
Note payable issued to Episcopal Health Foundation	2020	4.75	**167,053**	199,258
Capital leases	–		**177,771**	191,316
Other debt	–	–	**476,141**	410,474
Total debt obligations	–	–	**9,057,274**	8,809,133
Less amounts classified as current:	–	–		
Variable-rate debt with self-liquidity			**(96,700)**	(163,300)
Commercial paper and current portion of debt			**(1,769,390)**	(1,246,559)
Long-term debt			**$ 7,191,184**	$ 7,399,274

9. Debt Obligations (continued)

The fair value of debt obligations was approximately $9.4 billion at June 30, 2016. Management has determined the carrying values of the variable-rate bonds are representative of fair values as of June 30, 2016, as the interest rates are set by the market participants. The fair value of the fixed-rate tax-exempt bond obligations is determined by applying credit spreads for similar tax-exempt obligations in the marketplace, which are then used to calculate6a price/yield for the outstanding obligations (Level 2 inputs).

A summary of scheduled principal payments, based upon stated maturities, on debt obligations for the next five-years is as follows (in thousands):

	Amounts Due
Year Ending June 30:	
2017	$ 1,866,090
2018	494,453
2019	418,890
2020	176,246
2021	122,702

CHI issues the majority of its debt under the COD and is the sole obligor. Bondholder security resides both in the unsecured promise by CHI to pay its obligations and in its control of its Direct and Designated Affiliates. Covenants include a minimum CHI debt service coverage ratio and certain limitations on secured debt. The Direct Affiliates of CHI, defined as Participants under the COD, have agreed to certain covenants related to corporate existence, maintenance of insurance and exempt use of bond-financed facilities. Effective in July 2015, the Sylvania Master Trust Indenture was discharged and CHI issued obligations under the COD to support the repayment of the Sylvania Master Trust Indenture debt. There were no modifications to the payment terms or holders of the Sylvania Master Trust Indenture debt.

Debt issued under the St. Leonard Master Trust Indenture is secured by the property of St. Leonard in Centerville, Ohio, and a pledge of gross revenues.

As part of the current year acquisitions discussed in Note 4, *Acquisitions, Affiliations, and Divestitures,* CHI acquired a total of $177.7 million of debt, which is reported within "Other debt" in the table above. The acquired debt includes bonds and bank loans that are secured by pledges of revenues, as well as property for certain of the bank loans. Under the terms of the

9. Debt Obligations (continued)

various bond indentures, the acquired entities are required to maintain certain deposits with trustees, are limited in their ability to incur additional borrowings, and are required to satisfy certain measures of financial performance as long as the bonds are outstanding.

Debt Redemptions and Re-Issuances

In February 2016, CHI redeemed $300.0 million of Series 2006C fixed-rate bonds. The bond redemption was funded by the issuance of a $333.7 million bank loan which matures on December 30, 2016. The bond redemption resulted in a loss on redemption of $30.5 million for the year ended June 30, 2016.

In November 2015, CHI redeemed $55.0 million of Series 2008C and $50.0 million of Series 2008D fixed-rate bonds due to November 2015 mandatory tender dates. The 2008C fixed-rate bonds were reissued as $53.0 million floating rate notes, re-priced with new interest rates and issued to new holders in November 2015. The 2008D fixed-rate bonds were reissued at a premium, for gross proceeds of $48.8 million in fixed-rate bonds, re-priced with new interest rates and issued to new holders in November 2015.

In September 2015, CHI redeemed $52.8 million of Series 2004B and $66.6 million of Series 2004C variable-rate bonds in connection with the sale of the Reading MBO on July 1, 2015.

In July and August 2015, CHI redeemed $236.5 million of tax-exempt, variable-rate bonds with proceeds from certain tax-exempt bank loans and proceeds from the sale of certain tax-exempt bonds to certain banks. Included in the transaction were $21.4 million of Series 2000B, $91.4 million of Series 2002B, $73.7 million of Series 2004B, and $50.0 million of Series 2008C variable-rate bonds, which were redeemed and reissued under Direct Purchase Agreements as $40.0 million of Series 2015-1, $73.7 million of Series 2015-2, $72.8 million of Series 2015A, and $50.0 million of Series 2015B variable-rate bonds.

In April 2015, March 2015 and November 2014, CHI redeemed certain bonds that were originally acquired as part of the business combinations in fiscal years 2015 and 2014. The debt redemptions resulted in a loss on redemption of $17.6 million for the year ended June 30, 2015.

9. Debt Obligations (continued)

Liquidity Facilities, Credit Facilities, and Other Lines of Credit

CHI has two types of external liquidity facilities: those that are dedicated to specific series of variable-rate demand bonds (VRDB) and those that are not dedicated to a particular series of VRDBs but may be used to support CHI's obligations to fund tenders of VRDBs and pay the maturing principal of commercial paper. Liquidity facilities that are dedicated to specific series of bonds were $824.0 million and $882.7 million at June 30, 2016 and 2015, respectively, of which $5.8 million and $58.7 million, are classified as current at June 30, 2016 and 2015, respectively. The remaining $1.2 billion is reported as long-term debt at both June 30, 2016 and 2015, due to the repayment terms on any associated drawings extending beyond the subsequent fiscal year under the terms of the specific agreements.

Liquidity facilities not dedicated for specific series of VRDBs but used to support CHI's obligations to fund tenders and to pay maturing principal of commercial paper were $425.0 million and $420.0 million at June 30, 2016 and 2015, respectively. At June 30, 2016 and 2015, commercial paper of $815.5 million and $741.1 million was classified as current due to maturities of less than one year. At June 30, 2016 and 2015, $96.7 million and $163.3 million, respectively, of VRDBs were classified as current due to the holder's ability to put such VRDBs back to CHI without liquidity facilities dedicated to these bonds.

