INOVA™
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8110 Gatehouse Road
Suite 400 West
Falls Church, VA 22042

March 24, 2017

Dear Investor:

Enclosed are Inova Health System's 2016 Audited Consolidated Financial Statements and Other Supplementary Information Relating to the IHS Obligated Group. Management discussion and analysis is also enclosed for the years ended December 31, 2016 and 2015.

We appreciate your interest in Inova Health System. If we can provide any other information, please let me know.

Sincerely,

Chris Smith
Director, Financial Reporting
(703) 289-2455
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Attachments

Inova Health System
Management's Discussion and Analysis of Results of Operations and Financial Position

Introduction

Inova Health System ("IHS") is an integrated, not-for-profit health care delivery system that owns, operates and manages clinical, educational, research, and hospital facilities located in Northern Virginia, serving Northern Virginia, the Washington, D.C. metropolitan area, and contiguous counties in Virginia and Maryland. The principal line of business for IHS is the delivery of acute care hospital services at five hospitals located in Northern Virginia. IHS also operates an integrated network of health services including ambulatory care, home health care, senior services, assisted living, and other health related services. IHS also maintains a group of primary care and specialty physicians operating as the Inova Medical Group. IHS formed a Population Health division in 2013 that operates INTotal Health, a Medicaid health maintenance organization ("HMO"), a Program of All-Inclusive Care for the Elderly ("PACE"), a clinically integrated physician network known as Signature Partners, and Innovation Health; a joint venture with Aetna offering commercial health insurance plans. In 2015 IHS formed the Inova Center for Personalized Health ("ICPH") which is committed to lead the way in the integration of genomics into personalized medicine and individualized wellness.

The following discussion and analysis provides information that IHS management believes is relevant to an assessment and understanding of IHS' results of operations and financial position. This analysis should be read in conjunction with IHS' financial statements for the years ended December 31, 2016 and 2015. The discussion and analysis focuses on IHS as a whole, which management believes provides a fair description and analysis, in all material respects, of the Obligated Group's results of operations and financial condition, insofar as the Obligated Group represents approximately 86.9% of total operating revenues and 99.9% of unrestricted net assets of IHS as of and for the twelve months ended December 31, 2016.

Results of Operations as of and for the years ended December 31, 2016 and 2015

Operating Revenues. Total operating revenues for IHS for the year ended December 31, 2016 were $3.3 billion, up 9.5% over the comparable period in 2015. The revenue increase was driven by growth of traditional fee for service health services including: 3.8% in acute admissions; 15.4% in observation cases; 4.6% in deliveries; and 2.6% in emergency admissions. Much of the growth in acute care services is attributable to expansion and the opening of the new Women's Hospital and Children's Hospital on the Inova Fairfax Medical Campus. This newly renovated campus provides private accommodations and expanded capacity in certain services. Freestanding ambulatory surgery cases rose by 5.2% over prior year.

Operating Expenses. Total operating expenses for the twelve months ended December 31, 2016 were $3.1 billion, an increase of 13.6% over the comparable period in 2015. Salaries and benefits increased $189.3 million, or 14.2%, primarily due to increased staffing associated with higher patient activity and substantial growth in the number of employed physicians. Premium labor costs required to fully staff inpatient units contributed to the growth in salaries. Interest and Depreciation expenses were $60.4 million or 29.0% higher in 2016, primarily as a result of the new hospital construction projects coming on line this year. Other operating

expenses increased by $237.1 million, or 19.5%, primarily due to general volumes and higher inpatient surgeries, which result in higher supply costs.

One-time Charges: In order to reduce business risk and achieve long-term cost savings, Inova entered into two transactions that resulted in sizable non-cash accounting losses:

- $18.0 million accounting loss related to refunding of $259 million of tax-exempt debt (see *Debt Structure and Liability Management* section herein).
- $64.5 million accounting loss on termination of the IHS' defined benefit pension plan, which was fully liquidated in December 2016 (see *Pension Plan Termination* section herein)

In addition, Inova recognized a one-time accounting charge for $48.4 million related to the impairment of goodwill and intangible assets for INTotal, Inova's Medicaid health plan (see *Impairment on Goodwill and Intangible Assets* section herein)

Operating Income. IHS' operating income before the loss on settlement of the defined benefit pension plan and loss on impairment of goodwill and intangible assets was $130.8 million, or 4.0% of total operating revenues, for the year ended December 31, 2016, as compared to $221.4 million income, or 7.5% of total operating revenues, in 2015.

Investment Performance and Other Non-Operating Activity. The following table shows the components of *investment income and other, net* from IHS' consolidated statements of operations for the years ended December 31, 2016 and 2015 (dollars in thousands).

