



RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Financial Statements

September 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Financial Statements

September 30, 2016 and 2015

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KPMG LLP
6th Floor, Suite A
100 Westminster Street
Providence, RI 02903-2321

Independent Auditors' Report

The Board of Trustees
Rhode Island Hospital:

We have audited the accompanying consolidated financial statements of Rhode Island Hospital and Affiliates, which comprise the consolidated statements of financial position as of September 30, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Rhode Island Hospital and Affiliates as of September 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Providence, Rhode Island
February 23, 2017

RHODE ISLAND HOSPITAL AND AFFILIATES

Consolidated Statements of Financial Position

September 30, 2016 and 2015

(In thousands)

Assets	2016	2015	Liabilities and Net Assets	2016	2015
Current assets:			Current liabilities:		
Cash and cash equivalents	\$ 51,860	\$ 39,671	Accounts payable	\$ 53,717	\$ 52,994
Patient accounts receivable	155,625	172,176	Accrued employee benefits and compensation	28,039	30,076
Less allowance for doubtful accounts	<u>(36,863)</u>	<u>(37,084)</u>	Other accrued expenses	16,557	17,302
Net patient accounts receivable	118,762	135,092	Revolving credit loan payable	28,000	38,000
Other receivables	<u>11,299</u>	<u>9,613</u>	Current portion of long-term debt	15,986	14,310
Total receivables	130,061	144,705	Current portion of estimated third-party payor settlements	10,103	5,550
Assets limited as to use	—	730	Estimated health care benefit self-insurance costs	<u>7,733</u>	<u>6,754</u>
Inventories	19,747	17,877	Total current liabilities	160,135	164,986
Prepaid expenses and other current assets	<u>2,377</u>	<u>2,347</u>	Long-term debt, net of current portion	235,403	243,754
Total current assets	204,045	205,330	Estimated third-party payor settlements, net of current portion	25,736	25,736
Interest in net assets of Rhode Island Hospital Foundation	51,628	51,353	Accrued pension liability	191,797	164,463
Assets limited as to use	469,917	466,525	Other liabilities	<u>15,636</u>	<u>15,719</u>
Less amount required to meet current obligations	<u>—</u>	<u>(730)</u>	Total liabilities	628,707	614,658
Noncurrent assets limited as to use	469,917	465,795	Net assets:		
Property and equipment, net	556,086	573,892	Unrestricted	339,082	376,359
Other assets:			Temporarily restricted	243,974	239,546
Deferred charges and financing costs, net	1,685	4,418	Permanently restricted	<u>74,852</u>	<u>74,143</u>
Other noncurrent assets	<u>3,254</u>	<u>3,918</u>	Total net assets	657,908	690,048
Total other assets	4,939	8,336			
Total assets	\$ <u>1,286,615</u>	\$ <u>1,304,706</u>	Total liabilities and net assets	\$ <u>1,286,615</u>	\$ <u>1,304,706</u>

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES
Consolidated Statements of Operations and Changes in Net Assets
Years ended September 30, 2016 and 2015
(In thousands)

	<u>2016</u>	<u>2015</u>
Unrestricted revenues and other support:		
Patient service revenue, net of contractual allowances	\$ 1,196,188	\$ 1,118,195
Provision for bad debts	<u>(41,114)</u>	<u>(39,705)</u>
Net patient service revenue	1,155,074	1,078,490
Other revenue	24,157	26,285
Endowment earnings contributed toward community benefit	8,214	8,638
Net assets released from restrictions used for operations	17,111	15,325
Net assets released from restrictions used for research	<u>52,928</u>	<u>50,396</u>
Total unrestricted revenues and other support	<u>1,257,484</u>	<u>1,179,134</u>
Operating expenses:		
Compensation and benefits	665,590	646,332
Supplies and other expenses	307,317	278,875
Purchased services	160,684	144,879
Depreciation and amortization	50,484	46,544
Interest	11,794	12,976
License fees	<u>58,734</u>	<u>53,457</u>
Total operating expenses	<u>1,254,603</u>	<u>1,183,063</u>
Income (loss) from operations	<u>2,881</u>	<u>(3,929)</u>
Nonoperating gains and losses:		
Net realized losses on board-designated investments	(4,719)	(2,836)
Loss on advance refunding of debt	(14,970)	—
Other nonoperating losses, net	<u>(1,272)</u>	<u>(16)</u>
Total nonoperating losses, net	<u>(20,961)</u>	<u>(2,852)</u>
Deficiency of revenues over expenses	<u>\$ (18,080)</u>	<u>\$ (6,781)</u>

RHODE ISLAND HOSPITAL AND AFFILIATES
Consolidated Statements of Operations and Changes in Net Assets
Years ended September 30, 2016 and 2015
(In thousands)

	<u>2016</u>	<u>2015</u>
Unrestricted net assets:		
Deficiency of revenues over expenses	\$ (18,080)	\$ (6,781)
Other changes in unrestricted net assets:		
Change in funded status of pension and other postretirement plans, other than net periodic pension and postretirement benefit costs	(28,671)	(18,995)
Net change in unrealized gains on investments available for sale	5,648	(10,930)
Net assets released from restrictions used for purchase of property and equipment	4,152	3,999
Donated equipment	—	107
Decrease in interest in net assets of Rhode Island Hospital Foundation	(334)	(606)
Transfers from Rhode Island Hospital Foundation	—	3,190
Transfers from (to) Hospital Properties, Inc.	8	(113)
Decrease in unrestricted net assets	<u>(37,277)</u>	<u>(30,129)</u>
Temporarily restricted net assets:		
Gifts, grants and bequests	59,931	55,352
Income from restricted endowment and other restricted investments	2,692	1,285
Increase (decrease) in interest in net assets of Rhode Island Hospital Foundation	341	(1,683)
Transfers from Rhode Island Hospital Foundation	5,996	6,683
Transfers from Newport Hospital	44	118
Net assets released from restrictions	(74,191)	(69,720)
Net realized and unrealized gains (losses) on investments	9,615	(4,275)
Increase (decrease) in temporarily restricted net assets	<u>4,428</u>	<u>(12,240)</u>
Permanently restricted net assets:		
Net change in unrealized gains on investments held in perpetual trusts by others	441	(1,061)
Increase in interest in net assets of Rhode Island Hospital Foundation	268	141
Increase (decrease) in permanently restricted net assets	<u>709</u>	<u>(920)</u>
Decrease in net assets	(32,140)	(43,289)
Net assets, beginning of year	<u>690,048</u>	<u>733,337</u>
Net assets, end of year	<u>\$ 657,908</u>	<u>\$ 690,048</u>

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES
Consolidated Statements of Cash Flows
Years ended September 30, 2016 and 2015
(In thousands)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Decrease in net assets	\$ (32,140)	\$ (43,289)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Change in funded status of pension and other postretirement plans, other than net periodic pension and postretirement benefit costs	28,671	18,995
Loss on advance refunding of debt	14,970	—
Net realized and unrealized (gains) losses on investments	(10,985)	19,102
Undistributed portion of change in interest in net assets of Rhode Island Hospital Foundation	(275)	2,148
Transfers from Rhode Island Hospital Foundation	(5,996)	(9,873)
Transfers from Newport Hospital	(44)	(118)
Transfers (from) to Hospital Properties, Inc.	(8)	113
Depreciation and amortization	50,484	46,544
Provision for estimated health care benefit self-insurance costs	67,737	61,351
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(66,758)	(59,537)
Net decrease in patient accounts receivable	16,330	2,783
Increase in accounts payable	723	9,745
(Decrease) increase in accrued employee benefits and compensation	(2,037)	1,860
Increase (decrease) in estimated third-party payor settlements	4,553	(14,549)
(Decrease) increase in all other current and noncurrent assets and liabilities, net	(4,534)	6,740
Net cash provided by operating activities	<u>60,691</u>	<u>42,015</u>
Cash flows from investing activities:		
Purchase of property and equipment	(32,254)	(71,213)
Net decrease in funds held by third parties under long-term debt agreements	9,537	1,761
Other net increases in assets limited as to use	(1,944)	(4,024)
Net cash used in investing activities	<u>(24,661)</u>	<u>(73,476)</u>
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	227,078	—
Payments to defease refunded bonds	(232,657)	—
(Payments on) proceeds from revolving credit loan payable	(10,000)	38,000
Increase in notes payable	—	4,000
Payments on long-term debt	(14,310)	(13,713)
Transfers from Rhode Island Hospital Foundation	5,996	9,873
Transfers from Newport Hospital	44	118
Transfers from (to) Hospital Properties, Inc.	8	(113)
Net cash (used in) provided by financing activities	<u>(23,841)</u>	<u>38,165</u>
Net increase in cash and cash equivalents	12,189	6,704
Cash and cash equivalents, beginning of year	<u>39,671</u>	<u>32,967</u>
Cash and cash equivalents, end of year	<u>\$ 51,860</u>	<u>\$ 39,671</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 10,356</u>	<u>\$ 13,627</u>

See accompanying notes to consolidated financial statements.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(1) Description of Organization

Rhode Island Hospital (the Hospital), located in Providence, Rhode Island, is a 719-bed nonprofit general acute care teaching hospital with university affiliation providing a comprehensive range of diagnostic and therapeutic services for the acute care of patients principally from Rhode Island and southeastern Massachusetts. As a complement to its role in service and education, the Hospital actively supports research. The Hospital is accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) and participates as a provider primarily in Medicare, Blue Cross, and Medicaid programs. The Hospital is also a member of Voluntary Hospitals of America, Inc. (VHA).

Effective August 9, 1994, the Hospital and The Miriam Hospital (TMH) of Providence, RI (247 beds) implemented a plan which included the creation of a not-for-profit parent company, Lifespan Corporation. Each hospital continues to maintain its own identity, as well as its own campus and its own name. Lifespan, the sole member of the Hospital and TMH, has the responsibility for strategic planning and initiatives, capital and operating budgets, and overall governance of the consolidated organization.