At June 30, 2016 and 2015, CHI had a credit facility with Bank of New York Mellon totaling $69.0 million and $55.0 million, respectively, of which letters of credit totaling $63.9 million and $53.0 million, respectively, have been designated for the benefit of third parties, principally in support of the self-insurance programs administered by FIIL. No amounts were outstanding under this credit facility at June 30, 2016 and 2015.

At June 30, 2016 and 2015, CHI had $450.0 million and $200.0 million, respectively, of outstanding bank lines-of-credit that are classified as current due to maturities of less than one year. Of the total amount outstanding, $200.0 million is due in November 2016 and $250.0 million in June 2017. The bank line-of-credit agreements were fully drawn as of June 30, 2016 and 2015. Proceeds were used for general purposes and capital improvements.

9. Debt Obligations (continued)

Interest Rate Swap Agreements

CHI utilizes various interest rate swap contracts to manage the risk of increased interest rates payable of certain variable-rate bonds. The fixed-payer swap agreements convert CHI's variable-rate debt to fixed-rate debt. Generally, it is CHI policy that all counterparties have an AA rating or better. The swap agreements generally require CHI to provide collateral if CHI's liability, determined on a mark-to-market basis, exceeds a specified threshold that varies based upon the rating on CHI's long-term indebtedness.

In April 2016, Standard & Poor's lowered CHI's long-term debt rating to "A-" from "A", with negative outlook, and in May 2016, Moody's downgraded CHI's long-term debt rating to "A3" from "A2", with negative outlook. Subsequently in July 2016, Fitch also downgraded CHI's long-term debt rating to "BBB+" from "A+", with negative outlook.

Based upon the swap agreements in place as of June 30, 2016, a reduction in CHI's credit rating to BBB+ or BBB would obligate CHI to post additional cash collateral of $38.0 million or $67.0 million, respectively. If CHI's credit rating were to fall below BBB, the swap counterparties would have the option to require CHI to settle the swap liabilities at the recorded fair value, which was $75.1 million as of June 30, 2016.

The fair value of the swaps is estimated based on the present value sum of anticipated future net cash settlements until the swaps' maturities. Cash collateral balances are netted against the fair value of the swaps, and the net amount is reflected in other liabilities in the accompanying consolidated balance sheets. At June 30, 2016 and 2015, the net swap liability reflected in other liabilities was $75.1 million and $123.6 million, respectively, net of swap collateral posted of $341.1 million and $176.4 million, respectively. The change in the fair value of swap agreements was a net loss of $116.3 million and $33.7 million for the years ended June 30, 2016 and 2015, respectively, reflected in realized and unrealized losses on interest rate swaps in the accompanying consolidated statements of operations.

9. Debt Obligations (continued)

The following is a summary of interest rate swap contracts (in thousands):

		Swap Contracts Outstanding		Fair Value Liability (Asset)		Notional Amount	
	Maturity	June 30		June 30		June 30	
	Date	2016	2015	2016	2015	2016	2015
Basis swaps	2028	**1**	1	**$ (736)**	$ (511)	**$ 30,000**	$ 30,000
Fixed-payer swaps	2017–2047	**16**	16	**415,308**	299,065	**1,452,710**	1,476,193
Total return swaps	2016–2020	**29**	33	**1,705**	1,430	**223,787**	231,512
		46	50	**$ 416,277**	$ 299,984	**$ 1,706,497**	$ 1,737,705

10. Retirement Plans

CHI Pension Plan

CHI and its direct affiliates maintain a variety of noncontributory, defined benefit retirement plans (Retirement Plans) for their employees. Certain of these plans were frozen in previous fiscal years, and benefits earned by employees through that time period remain in the Retirement Plans, where employees continue to receive interest credits and vesting credits, if applicable. Vesting occurs over a five-year period. Benefits in the Retirement Plans are based on compensation, retirement age, and years of service. Substantially all of the Retirement Plans are qualified as church plans and are exempt from certain provisions of both the Employee Retirement Income Security Act of 1974 and Pension Benefit Guaranty Corporation premiums and coverage. Funding requirements are determined through consultation with independent actuaries.

CHI recognizes the funded status (that is, the difference between the fair value of plan assets and the projected benefit obligations) of its Plans in the consolidated balance sheets, with a corresponding adjustment to net assets. Actuarial gains and losses that arise and are not recognized as net periodic pension cost in the same periods are recognized as a component of changes in net assets.

During fiscal year 2016, CHI acquired the pension plan assets and liabilities of Trinity and during fiscal year 2015, of Sylvania (the Acquired plans) which are included below from the respective dates of acquisition.

10. Retirement Plans (continued)

A summary of the changes in the benefit obligation, fair value of plan assets and funded status of the Plans at the June 30 measurement dates is as follows (in thousands):

	2016	2015
Change in benefit obligation:		
Benefit obligation, beginning of year	**$ 4,865,377**	$ 4,473,629
Service cost	**15,518**	24,022
Interest cost	**201,192**	192,412
Actuarial loss	**634,831**	14,178
Acquired plans	**64,354**	399,025
Plan amendments	**(24)**	–
Transfers	**–**	(1,370)
Curtailments	**(2,806)**	–
Settlements	**(58,111)**	(14,121)
Benefits paid	**(285,904)**	(220,400)
Expenses paid	**(2,993)**	(1,998)
Benefit obligation, end of year	**5,431,434**	4,865,377
Change in the Plans' assets:		
Fair value of the Plans' assets, beginning of year	**4,132,797**	3,977,271
Actual return on the Plans' assets, net of expenses	**68,999**	117,281
Employer contributions	**19,521**	16,854
Acquired plans	**47,946**	259,140
Transfers	**(26,746)**	(1,323)
Settlements	**(58,111)**	(14,028)
Benefits paid	**(285,819)**	(220,400)
Expenses paid	**(2,993)**	(1,998)
Fair value of the Plans' assets, end of year	**3,895,594**	4,132,797
Funded status of the Plans	**$ (1,535,840)**	$ (732,580)
End-of-year values:		
Projected benefit obligation	**$ 5,431,434**	$ 4,865,377
Accumulated benefit obligation	**5,422,498**	4,849,063

10. Retirement Plans (continued)

Included in net assets at June 30, 2016, are unrecognized actuarial losses of $1.7 billion that have not yet been recognized in net periodic pension cost. The actuarial losses included in net assets and expected to be recognized in net periodic pension cost during the fiscal year ending June 30, 2017, total $65.3 million.