	2016	2015
Interest and other income, net	$ 64,866	$ 64,896
Gains in fair market value of interest rate swaps	1,681	6,504
Loss on termination of swap	(1,853)	-
Loss on extinguishment of debt	(18,000)	-
Realized gains (losses)	226,066	(86,983)
Noncontrolling interest	(12,914)	(11,173)
Other	5,174	2,514
Investment (loss) income and other, net	$ 265,020	$ (24,242)

Financial Position as of December 31, 2016

Current Assets and Liquidity. IHS' unrestricted cash and investments at December 31, 2016 were $4.5 billion, of which $2.2 billion represented investments that could not be liquidated within 3 days. In addition to its unrestricted cash position at December 31, 2016, IHS had $22.0 million of bond proceeds available to fund current and future construction projects.

Investments. The following table summarizes the asset allocation for the Strategic Fund and the Capital Fund, which together comprised the Board designated funds as of December 31, 2016 (dollars in thousands):

	Amount	%
Strategic Fund		
Cash and cash equivalents	$ 324,644	7.7%
Fixed income	663,715	15.7%
Public equity	2,036,491	48.2%
Growth hedge fund	184,754	4.4%
Private equity	66,308	1.6%
Diversifying hedge fund	610,895	14.5%
Real assets	149,610	3.4%
	4,036,417	95.5%
Capital Fund	189,985	4.5%
Total	$ 4,226,402	100.0%

The Strategic and Capital Funds in total grew by $341 million or 8.8% over their 2015 year-end values.

Fixed income securities are primarily investment quality global bonds with maturities ranging from 1 year to 30 years. Public equity securities are typically exchange traded stocks. Private equity includes early stage venture capital and medium to large buyout funds. Real Assets include private real estate, commodities and inflation-protected securities.

IHS maintains a special portfolio comprised of limited maturity, high quality bonds (Capital Fund). This fund was established to ensure that IHS would have sufficient liquidity to complete critical construction projects in the event of a major financial market disruption.

Property, Plant, and Equipment. Capital expenditures were $237.7 million for the year ended December 31, 2016 including $76.1 million related to major hospital expansion and renovation projects, $20.5 million for the ICPH campus, $38.5 million related to Information Technology strategic and infrastructure projects, and $102.6 million related to major and minor equipment purchases. The major hospital projects include capitalization of the new women's and children's hospital at Inova Fairfax Medical Campus which opened in January 2016.

All planned capital expenditures are regularly evaluated based upon business need, economic conditions and IHS' financial position. IHS management currently anticipates that capital expenditures will be financed with a combination of operating cash flow, existing cash reserves, donations and tax-exempt borrowing. The actual undertaking of any construction project or equipment purchase program contemplated by IHS is dependent upon a number of factors, including receipt of appropriate Certificates of Public Need from the Virginia Department of Health and subject to changes in the methods and requirements pertaining to the delivery of necessary health care services.

Debt Structure and Liability Management. At December 31, 2016, total long-term debt outstanding, including financing obligations, was $1.7 billion, or 26.8% of capitalization. On May 11, 2016, the Industrial Development Authority of Fairfax County, Virginia ("Authority") issued $243 million of Series 2016 bonds to advance refund $119.5 million of Series 2009A fixed rate bonds and currently refund all of Inova's *Window* VRDB's.

IHS maintains a self-liquidity taxable commercial paper ("CP") program with $100.0 million outstanding of short term debt having maturity dates from one to 270 days. The outstanding CP is included in notes payable and other liabilities in the current liabilities section of this balance sheet.

As of December 31, 2016, IHS had $144.5 million notional amount of fixed payer swaps with three counterparties with a total fair value of ($2.8) million. The notional amount includes a $69.5 million notional forward-starting interest rate swap that was entered into on March 3, 2016 with JP Morgan as counterparty. This swap calls for a fixed rate payment of 1.447% with cash flows commencing in May 2019 and running through May 2034.

On August 2, 2016, IHS entered into a new $100.0 million unsecured line of credit. As of December 31, 2016, IHS maintains unsecured lines of credit with three large commercial banks with a combined available principal amount of $237.5 million. There were no amounts outstanding on these credit lines as of December 31, 2016.

Pension Plan Termination. Effective January 1, 2015, IHS implemented a "hard freeze" on its Cash Balance Pension Plan (the "Plan") for all employees in favor of enhancing the matching benefit under its existing 401(k) plan. Through a series of transactions, IHS terminated the Plan in the fourth quarter of 2016 and as of December 31, 2016 no longer has any employee retirement income obligations. A one-time, non-cash charge of $64.5 million was recognized upon Plan termination.

Impairment on Goodwill and Intangible Assets. Inova purchased INTotal Health, a Medicaid health plan, on December 1, 2012. Approximately $68.6 million of the purchase price was allocated to goodwill and other intangible assets. The initial valuation assumed certain growth characteristics at the time including the anticipation of expanded Medicaid eligibility in Virginia. The Commonwealth of Virginia has not expanded Medicaid eligibility as allowed under the Affordable Care Act. Additionally, in the spring of 2016, the Commonwealth announced that it was aggregating certain special needs populations into a new statewide Medicaid insurance program. The Commonwealth sought proposals from health plans seeking to insure these populations in exchange for a monthly premium. INTotal was not selected as one of the special needs plans which management projects could result in an annual premium reduction of up to $40 million annually.