The composition of the Boards of Trustees of each of the Lifespan system hospitals and of both Newport Health Care Corporation and Gateway Healthcare, Inc. is defined as those persons serving from time to time as the directors of Lifespan Corporation. As a result, the Boards of each entity are comprised of the same individuals. The Board of each entity, however, retains its responsibilities and authorities to that entity.

(2) Charity Care and Other Community Benefits

The total net cost of charity care and other community benefits provided by the Hospital for the years ended September 30, 2016 and 2015 is summarized in the following table:

	2016	2015
Charity care	\$ 19,452	\$ 21,894
Medical education, net	47,602	45,337
Research	11,556	12,478
Subsidized health services	11,575	13,744
Unreimbursed Medicaid costs	36,624	19,681
Community health improvement services and community benefit operations	915	855
Total	<u>\$ 127,724</u>	<u>\$ 113,989</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

Charity Care

The Hospital provides full charity care for individuals at or below twice the federal poverty level, with a sliding scale for individuals based upon the federal poverty level guidelines, as set by the Department of Health and Human Services. In addition, a substantial discount consistent with Medicare program reimbursement is offered to all other uninsured patients. The Hospital determines the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including compensation and benefits, supplies, and other operating expenses, based on data from its costing system. The total cost, excluding medical education and research, incurred by the Hospital to provide charity care amounted to \$19,452 and \$21,894 in 2016 and 2015, respectively. The decline in 2016 is due largely to the January 1, 2014 expansion of Medicaid eligibility and the continued growth of health insurance exchanges. Charges forgone, based on established rates, amounted to \$67,031 and \$75,822 in 2016 and 2015, respectively.

Medical Education

The Hospital provides the setting for and substantially supports medical education in various clinical training and nursing programs. The total cost of medical education provided by the Hospital exceeded the reimbursement received from third-party payors by \$47,602 and \$45,337 in 2016 and 2015, respectively. In 1969, the Hospital and certain other Rhode Island hospitals entered into an affiliation agreement to participate jointly in various clinical training programs and research activities with Brown Medical School, renamed The Warren Alpert Medical School of Brown University (Brown). In 2010, Brown named the Hospital its Principal Teaching Hospital. TMH and EPBH continue to be designated as major teaching affiliates. The goals of the partnership are to facilitate the expansion of joint educational and research programs in order to compete both clinically and academically. The Hospital currently sponsors 49 graduate medical education programs accredited by or under the auspices of the Accreditation Council for Graduate Medical Education (ACGME), while also sponsoring another 34 hospital-approved residency and fellowship programs. The Hospital serves as the principal setting for these clinical training programs, which encompass the following disciplines: internal medicine and medicine subspecialties, including hematology and oncology; orthopedics and orthopedic subspecialties; clinical neurosciences and related subspecialties; general surgery and surgical subspecialties; pediatrics and pediatric subspecialties, including hematology and oncology; dermatology; radiology and radiology subspecialties; pathology; child psychiatry; emergency medicine and emergency medicine subspecialties; dentistry; and medical physics. The Hospital provides stipends to residents and physician fellows while in training.

In addition, the Hospital is a participating clinical training site for residents from other programs in anesthesiology, family medicine, hematology/oncology, obstetrics/gynecology (OB/Gyn) and OB/Gyn subspecialties, otolaryngology, pediatric dentistry, podiatry, psychiatry and its subspecialties of forensic psychiatry and geriatric psychiatry, orthopedics, rheumatology, and radiation oncology.

Various departments and specialties at the Hospital serve as a clinical site for the physician assistant schools of Johnson & Wales University, Bryant University, and the Massachusetts College of Pharmacy. In addition, Behavioral Medicine at the Hospital, in collaboration with Brown, sponsors research and clinical psychology training programs for interns, postdoctoral fellows, and faculty trainees.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

Medical Education (continued)

With respect to nursing education, the Hospital has developed educational affiliations with the University of Rhode Island College of Nursing; Rhode Island College School of Nursing; Community College of Rhode Island (CCRI); Salve Regina University; Boston College; Yale University; Regis College; Simmons College; St. Joseph's Health Services' School of Nursing; the University of Massachusetts campuses at Dartmouth, Boston, Amherst, and Worcester; Framingham University; the University of Connecticut; The New England Institute of Technology; Northeastern University; Drexel University; Walden University; Georgetown University School of Nursing and Health Studies; Duke University School of Nursing; and the University of Pennsylvania, as well as other Schools of Nursing, pursuant to which their nursing students obtain clinical training and experience at the Hospital. The Hospital does not receive any compensation from the various schools for providing a clinical setting for the student nurse training. The Hospital also serves as a clinical site for Certified Nursing Assistants.

The Lifespan School of Medical Imaging collaborates with Rhode Island College in the following programs: diagnostic medical sonography; nuclear medicine technology; radiologic technology; and magnetic resonance imaging. Students complete educational experiences at the Hospital, as well as other outpatient sites. The Hospital also sponsors training programs in computed tomography and mammography.

At the Hospital, clinical affiliations/student clinical training programs are provided through contracts with a number of colleges and universities in the professional areas of speech-language pathology and audiology, physical therapy, physical therapy assistants, occupational therapy, and certified occupational therapy assistants. The Hospital has clinical training affiliations in respiratory therapy with The New England Institute of Technology and CCRI. In addition, the Hospital serves as the clinical setting for training programs in histology, cytology, phlebotomy, child development, and medical-laboratory science (medical technology); related clinical affiliations with the University of Rhode Island, Salve Regina University, and Rhode Island College allow students to obtain clinical education and experience on site at the Hospital.

The Hospital has clinical affiliations/student clinical training programs for pharmacy students provided through contracts with a number of colleges and universities. A majority of the pharmacy students attend the University of Rhode Island, Massachusetts College of Pharmacy and Allied Health Sciences, and Northeastern University. In addition, the Hospital's Pharmacy Department co-sponsors second-year postgraduate specialized residency programs in oncology and ambulatory care pharmacy. The Hospital's pharmacists participate in the education of pharmacy, nursing, and physician assistant students by providing didactic lectures at the University of Rhode Island's College of Pharmacy, Rhode Island Colleges Advanced Practice Nursing Program, Johnson & Wales University's Center for Physician Assistant Studies, and Bryant University's Physician Assistant Program. In addition, the Hospital has clinical social work student contracts with Rhode Island College, Boston University, Boston College, Smith College, Simmons College, and Bridgewater State University.

Research

The Hospital conducts extensive medical research and is in the forefront of biomedical health care delivery research and among the leaders nationally in the National Institutes of Health programs. The Hospital also sponsors a significant level of these research activities, as indicated in the table on page 6.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(2) Charity Care and Other Community Benefits (continued)

Research (continued)

Federal support accounts for approximately 65% of all externally funded research at the Hospital. Researchers focus on clinical trials which investigate prevention and treatment of HIV/AIDS, obesity, cancer, diabetes, cardiac disease, neurological problems, orthopedic advancements, and mental health concerns. Researchers work in the laboratory or with patients, or both.

Subsidized Health Services

The Hospital substantially subsidizes various health services including the following programs: adult psychiatry, diabetes, dental, and Alzheimer's, as well as the Center for Special Children, early intervention, and certain other specialty services.

Unreimbursed Medicaid Costs

The Hospital subsidizes the cost of treating patients who receive government assistance where reimbursement is below cost. Medicaid is a means-tested health insurance program, jointly funded by state and federal governments. States administer the program and set rules for eligibility, benefits, and provider payments within broad federal guidelines. The program provides health care coverage to low-income children and families, pregnant women, long-term unemployed adults, seniors, and persons, and persons with disabilities. Eligibility is determined by a variety of factors, which include income relative to the federal poverty line, age and immigration status, and assets. The unreimbursed Medicaid costs do not include any allocation of medical education or research costs.

Community Health Improvement Services and Community Benefit Operations

The Hospital also provides numerous other services to the community for which charges are not generated. These services include certain emergency services, community health screenings for cardiac health, prostate cancer and other diseases, smoking cessation, immunization and nutrition programs, diabetes education, community health training programs, patient advocacy, foreign language translation, physician referral services, and charitable contributions.

(3) Summary of Significant Accounting Policies

(a) Basis of Presentation

The consolidated financial statements, which are prepared on the accrual basis of accounting, include the accounts of the Hospital, RIH Ventures (RIHV), Radiosurgery Center of Rhode Island, LLC (RCRI), and Lifespan Pharmacy, LLC. Operations of RIHV include phlebotomy services which facilitate laboratory specimen testing, as well as parking facilities that serve patients and staff of the Hospital. The Hospital owns a 100% interest in RCRI, a limited liability company formed to operate a radiation therapy center utilizing cyberknife technology. The Hospital is also the sole member of Lifespan Pharmacy, LLC, which provides services to both patients and employees. All significant intercompany accounts and transactions have been eliminated in consolidation.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(a) Basis of Presentation (continued)

The Hospital considers events and transactions that occur after the consolidated statement of financial position date, but before the consolidated financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. These consolidated financial statements were issued on February 23, 2017 and subsequent events have been evaluated through that date.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use by board-designation or other arrangements under trust agreements.

(d) Investments and Investment Income

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 820-10, *Fair Value Measurements and Disclosures* (ASC 820-10), defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. ASC 820-10 establishes a fair value hierarchy that prioritizes inputs used to measure fair value into three levels:

- Level 1 – quoted prices (unadjusted) in active markets that are accessible at the measurement date;
- Level 2 – observable prices that are based on inputs not quoted in active markets, but which are corroborated by market data; and
- Level 3 – unobservable inputs that are used when little or no market data is available.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In determining fair value, the Hospital utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible.

