Consolidated Financial Statements and Supplementary Information

Catholic Health Initiatives
Years Ended June 30, 2017 and 2016
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Catholic Health Initiatives

Consolidated Financial Statements
and Supplementary Information

Years Ended June 30, 2017 and 2016

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, 2017 and 2016, 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 as of June 30, 2017 and 2016, 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 15, 2017

Catholic Health Initiatives

Consolidated Balance Sheets
(In Thousands)

	June 30	
	2017	**2016**
Assets		
Current assets:		
Cash and equivalents	**$ 1,033,166**	$ 1,305,242
Net patient accounts receivable, less allowances for bad debts of $1,024,099 and $968,148 at June 30, 2017 and 2016, respectively	**2,154,248**	2,161,237
Other accounts receivable	**251,137**	274,432
Current portion of investments and assets limited as to use	**65,161**	63,146
Inventories	**302,406**	280,623
Assets held for sale	**582,344**	665,428
Prepaid and other	**153,626**	147,554
Total current assets	**4,542,088**	4,897,662
Investments and assets limited as to use:		
Internally designated for capital and other funds	**5,310,808**	4,952,065
Mission and ministry fund	**126,795**	125,166
Capital resource pool	**136,585**	261,572
Held by trustees	**76,850**	113,235
Held for insurance purposes	**876,922**	841,048
Restricted by donors	**258,511**	264,949
Total investments and assets limited as to use	**6,786,471**	6,558,035
Property and equipment, net	**8,569,313**	9,034,052
Investments in unconsolidated organizations	**1,321,453**	1,260,021
Intangible assets and goodwill, net	**473,837**	462,838
Notes receivable and other	**238,588**	446,522
Total assets	**$ 21,931,750**	$ 22,659,130

	June 30	
	2017	**2016**
Liabilities and net assets		
Current liabilities:		
Compensation and benefits	**$ 642,623**	$ 682,053
Third-party liabilities, net	**85,087**	114,065
Accounts payable and accrued expenses	**1,689,849**	1,750,402
Liabilities held for sale	**165,735**	175,239
Variable-rate debt with self-liquidity	**96,700**	96,700
Commercial paper and current portion of debt	**2,017,508**	1,768,028
Total current liabilities	**4,697,502**	4,586,487
Pension liability	**1,110,983**	1,535,840
Self-insured reserves and claims	**635,780**	646,714
Other liabilities	**1,172,549**	1,262,068
Long-term debt	**6,588,202**	7,180,925
Total liabilities	**14,205,016**	15,212,034
Net assets:		
Net assets attributable to CHI	**7,047,905**	6,704,217
Net assets attributable to noncontrolling interests	**367,483**	423,424
Unrestricted	**7,415,388**	7,127,641
Temporarily restricted	**214,250**	224,524
Permanently restricted	**97,096**	94,931
Total net assets	**7,726,734**	7,447,096
Total liabilities and net assets	**$ 21,931,750**	$ 22,659,130

See accompanying notes.

Catholic Health Initiatives

Consolidated Statements of Operations
(In Thousands)

	Year Ended June 30	
	2017	**2016**
Revenues:		
Net patient services revenues before provision for doubtful accounts	**$ 15,335,886**	$ 14,688,559
Provision for doubtful accounts	**(885,018)**	(841,532)
Net patient services revenues	**14,450,868**	13,847,027
Other operating revenues:		
Donations	**30,954**	36,983
Changes in equity of unconsolidated organizations	**48,404**	133,375
Gains on business combinations	**–**	223,036
Hospital ancillary revenues	**339,072**	351,509
Other	**678,166**	597,657
Total other operating revenues	**1,096,596**	1,342,560
Total operating revenues	**15,547,464**	15,189,587
Expenses:		
Salaries and wages	**6,294,834**	6,117,712
Employee benefits	**1,201,044**	1,182,203
Purchased services, medical professional fees, medical claims and consulting	**2,402,478**	2,232,689
Supplies	**2,550,328**	2,490,524
Utilities	**210,285**	212,732
Rentals, leases, maintenance and insurance	**901,272**	898,020
Depreciation and amortization	**846,291**	833,394
Interest	**295,476**	281,581
Other	**1,056,536**	1,019,385
Total operating expenses before restructuring, impairment and other losses	**15,758,544**	15,268,240
Loss from operations before restructuring, impairment and other losses	**(211,080)**	(78,653)
Restructuring, impairment and other losses	**374,167**	292,758
Loss from operations	**(585,247)**	(371,411)
Nonoperating gains (losses):		
Investment gains (losses), net	**638,519**	(3,384)
Losses on extinguishment of debt	**(19,586)**	(29,469)
Realized and unrealized gains (losses) on interest rate swaps	**92,698**	(154,816)
Other nonoperating gains (losses)	**2,006**	(16,491)
Total nonoperating gains (losses)	**713,637**	(204,160)
Excess (deficit) of revenues over expenses	**128,390**	(575,571)
Excess of revenues over expenses attributable to noncontrolling interest	**19,948**	25,082
Excess (deficit) of revenues over expenses attributable to CHI	**$ 108,442**	$ (600,653)

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, 2015	$ 8,150,235	$ 445,687	$ 8,595,922	$ 268,317	$ 97,776	$ 8,962,015
(Deficit) excess of revenues over expenses	(600,653)	25,082	(575,571)	–	–	(575,571)
Net loss from discontinued operations	(133,469)	(21,056)	(154,525)	–	–	(154,525)
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 acquisitons	–	–	–	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	(10,338)	(11,018)	(21,356)	(4,669)	2,888	(23,137)
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
Excess of revenues over expenses	**108,442**	**19,948**	**128,390**	**–**	**–**	**128,390**
Net loss from discontinued operations	**(134,388)**	**(18,500)**	**(152,888)**	**–**	**–**	**(152,888)**
Change in pension funded status	**335,923**	**73**	**335,996**	**–**	**–**	**335,996**
Temporarily and permanently restricted contributions	**–**	**–**	**–**	**40,754**	**2,034**	**42,788**
Net assets released from restriction for capital	**33,737**	**–**	**33,737**	**(33,737)**	**–**	**–**
Net assets released from restriction for operations	**–**	**–**	**–**	**(19,939)**	**–**	**(19,939)**
Investment (losses) income	**(423)**	**–**	**(423)**	**7,811**	**1,113**	**8,501**
Distributions to noncontrolling owners	**–**	**(28,935)**	**(28,935)**	**–**	**–**	**(28,935)**
Other changes in net assets	**397**	**(28,527)**	**(28,130)**	**(5,163)**	**(982)**	**(34,275)**
Net increase (decrease) in net assets	**343,688**	**(55,941)**	**287,747**	**(10,274)**	**2,165**	**279,638**
Balances, June 30, 2017	**$ 7,047,905**	**$ 367,483**	**$ 7,415,388**	**$ 214,250**	**$ 97,096**	**$ 7,726,734**

See accompanying notes.