IHS performs an annual assessment of its goodwill and indefinite lived intangible assets, which involves a comparison of the estimated fair value of these items to their asset carrying value. As a result of the market changes described above, the revised forecasted amounts caused the estimated fair value of INTotal to drop below its carrying value as of October 1, 2016. As a result, a one-time impairment loss of $48.4 million was recognized by INTotal for goodwill and each of its intangible assets. The amount of impairment losses was determined based on the difference between the carrying value of goodwill and intangible assets when compared to the implied fair value of goodwill and estimated fair value intangible assets.

Other Financial Information

The following are selected financial indicators for IHS as of and for the twelve months ended December 31, 2016 and 2015:

	2016	2015
Operating Margin[1]	4.0%	7.5%
Operating Cash Flow Margin[2]	12.3%	14.5%
Net Days in Accounts Receivable[3]	38.1	38
Days in Unrestricted Cash[4]	567.7	586.6
Unrestricted Cash to Debt[5]	2.5x	2.3x
Debt Service Coverage[6]	7.6x	5.8x

1 Operating income with losses on impairment of goodwill and intangibles, bad debt extinguishment, and pension plan termination added back divided by operating revenue

2 Operating income with losses on impairment of goodwill and intangibles, bad debt extinguishment, and pension plan termination added back, plus interest expense, depreciation and amortization expense, divided by operating revenue

3 Net Patient Receivables divided by three-month average daily net patient service revenue

4 Cash and short-term investments plus unrestricted cash reserves and unrestricted long-term investments divided by operating expenses less depreciation and amortization expense.

5 Cash and short-term investments plus unrestricted cash reserves plus unrestricted long-term investments divided by debt-current portion plus Debt-long-term portion

6 Income available for debt service (annualized) divided by long-term debt service requirement

INOVA HEALTH SYSTEM

Audited Consolidated Financial Statements and Other Supplementary Information Relating to the IHS Obligated Group

Period Ended
December 31, 2016

Inova Health System
Audited Consolidated Financial Statements
and Other Supplementary Information
Relating to the IHS Obligated Group
December 31, 2016 and 2015

Audited Consolidated Financial Statements

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Building a better working world

Report of Independent Auditors

The Board of Trustees
Inova Health System

We have audited the accompanying consolidated financial statements of Inova Health System (IHS), which comprise the consolidated balance sheets as of December 31, 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 financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Inova Health System at December 31, 2016 and 2015, and the consolidated results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

March 24, 2017

Inova Health System
Consolidated Balance Sheets
December 31, 2016 and 2015
(in thousands)

	2016	2015
ASSETS		
Current Assets		
Cash and cash equivalents	$ 284,076	$ 246,932
Assets whose use is limited, current	129,985	171,345
Patient accounts receivable (less allowance for doubtful accounts: 2016 - $94,624 ; 2015 - $77,743)	306,721	283,728
Other current assets	127,022	117,258
Total Current Assets	847,804	819,263
Property, Equipment and Leasehold Interests, net (Note 5)	1,989,253	1,963,873
Assets Whose Use Is Limited (Notes 2, 6, 7, 13)		
Held by bond trustee	22,039	87,502
By board for plant replacement and expansion	4,036,417	3,558,986
By board for construction projects	189,985	326,172
By donor	112,283	99,766
For professional liability	106,647	96,227
For health plan liability	12,178	12,102
	4,479,549	4,180,755
Less amounts required to meet current obligations	(129,985)	(171,345)
Total Assets Whose Use Is Limited, noncurrent	4,349,564	4,009,410
Other Assets		
Investments in and receivables from affiliates (Note 8)	41,808	48,568
Goodwill and other intangible assets (Note 9)	62,472	94,942
Prepaid pension asset (Note 12)	-	52,939
Other long-term assets	43,485	34,184
Total Other Assets	147,765	230,633
TOTAL ASSETS	$ 7,334,386	$ 7,023,179
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and other accrued expenses	$ 338,196	$ 328,448
Third-party settlements	47,000	45,592
Notes payable and other liabilities	144,945	137,113
Current portion of long-term debt (Note 10)	156,789	202,551
Total Current Liabilities	686,930	713,704
Non-current Liabilities		
Long-term debt, less current portion (Note 10)	1,342,349	1,313,337
Interest rate swap liability (Note 11)	2,846	22,767
Financing obligation (Note 15)	183,410	181,968
Other non-current obligations	95,655	91,081
Total Non-current Liabilities	1,624,260	1,609,153
Net Assets		
Unrestricted	4,891,147	4,584,661
Temporarily restricted	94,819	78,708
Permanently restricted	37,230	36,953
Total Net Assets	5,023,196	4,700,322
TOTAL LIABILITIES AND NET ASSETS	$ 7,334,386	$ 7,023,179