The components of net periodic pension expense (income) are as follows (in thousands):

	2016	2015
Components of net periodic pension expense (income):		
Service cost	**$ 15,518**	$ 24,022
Interest cost	**201,192**	192,412
Expected return on the Plans' assets	**(274,718)**	(279,186)
Actuarial losses	**38,134**	41,828
Settlements	**26,157**	532
	$ 6,283	$ (20,392)

The service cost, interest cost, expected return on the Plans' assets, actuarial losses, and amortization of prior service benefit components of net periodic pension expense (income) are recognized in the consolidated statements of operations within employee benefits expense. Curtailments and settlements components of net periodic pension expense (income) are recognized in the consolidated statements of operations within restructuring, impairment and other losses.

CHI has historically used a single weighted average discount rate derived from the yield curve used to determine its pension benefit obligations to calculate the interest cost and service cost components of net periodic benefit costs for its defined benefit plan. In 2016, CHI changed the method used to estimate the service cost and interest cost components of net periodic pension cost to use a full yield curve "spot rate" approach that applies the specific spot rates along the yield curve to the plans' projected cash flows for certain benefit plans that had a remeasurement event during the year, the impact of which was immaterial. Additionally, for 2017 and going forward, CHI has determined that adopting the full yield curve "spot rate" approach for all other plans is preferable because it provides a more direct matching between the individual cash flows and the discount rates applied to those cash flows. As a result of this change in accounting method, service and interest costs are expected to decrease by approximately $34.9 million for the year ending June 30, 2017.

10. Retirement Plans (continued)

The assumption for the expected return on the Plans' assets is based on historical returns and adherence to the asset allocations set forth in the Plans' investment policies.

Weighted-average assumptions used to determine the pension benefit obligation for the years ended June 30 are as follows:

	2016	2015
Discount rate	**3.53%**	4.29%
Rate of compensation increase	**n/a**	n/a

The decrease in the discount rate to 3.53% at June 30, 2016, increased the pension benefit obligation by approximately $282.7 million.

Weighted-average assumptions used to determine the net periodic pension expense (income) for the years ended June 30 are as follows:

	2016	2015
Discount rate	**4.29%**	4.15%
Expected return on Plans' assets	**7.20**	7.20
Rate of compensation increase	**n/a**	n/a

CHI expects to contribute $8.2 million to the Plans in fiscal year 2017. A summary of expected benefits to be paid to the Plans' participants and beneficiaries is as follows (in thousands):

	Estimated Payments
Year Ending June 30:	
2017	$ 347,026
2018	273,912
2019	278,398
2020	284,995
2021	292,618
2022–2024	1,516,088

10. Retirement Plans (continued)

A summary of the Plans' assets at June 30 is as follows (in thousands):

	2016	2015
Assets		
Plans' interest in the CHI Master Trust	**$ 3,610,915**	$ 3,774,748
Investments in securities	**319,782**	379,336
Receivables for securities sold	**2,580**	5,848
Foreign currency exchange contracts	**49,611**	54,989
Other receivables	**5,346**	6,530
Total assets	**$ 3,988,234**	$ 4,221,451
Liabilities		
Payable for securities purchased	**$ 42,902**	$ 33,453
Foreign currency exchange contracts	**49,671**	55,188
Other liabilities	**67**	13
Total liabilities	**92,640**	88,654
Total plans' assets	**$ 3,895,594**	$ 4,132,797

10. Retirement Plans (continued)

The Plans' financial instruments measured at fair value on a recurring basis were determined using the following inputs at June 30 (in thousands):

	2016			
	Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Total	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Cash and short-term investments	$ 34,511	$ 30,859	$ 3,652	$ –
Equity securities	33,288	25,800	7,488	–
Fixed-income securities	251,983	66,549	164,039	21,395
Investments in securities	319,782	123,208	175,179	21,395
Foreign currency exchange contracts	49,611	–	49,611	–
Total assets	$ 369,393	$ 123,208	$ 224,790	$ 21,395
Liabilities				
Foreign currency exchange contracts	$ 49,671	$ –	$ 49,671	$ –
Total liabilities	$ 49,671	$ –	$ 49,671	$ –

10. Retirement Plans (continued)

		2015		
	Fair Value Measurements at Reporting Date Using			
		(Level 1)	(Level 2)	(Level 3)
	Total	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets				
Cash and short-term investments	$ 50,639	$ 45,436	$ 5,203	$ –
Equity securities	8,004	191	7,813	–
Fixed-income securities	320,693	45,590	252,474	22,629
Investments in securities	379,336	91,217	265,490	22,629
Foreign currency exchange contracts	54,989	–	54,989	–
Total assets	$ 434,325	$ 91,217	$ 320,479	$ 22,629
Liabilities				
Foreign currency exchange contracts	$ 55,188	$ –	$ 55,188	$ –
Total liabilities	$ 55,188	$ –	$ 55,188	$ –

For the years ended June 30, 2016 and 2015, the changes in fair value of the Plans' investments in securities, for which Level 3 inputs were used, are as follows (in thousands):

	Fixed-Income
Investments at fair value at July 1, 2014	$ 27,178
Purchases/contributions of investments	23,465
Sales/distributions of investments	(27,316)
Net change in unrealized appreciation on investments and effect of foreign currency translation	(2,340)
Net realized gains on investments	1,642
Investments at fair value at June 30, 2015	22,629
Purchases/contributions of investments	**6,429**
Sales/distributions of investments	**(8,573)**
Net change in unrealized depreciation on investments and effect of foreign currency translation	**625**
Net realized gains on investments	**285**
Investments at fair value at June 30, 2016	**$ 21,395**

10. Retirement Plans (continued)

There were no significant transfers between Levels 1 and 2 during any period presented.