Catholic Health Initiatives

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30, 2017	2016
Operating activities		
Increase (decrease) in net assets	**$ 279,638**	$ (1,514,919)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	**846,291**	833,394
Provision for bad debts	**885,018**	841,532
Changes in equity of unconsolidated organizations	**(48,404)**	(133,375)
Net gains on business combinations	**–**	(223,036)
Net gains on sales of facilities and investments in unconsolidated organizations	**(195,583)**	(244,003)
Noncash operating expenses related to restructuring, impairment and other losses	**110,453**	143,977
Losses on extinguishment of debt	**19,586**	29,469
(Increase) decrease in fair value of interest rate swaps	**(127,866)**	116,327
Noncash pension adjustments	**(345,344)**	806,373
Pension cash contributions	**(79,513)**	(19,521)
Net changes in current assets and liabilities:		
Net patient and other accounts receivable	**(850,461)**	(974,031)
Other current assets	**(27,796)**	35,815
Current liabilities	**(101,894)**	99,709
Other changes	**30,246**	107,291
Net cash used in operating activities, before net change in investments and assets limited as to use	**394,371**	(94,998)
Net (increase) decrease in investments and assets limited as to use	**(246,020)**	703,181
Net cash provided by operating activities	**148,351**	608,183
Investing activities		
Purchases of property, equipment, and other capital assets	**(705,147)**	(885,054)
Investments in unconsolidated organizations	**(106,082)**	(62,670)
Business acquisitions, net of cash acquired	**(64,432)**	(2,453)
Proceeds from asset sales	**597,434**	750,266
Distributions from investments in unconsolidated organizations	**39,696**	65,411
Loans to unconsolidated affiliates	**(3,721)**	–
Net repayments of notes receivable	**148,154**	16,575
Other changes	**(12,380)**	(12,711)
Net cash used in investing activities	**(106,478)**	(130,636)
Financing activities		
Proceeds from issuance of debt and bank loans	**240,129**	993,998
Costs associated with issuance of debt	**–**	(1,076)
Repayment of debt	**(636,114)**	(948,871)
Swap cash collateral received (posted)	**82,036**	(164,725)
Net cash used in financing activities	**(313,949)**	(120,674)
(Decrease) increase in cash and equivalents	**(272,076)**	356,873
Cash and equivalents at beginning of period	**1,305,242**	948,369
Cash and equivalents at end of period	**$ 1,033,166**	$ 1,305,242
Supplemental disclosures of noncash investing activity		
Noncash purchases of property and equipment	**$ 53,881**	$ 77,983
Supplemental disclosures of cash flow information		
Cash paid during the year for interest, including amounts capitalized	**$ 325,142**	$ 324,799

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 101 hospitals, including four academic medical centers, and 29 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.

1. Summary of Significant Accounting Policies (continued)

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 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 in 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, CHI added approximately $93.3 million 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 Debts	Reserve for Charity	Total Accounts Receivable Allowances
Balance at July 1, 2015	$ (3,712,688)	$ (903,127)	$ (304,135)	$ (4,919,950)
Additions	(34,452,201)	(841,532)	(893,974)	(36,187,707)
Reductions	34,188,433	776,511	1,019,938	35,984,882
Balance at June 30, 2016	(3,976,456)	(968,148)	(178,171)	(5,122,775)
Additions	**(36,770,178)**	**(885,018)**	**(1,078,658)**	**(38,733,854)**
Reductions	**37,061,610**	**829,067**	**1,026,052**	**38,916,729**
Balance at June 30, 2017	**$ (3,685,024)**	**$ (1,024,099)**	**$ (230,777)**	**$ (4,939,900)**

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.

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.

1. Summary of Significant Accounting Policies (continued)

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 (deficit) 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 (deficit) 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 if it meets certain criteria. 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 $12.9 million and $17.5 million was recorded in the years ended June 30, 2017 and 2016, 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 $12.6 million and $12.8 million was recorded in the years ended June 30, 2017 and 2016, 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; no such circumstances were identified at June 30, 2017, with the exception of the Houston MBO discussed below. 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 the reporting unit's 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.

Effective in November 2016 and January 2017, the Houston MBO acquired various physician and diagnostic operations in Texas, which resulted in the recognition of $43.9 million of total goodwill, calculated as the difference between the consideration paid and the fair value of assets acquired and liabilities assumed. Based upon the Houston MBO's quantitative goodwill analysis performed as of June 30, 2016, which resulted in the impairment of the Houston MBO's goodwill balances, CHI performed a goodwill impairment review of the Houston MBO as of December 31, 2016 and March 31, 2017. The goodwill impairment reviews indicated that the fair value of the Houston MBO's net assets remained below its carrying value. As a result, CHI determined that the $43.9 million of goodwill acquired during fiscal year 2017 was impaired, and impairment charges were recorded in the consolidated statement of operations for fiscal year 2017.

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.

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 net loss from discontinued operations within the consolidated statements of changes in net assets for fiscal year 2016.

1. Summary of Significant Accounting Policies (continued)

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

	2017	2016
Intangible assets, beginning of year	**$ 251,776**	$ 238,491
Current year acquisitions	**4,783**	13,285
Sale and other adjustments	**(20,525)**	–
Intangible assets, end of year	**236,034**	251,776
Accumulated amortization, beginning of year	**(50,680)**	(38,140)
Intangible amortization expense	**(12,581)**	(12,783)
Sale and other adjustments	**15,891**	243
Accumulated amortization, end of year	**(47,370)**	(50,680)
Intangible assets, net	**188,664**	201,096
Goodwill, beginning of year	**261,742**	350,149
Current year acquisitions	**67,567**	22,766
Impairments	**(44,136)**	(111,173)
Goodwill, end of year	**285,173**	261,742
Total intangible assets and goodwill, net	**$ 473,837**	$ 462,838

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 as of June 30, 2016, include balances from Bethesda Hospital, Inc. (Bethesda), the non-CHI joint operating agreement (JOA) partner in the Cincinnati, Ohio JOA. As of June 30, 2016, Bethesda was a Designated Affiliate in the CHI credit group under the Capital Obligation Document (COD). In February 2017, Bethesda repaid its notes receivable balance of $139.7 million payable to CHI and is no longer considered a Designated Affiliate in the CHI credit group under the COD.

1. Summary of Significant Accounting Policies (continued)

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

	2017	2016
Notes receivable:		
From related entities	**$ 135**	$ 148,289
Other	**25,483**	36,384
Long-term pledge receivables	**37,911**	36,324
Reinsurance recoverable on unpaid losses and loss adjustment expense	**29,089**	32,226
Deferred compensation assets	**58,558**	76,679
Other long-term assets	**87,412**	116,620
Total notes receivable and other	**$ 238,588**	$ 446,522

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 (deficit) of revenue over expenses as donation revenues. Other 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.

1. Summary of Significant Accounting Policies (continued)

Performance Indicator

The performance indicator is the excess (deficit) 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 U.S. generally accepted accounting principles (U.S. GAAP).

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 extinguishment of debt, 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 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 revenue in the accompanying consolidated statements of operations and changes in net assets. The estimated cost of charity care provided was $251.6 million and $204.9 million in 2017 and 2016, respectively, for continuing operations, and $15.9 million and $8.0 million in 2017 and 2016, respectively, for discontinued operations.

1. Summary of Significant Accounting Policies (continued)

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 asset disposals, 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 6.2% and 6.0% in 2017 and 2016, 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 and goodwill 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. Details of CHI's restructuring, impairment and other losses is as follows (in thousands):

	2017	2016
Impairment charges	**$ 48,356**	$ 111,188
Changes in business operations	**207,539**	115,809
Severance costs	**78,594**	40,708
Pension settlement costs	**39,678**	25,053
Total from continuing operations	**374,167**	292,758
Discontinued operations	**14,540**	28,253
Total restructuring, impairment and other losses	**$ 388,707**	$ 321,011

Noncash impairment charges, changes in business operations and pension settlement costs from continuing operations included in the consolidated statements of operations totaled $150.1 million and $169.0 million for the fiscal years ended June 30, 2017 and 2016, respectively. Discontinued operations are reported in the consolidated statements of changes in net assets.

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, 2017, CHI has a deferred tax asset of $100.4 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 $95.7 million against the deferred tax asset associated with these NOL carryforwards.

1. Summary of Significant Accounting Policies (continued)

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.

Use of Estimates

The preparation of financial statements in conformity with 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.

New Accounting Pronouncements

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.

Cloud Computing Arrangements – In April 2015, the FASB issued ASU No. 2015-05, *Intangibles-Goodwill and Other – Internal-Use Software (Subtopics 340-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, to provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments in this update apply only to internal-use software that a customer obtains access to in a hosting arrangement if certain criteria are met. ASU 2015-05 is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years, with early adoption permitted. The adoption of ASU 2015-05 did not have a material effect on CHI's consolidated financial statements.