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets
For the Years Ended December 31, 2016 and 2015
(in thousands)

	2016	2015
Operating Revenues		
Net patient service revenue	$ 3,069,800	$ 2,762,750
Provision for bad debts	(140,165)	(100,060)
Net Patient Service Revenue Less Provision for Bad Debts	2,929,635	2,662,690
Premium revenue	209,488	198,350
Other operating revenue	116,401	111,086
Total Operating Revenues	3,255,524	2,972,126
Operating Expenses		
Salaries and benefits	1,517,961	1,328,687
Other operating expenses	1,190,934	1,070,234
Medical claims	147,105	143,571
Depreciation and amortization	216,595	179,565
Interest	52,053	28,637
Total Operating Expenses	3,124,648	2,750,694
Operating Income before Loss on Settlement of Defined Benefit Pension Plan and Loss on Impairment of Goodwill and Intangible Assets	**130,876**	**221,432**
Loss on settlement of defined benefit pension plan	64,494	-
Loss on impairment of goodwill and intangible assets	48,406	-
Total Loss on Settlement of Defined Benefit Pension Plan and Loss on Impairment of Goodwill and Intangible Assets	112,900	-
Operating Income after Loss on Settlement of Defined Benefit Pension Plan and Loss on Impairment of Goodwill and Intangible Assets	17,976	221,432
Non-Operating Revenues (Expenses)		
Investment income (loss) and other, net	265,020	(24,242)
Excess of Revenues Over Expenses	282,996	197,190

Continued on page 4.

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets (continued)
For the Years Ended December 31, 2016 and 2015
(in thousands)

	2016	2015
Unrestricted Net Assets		
Excess of revenues over expenses (from page 3)	282,996	197,190
Unrealized (loss)/gain on investments, net	(150)	2,230
Capital reimbursements for grants	2,048	-
Change in plan assets and benefit obligations of pension	16,463	28,923
Other	5,129	(1,686)
Increase in Unrestricted Net Assets	306,486	226,657
Temporarily Restricted Net Assets		
Gifts and bequests	30,123	20,100
Restricted investment income	970	875
Unrealized gain/(loss) on investments, net	44	(61)
Net assets released from restriction	(14,519)	(10,056)
Other	(507)	(653)
Increase in Temporarily Restricted Net Assets	16,111	10,205
Permanently Restricted Net Assets		
Gifts and bequests	102	32
Restricted investment loss	(864)	(774)
Unrealized gain/ (loss) on investments, net	405	(1,548)
Other	634	255
Increase/(Decrease) in Permanently Restricted Net Assets	277	(2,035)
Increase in Net Assets	322,874	234,827
Net Asset, Beginning of Year	4,700,322	4,465,495
NET ASSETS, END OF YEAR	**$ 5,023,196**	**$ 4,700,322**

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015
(in thousands)

	2016	2015
Operating Activities		
Change in net assets	$ 322,874	$ 234,827
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	216,595	179,565
Change in plan assets and benefit obligations of pension	(16,463)	(28,923)
Loss on impairment of goodwill and intangible assets	48,406	-
Loss on extinguishment of debt	18,000	-
Net realized and unrealized (gains)/losses on investments	(229,232)	86,099
Change in fair value of interest rate swaps	(2,164)	398
Equity investment losses, net	22,393	7,413
Increase in accounts receivable and third-party settlements, net	(22,630)	(28,995)
Increase in other current assets	(8,673)	(4,816)
Increase/(Decrease) in accounts payable and other current liabilities	17,628	(20,078)
Decrease in pension asset	69,402	6,724
Increase/(Decrease) in estimated professional liability and other deferred liability items	4,987	(7,235)
Restricted contributions and investment income	(30,331)	(20,132)
Other	(8,396)	(8,820)
Net Cash Provided by Operating Activities	402,396	396,027
Investing Activities		
Capital expenditures	(237,678)	(294,586)
Investments in and advances to joint ventures and affiliates	(35,835)	(31,362)
Purchases of marketable securities	(3,094,952)	(1,521,283)
Proceeds from sale of marketable securities	3,025,388	1,440,797
Other	-	7,965
Net Cash Used in Investing Activities	(343,077)	(398,469)
Financing Activities		
Principal payments on long-term debt	(29,979)	(43,556)
Proceeds from issuance of long-term debt	278,027	-
Refunding of long-term debt	(279,400)	-
Swap termination and modification payments	(17,757)	(7,398)
Restricted contributions and investment income	30,331	20,132
Other	(3,397)	(2,092)
Net Cash Used in by Financing Activities	(22,175)	(32,914)
Net Increase/(Decrease) in Cash and Cash Equivalents	37,144	(35,356)
Cash and cash equivalents at beginning of year	246,932	282,288
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 284,076	$ 246,932
Supplemental Disclosure of Non-cash Activities		
Financing obligation used to purchase capital lease assets	$ -	$ 184,413

See notes to the consolidated financial statements.