Certain of the Plans' investments are held in the CHI Master Trust, which was established for the investment of assets of the Plans. Each participating plan has an undivided interest in the CHI Master Trust. The CHI Master Trust assets are allocated among the participating plans by assigning to each plan those transactions (primarily contributions, benefit payments, and plan-specific expenses) that can be specifically identified and by allocating among all plans, in proportion to each plan's beneficial interest in the CHI Master Trust, income and expenses resulting from the collective investment of the assets of the CHI Master Trust.

The CHI Master Trust investment portfolio is designed to preserve principal and obtain competitive investment returns and long-term investment growth, consistent with actuarial assumptions, while minimizing unnecessary investment risk. Diversification is achieved by allocating assets to various asset classes and investment styles and by retaining multiple investment managers with complementary philosophies, styles and approaches. Although the objective of the CHI Master Trust is to maintain asset allocations close to target, temporary periods may exist where allocations are outside of the expected range due to market conditions. The use of leverage is prohibited except as specifically directed in the alternative investment allocation. The portfolio is managed on a basis consistent with the CHI social responsibility guidelines.

A summary of the CHI Master Trust asset allocation targets, ranges by asset class and allocations by asset class within the CHI Master Trust at the measurement dates of June 30 is as follows:

	2016	**2015**	**Target**	**Range**
Equity securities	**46.0%**	46.9%	45.0%	35.0–55.0%
Fixed-income securities	**33.9**	34.8	35.0	25.0–45.0
Alternative investments	**20.1**	18.3	20.0	10.0–30.0

The CHI Master Trust allocation to alternative investments is based upon contractual commitment levels to various funds. These commitments are drawn by the fund managers as opportunities arise to invest the capital. As of June 30, 2016, the CHI Master Trust had committed to invest $380.5 million in 26 funds, of which $361.8 million had been invested. The remaining $18.7 million will be invested when, and if, requested by the funds. Alternative

10. Retirement Plans (continued)

investments within the CHI Master Trust have limited liquidity and as of June 30, 2016, $155.0 million of investments are illiquid and not available for redemption, and $579.0 million of investments are available for redemption within 180 days at the request of the CHI Master Trust.

A summary of the CHI Master Trust's assets at June 30 is as follows (in thousands). At both June 30, 2016 and 2015, the Plans' interest in the net assets of the CHI Master Trust was approximately 99.9%:

	2016	2015
Assets		
Investments in securities	**$ 3,610,005**	$ 3,767,141
Receivables for securities sold	**40,243**	32,915
Foreign currency exchange contracts	**57,155**	18,190
Other receivables	**10,499**	10,868
Total assets	**$ 3,717,902**	$ 3,829,114
Liabilities		
Payable for securities purchased	**$ 46,641**	$ 34,534
Foreign currency exchange contracts	**57,601**	17,892
Other liabilities	**2,742**	1,937
Total liabilities	**106,984**	54,363
Total CHI Master Trust assets	**$ 3,610,918**	$ 3,774,751

10. Retirement Plans (continued)

The CHI Master Trust's financial instruments measured at fair value on a recurring basis were determined using the following inputs at June 30 (in thousands):

	2016					
	Fair Value Measurements at Reporting Date Using					
				(Level 1)	(Level 2)	(Level 3)
	Total	Investments Measured at Net Asset Value (NAV)	Total	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets						
Cash and short-term investments	**$ 107,654**	**$ –**	**$ 107,654**	**$ 97,376**	**$ 10,278**	**$ –**
Equity securities	**1,609,188**	**–**	**1,609,188**	**1,605,648**	**3,540**	**–**
Fixed-income securities	**1,159,154**	**–**	**1,159,154**	**339,928**	**655,080**	**164,146**
Alternative investments	**734,009**	**734,009**	**–**	**–**	**–**	**–**
Investments in securities	**3,610,005**	**734,009**	**2,875,996**	**2,042,952**	**668,898**	**164,146**
Foreign currency exchange contracts	**57,155**	**–**	**57,155**	**–**	**57,155**	**–**
Total assets	**$ 3,667,160**	**$ 734,009**	**$ 2,933,151**	**$ 2,042,952**	**$ 726,053**	**$ 164,146**
Liabilities						
Foreign currency exchange contracts	**$ 57,601**	**$ –**	**$ 57,601**	**$ –**	**$ 57,601**	**$ –**
Total liabilities	**$ 57,601**	**$ –**	**$ 57,601**	**$ –**	**$ 57,601**	**$ –**

	2015					
	Fair Value Measurements at Reporting Date Using					
				(Level 1)	(Level 2)	(Level 3)
	Total	Investments Measured at Net Asset Value (NAV)	Total	Quoted Prices in Active Markets	Other Observable Inputs	Unobservable Inputs
Assets						
Cash and short-term investments	$ 132,940	$ –	$ 132,940	$ 115,594	$ 17,346	$ –
Equity securities	1,702,746	–	1,702,746	1,698,849	3,897	–
Fixed-income securities	1,241,230	–	1,241,230	325,523	753,386	162,321
Alternative investments	690,225	690,225	–	–	–	–
Investments in securities	3,767,141	690,225	3,076,916	2,139,966	774,629	162,321
Foreign currency exchange contracts	18,190	–	18,190	–	18,190	–
Total assets	$ 3,785,331	$ 690,225	$ 3,095,106	$ 2,139,966	$ 792,819	$ 162,321
Liabilities						
Foreign currency exchange contracts	$ 17,892	$ –	$ 17,892	$ –	$ 17,892	$ –
Total liabilities	$ 17,892	$ –	$ 17,892	$ –	$ 17,892	$ –