1. Summary of Significant Accounting Policies (continued)

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.

Presentation of Financial Statements of Not-for-Profit Entities – In August 2016, the FASB issued ASU No. 2016-14, *Not-for Profit Entities (Topic 958)*, to change the way a not-for-profit entity (NFP) classifies and presents net assets on the face of the financial statements, and presents information in the financial statements and notes about the NFP's liquidity, financial performance and cash flows. The amendment changes the way an NFP reports classes of net assets, from the currently required three classes to two, by eliminating the distinction between resources with permanent restrictions and those with temporary restrictions. The amendment also requires the NFP to provide enhanced disclosure about the nature, amounts and effects of the various types of donor-imposed restrictions, the NFP's management of its liquidity to meet short-term demands for cash, and the types of resources used and how they are allocated to carrying out the NFP's activities. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Early application is permitted.

Classification of Certain Cash Receipts and Cash Payments – In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230)*, to provide guidance on the presentation and classification of eight specific cash flow issues, including debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity method investees, and separately identifiable cash flows and application of the predominance principle. The objective of the amendment is to reduce the existing diversity in practice. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted.

1. Summary of Significant Accounting Policies (continued)

Restricted Cash – In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230)*, to provide guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. The amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted.

Simplifying the Test for Goodwill Impairment – In January 2017, the FASB issued ASU No. 2017-04, *Intangibles–Goodwill and Other (Topic 350)*, to provide guidance on simplifying how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. Instead, the entity will record a goodwill impairment loss based on the excess of the reporting unit's carrying amount of goodwill over its fair value, which is based on the current Step 1. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, and CHI has elected early adoption of this amendment.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost – In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715)*, to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendments in this update require that an employer disaggregate the service cost component and the other components of net benefit cost, and that the service cost component be reflected in the same line item as other employee compensation costs. The other components of net benefit cost would be reported as nonoperating gains (losses) on the consolidated statement of operations. ASU 2017-07 is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted.

Reclassifications

Certain reclassifications were made to the fiscal year 2016 consolidated financial statement presentation to conform to the 2017 presentation – supply costs not related to direct patient care in the amount of $125.9 million for the year ended June 30, 2017, were reclassified from supplies expenses to other expenses on the consolidated statements of operations.

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.

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

	2017	**2016**
Cost of community benefit:		
Cost of charity care provided	**$ 251,634**	$ 204,927
Unpaid cost of public programs, Medicaid and other indigent care programs	**605,930**	523,348
Nonbilled services	**29,355**	34,700
Cash and in-kind donations	**19,559**	28,974
Education research	**123,883**	115,410
Other benefit	**109,463**	117,802
Total cost of community benefit from continuing operations	**1,139,824**	1,025,161
Total cost of community benefit from discontinued operations	**75,929**	72,913
Total cost of community benefit	**1,215,753**	1,098,074
Unpaid cost of Medicare from continuing operations	**911,572**	956,725
Total cost of community benefit and the unpaid cost of Medicare	**$ 2,127,325**	$ 2,054,799

2. Community Benefit (Unaudited) (continued)

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 years 2017 and 2016, CHI received $20.9 million and $29.5 million, respectively, in funds used to subsidize charity care provided.

The total cost of community benefit from continuing and discontinued operations was 7.0% and 6.5% of total operating expenses before restructuring, impairment and other losses in fiscal years 2017 and 2016, respectively. The total cost of community benefit and the unpaid cost of Medicare from continuing and discontinued operations was 12.3% and 12.2% of total operating expenses before restructuring, impairment and other losses in 2017 and 2016, 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 Joint Operating Companies (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, 2017 and 2016, 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 $381.7 million and $351.9 million at June 30, 2017 and 2016, 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.

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

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.

Conifer Health Solutions (Conifer) – As of June 30, 2017 and 2016, CHI holds a 23.8% equity method investment in Conifer totaling $614.0 million and $570.7 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 of $431.1 million and $458.9 million, as of June 30, 2017 and 2016, respectively, reported in other liabilities on the accompanying consolidated balance sheets. The deferred income balances are being amortized straight line over the remaining agreement term expiring in January 2033, offsetting revenue cycle services fees paid to Conifer, which are reported in purchased services expense in the accompanying 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 $253.3 million and $261.8 million greater than CHI's equity interest in the underlying net assets of Conifer as of June 30, 2017 and 2016, respectively, due to basis differences in the carrying amounts of the tangible and intangible assets of $186.6 million and $195.1 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, 2017 and 2016. 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.

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

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):

	2017							
	Medical Office Buildings	**Outpatient and Diagnostic Services**	**Ambulatory Surgery Centers**	**Physician Practices**	**Hospital-Based Services**	**ACO/ CCO/ CIN**	**Other Investees**	**Total**
Total assets	**$ 17,345**	**$ 90,399**	**$ 87,958**	**$ 13,469**	**$ 185,356**	**$ 107,722**	**$ 256,017**	**$ 758,266**
Total debt	**170**	**5,976**	**21,996**	**2**	**17,343**	**31,063**	**87,992**	**164,542**
Net assets	**17,233**	**75,284**	**61,527**	**9,658**	**150,231**	**76,659**	**142,455**	**533,047**
Net patient services revenues	**–**	**84,779**	**119,056**	**7,332**	**177,431**	**–**	**193,722**	**582,320**
Total revenues, net	**3,577**	**137,557**	**130,356**	**7,332**	**177,889**	**180,436**	**272,215**	**909,362**
Excess (deficit) of revenues over expenses	**3,157**	**23,789**	**35,460**	**(1,747)**	**32,968**	**1,723**	**20,610**	**115,960**

	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	$ 176,015	$ 128,069	$ 176,054	$ 884,457
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	143,318	78,961	104,998	593,824
Net patient services revenues	–	312,518	98,850	6,271	138,390	–	116,540	672,569
Total revenues, net	1,889	419,513	100,251	6,628	138,657	179,066	161,319	1,007,323
Excess of revenues over expenses	10,012	41,496	30,364	105	33,155	7,091	6,399	128,622

4. Acquisitions, Affiliations, and Divestitures

The following table is a summary of significant business combinations and affiliations that occurred in fiscal year 2017 (in thousands):

Purchase consideration:	
Cash	**$ 64,432**
Current liabilities	**723**
Debt	**27,755**
	$ 92,910
Purchase price allocation:	
Inventory	**$ 3,041**
Property and equipment	**39,681**
Intangible assets	**4,343**
Goodwill	**50,702**
Current liabilities	**(752)**
Debt	**(4,105)**
	$ 92,910

During fiscal year 2017, CHI entered into various business combinations and affiliations, including the acquisition by a subsidiary of CHI of the operations of a multi-specialty group in the state of Texas. The operations include a general acute care hospital and emergency room, an ambulatory surgery center, a management company, and an independent physician association comprising of more than 80 health care providers. For the fiscal year ended June 30, 2017, the affiliations and acquisitions reported a combined $52.0 million in operating revenues and $(17.5) million in deficit of revenues over expenses in the CHI consolidated results of operations.

4. Acquisitions, Affiliations and Divestitures (continued)

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

	Trinity	Brazosport	LUH	Other	Total
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

	Trinity	Brazosport	LUH	Other	Total
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	–	–	1,200	1,410
Goodwill	–	–	–	18,648	18,648
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 net assets	(9,205)	(1,286)	(3,651)	(61)	(14,203)
	$ 145,109	$ 21,293	$ 111,551	$ 43,975	$ 321,928

4. Acquisitions, Affiliations, and Divestitures (continued)

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 remeasurement 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 future cash flows and probability-weighted performance assumptions. Excluding the business combination gain, Trinity reported $237.6 million and $103.7 million in operating revenues, respectively, and $27.8 million and $13.0 million of excess of revenues over expenses, respectively, to the CHI consolidated results of operations for the fiscal year ended June 30, 2017 and for the period February 1, 2016 through June 30, 2016, respectively.