1. Nature of Operations

Organization: Inova Health System ("IHS") is an integrated, not-for-profit health care delivery system that owns, operates and manages clinical, educational, research and hospital facilities located in Northern Virginia, serving Northern Virginia, the Washington, D.C. metropolitan area and contiguous counties in Virginia and Maryland. The principal line of business for IHS is the delivery of acute care hospital services at five hospitals located in Northern Virginia. IHS also operates an integrated network of health services including a medical group, ambulatory care, home health care, senior services, assisted living and other health related services.

IHS formed a Population Health division in 2013 that operates INTotal Health, a Medicaid health maintenance organization ("HMO"), a Program of All-Inclusive Care for the Elderly ("PACE") program, a clinically integrated physician network known as Signature Partners, and Innovation Health a joint venture with Aetna offering commercial health insurance plans. In 2015 IHS formed the Inova Center for Personalized Health ("ICPH") which is committed to lead the way in the integration of genomics into personalized medicine and individualized wellness.

2. Summary of Significant Accounting Policies

Basis of Presentation: The financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of Consolidation: The IHS consolidated financial statements include the accounts of the Inova Health System Foundation (the "Foundation"); Inova Health Care Services ("IHCS"); Loudoun Hospital Center ("LHC"); Inova Holdings, Inc. ("IHI"); and their majority-owned subsidiaries and controlled affiliates. All material intercompany accounts and transactions have been eliminated in consolidation.

The Foundation is a tax-exempt, non-stock corporation, which controls its affiliated corporations through its authority to appoint the governing boards of the tax-exempt, non-stock affiliates or its stock ownership. The Foundation also supports and maintains the programs, services, and facilities of IHS' health care delivery system in part through the solicitation, receipt, administration, and distribution of philanthropic gifts on behalf of its tax-exempt affiliates. INTotal Health, LLC ("INTotal"), a wholly-owned subsidiary of the Foundation, is a Medicaid HMO licensed and authorized to do business in Virginia.

IHCS is a tax-exempt, non-stock corporation that serves the health care needs of the community by establishing, maintaining and operating hospital and health care facilities, programs, and other shared and integrated health care delivery arrangements. IHCS operates the following facilities, among others: Inova Fairfax Hospital ("Fairfax"); Inova Mount Vernon Hospital ("Mount Vernon"), Inova Fair Oaks Hospital ("Fair Oaks") and Inova Alexandria Hospital ("Alexandria"). IHCS also provides and manages the clinical, non-hospital facilities and programs whose services include senior services, assisted living facilities, addiction treatment services for adults and adolescents, outpatient rehabilitation services, urgent care and other outpatient health care services. IHCS also maintains a group of primary care and specialty physicians operating as the Inova Medical Group.

LHC is a tax-exempt, non-stock corporation that serves the health care needs of Loudoun County, Virginia, and surrounding areas. In addition to Inova Loudoun Hospital ("Loudoun"), LHC operates Loudoun Nursing and Rehabilitation Center, Loudoun Healthcare Foundation and other health care and related facilities.

2. Summary of Significant Accounting Policies (continued)

IHI is a wholly owned subsidiary of the Foundation and is the parent holding company for various taxable entities within IHS including Technical Dynamics Inc., a biomedical equipment maintenance and engineering company. IHI and its subsidiaries operate facilities providing a variety of health care and support services to patients and to affiliated health care providers.

Cash and Cash Equivalents: Cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. Cash equivalents are valued at cost, which approximates fair value.

Patient Accounts Receivable: Patient accounts receivable include charges for amounts due from all patients less allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid and other insurers. The provision for bad debts is recognized when providing an allowance for uncollectible accounts.

All operating entities of IHS treat emergency patients and provide medically necessary treatment to patients regardless of their ability to pay. A patient is classified as a charity patient based upon established IHS policies that consider patient income levels. Since IHS does not pursue collection of amounts that qualify as charity care, they are deducted from gross revenue.

Assets Whose Use Is Limited: Assets whose use is limited include board-designated funds for the acquisition of property and equipment, funds restricted by donors for charitable purposes, funds to cover self-insurance and medical claim liabilities, and trustee-held assets for the retirement of long-term liabilities.

Investments in equity securities with readily determinable fair values and all investments in debt securities held by IHS' custodian are designated as trading securities. Investment income (including realized gains and losses on investments, unrealized gains and losses on trading securities, interest, and dividends) is included in excess of revenues over expenses unless such earnings are subject to donor-imposed restrictions. Investment income restricted by donor stipulations is reported as an increase in temporarily restricted net assets. Unrealized gains and losses on investments classified as other-than-trading are reported as a change in unrestricted net assets and, in accordance with relevant accounting literature, are excluded from excess of revenues over expenses. Alternative investments are accounted for under the equity method of accounting.