Following is a description of the valuation methodologies used for investments measured at fair value:

Cash and short-term investments: Valued at the net asset value (NAV) reported by the financial institution, with maturities of three months or less when purchased.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(d) Investments and Investment Income (continued)

U.S. government/agency and corporate obligations: Valued using market quotations or prices obtained from independent pricing sources which may employ various pricing methods to value the investments, including matrix pricing based on quoted prices for securities with similar coupons, ratings and maturities. These investments are designated by the Hospital as trading securities.

Corporate equity securities: Valued at the closing prices reported by an active market in which the individual securities are traded. These investments are designated by the Hospital as trading securities.

Collective investment funds: Investments in collective investment funds with monthly pricing and liquidity are valued using NAV as reported by the investment manager, which approximates the market values of the underlying investments within the fund or realizable value as estimated by the investment manager. Otherwise, such investments are recorded at historical cost. The Hospital has applied the provisions of Accounting Standards Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*, which permits the use of NAV per share or its equivalent reported by each underlying investment fund as a practical expedient to estimate the fair value of the investment.

The Hospital has also applied the provisions of ASU No. 2015-07, *Fair Value Measurement: Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)* (ASU 2015-07). Among other things, ASU 2015-07 removes the requirement to classify, within the fair value hierarchy table in Levels 2 or 3, investments in certain funds measured at net asset value (NAV) or its equivalent as a practical expedient to estimate fair value. ASU 2015-07 also requires that any NAV-measured investments excluded from the fair value hierarchy table be summarized as an adjustment to the table so that such investments can be reconciled to investments reported in the consolidated statements of financial position.

ASU No. 2015-10, *Corrections and Improvements*, amended the definition of readily determinable fair value to include equity securities in structures that are similar to mutual funds where the fair value per share is determined and published on a regular basis and is the basis for current transactions. The Hospital has reassessed the basis of fair value for its investments and concluded that certain investments have readily determinable fair values consistent with the amendment. As a result, NAV disclosures have been amended, and certain investments within the endowment and retirement plan previously accounted for using NAV as a practical expedient as of September 30, 2015 and previously excluded from the fair value hierarchy were determined to have readily determinable fair values and have been included in the fair value hierarchy. Endowment investments of approximately \$6,530 and \$32,842 have been included as Level 1 and Level 2 investments, respectively. Retirement plan investments of approximately \$5,206 and \$14,072 have been included as Level 1 and Level 2 investments, respectively.

Investments of less than 5% in limited partnerships are recorded at historical cost. Investments of 5% or more in limited partnerships, limited liability corporations, or similar investments are accounted for using the equity method.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(d) Investments and Investment Income (continued)

Investments designated by the Hospital as trading securities are reported at fair value, with gains or losses resulting from changes in fair value recognized in the consolidated statements of operations and changes in net assets as realized gains or losses on investments. For investment securities other than trading, a decline in the market value of the security below its cost that is designated to be other than temporary is recognized through an impairment charge classified as a realized loss, and a new cost basis is established.

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the deficiency of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments other than those designated as trading securities are excluded from the deficiency of revenues over expenses.

Realized gains or losses on sales of investments are determined by the average cost method. Realized gains or losses on unrestricted investments are recorded as nonoperating gains or losses; realized gains or losses on restricted investments are recorded as an addition to or deduction from the appropriate restricted net asset category.

Investment income from funds held by third parties under long-term debt agreements is recorded as other revenue. The Hospital maintains a spending policy for certain of its board-designated funds which provides that investment income from such funds is recorded within unrestricted revenues as endowment earnings contributed toward community benefit.

Income from permanently restricted investments is recorded within nonoperating gains when unrestricted by the donor and as an addition to the net assets of the appropriate temporarily restricted fund when restricted by the donor.

(e) Assets Limited as to Use

Assets limited as to use primarily include designated assets set aside by the Hospital's Board for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets whose use by the Hospital has been permanently restricted by donors or limited by grantors or donors to a specific purpose, as well as assets held by third parties under long-term debt agreements and irrevocable split-interest trusts. Amounts required to meet current liabilities of the Hospital are reported in current assets in the consolidated statements of financial position.

(f) Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed over the estimated useful life of each class of depreciable asset using the straight-line method. Buildings and improvements lives range from 5 to 40 years and equipment lives range from 3 to 20 years.

(g) Deferred Financing Costs

Deferred financing costs, which relate to the issuance of long-term bonds payable to the Rhode Island Health and Educational Building Corporation (RIHEBC), are being amortized ratably over the periods the bonds are outstanding.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(h) *Goodwill and Indefinite-Lived Intangible Assets*

Goodwill and intangible assets determined to have indefinite lives are not subject to amortization. Goodwill and indefinite-lived intangible assets are reviewed for impairment on an annual basis or more frequently if circumstances indicate a potential impairment exists or has occurred.

(i) *Classification of Net Assets*

FASB ASC Subtopic 958-250 (ASC 958-250) provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) disclosures about endowment funds, including donor-restricted endowment funds and board-designated endowment funds.

The Hospital is incorporated in and subject to the laws of Rhode Island, which adopted UPMIFA effective as of June 30, 2009. Under UPMIFA, the assets of a donor-restricted endowment fund may be appropriated for expenditure by the Hospital in accordance with the standard of prudence prescribed by UPMIFA. As a result of this law and ASC 958-250, the Hospital has classified its net assets as follows:

- *Permanently restricted net assets* contain donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by actions of the Hospital and primarily consist of the historic dollar value of contributions to establish or add to donor-restricted endowment funds.
- *Temporarily restricted net assets* contain grantor or donor-imposed stipulations as to the timing of their availability or use for a particular purpose, including research activities. These net assets are released from restrictions when the specified time elapses or when actions have been taken to meet the restrictions. Net assets of donor-restricted endowment funds in excess of their historic dollar value are classified as temporarily restricted net assets until appropriated by the Hospital and spent in accordance with the standard of prudence imposed by UPMIFA.
- *Unrestricted net assets* contain no donor-imposed restrictions and are available for the general operations of the Hospital. Such net assets may be designated by the Hospital for specific purposes, including functioning as endowment funds.

See note 5 for more information about the Hospital's endowment.

(j) *Deficiency of Revenues Over Expenses*

The consolidated statements of operations and changes in net assets include deficiency of revenues over expenses. Changes in unrestricted net assets which are excluded from deficiency of revenues over expenses, consistent with industry practice, include the change in the funded status of pension and other postretirement plans, the net change in unrealized gains on investments available-for-sale, net assets released from restrictions used for purchase of property and equipment, and the change in interest in net assets of Rhode Island Hospital Foundation.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(k) Net Patient Service Revenue

The Hospital provides care to patients under Medicare, Medicaid, managed care, and commercial insurance contractual arrangements. The Hospital has agreements with many third-party payors that provide for payments to the Hospital at amounts less than its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with some third-party payors.

Medicare and Medicaid utilize prospective payment systems for most inpatient hospital services rendered to program beneficiaries based on the classification of each case into a diagnostic-related group (DRG). Outpatient hospital services are primarily paid using an ambulatory payment classification system.

The majority of payments from managed care and commercial insurance companies are based upon fixed fee arrangements, some of which follow a DRG-based approach, while others employ a combination of per diem rates and specific case rates for inpatient services, along with fixed fees applicable to outpatient services.

Settlements and adjustments arising under reimbursement arrangements with some third-party payors, primarily Medicare, Medicaid, and Blue Cross, are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has classified a portion of accrued estimated third-party payor settlements as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year. Changes in the Medicare and Medicaid programs, such as the reduction of reimbursement, could have an adverse impact on the Hospital.

(l) Provision for Bad Debts

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Hospital analyzes its past history and identifies its revenue trends for each of its major payors to estimate the appropriate allowance for doubtful accounts and the associated provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant allowance for doubtful accounts and provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if applicable) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(3) Summary of Significant Accounting Policies (continued)

(l) Provision for Bad Debts (continued)

The Hospital's allowance for doubtful accounts for self-pay patients increased from 69% of self-pay accounts receivable at September 30, 2015 to 86% of self-pay accounts receivable at September 30, 2016. The Hospital's self-pay writeoffs for the years ended September 30, 2016 and 2015 amounted to \$38,316 and \$45,184, respectively. The Hospital did not change its charity care or uninsured discount policies during the years ended September 30, 2016 and 2015, respectively.

(m) Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue (see note 2).

(n) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. The gifts are reported as temporarily or permanently restricted support that increases those net asset classes if they are received with stipulations that limit the use of the assets. When a donor or grantor restriction expires, that is, when a stipulated purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

(o) Inventories

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost or net realizable value.

(p) Estimated Self-Insurance Costs

The Hospital participates in Lifespan self-insurance programs with other Lifespan affiliates for losses arising from professional liability/medical malpractice, general liability, and workers' compensation claims, as well as health benefits to its employees. The Hospital has recorded provisions for estimated claims, which are based on the Hospital's own experience. The provisions for self-insured losses include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

(q) Fair Value of Financial Instruments

The carrying amounts recorded in the consolidated statements of financial position for cash and cash equivalents, patient accounts receivable, assets limited as to use, accounts payable, accrued expenses, estimated third-party payor settlements, and estimated health care benefit self-insurance costs approximate their respective fair values. The estimated fair values of the Hospital's assets limited as to use, pension-related assets, and long-term debt are disclosed in notes 5, 8, and 11, respectively.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(4) Disproportionate Share

The Hospital is a participant in the State of Rhode Island's Disproportionate Share Program, established in 1995 to assist hospitals which provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including the Hospital, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. Total payments to the Hospital under the Disproportionate Share Program aggregated \$52,662 and \$58,762 in 2016 and 2015, respectively, and are reflected as part of net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

For periods beyond 2017, the federal government is scheduled to reduce the level of federal matching funds for the Disproportionate Share Program. Accordingly, it may be necessary for the State of Rhode Island to modify the program and the reimbursement to Rhode Island hospitals under the program. At this time, the scope of such modifications or their effect on the Hospital cannot be reasonably determined.