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 $78.7 million and $33.7 million in operating revenues, respectively, and $(10.7) million and $(1.3) million of deficit of revenues over expenses, respectively, to the CHI consolidated results of operations for the fiscal year ended June 30, 2017 and for the period from February 1, 2016 through June 30, 2016, respectively.

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 $183.0 million and $160.9 million in operating revenues, respectively, and $(12.5) million and $(8.6) million of deficit of revenues over expenses, respectively, to the CHI consolidated results of operations for the fiscal year ended June 30, 2017 and for the period from August 1, 2015 through June 30, 2016, respectively.

4. Acquisitions, Affiliations, and Divestitures (continued)

Had CHI owned the above acquired entities 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):

	2017 Pro Forma Total CHI	2016 Pro Forma Total CHI
Operating revenues	**$ 15,583,123**	$ 15,312,149
Operating loss before restructuring	**(208,473)**	(294,984)
Excess (deficit) of revenues over expenses	**130,997**	(800,823)

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.

Other Affiliations

Pathology Associates Medical Laboratories, LLC (PAML) – Effective in May 2017, CHI sold all of its interests in PAML to Laboratory Corporation of America Holdings (LabCorp). As part of the agreement, LabCorp will also acquire CHI's direct and indirect interests in three CHI joint ventures with PAML in the states of Colorado, Kentucky and Washington. Nonrefundable gross sales proceeds attributable to CHI and its affiliates of $96.7 million were received in May 2017, resulting in a gain on sale of $40.2 million reflected in other operating revenues in the consolidated statements of operations.

KentuckyOne/UMC JOA dissolution – In December 2016, KentuckyOne Health, a subsidiary of CHI, and University Medical Center (UMC) agreed to restructure their existing JOA, originally entered into in March 2013, which had given KentuckyOne Health control over substantially all of UMC's operations, including University of Louisville Hospital and the James Graham Brown Cancer Center. Among the various capital investment and funding aspects of the new agreement, the new agreement also called for UMC to take over the management of UMC operations effective on July 1, 2017, at which time CHI ceased consolidating the operations of UMC.

4. Acquisitions, Affiliations, and Divestitures (continued)

For the fiscal years ended June 30, 2017 and 2016, UMC reported total operating revenues of $515.2 million and $528.7 million, respectively, and excess of revenues over expenses of $18.1 million and $43.8 million, respectively. The CHI consolidated balance sheets also included UMC total assets of $605.5 million and $516.9 million as of June 30, 2017 and 2016, respectively. Upon deconsolidation of UMC on July 1, 2017, CHI incurred a loss of approximately $318.0 million.

Dignity Health – On October 24, 2016, CHI and Dignity Health signed a nonbinding letter of intent to explore aligning their organizations and expanding their mission of service in communities across the nation. The potential alignment would strengthen CHI and Dignity Health's leadership role in transforming health care through increased patient access and enhanced clinical excellence. The boards and sponsors of the two health systems are continuing to evaluate the potential alignment and are in the final stages of the due diligence process. CHI can give no assurance that the transaction will occur.

Discontinued Operations

In May 2017, CHI approved a plan to sell or otherwise dispose of certain entities of Jewish Hospital and St. Mary's Healthcare, Inc. System (JHSMH). CHI will begin to market the sale of these operations and anticipates closing on a sale by the end of the calendar year.

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. A letter of intent for the Medicare Advantage health insurance operations has been received, with an anticipated sale in fiscal year 2018. Although there has been significant interest in the QualChoice Health commercial operations, the uncertainty surrounding the Affordable Care Act and current political environment has delayed the anticipated sale of this operation to a timeline outside of CHI's control. CHI remains committed to selling or otherwise disposing of the QualChoice Health commercial operations and continues to actively market these operations.

The JHSMH and QualChoice Health operations are reflected as discontinued operations and held for sale as of June 30, 2017 and 2016, 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.

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 Denville MBO sale included $20.9 million of working capital settlements; as of June 30, 2016, CHI had received $62.0 million for the sale of the hospital operations of the Denville MBO plus $16.0 million in estimated working capital settlements net of closing costs. The Reading and Denville MBOs are reflected as discontinued operations in accordance with Accounting Standards Codification (ASC) 205-20, *Discontinued Operations*.

The results of operations of Louisville, 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):

	2017	2016
Other accounts receivable	**$ 31,204**	$ 75,769
Investments held for insurance purposes	**132,519**	116,950
Property and equipment, net	**380,495**	430,556
Other assets	**35,725**	35,165
Total major classes of assets of the discontinued operations	**579,943**	658,440
Other assets classified as held for sale	**2,401**	6,988
Total assets classified as held for sale	**$ 582,344**	$ 665,428
Compensation and benefits	**$ 48,530**	$ 54,775
Accounts payable and accrued expenses	**44,898**	34,214
Debt	**10,258**	11,621
Self-insured reserves	**62,049**	74,629
Total major classes of liabilities of the discontinued operations classified as held for sale	**$ 165,735**	$ 175,239

4. Acquisitions, Affiliations, and Divestitures (continued)

The $2.4 million and $7.0 million of other assets classified as held for sale as of June 30, 2017 and 2016, respectively, represent real estate assets which are scheduled to be sold in fiscal year 2018, 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):

	2017	2016
Net patient service revenues	**$ 763,007**	$ 827,096
Insurance premium revenues	**573,811**	516,844
Gain on sale	**751**	73,711
Other revenues	**26,441**	84,090
Total operating revenues	**1,364,010**	1,501,741
Salaries, wages, and employee benefits	**(491,504)**	(584,955)
Medical claims	**(526,683)**	(482,402)
Depreciation	**(42,931)**	(49,870)
Other expenses	**(439,656)**	(502,364)
Total operating expenses before restructuring, impairment and other losses	**(1,500,774)**	(1,619,591)
Loss from operations before restructuring, impairment and other losses	**(136,764)**	(117,850)
Restructuring, impairment, and other losses	**(14,540)**	(28,253)
Loss from operations	**(151,304)**	(146,103)
Nonoperating losses	**(1,584)**	(8,422)
Deficit of revenues over expenses	**$ (152,888)**	$ (154,525)

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.

The discontinued operations reported $23.0 million and $48.0 million in capital expenditures for fiscal years 2017 and 2016, respectively.

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.

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

	2017	**2016**
Medicare	**36%**	32%
Medicaid	**13**	13
Managed care	**38**	38
Self-pay	**3**	4
Commercial and other	**10**	13
	100%	100%

5. Net Patient Services Revenues (continued)

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 $86.1 million and $112.1 million at June 30, 2017 and 2016, respectively, are included in third-party liabilities. Net patient services revenues from continuing operations increased by $78.2 million and $94.6 million in fiscal year 2017 and 2016, respectively, 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):

	2017	2016
Cash and equivalents	**$ 150,960**	$ 185,325
CHI Investment Program	**5,730,972**	5,266,787
Marketable equity securities	**274,948**	342,327
Marketable fixed-income securities	**664,433**	802,382
Hedge funds and other investments	**30,319**	24,360
	6,851,632	6,621,181
Less current portion	**(65,161)**	(63,146)
	$ 6,786,471	$ 6,558,035

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

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

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 accompanying 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% of total Program assets at June 30, 2017 and 2016, respectively.

The Program asset allocation at June 30 is as follows:

	2017	**2016**
Equity securities	**41%**	44%
Fixed-income securities	**39**	32
Alternative investments	**19**	23
Cash and equivalents	**1**	1
	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.