Fair Value Measurements: IHS evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level in which to classify them for each reporting period. See Note 7.

Property, Equipment and Leasehold Interests: Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets, and is computed using the straight-line method. The general range of useful lives is five to twenty years for land improvements, ten to thirty years for buildings, fixed equipment, and leasehold improvements, and five to ten years for major movable equipment. Software and other IT equipment are included in major movable equipment with useful lives of three to five years. Equipment under capital lease obligations is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Repairs and maintenance are expensed as incurred.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support.

2. Summary of Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use by IHS has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by IHS in perpetuity.

Donor-restricted Gifts: Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Contributions received are reported as either temporarily or permanently restricted assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying consolidated statements of operations and changes in net assets as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received and contributions received where no restrictions were stipulated are reflected as unrestricted contributions reported in the accompanying consolidated financial statements as other operating revenue.

Investments in and Receivables from Affiliates: IHS makes investments in corporations and other forms of businesses. Investments where less than 20% of the ownership interest is held by IHS, and IHS does not exert significant influence over the investee, are accounted for using the cost method. Investments where 20% to 50% of the voting common stock is owned by IHS as well as certain partnership and limited liability company investments are accounted for using the equity method. The equity method is also applied to investments in which IHS owns less than 20% of the ownership interest but can exert significant influence over the investee. See Note 8.

Goodwill and Other Intangible Assets: Financial Accounting Standard Board ("FASB") guidance requires business combinations to be accounted for using the acquisition method of accounting and it also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. Goodwill represents the excess of cost of acquisition over the fair value of net assets acquired. Other intangible assets primarily represent the values assigned to subscriber bases, provider and hospital networks, and trademarks. Goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment at least annually. See Note 9.

Interest Rate Swap Agreements: IHS has entered into interest rate swap agreements to manage the net exposure to interest rate changes related to its borrowings and to manage its overall borrowing costs. For designated cash flow hedges, the change in its fair value is recorded as a change in other unrestricted net assets. For interest rate swaps not designated or qualifying as hedges, changes in fair value are recorded in investment income and other, net. See Note 11.

Premium Revenue: IHS records premium revenues based on premium information from each government agency with whom they contract to provide services. Premiums are due monthly and are recognized as revenue during the period in which IHS is obligated to provide service to members. Premium payments from contracts with government agencies are based on eligibility lists produced by the government agencies.

Medical Claims Liability: INTotal incurs medical claims expenses on behalf of its members and establishes an accrual for amounts billed and not paid and an estimate of costs incurred for unbilled services provided. The estimated liability for unbilled services is based principally on historical payment patterns using actuarial techniques. Changes in assumptions for medical costs caused by changes in actual experience could cause these estimates to change in the near term. Such changes are reflected in current operations. Medical claims liability is recorded in notes payable and other liabilities in the accompanying consolidated balance sheets.

2. Summary of Significant Accounting Policies (continued)

Income Taxes: The Foundation, IHCS, LHC, and INTotal Health are not-for-profit corporations and have been determined to be exempt from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code. IHI and its subsidiaries are taxable organizations. Deferred income taxes are provided for all significant timing differences between revenues and expenses reported for financial statement and for tax purposes. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements.

Risk Factors: IHS' ability to maintain and/or increase future revenues or income could be adversely affected by: (i) the pressure to contain costs and assume risks that may result from payors promoting alternative methods for health care delivery or payment of services, such as discounted fee for service networks, valued-based payments, and capitated fee arrangements; (ii) increased competition from other hospital facilities and integrated health care delivery systems in IHS' service areas; (iii) new statutory, legal or regulatory requirements, or structural, operational or payment changes to the health care industry, resulting from the enactment and implementation of the Patient Protection and Affordable Care Act and other similar health care reform measures; (iv) Changes in revenue mix, or delays in receiving payments from third party payors, including any payments from the State of Virginia that may result if there were delays in appropriations and state budget deficits; (v) proposed and/or future changes in the laws, rules, regulations and policies relating to the definition, activities, and/or taxation of non-profit tax-exempt entities; (vi) future legislation, regulation or other actions by federal, state and local governments and their agencies which may impose requirements or continue the trend toward more restrictive limitations on reimbursement for health care services; (vii) future legislation or adverse trends affecting the costs related to professional liability coverage; (viii) the future of Virginia's Certificate of Need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate IHS' ability to expand new services; (ix) changes in general and local economic conditions that could influence patients' ability to pay for services or the adequacy of patients' health insurance coverage; (x) a potential shortage of physicians, qualified nurses and other skilled health care professionals in the local employment market; (xi) the future renewal of IHS' Medicaid HMO contracts that renew annually and drive the majority of IHS' premium revenue; and (xii) changes in general and local economic conditions that could cause volatility in capital and debt markets and may impose limitations to timely access to debt markets.