10. Retirement Plans (continued)

For the years ended June 30, 2016 and 2015, the changes in fair value of the CHI Master Trust's investments, for which Level 3 inputs were used, are as follows (in thousands):

	Fixed-Income
Investments at fair value at July 1, 2014	$ 99,616
Purchases/contributions of investments	210,510
Sales/distributions of investments	(143,239)
Net change in unrealized appreciation on investments and effect of foreign currency translation	(2,816)
Net realized gains on investments	(1,750)
Investments at fair value at June 30, 2015	162,321
Purchases/contributions of investments	**148,796**
Sales/distributions of investments	**(142,434)**
Net change in unrealized (depreciation) appreciation on investments and effect of foreign currency translation	**(2,205)**
Net realized (losses) gains on investments	**(2,332)**
Investments at fair value at June 30, 2016	**$ 164,146**

There were no significant transfers between Levels 1 and 2 during any period presented.

CHI 401(k) Retirement Savings Plan

CHI sponsors the CHI 401(k) Retirement Savings Plan (401(k) Savings Plan) for its employees whereby CHI matches 100.0% of the first 1.0% of eligible pay an employee contributes to the plan, and 50.0% of the next 5.0% of eligible pay contributed to the plan, for a maximum employer matching rate of 3.5% of eligible pay. On an annual basis and regardless of whether or not an employee participates in the 401(k) Savings Plan, CHI will also contribute 2.5% of eligible pay to an employee's 401(k) Savings Plan account. This contribution is made if an employee reaches 1,000 hours in the first year of employment, or every calendar year thereafter, and is employed on the last day of the calendar year. An employee is fully vested in the plan for employer contributions after three years of service. CHI recorded 401(k) Savings Plan expense of $221.7 million and $199.6 million for the years ended June 30, 2016 and 2015, respectively.

11. Concentrations of Credit Risk

CHI grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. CHI's exposure to credit risk on patient accounts receivable is limited by the geographical diversity of its MBOs. The mix of net patient accounts receivable at June 30 approximated the following:

	2016	2015
Medicare	**27%**	27%
Medicaid	**11**	11
Managed care	**33**	34
Self-pay	**11**	8
Commercial and other	**18**	20
	100%	100%

CHI maintains long-term investments with various financial institutions and investment management firms through its investment program, and its policy is designed to limit exposure to any one institution or investment. Management does not believe there are significant concentrations of credit risk at June 30, 2016 and 2015.

12. Commitments and Contingencies

Litigation

During the normal course of business, CHI may become involved in litigation. Management assesses the probable outcome of unresolved litigation and records estimated settlements. After consultation with legal counsel, management believes that any such matters will be resolved without material adverse impact to the consolidated financial position or results of operations of CHI.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Management believes CHI is in compliance with all applicable laws and regulations of the Medicare and Medicaid programs. Compliance with such laws and regulations is complex and can be

12. Commitments and Contingencies

subject to future governmental interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs. Certain CHI entities have been contacted by governmental agencies regarding alleged violations of Medicare practices for certain services. In the opinion of management after consultation with legal counsel, the ultimate outcome of these matters will not have a material adverse effect on CHI's consolidated financial position.

Operating Leases

CHI leases certain real estate and equipment under operating leases, which may include renewal options and escalation clauses. Future minimum lease payments required for the next five years and thereafter for all operating leases that have initial or remaining noncancelable lease terms in excess of one year at June 30, 2016, are as follows (in thousands):

	Amounts Due
Year ending June 30:	
2017	$ 205,409
2018	172,917
2019	144,400
2020	129,396
2021	108,920
Thereafter	355,571
	$ 1,116,613

Lease expense under operating leases for continuing operations for the years ended June 30, 2016 and 2015, totaled approximately $292.4 million and $275.3 million, respectively.

Capital Commitments

As of June 30, 2016, CHI has legally committed to fund $1.4 billion of capital improvements related to certain acquisitions and affiliations.

13. Insurance Programs

FIIL, a wholly owned captive insurance company of CHI, provides hospital professional liability, employment practices liability, miscellaneous professional liability, and commercial general liability coverage, primarily to CHI healthcare providers and all employees, including employed physicians. Coverage is provided either on a directly written basis or through a reinsurance fronting relationship with commercial insurance carriers. Policies written provide coverage with primary limits in the amount of $10.0 million for each and every claim in fiscal years 2016 and 2015. For the policy year July 1, 2015 to July 1, 2016, there is an annual policy aggregate of $85.0 million eroded by hospital professional liability and commercial general liability claims, subject to a $175,000 continuing underlying per claim limit. Effective July 1, 2011, FIIL provided excess umbrella liability coverage to CHI for claims in excess of the underlying limits discussed above. The limits provided under such excess coverage are $200.0 million per claim and in the aggregate. At June 30, 2016 and 2015, investments and assets limited as to use held for insurance purposes included $59.9 million and $54.9 million, respectively, held as collateral for the reinsurance fronting arrangement.

FIIL provided workers’ compensation coverage to CHI entities on a directly written basis for the current and prior fiscal years, with limits of liability of $1 million per claim. FIIL did not reinsure this coverage for the current and prior fiscal years.

The liability for self-insured reserves and claims represents the estimated ultimate net cost of all reported and unreported losses incurred through June 30. The reserves for unpaid losses and loss adjustment expenses are estimated using individual case-based valuations, statistical analyses and the expertise of an independent actuary.