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

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, 2017, the Program had committed to invest $815.0 million in 41 funds, of which $698.6 million had been invested. The remaining $116.4 million will be invested when, and if, requested by the funds. Alternative investments within the Program have limited liquidity. As of June 30, 2017, illiquid investments not available for redemption totaled $378.9 million, and investments available for redemption within 180 days at the request of the Program totaled $813.2 million.

Investment gains (losses) are comprised of the following for the years ended June 30 (in thousands):

	2017	**2016**
Dividend and interest income	**$ 146,582**	$ 149,800
Net realized gains	**338,400**	149,802
Net unrealized gains (losses)	**153,537**	(302,986)
Total investment gains (losses) from continuing operations	**638,519**	(3,384)
Total investment losses from discontinued operations	**(1,584)**	(8,422)
Total investment gains (losses)	**$ 636,935**	$ (11,806)

Direct expenses of the Program are less than 0.3% 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.

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.

7. Fair Value of Assets and Liabilities (continued)

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):

	2017			
	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	$ 150,960	$ 130,400	$ 20,560	$ –
Equity securities	274,948	274,948	–	–
Fixed-income securities	664,433	170,425	494,008	–
Other investments	3,523	–	–	3,523
Deferred compensation assets:				
Cash and short-term investments	6,708	6,708	–	–
	$ 1,100,572	$ 582,481	$ 514,568	$ 3,523
Liabilities				
Interest rate swaps	$ 287,990	$ –	$ 287,990	$ –
Contingent consideration	177,189	–	–	177,189
Deferred compensation liability	6,708	6,708	–	–
	$ 471,887	$ 6,708	$ 287,990	$ 177,189

7. Fair Value of Assets and Liabilities (continued)

	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

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

7. Fair Value of Assets and Liabilities (continued)

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 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 $37.4 million of payments made since June 30, 2016, and to reflect a $7.4 million increase 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):

	2017	2016
Land and improvements	**$ 780,135**	$ 687,279
Buildings and improvements	**7,244,245**	7,316,817
Equipment	**5,691,549**	5,486,136
Software	**1,113,667**	1,008,466
	14,829,596	14,498,698
Less accumulated depreciation and amortization	**(7,146,842)**	(6,537,012)
	7,682,754	7,961,686
Construction in progress	**886,559**	1,072,366
	$ 8,569,313	$ 9,034,052

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 as of June 30, 2017 and 2016, were $746.3 million and $784.1 million, respectively. For the fiscal years ended June 30, 2017 and 2016, CHI recorded $137.8 million and $111.6 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 10 years.

8. Property and Equipment (continued)

During fiscal years 2017 and 2016, CHI sold various 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 buyers, 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.

In fiscal years 2017 and 2016, real estate assets with a net book value of $281.8 million and $332.3 million, respectively, were sold for gross proceeds of $366.5 million and $601.7 million, respectively. As a result of the sales, CHI recognized $22.0 million and $59.4 million gains on sales, reflected in other operating revenues in the consolidated statements of operations for the years ended June 30, 2017 and 2016, respectively. CHI also recorded short-term deferred gains of $5.8 million and $20.1 million, respectively, and long-term deferred gains of $52.2 million and $180.6 million, respectively, for fiscal year 2017 and fiscal year 2016. On the consolidated balance sheets, the short-term deferred gains are a component of accrued expenses, and the long-term deferred gains are a component of other long-term liabilities.

CHI also sold various other assets during fiscal year 2017 for net proceeds of $101.7 million reflected within other operating revenues as gain on sale on the consolidated statement of operations for the year ended June 30, 2017.

9. Debt Obligations

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

	Maturity Date	Interest Rates at June 30, 2017	2017	2016
Debt secured under the CHI COD				
Variable-rate bonds:				
CHI Series 2004B	2044	1.97%	**$ 54,200**	$ 54,200
CHI Series 2004C	2039	1.25–1.32	**96,700**	96,700
CHI Series 2008A	2037	1.72	**119,450**	120,175
CHI Series 2008C	2040	1.96	**52,990**	52,990
CHI Series 2011B	2046	2.31	**158,155**	158,155
CHI Series 2011C	2046	1.80	**118,000**	118,000
CHI Series 2013B	2035	1.91–2.31	**200,000**	200,000
CHI Series 2013C	2046	2.49	**100,000**	100,000
CHI Series 2013E Taxable	2046	2.55	**125,000**	125,000
CHI Series 2013F Taxable	2046	2.42	**75,000**	75,000
CHI Series 2015-1	2032	1.61	**36,700**	38,400
CHI Series 2015-2	2027	1.61	**63,472**	73,700
CHI Series 2015A	2032	1.71–1.79	**66,100**	69,500
CHI Series 2015B	2042	1.71	**27,270**	50,000
CHI Series 2016 Taxable	2021	3.80	**200,000**	–
Commons of Providence Series 2009B	2034	2.71	**5,860**	–
Providence Care Center Series 2009C	2034	2.71	**4,160**	–
Providence Residential Community Series 2009A	2034	2.71	**6,770**	–
Fixed-rate bonds:				
CHI Series 2002A	–	–	**–**	920
CHI Series 2004A	2034	4.75–5.0	**123,170**	140,985
CHI Series 2006A	2042	4.0–5.0	**268,015**	270,635
CHI Series 2008D	2039	5.0–6.38	**445,220**	452,065
CHI Series 2009A	2040	4.0–5.5	**573,680**	672,050
CHI Series 2009B	2040	1.88–5.25	**208,560**	217,720
CHI Series 2011A	2041	3.25–5.25	**436,470**	451,270
CHI Series 2012A	2036	3.5–5.0	**199,670**	264,170
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	7.0	**27,510**	27,990
St. Clare Commons Series 2012A	2042	3.17	**30,945**	31,720
St. Joseph Manor Series 1997B	2028	5.38	**13,895**	13,895
St. Joseph Regional Health Center Series 1993B	2019	6.0	**6,010**	8,760
St. Joseph Regional Health Center Series 1997A	2028	5.38	**36,472**	45,017
St. Joseph Regional Health Center Series 2014	2032	2.84	**25,255**	25,255

9. Debt Obligations (continued)

	Maturity Date	Interest Rates at June 30, 2017	2017	2016
Debt secured under the CHI COD (continued)				
Bank line of credit	7/2017	2.17%	**$ 250,000**	$ 250,000
Bank line of credit	–	–	**–**	200,000
Bank loan	12/2017	2.86	**333,741**	333,741
Commercial paper	2017	1.49	**815,519**	815,519
Unamortized debt premium and discount, net			**24,842**	31,580
Unamortized debt issuance costs			**(28,605)**	(31,295)
Total debt secured under the CHI COD			**7,940,796**	8,194,417
Other debt				
St. Leonard Master Trust Indenture	2040	6.0–6.63	**40,732**	41,892
Note payable issued to Episcopal Health Foundation	2020	4.0	**133,560**	167,053
Capital leases			**168,642**	166,150
Other debt			**418,680**	476,141
Total debt obligations			**8,702,410**	9,045,653
Less amounts classified as current:				
Variable-rate debt with self-liquidity			**(96,700)**	(96,700)
Commercial paper and current portion of debt			**(2,017,508)**	(1,768,028)
Long-term debt			**$ 6,588,202**	$ 7,180,925

The fair value of debt obligations was approximately $8.8 billion at June 30, 2017. Management has determined the carrying values of the variable-rate bonds are representative of fair values as of June 30, 2017, 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 calculate a 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:	
2018	$ 2,114,208
2019	437,239
2020	180,950
2021	126,271
2022	130,410

9. Debt Obligations (continued)

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 September 2016, CHI issued obligations under the COD to support the repayment of three series of previously outstanding Providence, Ohio, bonds (the Ohio bonds); the Ohio bonds were classified as other debt as of June 30, 2016, in the table above. There were no modifications to the payment terms or holders of the Ohio bonds.