(5) Investments

The composition of assets limited as to use at September 30, 2016 and 2015 is set forth in the following table:

	<u>2016</u>	<u>2015</u>
Unrestricted board-designated funds	\$ 201,151	\$ 191,750
Funds held by third parties under long-term debt agreements	99	9,636
Temporarily restricted funds	229,428	226,341
Permanently restricted funds	<u>39,239</u>	<u>38,798</u>
Total	<u>\$ 469,917</u>	<u>\$ 466,525</u>

Assets limited as to use at September 30 are classified as follows:

	<u>2016</u>	<u>2015</u>
Available-for-sale	\$ 273,074	\$ 299,012
Trading	<u>196,843</u>	<u>167,513</u>
Total	<u>\$ 469,917</u>	<u>\$ 466,525</u>

Assets limited as to use are classified as trading securities if the buy/sell decision with respect to each portfolio security is the responsibility of an external investment manager. All other assets limited as to use are classified as available-for-sale securities.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Fair Value

The following tables summarize the Hospital's investments and assets held in trust by major category within the ASC 820-10 fair value hierarchy as of September 30, 2016 and 2015, as well as related strategy and liquidity/notice requirements:

	2016				Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3	Total		
U.S. equities:						
Large cap value	\$ 19,434	\$ —	\$ —	\$ 19,434	Daily	One
Mid-cap value	25,970	—	—	25,970	Daily	One
Large cap growth	54,533	—	—	54,533	Daily	One
International equities:						
Developing markets	—	36,678	—	36,678	Monthly	Five - Thirty-one
Emerging markets	5,619	—	—	5,619	Daily	One
Commodities:						
Energy	8,620	—	—	8,620	Daily	One
Various	6,632	—	—	6,632	Daily	One
Real estate	—	9,153	—	9,153	Monthly	Sixteen
Fixed income:						
U.S. Treasuries	34,252	—	—	34,252	Daily	One
U.S. Government and agency	—	13,141	—	13,141	Daily	One
Domestic bonds	—	38,172	—	38,172	Daily	One
Cash and short-term investments	9,342	—	—	9,342	Daily	One
	<u>164,402</u>	<u>97,144</u>	<u>—</u>	<u>261,546</u>		
Assets held in trust (note 6)	—	—	12,610	12,610	Illiquid	N/A
Held by third parties under long-term debt agreements (note 11)	99	—	—	99	Daily	One
Total	<u>\$ 164,501</u>	<u>\$ 97,144</u>	<u>\$ 12,610</u>	<u>\$ 274,255</u>		

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

	2015				Redemption or liquidation	Days' notice
	Level 1	Level 2	Level 3	Total		
U.S. equities:						
Large cap value	\$ 19,818	\$ —	\$ —	\$ 19,818	Daily	One
Mid-cap value	23,366	—	—	23,366	Daily	One
Large cap growth	50,252	—	—	50,252	Daily	One
International equities:						
Developing markets	—	32,842	—	32,842	Monthly	Five - Thirty-one
Emerging markets	619	—	—	619	Daily	One
Commodities:						
Energy	2,622	—	—	2,622	Daily	One
Various	6,530	—	—	6,530	Daily	One
Real estate	—	7,923	—	7,923	Monthly	Fifteen
Fixed income:						
U.S. Treasuries	19,821	—	—	19,821	Daily	One
U.S. Government and agency	—	10,273	—	10,273	Daily	One
Domestic bonds	—	37,727	—	37,727	Daily	One
Cash and short-term investments	5,696	—	—	5,696	Daily	One
	<u>128,724</u>	<u>88,765</u>	<u>—</u>	<u>217,489</u>		
Assets held in trust (note 6)	—	—	12,169	12,169	Illiquid	N/A
Held by third parties under long-term debt agreements (note 11)	9,636	—	—	9,636	Daily-Illiquid	One-N/A
Total	<u>\$ 138,360</u>	<u>\$ 88,765</u>	<u>\$ 12,169</u>	<u>\$ 239,294</u>		

The following tables reconcile NAV-measured investments to investments reported in the consolidated statements of financial position as of September 30, 2016 and 2015.

	2016	Redemption or liquidation	Days' notice
Marketable alternatives:			
Multiple strategies	\$ 21,684	Quarterly	Sixty - Ninety
Long-short equity	13,615	Monthly - Illiquid	Sixty - N/A
Absolute return strategies	76,229	Semi-monthly - Annually	Five - Sixty-five
International equities:			
Developed markets	16,439	Monthly	Ten
Emerging markets	38,934	Monthly - Quarterly	Ten - Ninety
Fixed income:			
U.S. Treasury inflation-protected	<u>9,155</u>	Daily	Two
Total investments measured at NAV	176,056		
All other investments	<u>274,255</u>		
Total investments	<u>\$ 450,311</u>		

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

	<u>2015</u>	<u>Redemption or liquidation</u>	<u>Days' notice</u>
Marketable alternatives:			
Multiple strategies	\$ 21,554	Quarterly - Monthly	Sixty - Ninety
Long-short equity	9,938	Monthly	Sixty
Absolute return strategies	96,280	Semi-monthly - Annually	Five - Sixty-five
International equities:			
Developed markets	11,534	Monthly	Ten
Emerging markets	38,683	Monthly - Quarterly	Ten - Ninety
Commodities:			
Various	145	Daily - Illiquid	One - N/A
Fixed income:			
U.S. Treasury inflation-protected	8,493	Daily	Two
Global bonds	<u>20,157</u>	Daily	Ten
Total investments measured at NAV	206,784		
All other investments	<u>239,294</u>		
Total investments	<u>\$ 446,078</u>		

Investments held by third parties under long-term debt agreements consist of money market funds invested in U.S. Government and agency obligations and other high-quality, short-term debt securities.

Investments of less than 5% in collective investment funds which do not have monthly pricing or liquidity are recorded at historical cost. Investments of less than 5% in limited partnerships are also recorded at historical cost. The aggregate historical cost of these investments, which is less than market value as reported by investment managers, amounted to \$19,606 at September 30, 2016 and \$20,447 at September 30, 2015.

There were no transfers between Level 1 and Level 2 fair value measurements during the years ended September 30, 2016 and 2015.

The following table presents Lifespan's activity for the years ended September 30, 2016 and 2015 for investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820-10:

	<u>Assets held in trust</u>	
	<u>2016</u>	<u>2015</u>
Fair value at October 1	\$ 12,169	13,230
Net unrealized gains (losses)	<u>441</u>	<u>(1,061)</u>
Fair value at September 30	<u>\$ 12,610</u>	<u>12,169</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Investment Income, Gains and Losses

Investment income, gains and losses for cash equivalents and assets limited as to use are comprised of the following for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Other revenue:		
Investment income	\$ <u>358</u>	\$ <u>174</u>
Endowment earnings contributed toward community benefit:		
Interest and dividend income	\$ <u>8,214</u>	\$ <u>8,638</u>
Nonoperating gains and losses:		
Net realized losses on board-designated investments	\$ <u>(4,719)</u>	\$ <u>(2,836)</u>
Other changes in unrestricted net assets:		
Net change in unrealized gains on investments available for sale	\$ <u>5,648</u>	\$ <u>(10,930)</u>
Changes in temporarily restricted net assets:		
Income from restricted endowment and other restricted investments	\$ <u>2,692</u>	\$ <u>1,285</u>
Net realized and unrealized gains (losses) on investments	<u>9,615</u>	<u>(4,275)</u>
	\$ <u>12,307</u>	\$ <u>(2,990)</u>
Changes in permanently restricted net assets:		
Net change in unrealized gains on investments held in perpetual trusts by others	\$ <u>441</u>	\$ <u>(1,061)</u>

Commitments

Venture capital, private equity, and certain energy investments are made through limited partnerships. Under the terms of these agreements, the Hospital is obligated to remit additional funding periodically as capital or liquidity calls are exercised by the manager. These partnerships have a limited existence, generally ten years, and such agreements may provide for annual extensions for the purpose of disposing portfolio positions and returning capital to investors. However, depending on market conditions, the inability to execute the fund's strategy, and other factors, a manager may extend the terms of a fund beyond its originally anticipated existence or may wind the fund down prematurely. The Hospital cannot anticipate such changes because they are based on unforeseen events, but should they occur they may result in less liquidity or return from the investment than originally anticipated. As a result, the timing and amount of future capital or liquidity calls expected to be exercised in any particular future year is uncertain. The aggregate amount of unfunded commitments associated with the above noted investment categories as of September 30, 2016 was \$17,666.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Investments with Unrealized Losses

Information regarding investments with unrealized losses at September 30, 2016 and 2015 is presented below, segregated between those that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months:

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
September 30, 2016:						
Unrestricted board-designated and temporarily restricted funds:						
Collective investment funds	\$ 10,609	\$ 334	\$ 40,597	\$ 2,323	\$ 51,206	\$ 2,657
Total temporarily impaired securities	<u>\$ 10,609</u>	<u>\$ 334</u>	<u>\$ 40,597</u>	<u>\$ 2,323</u>	<u>\$ 51,206</u>	<u>\$ 2,657</u>

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
September 30, 2015:						
Unrestricted board-designated and temporarily restricted funds:						
Collective investment funds	\$ 80,480	\$ 4,413	\$ 37,869	\$ 6,607	\$ 118,349	\$ 11,020
Total temporarily impaired securities	<u>\$ 80,480</u>	<u>\$ 4,413</u>	<u>\$ 37,869</u>	<u>\$ 6,607</u>	<u>\$ 118,349</u>	<u>\$ 11,020</u>

The Hospital reviewed the above investments with unrealized losses and determined that no impairment was considered to be other than temporary. In the evaluation of whether an impairment is other than temporary, the Hospital considers the reasons for the impairment, its ability and intent to hold the investment until the market price recovers, the severity and duration of the impairment, current market conditions, and expected future performance.