The estimates for loss reserves are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for unpaid losses and loss adjustment expenses are adequate. The estimates are reviewed periodically, with consultation from independent actuaries, and any adjustments to the loss reserves are reflected in current operations. As a result of these reviews of claims experience, estimated reserves were reduced by $46.6 million and $57.3 million in 2016 and 2015, respectively. The reserves for unpaid losses and loss adjustment expenses relating to the workers’ compensation program were discounted, assuming a 4.0% annual return at June 30, 2016 and 2015, to a present value of $156.9 million and $157.7 million at June 30, 2016 and 2015, respectively, and represented a discount of $51.8 million and $52.4 million in 2016 and 2015, respectively. Reserves related to professional liability, employment practices and general liability are not discounted.

13. Insurance Programs (continued)

FIIL holds $809.8 million and $796.8 million of investments held for insurance purposes as of June 30, 2016 and 2015, respectively. Distribution of amounts from FIIL to CHI are subject to the approval of the Cayman Island Monetary Authority. CHI established a captive management operation (Captive Management Initiatives, Ltd.) based in the Cayman Islands, which currently manages FIIL as well as operations of other unrelated parties.

CHI, through its Welfare Benefit Administration and Development Trust, provides comprehensive health and dental coverage to certain employees and dependents through a self-insured medical plan. Accounts payable and accrued expenses include $63.7 million and $61.1 million for unpaid claims and claims adjustment expenses for CHI's self-insured medical plan at June 30, 2016 and 2015, respectively. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for unpaid losses and loss adjustment expenses are adequate. The estimates are reviewed periodically and, as adjustments to the liability become necessary, such adjustments are reflected in current operations. CHI has stop-loss insurance to cover unusually high costs of care beyond a predetermined annual amount per enrolled participant.

14. Subsequent Events

CHI's management has evaluated events subsequent to June 30, 2016 through September 23, 2016, which is the date these consolidated financial statements were available to be issued. There have been no material events noted during this period that would either impact the results reflected herein or CHI's results going forward, except as disclosed below.

Effective in September 2016, CHI sold certain real estate assets to an unrelated third party for net proceeds of $167.5 million.

Supplemental Information

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Report of Independent Auditors on Supplemental Information

The Board of Stewardship Trustees
Catholic Health Initiatives

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements of Catholic Health Initiatives as a whole. The following consolidating financial information 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 our 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. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

September 23, 2016

Mercy Medical Center, Inc.

Consolidating Balance Sheet

(In Thousands)

June 30, 2016

	Mercy Medical Center	CMG	Linus Oaks, Inc.	Mercy Foundation Inc.	Mercy Services Corporation	Eliminations and Adjustments	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated
Assets							
Current assets:							
Cash and equivalents	$ 31,165	$ 374	$ –	$ 237	$ 120	$ –	$ 31,896
Net patient accounts receivable, less allowance for bad debts of $4,234	24,769	2,040	–	–	–	–	26,809
Other accounts receivable	46,878	2,191	–	–	355	(43,561)	5,863
Current portion of investments and assets limited as to use	–	–	–	–	–	–	–
Inventories	3,850	–	15	–	864	–	4,729
Assets held for sale	–	–	–	–	–	–	–
Prepaid and other	1,277	41	2	–	–	–	1,320
Total current assets	107,939	4,646	17	237	1,339	(43,561)	70,617
Investments and assets limited as to use:							
Internally designated for capital and other funds	96,163	–	4,032	3,379	–	–	103,574
Mission and Ministry Fund	–	–	–	–	–	–	–
Capital Resource Pool	–	–	–	–	–	–	–
Held by trustees	–	–	–	–	–	–	–
Held for insurance purposes	–	–	–	–	–	–	–
Restricted by donors	15	–	–	1,340	–	–	1,355
Total investments and assets limited as to use	96,178	–	4,032	4,719	–	–	104,929
Property and equipment, net	67,709	470	3,571	68	31	–	71,849
Investments in unconsolidated organizations	34,217	–	–	–	–	(301)	33,916
Intangible assets and goodwill, net	–	–	–	–	–	–	–
Notes receivable and other	363	–	–	56	–	–	419
Total assets	$ 306,406	$ 5,116	$ 7,620	$ 5,080	$ 1,370	$ (43,862)	$ 281,730

Mercy Medical Center, Inc.

Consolidating Balance Sheet (continued)

(In Thousands)

June 30, 2016

	Mercy Medical Center	CMG	Linus Oaks, Inc.	Mercy Foundation Inc.	Mercy Services Corporation	Eliminations and Adjustments	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated
Liabilities and net assets							
Current liabilities:							
Compensation and benefits	$ 8,801	$ 2,248	$ 147	$ –	$ 88	$ –	$ 11,284
Third-party liabilities, net	656	–	–	–	–	–	656
Accounts payable and accrued expenses	19,121	43,197	816	1,397	188	(43,561)	21,158
Liabilities held for sale	–	–	–	–	–	–	–
Variable-rate debt with self-liquidity	–	–	–	–	–	–	–
Current portion of long-term debt	2,273	–	–	–	–	–	2,273
Total current liabilities	30,851	45,445	963	1,397	276	(43,561)	35,371
Pension liability	–	–	–	–	–	–	–
Self-insured reserves and claims	–	–	–	–	–	–	–
Other liabilities	287	–	3,160	–	–	–	3,447
Long-term debt	23,960	–	–	–	–	–	23,960
Total liabilities	55,098	45,445	4,123	1,397	276	(43,561)	62,778
Net assets:							
Net assets attributable to CHI	251,293	(40,329)	3,497	2,343	1,094	(301)	217,597
Net assets attributable to noncontrolling interests	–	–	–	–	–	–	–
Unrestricted	251,293	(40,329)	3,497	2,343	1,094	(301)	217,597
Temporarily restricted	15	–	–	1,141	–	–	1,156
Permanently restricted	–	–	–	199	–	–	199
Total net assets	251,308	(40,329)	3,497	3,683	1,094	(301)	218,952
Total liabilities and net assets	$ 306,406	$ 5,116	$ 7,620	$ 5,080	$ 1,370	$ (43,862)	$ 281,730

Mercy Medical Center, Inc.