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.

During March 2017, CHI's long-term credit ratings were adjusted to BBB+ with a stable outlook from Standard & Poor's, and to Baa1 with a negative outlook from Moody's. CHI's long-term credit rating from Fitch remains at BBB+ with a negative outlook.

Debt Redemptions and Reissuances

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 with an original maturity of December 2016, which was subsequently extended to December 2017. The bond redemption resulted in a loss on redemption of $30.5 million for the year ended June 30, 2016.

In August 2016, CHI redeemed $62.0 million of Series 2012A fixed-rate bonds in connection with the sale in the prior fiscal year of the underlying real estate assets. The bond redemption was funded from the real estate sale proceeds and resulted in a loss on redemption of $8.5 million included in losses on extinguishment of debt in the consolidated statement of operations.

In September 2016, CHI redeemed $37.1 million of bonds that were originally acquired as part of the LUH business combination in fiscal year 2016. The bond redemption was funded by the issuance of $34.1 million of commercial paper and restricted investments.

In December 2016, CHI issued $200.0 million of Series 2016 Taxable variable-rate bonds. Proceeds were used to repay the $200.0 million bank line of credit which matured in December 2016.

9. Debt Obligations (continued)

As discussed in Note 1, *Summary of Significant Accounting Policies-Notes Receivable and Other Assets*, in February 2017, Bethesda repaid its notes receivable to CHI for previously loaned funds. CHI used those proceeds in February and March 2017 to redeem $97.0 million of Series 2004 and Series 2009 fixed-rate bonds, and $33.0 million of Series 2015 variable-rate bonds. The bond redemption resulted in a loss on redemption of $7.7 million. Bethesda is no longer a Designated Affiliate in the CHI credit group under the COD.

In May 2017, CHI redeemed $38.8 million of bonds originally acquired in fiscal year 2016 as part of the Brazosport acquisition. The bond redemption was funded by $24.4 million of cash, restricted investments, and the issuance of $14.4 million in commercial paper, resulting in a loss on redemption of $3.4 million.

Liquidity Facilities, Credit Facilities, and Other Lines of Credit

CHI has external liquidity facilities totaling $365.0 million and $425.0 million at June 30, 2017 and 2016, respectively, which can be used to support CHI's obligations to fund tenders of variable rate demand bonds (VRDB) and to pay maturing principal of commercial paper.

At both June 30, 2017 and 2016, CHI classified as current $815.5 million of commercial paper due to maturities of less than one year and $96.7 million of VRDBs due to the holder's ability to put such VRDBs back to CHI on a daily basis, after providing a seven-day notice to tender.

At both June 30, 2017 and 2016, CHI had a credit facility with a third-party bank totaling $69.0 million, of which letters of credit totaling $63.8 million and $63.9 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, 2017 and June 30, 2016.

At June 30, 2017 and 2016, CHI had $250.0 million and $450.0 million, respectively, of outstanding bank lines of credit which were classified as current due to maturities of less than one year. As previously disclosed, the $200.0 million line of credit matured in December 2016 and was funded by the issuance of $200.0 million of Series 2016 Taxable variable-rate bonds. The $250.0 million line of credit matured in July 2017 and was funded by the issuance of a new $250.0 million line of credit agreement with a third-party bank which matures in July 2018.

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-payor swap agreements convert CHI's variable-rate debt to fixed-rate debt. Generally, it is CHI's 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.

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, 2017 and 2016, the net swap liability reflected in other liabilities was $28.9 million and $75.1 million, respectively, net of swap collateral posted of $259.1 million and $341.1 million, respectively. The change in the fair value of swap agreements was a net gain (loss) of $127.9 million and $(115.4) million for the years ended June 30, 2017 and 2016, respectively, reflected in realized and unrealized losses on interest rate swaps in the accompanying consolidated statements of operations.

Based upon the swap agreements in place as of June 30, 2017, a reduction in CHI's credit rating to BBB would obligate CHI to post additional cash collateral of $28.9 million. 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 $28.9 million as of June 30, 2017.

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

		Swap Contracts Outstanding		**Fair Value Liability (Asset)**		**Notional Amount**	
	Maturity Date	**June 30, 2017**	**June 30, 2016**	**June 30, 2017**	**June 30, 2016**	**June 30, 2017**	**June 30, 2016**
Basis swaps	2028	**1**	1	**$ (374)**	$ (736)	**$ 30,000**	$ 30,000
Fixed-payer swaps	2024–2047	**15**	16	**286,882**	415,308	**1,411,223**	1,452,710
Total return swaps	2017–2020	**25**	29	**1,482**	1,705	**174,777**	223,337
		41	46	**$ 287,990**	$ 416,277	**$ 1,616,000**	$ 1,706,047

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. 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 (the Acquired plan) which is included below from the date 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):

	2017	2016
Change in benefit obligation:		
Benefit obligation, beginning of year	**$ 5,431,434**	$ 4,865,377
Service cost	**9,340**	15,518
Interest cost	**152,067**	201,192
Actuarial (gain) loss	**(146,604)**	634,831
Acquired plan	**–**	64,354
Plan amendments	**–**	(24)
Curtailments	**–**	(2,806)
Settlements	**(162,860)**	(58,111)
Benefits paid	**(103,315)**	(285,904)
Expenses paid	**(1,697)**	(2,993)
Benefit obligation, end of year	**5,178,365**	5,431,434
Change in the Plans' assets:		
Fair value of the Plans' assets, beginning of year	**3,895,594**	4,132,797
Actual return on the Plans' assets, net of expenses	**360,147**	68,999
Employer contributions	**79,513**	19,521
Acquired plan	**–**	47,946
Transfers	**–**	(26,746)
Settlements	**(162,860)**	(58,111)
Benefits paid	**(103,315)**	(285,819)
Expenses paid	**(1,697)**	(2,993)
Fair value of the Plans' assets, end of year	**4,067,382**	3,895,594
Funded status of the Plans	**$ (1,110,983)**	$ (1,535,840)
End-of-year values:		
Projected benefit obligation	**$ 5,178,365**	$ 5,431,434
Accumulated benefit obligation	**5,170,046**	5,422,498

10. Retirement Plans (continued)

Included in unrestricted net assets at June 30, 2017, are unrecognized actuarial losses of $1.3 billion that have not yet been recognized in net periodic pension cost. The actuarial losses included in unrestricted net assets and expected to be recognized in net periodic pension cost during the fiscal year ending June 30, 2017, total $44.8 million.

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

	2017	2016
Components of net periodic pension expense (income):		
Service cost	**$ 9,340**	$ 15,518
Interest cost	**152,067**	201,192
Expected return on the Plans' assets	**(271,545)**	(274,718)
Actuarial losses	**60,182**	38,134
Settlements	**40,608**	26,157
	$ (9,348)	$ 6,283

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.

Effective on July 1, 2017, 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 decreased by approximately $34.9 million for the year ended June 30, 2017.

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.

10. Retirement Plans (continued)

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

	2017	2016
Discount rate	**3.78%**	3.53%
Rate of compensation increase	**n/a**	n/a

The increase in the discount rate to 3.78% at June 30, 2017, decreased the pension benefit obligation by approximately $146.3 million.