Endowments

The Hospital's endowment consists of approximately 304 individual funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the Hospital to function as endowments. Investments associated with endowment funds, including funds designated by the Hospital to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Endowments (continued)

Endowment funds consist of the following at September 30, 2016:

	Unrestricted board- designated	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$ —	\$ 229,428	\$ 39,239	\$ 268,667
Internally board-designated endowment funds	<u>201,151</u>	<u>—</u>	<u>—</u>	<u>201,151</u>
Total endowment funds	<u>\$ 201,151</u>	<u>\$ 229,428</u>	<u>\$ 39,239</u>	<u>\$ 469,818</u>

Endowment funds consist of the following at September 30, 2015:

	Unrestricted board- designated	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$ —	\$ 226,341	\$ 38,798	\$ 265,139
Internally board-designated endowment funds	<u>191,750</u>	<u>—</u>	<u>—</u>	<u>191,750</u>
Total endowment funds	<u>\$ 191,750</u>	<u>\$ 226,341</u>	<u>\$ 38,798</u>	<u>\$ 456,889</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Endowments (continued)

Changes in endowment funds for the year ended September 30, 2016 are as follows:

	Unrestricted board- designated	Temporarily restricted	Permanently restricted	Total
Endowment funds, October 1, 2015	\$ 191,750	\$ 226,341	\$ 38,798	\$ 456,889
Interest and dividend income	8,250	2,692	—	10,942
Net realized and unrealized gains	929	9,615	441	10,985
Cash gifts, grants, and bequests	—	58,931	—	58,931
Transfers from Rhode Island Hospital Foundation	—	5,996	—	5,996
Transfers from Newport Hospital	—	44	—	44
Net assets released from restrictions	—	(74,191)	—	(74,191)
Deposits	1,842	—	—	1,842
Withdrawals	(1,620)	—	—	(1,620)
Endowment funds, September 30, 2016	<u>\$ 201,151</u>	<u>\$ 229,428</u>	<u>\$ 39,239</u>	<u>\$ 469,818</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

Endowments (continued)

Changes in endowment funds for the year ended September 30, 2015 are as follows:

	Unrestricted board- designated	Temporarily restricted	Permanently restricted	Total
Endowment funds, October 1, 2014	\$ 195,956	\$ 236,152	\$ 39,859	\$ 471,967
Interest and dividend income	8,656	1,285	—	9,941
Net realized and unrealized losses	(13,766)	(4,275)	(1,061)	(19,102)
Cash gifts, grants, and bequests	—	56,098	—	56,098
Transfers from Rhode Island Hospital Foundation	—	6,683	—	6,683
Transfers from Newport Hospital	—	118	—	118
Net assets released from restrictions	—	(69,720)	—	(69,720)
Deposits	1,842	—	—	1,842
Withdrawals	(938)	—	—	(938)
Endowment funds, September 30, 2015	<u>\$ 191,750</u>	<u>\$ 226,341</u>	<u>\$ 38,798</u>	<u>\$ 456,889</u>

(a) Interpretation of Relevant Law

The portion of donor-restricted endowment funds that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Hospital and donor-restricted endowment funds
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Hospital
- The investment policies of Lifespan

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(5) Investments (continued)

(b) Return Objectives and Risk Parameters

Lifespan has adopted investment policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets, including both donor-restricted funds and unrestricted board-designated funds. Under this policy, as approved by Lifespan, the endowment assets are invested in a manner that is intended to produce results that exceed the total benchmark return while assuming a moderate level of investment risk. The Hospital expects its endowment funds, over a full market cycle, to provide an average annual real rate of return of approximately 5% plus inflation annually. Actual returns in any given year or period of years may vary from this amount.

(c) Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, Lifespan relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Lifespan targets a diversified asset allocation that places emphasis on investments in public equity, marketable alternatives, real assets, and fixed income to achieve its long-term return objectives within prudent risk constraints.

(d) Spending Policy

The Hospital invests its endowment funds in accordance with the total return concept. Applicable endowments include unrestricted board-designated endowment funds and donor-restricted endowment funds. The governing Board of the Hospital has approved an endowment spending rate of 4% based on all of the above factors. This spending rate is applied to the trailing twelve-quarter average fair value of the applicable endowments.

(6) Assets Held in Trust

The Hospital is a beneficiary of various irrevocable split-interest trusts. The fair market value of these investments at September 30, 2016 and 2015 was \$12,610 and \$12,169, respectively, and is reported as permanently restricted funds within assets limited as to use in the consolidated statements of financial position.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(7) Property and Equipment

Property and equipment, by major category, is as follows at September 30:

	<u>2016</u>	<u>2015</u>
Land and improvements	\$ 36,053	\$ 36,023
Buildings and improvements	773,293	765,487
Equipment	<u>464,186</u>	<u>448,695</u>
	1,273,532	1,250,205
Less accumulated depreciation and amortization	<u>726,676</u>	<u>683,055</u>
	546,856	567,150
Construction in progress	<u>9,230</u>	<u>6,742</u>
Property and equipment, net	<u><u>\$ 556,086</u></u>	<u><u>\$ 573,892</u></u>

Depreciation and amortization expense for the years ended September 30, 2016 and 2015 amounted to \$50,484 and \$46,544, respectively.

The estimated cost of completion of construction in progress approximated \$8,400 at September 30, 2016, comprised of various projects. In addition, the Hospital has several building renovation projects pending contractual commitments with an estimated cost of completion of approximately \$4,500.

(8) Pension and Other Postretirement Benefits

Pension Benefits

Lifespan Corp. sponsors the Lifespan Corporation Retirement Plan (the Plan), which was established effective January 1, 1996 when the Rhode Island Hospital Retirement Plan (the RIH Plan) merged into The Miriam Hospital Retirement Plan. Upon completion of the merger, the new plan was renamed and is governed by provisions of the Plan. Each employee who was a participant in the RIH Plan and was an eligible employee on January 1, 1996 continues to be a participant on and after January 1, 1996, subject to the provisions of the Plan. Employees are included in the Plan on the first of the month which is the later of their first anniversary of employment or the attainment of age 18.

The Plan is intended to constitute a plan described in Section 414(k) of the Internal Revenue Code, under which benefits are derived from employer contributions based on the separate account balances of participants in addition to the defined benefits provided under the Plan, which are based on an employee's years of credited service and annual compensation. Lifespan's funding policy is to contribute amounts to the Plan sufficient to meet minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code as amended, plus such additional amounts as may be determined to be appropriate by Lifespan. Lifespan may also make certain discretionary matching contributions to participant account balances included in Plan assets based on salary deferral elections of participants.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Pension Benefits (continued)

Substantially all employees of Lifespan Corporation who meet the above requirements are eligible to participate in the Plan.

The provisions of FASB ASC Topic 715, *Compensation-Retirement Benefits: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (ASC 715), require an employer to recognize in its statement of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The funded-status amount is measured as the difference between the fair value of plan assets and the projected benefit obligation including all actuarial gains and losses and prior service cost. Based on September 30, 2016 and 2015 funded-status amounts for the Hospital's portion of the Plan, the Hospital recorded decreases in unrestricted net assets of \$28,328 and \$19,434 in 2016 and 2015, respectively.

The estimated amounts that will be amortized from unrestricted net assets into net periodic pension cost in 2017 are as follows:

Net actuarial loss	\$	13,416
Prior service cost		123
	\$	<u>13,539</u>

The following tables set forth the Plan's projected benefit obligation and the fair value of plan assets.

	<u>2016</u>	<u>2015</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 697,447	\$ 664,768
Service cost	24,869	24,945
Interest cost	27,606	31,413
Actuarial loss	69,601	3,875
Benefits paid	<u>(35,456)</u>	<u>(27,554)</u>
Projected benefit obligation at end of year	\$ <u>784,067</u>	\$ <u>697,447</u>

The accumulated benefit obligation at the end of 2016 and 2015 was \$708,237 and \$625,251, respectively.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

	<u>2016</u>	<u>2015</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 443,024	\$ 448,213
Actual return on plan assets	32,711	(12,843)
Employer contributions	42,283	35,208
Benefits paid	<u>(35,456)</u>	<u>(27,554)</u>
Fair value of plan assets at end of year	\$ <u>482,562</u>	\$ <u>443,024</u>

The funded status of the Plan and amounts recognized in Lifespan's consolidated statements of financial position at September 30, pursuant to ASC Topic 715 (as opposed to ERISA), are as follows:

	<u>2016</u>	<u>2015</u>
Funded status, end of year:		
Fair value of plan assets	\$ 482,562	\$ 443,024
Projected benefit obligation	<u>784,067</u>	<u>697,447</u>
Accrued pension liability	\$ <u>(301,505)</u>	\$ <u>(254,423)</u>

Amounts recognized in the Hospital's consolidated statements of financial position at September 30, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Accrued pension liability	\$ <u>191,797</u>	\$ <u>164,463</u>

	<u>2016</u>	<u>2015</u>
Amounts not yet reflected in Lifespan's net periodic pension cost and included in unrestricted net assets:		
Prior service benefit	\$ 2,840	\$ 3,383
Accumulated net actuarial loss	<u>(260,136)</u>	<u>(211,560)</u>
Amounts not yet recognized as a component of net periodic pension cost	(257,296)	(208,177)
Accumulated net periodic pension cost in excess of employer contributions	<u>(44,209)</u>	<u>(46,246)</u>
Net amount recognized by Lifespan	\$ <u>(301,505)</u>	\$ <u>(254,423)</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

	<u>2016</u>	<u>2015</u>
Sources of change in the Hospital's unrestricted net assets:		
Net loss arising during the year	\$ (38,252)	\$ (28,037)
Amortizations:		
Net actuarial loss	9,764	8,438
Prior service cost	<u>160</u>	<u>165</u>
Total unrestricted net asset loss recognized during the year	\$ <u><u>(28,328)</u></u>	\$ <u><u>(19,434)</u></u>