Subsequent Events: IHS has evaluated subsequent events for recognition and disclosure through March 24, 2017, the date the financial statements were available for issuance.

Recent Accounting Pronouncements: In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Key elements of the ASU include: 1.) Reducing net asset classifications from three categories to two reporting net assets with donor restrictions and net assets without donor restrictions, 2.) Expanding disclosures about the nature and amount of any donor restrictions, 3.) Expanding disclosures on any board designations of net assets without donor restrictions, and 4.) Classifying underwater donor-restricted endowments as net assets with donor restrictions. Additional disclosures, both qualitative and quantitative, will also be required. The new guidance is effective for fiscal years beginning after December 15, 2017. Management is currently evaluating the impact of the adoption of ASU 2016-14 on its consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). The underlying principle of ASU 2016-02 is that lessees should be required to recognize the assets and liabilities arising from leases on the statements of financial position. The guidance requires a lessee to recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous generally accepted accounting principles. There continues to be a differentiation between finance leases and operating leases. However, the principal difference from previous guidance is that the lease assets and lease liabilities arising from operating leases should be recognized in the consolidated balance sheets. The guidance is currently effective for fiscal years beginning after December 31, 2018. Management is currently evaluating the impact that the adoption of ASU 2016-02 will have on its consolidated financial statements.

In May 2015 the FASB issued Accounting Standards Update ("ASU") 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per share (or its equivalent)*. ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value ("NAV") per share practical expedient and limits the disclosure requirements. ASU 2015-07 is effective for annual and interim periods beginning after December 15, 2015. Management early adopted ASU 2015-07 and removed these investments from the summary of levels within the fair value hierarchy footnote disclosures.

In April 2015 the FASB issued ASU 2015-03, *Interest – imputation of interest*. ASU 2015-03 provides that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-03 is effective for annual periods beginning after December 15, 2015 for public business entities, with early adoption permitted. Management has early adopted ASU 2015-03.

In May 2014 the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of a five-step model. The new standard changes the healthcare industry specific guidance under ASU 2011-07, "Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities". ASU 2014-09 is effective for annual periods beginning after December 15, 2016, early adoption is permitted. On July 9, 2015, the FASB approved a one-year deferral of the effective date of the standard to 2018. Management is currently evaluating the effects the adoption of ASU 2014-09 will have on IHS' consolidated financial statements and disclosures. The evaluation includes identifying revenue streams to allow for ease of implementation. Management does not expect the impact to the consolidated financial statements to be material.

3. Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers and others for services rendered. IHS recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, IHS recognizes revenue on the basis of discounted (or negotiated) rates for services rendered as provided by policy. On the basis of historical experience, a portion of IHS' uninsured patients will be unable or unwilling to pay for the services provided. Thus, IHS records a provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts and after the provision for bad debts, is recognized from these major payer sources for the years ended December 31, 2016 and 2015 (in thousands) as follows:

	2016	2015
Gross Patient Revenue	$ 6,418,641	$ 5,673,500
Deductions:		
Medicare and Medicaid allowances	(1,636,588)	(1,410,095)
Commercial, self-pay, and other payor discounts and allowances	(1,426,974)	(1,229,885)
Charity care	(285,279)	(270,770)
Net Patient Service Revenue	3,069,800	2,762,750
Less: Provision for Bad Debts	(140,165)	(100,060)
Total	**$ 2,929,635**	**$ 2,662,690**

Significant portions of IHS' services are provided under agreements with the respective patients' health insurance carriers. The following summarizes the sources of gross revenue for acute care hospital services for the years ended December 31, 2016 and 2015:

	2016	2015
Managed care and commercial	52.0%	52.0%
Medicare	30.7%	31.2%
Medicaid (Includes Medicaid Managed Care)	10.1%	9.4%
Uninsured	7.2%	7.4%
Total	**100.0%**	**100.0%**

IHS agreements with third-party payers provide for payments to IHS at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

- *Managed Care and Commercial Payers*: Under managed care and commercial insurance plans, IHS is typically reimbursed for services provided under various contractual arrangements on a discounted fee, per diem or case rate basis. Patients covered by these types of contractual arrangements are obligated to pay IHS any copayments or deductible amounts required pursuant to the provisions of their managed care plans.

3. Net Patient Service Revenue (continued)

- *Medicare*: Inpatient acute, non-acute (psych, skilled nursing, rehab, and home health) and outpatient services provided to Medicare beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Ultimately, Medicare reimbursement also takes other factors into consideration such as medical education costs, disproportionate share payments, transplant costs and bad debts which are reimbursed at tentative rates with final settlement determined after submission and audit of the annual cost reports. IHS' classification of patients under the Medicare program and the appropriateness of their admission may be subject to independent review by a peer review organization.