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

	2017	2016
Discount rate	**3.53%**	4.29%
Expected return on Plans' assets	**7.20**	7.20
Rate of compensation increase	**n/a**	n/a

CHI expects to contribute $114.3 million to the Plans in fiscal year 2018. 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:	
2018	$ 331,231
2019	280,908
2020	283,250
2021	286,590
2022	292,003
2023–2027	1,511,296

10. Retirement Plans (continued)

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

	2017	2016
Assets		
Plans' interest in the CHI Master Trust	**$ 3,743,308**	$ 3,610,915
Investments in securities	**331,168**	319,782
Receivables for securities sold	**14,089**	2,580
Foreign currency exchange contracts	**20,455**	49,611
Other receivables	**6,497**	5,346
Total assets	**4,115,517**	3,988,234
Liabilities		
Payable for securities purchased	**27,324**	42,902
Foreign currency exchange contracts	**20,541**	49,671
Other liabilities	**270**	67
Total liabilities	**48,135**	92,640
Total Plans' assets	**$ 4,067,382**	$ 3,895,594

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):

	2017			
	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	**$ 62,061**	**$ 55,925**	**$ 6,136**	**$ –**
Equity securities	**44,679**	**38,796**	**5,883**	**–**
Fixed-income securities	**224,428**	**47,209**	**173,068**	**4,151**
Investments in securities	**331,168**	**141,930**	**185,087**	**4,151**
Foreign currency exchange contracts	**20,455**	**–**	**20,455**	**–**
Total assets	**$ 351,623**	**$ 141,930**	**$ 205,542**	**$ 4,151**
Liabilities				
Foreign currency exchange contracts	**$ 20,541**	**$ –**	**$ 20,541**	**$ –**
Total liabilities	**$ 20,541**	**$ –**	**$ 20,541**	**$ –**

	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)

For the years ended June 30, 2017 and 2016, 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 Securities
Investments at fair value at July 1, 2015	$ 22,629
Purchases/contributions of investments	6,429
Sales/distributions of investments	(8,573)
Net change in unrealized appreciation 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
Purchases/contributions of investments	**6,145**
Sales/distributions of investments	**(22,621)**
Net change in unrealized depreciation on investments and effect of foreign currency translation	**(172)**
Net realized losses on investments	**(596)**
Investments at fair value at June 30, 2017	**$ 4,151**

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

10. Retirement Plans (continued)

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:

	2017	**2016**	**Target**	**Range**
Equity securities	**48.2%**	46.0%	45.0%	35.0–55.0%
Fixed-income securities	**32.4**	33.9	35.0	25.0–45.0
Alternative investments	**19.4**	20.1	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, 2017, the CHI Master Trust had committed to invest $380.5 million in 26 funds, of which $364.7 million had been invested. The remaining $15.8 million will be invested when, and if, requested by the funds. Alternative investments within the CHI Master Trust have limited liquidity and as of June 30, 2017, $125.0 million of investments are illiquid and not available for redemption, and $600.6 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, 2017 and 2016, the Plans' interest in the net assets of the CHI Master Trust was approximately 99.9%.

10. Retirement Plans (continued)

	2017	2016
Assets		
Investments in securities	**$ 3,719,449**	$ 3,610,005
Receivables for securities sold	**68,884**	40,243
Foreign currency exchange contracts	**49,037**	57,155
Other receivables	**11,618**	10,499
Total assets	**3,848,988**	3,717,902
Liabilities		
Payable for securities purchased	**53,561**	46,641
Foreign currency exchange contracts	**49,408**	57,601
Other liabilities	**2,706**	2,742
Total liabilities	**105,675**	106,984
Total CHI Master Trust assets	**$ 3,743,313**	$ 3,610,918

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):

	2017					
			Fair Value Measurements at Reporting Date Using			
		Investments		**(Level 1)**	**(Level 2)**	**(Level 3)**
	Total	**Measured at Net Asset Value (NAV)**	**Total**	**Quoted Prices in Active Markets**	**Other Observable Inputs**	**Unobservable Inputs**
Assets						
Cash and short-term investments	**$ 106,397**	**$ –**	**$ 106,397**	**$ 100,642**	**$ 5,755**	**$ –**
Equity securities	**1,710,426**	**–**	**1,710,426**	**1,707,864**	**2,562**	**–**
Fixed-income securities	**1,171,383**	**–**	**1,171,383**	**330,660**	**662,532**	**178,191**
Alternative investments	**731,243**	**731,243**	**–**	**–**	**–**	**–**
Investments in securities	**3,719,449**	**731,243**	**2,988,206**	**2,139,166**	**670,849**	**178,191**
Foreign currency exchange contracts	**49,037**	**–**	**49,037**	**–**	**49,037**	**–**
Total assets	**$ 3,768,486**	**$ 731,243**	**$ 3,037,243**	**$ 2,139,166**	**$ 719,886**	**$ 178,191**
Liabilities						
Foreign currency exchange contracts	**$ 49,408**	**$ –**	**$ 49,408**	**$ –**	**$ 49,408**	**$ –**
Total liabilities	**$ 49,408**	**$ –**	**$ 49,408**	**$ –**	**$ 49,408**	**$ –**

10. Retirement Plans (continued)

	2016					
			Fair Value Measurements at Reporting Date Using			
		Investments		(Level 1)	(Level 2)	(Level 3)
	Total	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	$ –

For the years ended June 30, 2017 and 2016, 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 Securities
Investments at fair value at July 1, 2015	$ 162,321
Purchases/contributions of investments	148,796
Sales/distributions of investments	(142,434)
Net change in unrealized depreciation on investments and effect of foreign currency translation	(2,205)
Net realized losses on investments	(2,332)
Investments at fair value at June 30, 2016	164,146
Purchases/contributions of investments	**166,065**
Sales/distributions of investments	**(155,094)**
Net change in unrealized appreciation on investments and effect of foreign currency translation	**5,556**
Net realized losses on investments	**(2,482)**
Investments at fair value at June 30, 2017	**$ 178,191**

10. Retirement Plans (continued)

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 $229.7 million and $209.4 million for the years ended June 30, 2017 and 2016, respectively, which is reflected in employee benefits expenses in the accompanying consolidated statements of operations.

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:

	2017	**2016**
Medicare	**26%**	27%
Medicaid	**14**	11
Managed care	**33**	33
Self-pay	**10**	11
Commercial and other	**17**	18
	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, 2017 and 2016.

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 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 statements.

12. Commitments and Contingencies (continued)

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, 2017, are as follows (in thousands):

	Amounts Due
Year Ending June 30:	
2018	$ 219,753
2019	185,662
2020	163,378
2021	138,308
2022	116,542
Thereafter	2,230,385
	$ 3,054,028

Lease expense under operating leases for continuing operations for the years ended June 30, 2017 and 2016, totaled approximately $294.2 million and $272.4 million, respectively.

Capital Commitments

As of June 30, 2017, CHI has legally committed to fund $841.9 million 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 2017 and 2016. For the policy year July 1, 2016 to July 1, 2017, 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

13. Insurance Programs (continued)

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. FIIL reinsured 100% of the excess layer with various commercial insurance companies. At June 30, 2017 and 2016, investments and assets limited as to use held for insurance purposes included $55.9 million and $59.9 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 $63.3 million and $46.6 million in fiscal years 2017 and 2016, 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, 2017 and 2016, to a present value of $155.5 million and $156.9 million at June 30, 2017 and 2016, respectively, and represented a discount of $50.2 million and $51.8 million in 2017 and 2016, respectively. Reserves related to professional liability, employment practices and general liability are not discounted.

FIIL holds $848.8 million and $809.8 million of investments held for insurance purposes as of June 30, 2017 and 2016, 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.

13. Insurance Programs (continued)

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 $58.8 million and $63.7 million for unpaid claims and claims adjustment expenses for CHI's self-insured medical plan at June 30, 2017 and 2016, 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, 2017 through September 15, 2017, which is the date these consolidated financial statements were 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.

In September 2017, CHI purchased the noncontrolling interest in KentuckyOne Health from the remaining partner for $150 million – see Note 4, *Acquisitions, Affiliations and Divestitures*.

During August 2017, CHI St. Luke's in Houston, Texas, was impacted by Hurricane Harvey, which caused the temporary closure and evacuation of certain area facilities for a few days. Although all hospitals in Houston, Texas, are now operational, CHI is evaluating the impact of the hurricane on its facilities and operations in the state.