Consolidating Statement of Operations

(In Thousands)

Year Ended June 30, 2016

	Mercy Medical Center	CMG	Linus Oaks, Inc.	Mercy Foundation Inc.	Mercy Services Corporation	Eliminations and Adjustments	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated
Revenues:							
Net patient services revenues	$ 196,898	$ 20,366	$ 2,847	$ –	$ –	$ –	$ 220,111
Other operating revenues:							
Donations	–	–	–	1,324	7	(400)	931
Changes in equity of unconsolidated organizations	9,689	–	–	–	–	–	9,689
Gains on business combinations	–	–	–	–	–	–	–
Hospital ancillary revenues	2,364	–	4	–	2,555	–	4,923
Other	5,593	1,839	87	306	25	(705)	7,145
Total other operating revenues	17,646	1,839	91	1,630	2,587	(1,105)	22,688
Total operating revenues	214,544	22,205	2,938	1,630	2,587	(1,105)	242,799
Expenses:							
Salaries and wages	65,410	19,554	1,067	497	881	–	87,409
Employee benefits	17,276	3,936	296	161	314	–	21,983
Purchased services, medical professional fees, medical claims and consulting	34,319	2,655	138	297	186	(705)	36,890
Supplies	25,982	1,512	424	44	1,082	1	29,045
Utilities	1,572	138	295	4	47	–	2,056
Rentals, leases, maintenance and insurance	9,481	2,578	320	42	259	(1)	12,679
Depreciation and amortization	6,037	92	260	20	5	–	6,414
Interest	1,294	–	–	–	–	–	1,294
Other	11,536	520	177	669	171	(400)	12,673
Total operating expenses before restructuring, impairment and other losses	172,907	30,985	2,977	1,734	2,945	(1,105)	210,443
Income (loss) income from operations before restructuring, impairment and other losses	41,637	(8,780)	(39)	(104)	(358)	–	32,356
Restructuring, impairment and other losses	1,291	–	–	–	–	–	1,291
Income (loss) income from operations	40,346	(8,780)	(39)	(104)	(358)	–	31,065
Nonoperating (losses) gains:							
Investment (losses), net	(262)	–	(32)	(10)	–	–	(304)
Loss on defeasance of bonds	–	–	–	–	–	–	–
Realized and unrealized gains on interest rate swaps	–	–	–	–	–	–	–
Other nonoperating gains (losses)	–	–	–	–	–	–	–
Total nonoperating losses	(262)	–	(32)	(10)	–	–	(304)
Excess (deficit) excess of revenues over expenses	40,084	(8,780)	(71)	(114)	(358)	–	30,761
Excess (deficit) of revenues over expenses attributable to noncontrolling interest	–	–	–	–	–	–	–
Excess (deficit) excess of revenues over expenses attributable to CHI	$ 40,084	$ (8,780)	$ (71)	$ (114)	$ (358)	$ –	$ 30,761

Catholic Health Initiatives

Consolidating Balance Sheet

June 30, 2016
(In Thousands)

	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated	Other MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Assets								
Current assets:								
Cash and equivalents	$ 31,896	$ 815,711	$ 397,724	$ 165	$ (2,969)	$ 62,714	$ 1	$ 1,305,242
Net patient accounts receivable, less allowance for bad debts of $968,147	26,809	2,148,105	–	–	–	–	(13,677)	2,161,237
Other accounts receivable	5,863	241,237	333,611	10,716	50,370	30,583	(397,948)	274,432
Current portion of investments and assets limited as to use	–	5,917	57,229	–	–	–	–	63,146
Inventories	4,729	291,918	–	–	–	–	–	296,647
Assets held for sale	–	14,621	–	–	–	208,664	–	223,285
Prepaid and other	1,320	86,318	64,179	6	–	407	–	152,230
Total current assets	70,617	3,603,827	852,743	10,887	47,401	302,368	(411,624)	4,476,219
Investments and assets limited as to use:								
Internally designated for capital and other funds	103,574	4,529,115	248,865	–	70,249	–	262	4,952,065
Mission and Ministry Fund	–	–	150,166	–	–	–	(25,000)	125,166
Capital Resource Pool	–	–	261,572	–	–	–	–	261,572
Held by trustees	–	59,574	53,661	–	–	–	–	113,235
Held for insurance purposes	–	15,538	–	809,780	–	15,730	–	841,048
Restricted by donors	1,355	262,840	652	–	–	102	–	264,949
Total investments and assets limited as to use	104,929	4,867,067	714,916	809,780	70,249	15,832	(24,738)	6,558,035
Property and equipment, net	71,849	8,556,440	807,676	–	–	16,045	–	9,452,010
Investments in unconsolidated organizations	33,916	562,799	1,157,340	–	–	(73,482)	(417,067)	1,263,506
Intangible assets and goodwill, net	–	446,338	16,500	–	–	–	–	462,838
Notes receivable and other	419	758,965	3,642,931	26,751	1,598	1,870	(3,986,012)	446,522
Total assets	$ 281,730	$ 18,795,436	$ 7,192,106	$ 847,418	$ 119,248	$ 262,633	$ (4,839,441)	$ 22,659,130

Catholic Health Initiatives

Consolidating Balance Sheet (continued)

June 30, 2016
(In Thousands)