Net Periodic Pension Cost

Components of net periodic pension cost are as follows for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Service cost	\$ 24,869	\$ 24,945
Interest cost	27,606	31,413
Expected return on plan assets	(26,964)	(31,210)
Amortization of net actuarial loss	15,277	12,885
Amortization of prior service benefit	<u>(543)</u>	<u>(541)</u>
Net periodic pension cost for Lifespan	\$ <u><u>40,245</u></u>	\$ <u><u>37,492</u></u>
Net periodic pension cost for the Hospital	\$ <u><u>25,378</u></u>	\$ <u><u>24,025</u></u>

The following weighted average assumptions were used by the Plan's actuary to determine net periodic pension cost and benefit obligations:

	<u>2016</u>	<u>2015</u>
Discount rate for benefit obligations	3.62%	4.38%
Discount rate for net periodic pension cost	4.38%	4.33%
Rate of compensation increase	4.50%	4.50%
Expected long-term rate of return on Plan assets	7.25%	7.50%

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The asset allocation for the Plan at September 30, 2016 and 2015, and the target allocation for 2017, by asset category, are as follows:

Asset category	Target allocation 2017	Percentage of plan assets September 30	
		2016	2015
U.S. equities	22.0%	18.6%	20.0%
Marketable alternatives	20.0%	21.6	22.1
International equities	22.0%	22.6	20.3
Venture capital	—	0.4	0.6
Commodities	2.7%	2.6	2.8
Real estate	1.3%	1.4	1.3
Fixed income	30.0%	30.2	30.4
Cash and cash equivalents	2.0%	2.6	2.5
Total		100.0%	100.0%

The asset allocation table above does not include \$107,278 and \$103,593 of Plan assets at September 30, 2016 and 2015, respectively, attributable to the separate savings account balances of participants which are managed in various mutual funds by Fidelity Investments (Fidelity).

The overall financial objective of the Plan is to meet present and future obligations to beneficiaries, while minimizing long-term contributions to the Plan (by earning an adequate, risk-adjusted return on Plan assets), with moderate volatility in year-to-year contribution levels.

The primary investment objective of the Plan is to attain the average annual real total return (net of investment management fees) assumed in the Plan's most recent actuarial assumptions over the long term (rolling five-year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation as measured by the Consumer Price Index. It is recognized that the real return objective may be difficult to attain in every five-year period, but should be attainable over a series of five-year periods. Performance will also be measured against various benchmarks.

Lifespan employs a rigorous process to annually determine the expected long-term rate of return on Plan assets which is only changed based on significant shifts in economic and financial market conditions. This estimate is primarily driven by actual historical asset-class returns along with our long-term outlook for a globally diversified portfolio. Asset allocations are regularly reviewed and, if necessary, updated based on evaluations of future market returns for each asset class.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Fair Value

The following tables summarize the Plan's investments by major category within the ASC 820-10 fair value hierarchy as of September 30, 2016 and 2015, as well as related strategy and liquidity/notice requirements:

	2016			Redemption or liquidation	Days' notice
	Level 1	Level 2	Total		
U.S. equities:					
Mid-cap value	\$ 16,598	\$ —	\$ 16,598	Daily	One
Large cap growth	40,346	—	40,346	Daily	One
International equities:					
Developed markets	23,019	30,193	53,212	Daily - Monthly	One - Thirty-one
Commodities:					
Energy	4,404	—	4,404	Daily	One
Various	4,660	—	4,660	Daily	One
Real estate	—	4,227	4,227	Monthly	Sixteen
Fixed income:					
U.S. Treasuries	40,852	—	40,852	Daily	One
U.S. Government and agency	—	982	982	Daily	One
Domestic bonds	—	68,623	68,623	Daily	One
Cash and cash equivalents	13,122	—	13,122	Daily	One
Fidelity mutual funds	107,278	—	107,278	Daily	One
Total	<u>\$ 250,279</u>	<u>\$ 104,025</u>	<u>\$ 354,304</u>		
	2015			Redemption or liquidation	Days' notice
	Level 1	Level 2	Total		
U.S. equities:					
Large cap value	\$ 5,461	\$ —	\$ 5,461	Daily	One
Mid-cap value	15,258	—	15,258	Daily	One
Large cap growth	37,829	—	37,829	Daily	One
International equities:					
Developed markets	16,919	10,371	27,290	Daily - Monthly	One - Five
Commodities:					
Energy	3,249	—	3,249	Daily	One
Various	5,206	—	5,206	Daily	One
Real estate	—	3,701	3,701	Monthly	Fifteen
Fixed income:					
U.S. Treasuries	23,228	—	23,228	Daily	One
U.S. Government and agency	—	906	906	Daily	One
Domestic bonds	—	78,195	78,195	Daily	One
Cash and cash equivalents	7,696	—	7,696	Daily	One
Fidelity mutual funds	103,593	—	103,593	Daily	One
Total	<u>\$ 218,439</u>	<u>\$ 93,173</u>	<u>\$ 311,612</u>		

There were no transfers between Level 1 and Level 2 fair value measurements during the years ended September 30, 2016 and 2015.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The following tables reconcile NAV-measured Plan investments to the total fair value of Plan assets as of September 30, 2016 and 2015.

	2016	Redemption or liquidation	Days' notice
Marketable alternatives:			
Multiple strategies	\$ 10,474	Quarterly	Sixty - Ninety
Long-short equity	5,903	Monthly	Sixty
Absolute return strategies	65,192	Semi-monthly - Illiquid	Five - N/A
International equities:			
Developed markets	17,817	Monthly	Ten
Emerging markets	26,029	Monthly	Ten - Twenty
Venture capital	2,843	Illiquid	N/A
Total Plan investments measured at NAV	128,258		
All other Plan investments	354,304		
Total fair value of Plan assets	<u>\$ 482,562</u>		
	2015	Redemption or liquidation	Days' notice
Marketable alternatives:			
Multiple strategies	\$ 16,479	Quarterly - Annually	Sixty - Ninety-five
Long-short equity	5,250	Monthly	Sixty
Absolute return strategies	54,685	Semi-monthly - Illiquid	Five - N/A
International equities:			
Developed markets	27,131	Monthly	Ten - Thirty-one
Emerging markets	23,955	Monthly	Ten
Venture capital	3,912	Illiquid	N/A
Total Plan investments measured at NAV	131,412		
All other Plan investments	311,612		
Total fair value of Plan assets	<u>\$ 443,024</u>		

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Expected Cash Flows

Information about the expected cash flows for the Plan is as follows:

Employer contributions:		
2017 (required for Lifespan)	\$	53,120
2017 (required for the Hospital)		33,560
Expected benefit payments:		
2017	\$	53,101
2018		41,302
2019		38,182
2020		39,906
2021		41,858
2022 through 2026		231,790

Management evaluates its Plan assumptions annually and the expected employer contributions in 2017 could increase.

Other Postretirement Benefits

In addition to providing pension benefits, the Hospital provides certain health care and life insurance benefits to retired employees. As of December 31, 2003, health care and life insurance postretirement benefits were eliminated for all active employees of the Hospital with fewer than fifteen years of consecutive service.

The Hospital recognizes in its consolidated statements of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, and recognizes changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The funded-status amount is measured as the difference between the fair value of plan assets and the benefit obligation including all actuarial gains and losses and prior service cost. Based on September 30, 2016 and 2015 funded-status amounts for the Hospital's postretirement benefit plan, the Hospital recorded a decrease in unrestricted net assets of \$343 in 2016 and an increase in unrestricted net assets of \$439 in 2015. Approximately \$432 of net actuarial gain will be amortized from unrestricted net assets into net periodic postretirement benefit cost in 2017.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

Benefit Obligations

	<u>2016</u>	<u>2015</u>
Change in accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation at beginning of year	\$ 14,417	\$ 15,346
Service cost	201	225
Interest cost	607	640
Benefits paid	(928)	(1,003)
Actuarial gain	<u>(76)</u>	<u>(791)</u>
Accumulated postretirement benefit obligation at end of year	\$ <u>14,221</u>	\$ <u>14,417</u>

Funded Status

The Hospital has never funded its other postretirement benefit obligations. The funded status of the postretirement benefit plan, reconciled to the amount reported in the consolidated statements of financial position, follows:

	<u>2016</u>	<u>2015</u>
Benefit obligations	\$ <u>14,221</u>	\$ <u>14,417</u>
Funded status	\$ <u>(14,221)</u>	\$ <u>(14,417)</u>
Accrued postretirement benefit cost recognized in the consolidated statements of financial position	\$ <u>14,221</u>	\$ <u>14,417</u>

Amounts recognized in the consolidated statements of financial position at September 30, 2016 and 2015 consist of:

	<u>2016</u>	<u>2015</u>
Accrued postretirement benefit cost:		
Current (included in accrued employee benefits and compensation)	\$ 992	\$ 1,105
Noncurrent (included in other liabilities)	<u>13,229</u>	<u>13,312</u>
Total accrued postretirement benefit cost	\$ <u>14,221</u>	\$ <u>14,417</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

	<u>2016</u>	<u>2015</u>
Accumulated net actuarial gain not yet recognized as a component of net periodic postretirement benefit cost	\$ 4,449	\$ 4,791
Accumulated net periodic postretirement benefit cost	<u>(18,670)</u>	<u>(19,208)</u>
Net amount recognized	<u>\$ (14,221)</u>	<u>\$ (14,417)</u>
	<u>2016</u>	<u>2015</u>
Sources of change in unrestricted net assets:		
Net gain arising during the year	\$ 76	\$ 791
Amortizations:		
Net actuarial gain	<u>(419)</u>	<u>(352)</u>
Total unrestricted net asset (loss) gain recognized during the year	<u>\$ (343)</u>	<u>\$ 439</u>

Net Periodic Postretirement Benefit Cost

Components of net periodic postretirement benefit cost are as follows for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Service cost	\$ 201	\$ 225
Interest cost	607	640
Amortization of net actuarial gain	<u>(419)</u>	<u>(352)</u>
Net periodic postretirement benefit cost	<u>\$ 389</u>	<u>\$ 513</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(8) Pension and Other Postretirement Benefits (continued)