Supplementary Information

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Building a better working world

Report of Independent Auditors on Supplementary 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 consolidating details appearing in conjunction with the financial statements are 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 financial statements. The information has been subjected to the auditing procedures applied in our audits 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 financial statements or to the 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 financial statements as a whole.

Ernst + Young LLP

September 15, 2017

Catholic Health Initiatives

Consolidating Balance Sheet
(In Thousands)

June 30, 2017

	MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Assets							
Current assets:							
Cash and equivalents	$ 759,353	$ 177,590	$ 67	$ 19,567	$ 76,589	$ –	$ 1,033,166
Net patient accounts receivable, less allowance for bad debts of $1,024,099	2,168,221	–	–	–	–	(13,973)	2,154,248
Other accounts receivable	228,352	413,369	1,080	(93)	12,166	(403,737)	251,137
Current portion of investments and assets limited as to use	5,312	59,849	–	–	–	–	65,161
Inventories	302,406	–	–	–	–	–	302,406
Assets held for sale	396,935	–	–	–	185,409	–	582,344
Prepaid and other	76,738	76,350	6	–	532	–	153,626
Total current assets	3,937,317	727,158	1,153	19,474	274,696	(417,710)	4,542,088
Investments and assets limited as to use:							
Internally designated for capital and other funds	5,126,640	103,025	–	75,664	–	5,479	5,310,808
Mission and ministry fund	–	151,795	–	–	–	(25,000)	126,795
Capital resource pool	–	136,585	–	–	–	–	136,585
Held by trustees	16,707	60,143	–	–	–	–	76,850
Held for insurance purposes	15,090	–	848,753	–	13,079	–	876,922
Restricted by donors	257,738	657	–	–	116	–	258,511
Total investments and assets limited as to use	5,416,175	452,205	848,753	75,664	13,195	(19,521)	6,786,471
Property and equipment, net	7,867,403	687,832	–	–	14,078	–	8,569,313
Investments in unconsolidated organizations	647,633	1,025,372	–	–	15,522	(367,074)	1,321,453
Intangible assets and goodwill, net	459,537	14,300	–	–	–	–	473,837
Notes receivable and other	787,617	3,213,327	24,842	1,674	54	(3,788,926)	238,588
Total assets	$ 19,115,682	$ 6,120,194	$ 874,748	$ 96,812	$ 317,545	$ (4,593,231)	$ 21,931,750

Catholic Health Initiatives

Consolidating Balance Sheet (continued)

(In Thousands)

	MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Liabilities and net assets							
Current liabilities:							
Compensation and benefits	$ 498,250	$ 127,021	$ –	$ 1,155	$ 16,197	$ –	$ 642,623
Third-party liabilities, net	85,087	–	–	–	–	–	85,087
Accounts payable and accrued expenses	1,618,020	352,646	6,448	58,759	71,687	(417,711)	1,689,849
Liabilities held for sale	47,402	–	–	–	118,333	–	165,735
Variable-rate debt with self-liquidity	–	96,700	–	–	–	–	96,700
Current portion of long-term debt	206,888	1,955,188	–	–	–	(144,568)	2,017,508
Total current liabilities	2,455,647	2,531,555	6,448	59,914	206,217	(562,279)	4,697,502
Pension liability	268,073	848,489	–	–	–	(5,579)	1,110,983
Self-insured reserves and claims	13,856	4,246	617,553	–	125	–	635,780
Other liabilities	498,687	672,841	–	–	1,021	–	1,172,549
Long-term debt	3,704,208	6,517,952	–	–	10,700	(3,644,658)	6,588,202
Total liabilities	6,940,471	10,575,083	624,001	59,914	218,063	(4,212,516)	14,205,016
Net assets:							
Net assets attributable to CHI	11,554,064	(4,540,869)	250,747	36,898	99,328	(352,263)	7,047,905
Net assets attributable to noncontrolling interests	310,395	85,540	–	–	–	(28,452)	367,483
Unrestricted	11,864,459	(4,455,329)	250,747	36,898	99,328	(380,715)	7,415,388
Temporarily restricted	213,656	440	–	–	154	–	214,250
Permanently restricted	97,096	–	–	–	–	–	97,096
Total net assets	12,175,211	(4,454,889)	250,747	36,898	99,482	(380,715)	7,726,734
Total liabilities and net assets	$ 19,115,682	$ 6,120,194	$ 874,748	$ 96,812	$ 317,545	$ (4,593,231)	$ 21,931,750

Catholic Health Initiatives

Consolidating Statement of Operations
(In Thousands)

Year Ended June 30, 2017

	MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Revenues:							
Net patient services revenues	$ 14,634,150	$ –	$ –	$ –	$ –	$ (183,282)	$ 14,450,868
Other operating revenues:							
Donations	30,951	1	–	–	2	–	30,954
Changes in equity of unconsolidated organizations	8,318	(99,478)	–	–	2,401	137,163	48,404
Hospital ancillary revenues	336,467	48	–	–	2,557	–	339,072
Other	523,710	1,653,993	191,164	647,464	398,230	(2,736,395)	678,166
Total other operating revenues	899,446	1,554,564	191,164	647,464	403,190	(2,599,232)	1,096,596
Total operating revenues	15,533,596	1,554,564	191,164	647,464	403,190	(2,782,514)	15,547,464
Expenses:							
Salaries and wages	5,990,014	291,481	–	–	202,527	(189,188)	6,294,834
Employee benefits	1,336,787	40,328	32,314	664,064	56,090	(928,539)	1,201,044
Purchased services, medical professional fees, medical claims and consulting	2,542,714	856,627	11,970	3,173	149,661	(1,161,667)	2,402,478
Supplies	2,543,198	7,038	–	–	92	–	2,550,328
Utilities	190,201	19,987	–	–	97	–	210,285
Rentals, leases, maintenance and insurance	568,735	545,846	93,667	–	2,115	(309,091)	901,272
Depreciation and amortization	730,877	113,589	–	–	1,825	–	846,291
Interest	179,861	267,042	–	–	519	(151,946)	295,476
Other	1,176,052	47,412	486	2,190	9,641	(179,245)	1,056,536
Total operating expenses before restructuring, impairment and other losses	15,258,439	2,189,350	138,437	669,427	422,567	(2,919,676)	15,758,544
Income (loss) from operations before restructuring, impairment and other losses	275,157	(634,786)	52,727	(21,963)	(19,377)	137,162	(211,080)
Restructuring, impairment and other losses	161,986	199,850	6,715	–	5,616	–	374,167
Income (loss) from operations	113,171	(834,636)	46,012	(21,963)	(24,993)	137,162	(585,247)

Catholic Health Initiatives

Consolidating Statement of Operations (continued)
(In Thousands)

	MBOs	Corporate	FIIL	CHI Welfare Benefits Trust	Other	Eliminations and Adjustments	Consolidated
Nonoperating gains (losses):							
Investment gains (losses), net	$ 528,951	$ 46,541	$ 52,124	$ 5,524	$ (101)	$ 5,480	$ 638,519
Losses on extinguishment of debt	(3,408)	(16,178)	–	–	–	–	(19,586)
Realized and unrealized gains on interest rate swaps	7,506	85,192	–	–	–	–	92,698
Other nonoperating gains	1,553	–	–	–	–	453	2,006
Total nonoperating gains (losses)	534,602	115,555	52,124	5,524	(101)	5,933	713,637
Excess (deficit) of revenues over expenses	647,773	(719,081)	98,136	(16,439)	(25,094)	143,095	128,390
Excess (deficit) of revenues over expenses attributable to noncontrolling interest	32,989	(13,041)	–	–	–	–	19,948
Excess (deficit) of revenues over expenses attributable to CHI	$ 614,784	$ (706,040)	$ 98,136	$ (16,439)	$ (25,094)	$ 143,095	$ 108,442

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