	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated	Other MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Liabilities and net assets								
Current liabilities:								
Compensation and benefits	$ 11,284	$ 597,246	$ 131,549	$ –	$ 2,211	$ 25,856	$ (50,508)	$ 717,638
Third-party liabilities, net	656	109,628	–	–	–	–	–	110,284
Accounts payable and accrued expenses	21,158	1,571,073	390,126	5,705	63,701	58,220	(359,581)	1,750,402
Liabilities held for sale	–	101	–	–	–	131,713	–	131,814
Variable-rate debt with self-liquidity	–	–	96,700	–	–	–	–	96,700
Current portion of long-term debt	2,273	221,579	1,695,823	–	–	–	(150,285)	1,769,390
Total current liabilities	35,371	2,499,627	2,314,198	5,705	65,912	215,789	(560,374)	4,576,228
Pension liability	–	340,067	1,195,773	–	–	–	–	1,535,840
Self-insured reserves and claims	–	12,136	5,475	629,103	–	–	–	646,714
Other liabilities	3,447	494,756	764,402	–	–	1,000	(1,537)	1,262,068
Long-term debt	23,960	4,003,464	6,989,087	–	–	10,700	(3,836,027)	7,191,184
Total liabilities	62,778	7,350,050	11,268,935	634,808	65,912	227,489	(4,397,938)	15,212,034
Net assets:								
Net assets attributable to CHI	217,597	10,799,870	(4,175,849)	212,610	53,336	35,015	(438,362)	6,704,217
Net assets attributable to noncontrolling interests	–	327,983	98,581	–	–	–	(3,140)	423,424
Unrestricted	217,597	11,127,853	(4,077,268)	212,610	53,336	35,015	(441,502)	7,127,641
Temporarily restricted	1,156	222,801	439	–	–	129	(1)	224,524
Permanently restricted	199	94,732	–	–	–	–	–	94,931
Total net assets	218,952	11,445,386	(4,076,829)	212,610	53,336	35,144	(441,503)	7,447,096
Total liabilities and net assets	$ 281,730	$ 18,795,436	$ 7,192,106	$ 847,418	$ 119,248	$ 262,633	$ (4,839,441)	$ 22,659,130

Catholic Health Initiatives

Consolidating Statement of Operations

Year Ended June 30, 2016
(In Thousands)

	Mercy Medical Center, Inc. (Roseburg, OR) Consolidated	Other MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Revenues:								
Net patient services revenues	$ 220,111	$ 14,530,577	$ –	$ –	$ –	$ –	$ (162,850)	$ 14,587,838
Other operating revenues:								
Donations	931	36,644	52	–	–	480	(170)	37,937
Changes in equity of unconsolidated organizations	9,689	88,460	(193,860)	–	–	(100,180)	328,800	132,909
Gains on business combinations	–	223,036	–	–	–	–	–	223,036
Hospital ancillary revenues	4,923	348,664	416	–	–	3,201	–	357,204
Other	7,145	209,401	1,508,078	187,689	623,692	370,121	(2,302,544)	603,582
Total other operating revenues	22,688	906,205	1,314,686	187,689	623,692	273,622	(1,973,914)	1,354,668
Total operating revenues	242,799	15,436,782	1,314,686	187,689	623,692	273,622	(2,136,764)	15,942,506
Expenses:								
Salaries and wages	87,409	6,022,023	348,803	–	–	192,086	(172,839)	6,477,482
Employee benefits	21,983	1,336,086	63,564	31,607	626,346	54,748	(879,874)	1,254,460
Purchased services, medical professional fees, medical claims and consulting	36,890	2,424,579	785,702	14,643	2,857	141,478	(1,033,243)	2,372,906
Supplies	29,045	2,753,676	119	–	–	260	–	2,783,100
Utilities	2,056	207,053	22,513	–	–	97	–	231,719
Rentals, leases, maintenance and insurance	12,679	563,252	534,341	126,242	–	2,271	(300,309)	938,476
Depreciation and amortization	6,414	774,283	96,476	–	–	1,421	–	878,594
Interest	1,294	207,369	257,574	–	–	521	(166,664)	300,094
Other	12,673	954,233	53,072	548	3,703	2,526	(133,267)	893,488
Total operating expenses before restructuring, impairment and other losses	210,443	15,242,554	2,162,164	173,040	632,906	395,408	(2,686,196)	16,130,319
Income (loss) from operations before restructuring, impairment and other losses	32,356	194,228	(847,478)	14,649	(9,214)	(121,786)	549,432	(187,813)
Restructuring, impairment and other losses	1,291	180,129	110,328	–	–	3,755	–	295,503
Income (loss) from operations	31,065	14,099	(957,806)	14,649	(9,214)	(125,541)	549,432	(483,316)
Nonoperating (losses) gains:								
Investment (losses) gains, net	(304)	(40,394)	(1,009)	25,850	387	134	(1)	(15,337)
Gain (loss) on defeasance of bonds	–	1,820	(31,288)	–	–	–	(1)	(29,469)
Realized and unrealized losses on interest rate swaps	–	(2,770)	(152,046)	–	–	–	–	(154,816)
Other nonoperating (losses) gains	–	(16,143)	105	–	–	–	(452)	(16,490)
Total nonoperating (losses) gains	(304)	(57,487)	(184,238)	25,850	387	134	(454)	(216,112)
Excess (deficit) of revenues over expenses	30,761	(43,388)	(1,142,044)	40,499	(8,827)	(125,407)	548,978	(699,428)
Excess (deficit) of revenues over expenses attributable to noncontrolling interest	–	25,273	(20,043)	–	–	(1,451)	–	3,779
Excess (deficit) excess of revenues over expenses attributable to CHI	$ 30,761	$ (68,661)	$ (1,122,001)	$ 40,499	$ (8,827)	$ (123,956)	$ 548,978	$ (703,207)

1. Required Reserves

Oregon Revised Statutes ORS 101.060 requires that continuing care retirement communities establish and maintain specific service and operating reserves. For the year ended June 30, 2016, the reserves held by Linus Oakes, Inc., the Company's retirement community, were sufficient to meet this requirement.

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