The following weighted average assumptions were used by the plan's actuary to determine net periodic postretirement benefit cost and benefit obligations:

	<u>2016</u>	<u>2015</u>
Discount rate for benefit obligations	3.06%	4.38%
Discount rate for net periodic postretirement benefit cost	4.38%	4.33%

Assumed Health Care Cost Trend Rates at September 30:

	<u>2016</u>	<u>2015</u>
Health care cost trend rate assumed for next year	7.22%	7.22%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.50%	4.50%
Year that the rate reaches the ultimate trend rate	2030	2030

Assumed health care cost trend rates have a significant effect on the amounts reported. A one-percentage-point change in assumed health care cost trend rates would have the following effects as of September 30, 2016:

	<u>One-Percentage - Point Increase</u>	<u>One-Percentage - Point Decrease</u>
Effect on total of service cost and interest cost	\$ 65	\$ (58)
Effect on accumulated postretirement benefit obligation	1,017	(904)

Expected Cash Flows

Information about the expected cash flows for the postretirement benefit plan follows:

Expected benefit payments:	
2017	\$ 992
2018	1,182
2019	1,335
2020	1,402
2021	1,447
2022 through 2026	6,647

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(9) Patient Service Revenue and Related Reimbursement

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). The following is an approximate percentage breakdown of gross patient service revenue by payor type for the years ended September 30:

	2016	2015
Medicare and Senior Care	41%	40%
Blue Cross	16	17
Medicaid and RIte Care	24	23
Managed care	10	11
Commercial, self-pay, and other	9	9
	100%	100%

The Hospital grants credit to patients, most of whom are local residents. The Hospital generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, managed care, or commercial insurance policies). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Medicare cost reports filed annually with The Centers for Medicare and Medicaid Services (CMS) are subject to audit prior to final settlement. The 2016 Medicare cost report has not been filed and, therefore, is not settled. In addition, the Medicare cost reports for 2014 and 2015 have not been settled.

Regulations in effect require annual settlements based upon cost reports filed by the Hospital. These settlements are estimated and recorded in the accompanying consolidated financial statements. Changes in these estimates are reflected in the consolidated financial statements in the year in which they occur. Net patient service revenue in the accompanying consolidated statements of operations and changes in net assets was increased by \$9,201 and \$15,320 in 2016 and 2015, respectively, to reflect changes in the estimated settlements for certain prior years.

Revenues from Medicare and Medicaid programs accounted for approximately 41% and 24%, respectively, of the Hospital's gross patient service revenue for the year ended September 30, 2016. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(9) Patient Service Revenue and Related Reimbursement (continued)

The Hospital believes that it is in compliance with all applicable laws and regulations. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action; failure to comply with such laws and regulations can result in fines, penalties, and exclusion from Medicare and Medicaid programs.

(10) Income Tax Status

The Hospital and its affiliates are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from Federal income taxes pursuant to Section 501(a) of the Code.

The Hospital recognizes the effect of income tax positions only if those positions are more likely than not to be sustained. Recognized income tax positions are measured at the largest amount of benefit that is greater than fifty percent likely to be realized upon settlement. Changes in measurement are reflected in the period in which the change in judgment occurs. The Hospital did not recognize the effect of any income tax positions in either 2016 or 2015.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(11) Long-Term Debt

Long-term debt consists of the following at September 30:

	<u>2016</u>	<u>2015</u>
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2017 through 2039 in annual amounts ranging from \$6,540 to \$42,920 at rates ranging from 4% to 5% (2016 Series – Lifespan Obligated Group)	\$ 195,651	\$ —
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2016 through 2032 in annual amounts ranging from \$10,710 to \$15,020 at rates ranging from 4% to 5% (2006A Series – Lifespan Obligated Group)	—	111,636
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2027 through 2039 in annual amounts ranging from \$1,870 to \$7,900 at rates ranging from 6.125% to 7% (2009A Series – Lifespan Obligated Group)	—	72,441
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2016 through 2026 in annual amounts ranging from \$855 to \$14,705 at rates ranging from 5.25% to 5.75% (1996 Series – Lifespan Obligated Group)	—	41,502
Master lease and loan and security agreement due December 14, 2016 through 2020 in semiannual amounts ranging from \$3,555 to \$3,766 at 1.66% (the 2013 Financing)	20,758	25,736
Other	3,920	4,000
Unamortized premium – 2016 Series	31,060	—
Unamortized premium – 2006A Series	—	2,652
Unamortized premium – 2009A Series	—	97
	<u>251,389</u>	<u>258,064</u>
Less current portion	<u>15,986</u>	<u>14,310</u>
Long-term debt, net of current portion	\$ <u>235,403</u>	\$ <u>243,754</u>

The estimated fair value of the Hospital's long-term debt at September 30, 2016 and 2015 approximates \$217,000 and \$260,000, respectively, and is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of long-term debt is based on significant observable inputs and is categorized as Level 2 for purposes of valuation disclosure.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(11) Long-Term Debt (continued)

On August 11, 2016, the Rhode Island Health and Educational Building Corporation (RIHEBC) issued, on behalf of the Lifespan Obligated Group (OG), which consists of the Hospital, TMH, EPBH, Rhode Island Hospital Foundation (RIHF) and The Miriam Hospital Foundation (TMHF), \$265,470 of tax-exempt fixed rate serial and term bonds (the 2016 Bonds) due May 15, 2017 through 2039 in annual amounts ranging from \$6,540 to \$42,920 at coupon rates ranging from 4% to 5%, with an effective rate of approximately 3.15%. The purpose of the 2016 Bonds was to refund \$49,450 and \$129,185 of the OG's 1996 Bonds and 2006 Bonds, respectively, and advance refund \$114,985 of the OG's 2009 Bonds. These 2016 Hospital Financing Revenue Refunding Bonds are secured by a pledge of gross receipts of the Hospital, TMH, and EPBH (the Obligated Group Hospitals) and by mortgage liens on the Hospital's and TMH's real property and all buildings, structures and improvements thereon. The OG is jointly and severally liable for repayment of the 2016 Bonds, recorded directly by the Obligated Group Hospitals as follows:

The Hospital	\$	195,651
TMH		49,112
EPBH		<u>20,707</u>
Total	\$	<u><u>265,470</u></u>

Under the terms of the 2016 Bonds, the Obligated Group Hospitals are required to satisfy certain measures of financial performance as long as the bonds are outstanding. At September 30, 2016, management believes the Obligated Group Hospitals were in compliance with all covenants of the 2016 Bonds, including the requirement that the Obligated Group Hospitals maintain a Debt Service Coverage Ratio (DSCR) of 1.1x or higher. The DSCR is 2.66x for the year ended September 30, 2016, compared to 2.49x for the year ended September 30, 2015.

On June 14, 2013, the Hospital, TMH, and EPBH entered into a tax-exempt \$50,000 master lease and loan and security agreement (the 2013 Financing) with a seven-year term, to partially fund the capital costs associated with Lifespan's multi-year information systems conversion project. The 2013 Financing is secured by a first priority lien and security interest on the equipment (excluding intellectual property), goods, and other property financed with the proceeds of the 2013 Financing. The Hospital, TMH, and EPBH are jointly and severally liable for repayment of the 2013 Financing. Newport Hospital indirectly participated in the 2013 Financing via exchange for an equivalent interest in the Escrow Fund.

On July 8, 2008, the Board of Directors of Lifespan Corporation, acting as the sole corporate member of EPBH, adopted a resolution authorizing EPBH to become a member of the OG. The EPBH Board of Trustees, as well as the Boards of the Hospital and TMH, also authorized related resolutions.

On March 30, 2009, RIHEBC issued, on behalf of the OG, \$114,985 of tax-exempt bonds (the 2009A Bonds) for the purposes of financing the acquisition, construction, renovation, expansion and equipping of certain hospital and related health care facilities owned and operated by the Obligated Group Hospitals, including the expansion, construction, renovation, equipping and furnishing of a two-story addition to EPBH's existing building and the renovation of vacated space in the existing building.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(11) Long-Term Debt (continued)

On February 14, 2006, RIHEBC issued, on behalf of the OG, which consisted of the Hospital and TMH, \$192,135 of tax-exempt bonds (the 2006A Bonds) for the purpose of refunding \$123,405 and \$65,315 of the OG's 1996 Bonds and 2002 Bonds, respectively. On September 12, 2006, the Board of Directors of Lifespan Corporation, acting as the sole corporate member of both Rhode Island Hospital Foundation and The Miriam Hospital Foundation (the Foundations), adopted resolutions authorizing the Foundations to become members of the OG. The Boards of Trustees of each of the Foundations, as well as the then existing members of the OG, the Hospital and TMH, previously authorized related resolutions. The effective date for such change was October 1, 2006.

On December 1, 1996, RIHEBC issued, on behalf of the OG, \$214,585 of tax-exempt bonds (the 1996 Bonds), to finance portions of Lifespan's, the Hospital's and TMH's 1996, 1997, 1998, and 1999 expenditures for routine capital equipment and facility renovation/replacement, and to advance refund \$8,455 of TMH's 1989 Series A bonds, \$1,900 of TMH's 1992 Series A bonds, and \$10,065 of TMH's 1992 Series B bonds.

The Hospital's aggregate maturities of long-term debt for the five fiscal years ending in September 2021 are as follows: 2017, \$15,986; 2018, \$14,265; 2019, \$14,804, 2020, \$15,367; and 2021, \$10,549.

Agreements underlying the various Hospital Financing Revenue Bonds require that the Obligated Group Hospitals maintain certain funds included with assets limited as to use in the consolidated statements of financial position, as follows:

Project Funds – The Obligated Group Hospitals are required to apply monies in the Project Funds to pay the costs of debt issuance, facility renovation/replacement, and routine capital equipment.

Bond Fund – The Obligated Group Hospitals are required to make periodic deposits to the trustee sufficient to provide sinking funds for the payment of principal and interest to bondholders when due.

Debt Service Reserve Fund – The Obligated Group Hospitals are required to apply monies in the Debt Service Reserve Fund to remedy deficiencies in the Bond Fund, if any.

The balances of the Hospital's funds at September 30 are summarized as follows:

	2016	2015
Project Fund – 2016 Series	\$ 96	\$ —
Project Fund – 2009A Series	—	1,662
Bond Fund – 1996 Series	—	730
Debt Service Reserve Fund – 2009A Series	3	7,244
Total	<u>\$ 99</u>	<u>\$ 9,636</u>

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

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(In thousands)

(12) Revolving Credit Loan Payable

The members of the Lifespan Obligated Group (OG) entered into a credit agreement, dated April 22, 2015 and amended April 20, 2016, with Citizens Bank, N.A. for a line of credit facility up to a maximum principal amount of \$40,000 to finance working capital requirements. The principal outstanding bears interest per annum at 1.5% above the LIBOR Advantage rate. Interest is payable monthly and all outstanding principal and any accrued and unpaid interest is due on the maturity date of April 19, 2017. At September 30, 2016 and 2015, there was \$28,000 and \$38,000 outstanding under the facility at interest rates per annum of 2.031% and 1.704%, respectively. The OG is required to comply with various affirmative and negative covenants as well as maintain certain financial targets and ratios during the term of the line of credit. At September 30, 2016, the OG was in compliance with all of the associated covenants.

(13) Temporarily and Permanently Restricted Net Assets

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

	<u>2016</u>	<u>2015</u>
General health care service activities	\$ 183,006	\$ 180,658
Research	50,346	48,607
Interest in net assets of Rhode Island Hospital Foundation	<u>10,622</u>	<u>10,281</u>
Total	<u>\$ 243,974</u>	<u>\$ 239,546</u>

Permanently restricted net assets at September 30 are restricted to:

	<u>2016</u>	<u>2015</u>
General health care service activities	\$ 34,774	\$ 34,333
Research	4,461	4,461
Interest in net assets of Rhode Island Hospital Foundation	<u>35,617</u>	<u>35,349</u>
Total	<u>\$ 74,852</u>	<u>\$ 74,143</u>

Income from permanently restricted investments is expendable to support donor-restricted purposes.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

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(In thousands)

(14) Leases

The Hospital leases building space and equipment under various noncancelable operating lease agreements. Future minimum lease payments, by year and in the aggregate, under noncancelable operating leases with terms of one year or more consist of the following at September 30, 2016:

	<u>Amount</u>
Year ending September 30:	
2017	\$ 8,944
2018	6,722
2019	4,935
2020	3,670
2021	2,687
Thereafter	<u>3,738</u>
Total minimum lease payments	<u>\$ 30,696</u>

Rental expense, including rentals under leases with terms of less than one year, for the years ended September 30, 2016 and 2015 was \$15,897 and \$15,144, respectively.

(15) Concentrations of Credit Risk

The Hospital maintains its cash accounts at various financial institutions. The Hospital has not experienced any losses in such accounts and evaluates the credit worthiness of the financial institutions with which it conducts business. The Hospital believes it is not exposed to significant credit risk with respect to its cash balances.

Financial instruments which potentially subject the Hospital to concentrations of credit risk consist primarily of accounts receivable and certain investments. The risk associated with temporary cash investments is mitigated by the fact that the investments are placed with what management believes are high credit quality financial institutions. Investments, which include government and agency obligations, stocks, and corporate bonds, are not concentrated in any corporation, industry, or geographical area.

The Hospital receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Blue Cross, Medicaid, and various managed care entities. The Hospital has not historically incurred any significant concentrated credit losses in the normal course of business.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

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(In thousands)

(16) Malpractice and Other Litigation

Professional Liability/Medical Malpractice and General Liability

Professional liability/medical malpractice coverage for the Hospital is supplied on a claims-made basis by Rhode Island Sound Enterprises Insurance Co. Ltd. (RISE), Lifespan's affiliated captive insurance company, which underwrites the medical malpractice risk of the Hospital (including the Hospital's contractual commitment to indemnify certain eligible nonemployed physicians). The adequacy of the coverage provided and the funding levels are reviewed annually by independent actuaries and consultants. The professional liability/medical malpractice insurance provided by RISE has liability limits of \$4,000 per claim with no annual aggregate. RISE provides a second layer of coverage which has limits of an additional \$2,000 per claim with a \$2,000 annual aggregate. In addition, commercial umbrella excess insurance has been obtained by Lifespan to increase the professional liability limits to \$32,000 per claim.

Also covered under the Hospital's professional liability/medical malpractice policy are 676 nonemployed physicians. Each of these physicians is provided with a \$2,000 indemnification per claim and a \$6,000 annual indemnification aggregate.

The Hospital or its indemnified physicians have been named as defendants in a number of pending actions seeking damages for alleged medical malpractice liability. In the opinion of management, any liability and legal defense costs resulting from these actions will be within the limits of the Hospital's malpractice insurance coverage provided by RISE and/or commercial excess carriers.

General liability coverage is provided to the Hospital by RISE amounting to \$2,000 per claim and \$4,000 in the annual aggregate. Commercial excess liability insurance has been obtained by Lifespan which provides aggregate general liability coverage of \$80,000.

Workers' Compensation

The Hospital has incurred a number of workers' compensation claims and, in the opinion of management, the liability of the Hospital will be within the limits of the assets of Lifespan's workers' compensation self-insurance trust fund.

Other Litigation

The Hospital is involved in a number of miscellaneous suits and general liability suits arising in the course of business. After consultation with legal counsel, management estimates that any outstanding matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(17) Related-Party Transactions

The Hospital rents space and provides laundry and linen services to affiliates. Included in the Hospital's other revenue in the consolidated statements of operations and changes in net assets are the following amounts resulting from transactions with affiliates for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Rental income	\$ 3,662	\$ 3,179
Services rendered – laundry and linen	<u>1,640</u>	<u>1,572</u>
Total	<u><u>\$ 5,302</u></u>	<u><u>\$ 4,751</u></u>

The Hospital also rents space from affiliates. Included in the Hospital's operating expenses in the consolidated statement of operations and changes in net assets in both 2016 and 2015 is rental expense of \$2,640 and \$2,834, respectively, arising from transactions with affiliates.

The Hospital was charged a management fee by Lifespan of \$125,975 and \$108,006 in 2016 and 2015, respectively. Lifespan provides information services, human resources, financial, and various other support services to the Hospital.

Included in other accrued expenses in the consolidated statements of financial position are the following amounts due to certain related entities at September 30:

	<u>2016</u>	<u>2015</u>
Lifespan Physician Group, Inc.	\$ 5,431	\$ 806
TMH	1,322	1,352
Lifespan	4,620	5,558
Hospital Properties, Inc.	84	205
Newport Hospital	24	177
RIHF	<u>9</u>	<u>64</u>
Total	<u><u>\$ 11,490</u></u>	<u><u>\$ 8,162</u></u>

During the years ended September 30, 2016 and 2015, the Hospital received temporarily restricted net asset transfers from RIHF amounting to \$5,996 and \$6,683, respectively.

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

(In thousands)

(17) Related-Party Transactions (continued)

RIHF, whose sole corporate member is Lifespan Corporation, was established to engage in philanthropic activities to support the mission and purposes of Lifespan and the Hospital. Funds are distributed to the Hospital upon collection for use in conformity with purpose restrictions stipulated by donors, or as determined by the Boards of Trustees of the Hospital and RIHF. A summary of RIHF's assets, liabilities, net assets, (deficiency) excess of revenues over expenses, and changes in net assets follows. The Hospital's interest in the net assets of RIHF is reported as a noncurrent asset in the consolidated statements of financial position.

	2016	2015
Assets, principally assets limited as to use	\$ 52,025	\$ 51,656
Liabilities	\$ 397	\$ 303
Unrestricted net assets	5,389	5,723
Temporarily restricted net assets	10,622	10,281
Permanently restricted net assets	35,617	35,349
Total liabilities and net assets	\$ 52,025	\$ 51,656
Total unrestricted revenues, gains and other support	\$ 3,476	\$ 7,063
Total expenses	3,956	4,157
(Deficiency) excess of revenues over expenses	(480)	2,906
Other increases (decreases) in unrestricted net assets	146	(3,512)
Unrestricted net assets, beginning of year	5,723	6,329
Unrestricted net assets, end of year	\$ 5,389	\$ 5,723
Increase (decrease) in temporarily restricted net assets	\$ 341	\$ (1,683)
Temporarily restricted net assets, beginning of year	10,281	11,964
Temporarily restricted net assets, end of year	\$ 10,622	\$ 10,281
Increase in permanently restricted net assets	\$ 268	\$ 141
Permanently restricted net assets, beginning of year	35,349	35,208
Permanently restricted net assets, end of year	\$ 35,617	\$ 35,349

RHODE ISLAND HOSPITAL AND AFFILIATES

Notes to Consolidated Financial Statements

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(In thousands)

(18) License Fees

In 2016 and 2015, the State of Rhode Island has assessed a license fee to all Rhode Island hospitals, based on each hospital's 2014 and 2013 net patient service revenue, respectively, as defined. The Hospital's license fee expense was \$58,734 in 2016 and \$53,457 in 2015.

(19) Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	<u>2016</u>	<u>2015</u>
Health care services	\$ 1,015,167	\$ 963,769
Research	64,484	62,874
General and administrative:		
Depreciation and amortization	50,484	46,544
Interest	11,794	12,976
Other	<u>112,674</u>	<u>96,900</u>
Total general and administrative	<u>174,952</u>	<u>156,420</u>
	<u>\$ 1,254,603</u>	<u>\$ 1,183,063</u>