- *Medicaid*: The Medicaid program is administered by the Department of Medical Assistance Services ("DMAS") of the Commonwealth of Virginia, pursuant to federal and state laws and regulations. DMAS receives funding for program expenditures from both the federal government and the Commonwealth of Virginia. Federal and state laws or regulations may affect limits on Medicaid payment. For inpatient Medicaid and other state programs, IHCS and LHC are reimbursed based upon a blend of the new All-Patient Refined Diagnosis-Related Group (APR-DRG) and the All Payer-Diagnostic Related Group (AP-DRG) prospective payment systems. Outpatient reimbursement for Medicaid patients is paid under the Enhanced Ambulatory Patient Groups (EAPG) prospectively determined payment system.

Patient accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, IHS analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. Net patient service revenue also includes estimated retrospective adjustments resulting from future audits, reviews and investigations. Retrospective adjustments are considered in recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments are made known or as years are no longer subject to such audits, reviews and investigations. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimates will change by a material amount in the near term.

4. Charity Care and Other Community Benefits

IHS provides healthcare services to patients who meet certain criteria under its charity care policy without charge (or at amounts less than the established rates). Since IHS does not pursue collection of amounts that qualify as charity care, such amounts are not reported as net patient service revenue. The amounts reported as charity care represent the cost of rendering such services based on the cost to charge ratio for each hospital. Various government programs provide for the indigent, including Medicaid recipients. These programs provide a percentage of reimbursement for qualifying patients; however, payment is typically below the cost of those services.

In addition to charity and uncompensated care, IHS provides benefits to the broader community. These services include free health screenings, educational services, prevention services, and support programs. In addition, IHS incurs significant unreimbursed costs in providing medical education and performing medical research.

4. Charity Care and Other Community Benefits (continued)

IHS' estimated costs of providing services to the poor and broader community for the years ended December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Charity care	$ 123,217	$ 117,492
Unpaid cost of state programs to financially disadvantaged persons	82,916	68,735
Community health programs	18,822	18,915
Medical education and research	23,223	22,924
Total community benefits, at cost	**$ 248,178**	**$ 228,066**

5. Property, Equipment and Leasehold Interests

The components of property, equipment and leasehold interests, including capital lease assets, at cost, and the related accumulated depreciation were as follows at December 31, 2016 and 2015 (in thousands):

	2016	2015
Land and land improvements	$ 238,114	$ 237,356
Buildings, fixed equipment and leasehold improvements	2,468,879	2,011,644
Major movable equipment	1,400,356	1,241,847
	4,107,349	3,490,847
Less: Accumulated depreciation and amortization	(2,259,947)	(2,059,502)
	1,847,402	1,431,345
Construction-in-progress	141,851	532,528
Total	**$ 1,989,253**	**$ 1,963,873**

6. Investments

IHS' investments as of December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Trading securities	$ 1,614,384	$ 2,182,823
Alternative investments	2,460,877	1,619,591
Available for sale securities	404,288	378,341
Total	**$ 4,479,549**	**$ 4,180,755**

Net open trades related to trading securities were $(3.6) million for 2016 and $(3.6) million for 2015. IHS invests in an array of alternative investments, primarily real estate funds, distressed debt funds, private equity and fund of funds with varying ownerships percentages. Income from alternative investments is recorded in Investment income and other, net on the Statement of operations and changes in net assets. Total unfunded commitments to alternative investment funds are $183.4 million as of December 31, 2016.

6. Investments (continued)

Investment returns for the years ended December 31, 2016 and 2015 are summarized as follows (in thousands):

	2016	2015
Interest and dividend income	$ 64,544	$ 64,638
Net realized gains	226,495	33,058
Unrealized gains/(losses) related to trading securities	846	(119,685)
Net unrealized gains	299	621
Total	**$ 292,184**	**$ (21,368)**

	2016	2015
Included in investment income and other, net		
- Income from investments, net	$ 65,888	$ 73,585
- Income from alternative investments, net	225,045	24,010
Unrealized gains/(losses) related to trading securities	846	(119,685)
(Decrease)/increase in unrestricted net assets	(150)	2,230
Increase in temporarily restricted net assets	1,014	814
Decrease in permanently restricted net assets	(459)	(2,322)
Total	**$ 292,184**	**$ (21,368)**

IHS records investment values on a trade-date basis. Amounts for sales and purchases of securities unsettled as of the balance sheet date are included net in the fair value amounts disclosed above in the appropriate asset class. Open sales totaled $0.4 million and $0.02 million as of December 31, 2016 and 2015, respectively.

Investments are carried at estimated fair value, unless recorded on the equity method of accounting. Realized gains and losses from sales of investments are reflected in income for the period in which they occur. The average cost of the investment sold is used to determine the realized gain or loss. Interest and dividend income is reported net of investment-related expenses of $14.4 million in 2016 and $14.2 million in 2015.

Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. During the years ended December 31, 2016 and 2015, IHS did not recognize any other-than-temporary declines in the fair market value of investments.

Details of investments held as available for sale securities in assets whose use is limited as of December 31, 2016 and 2015 are as follows (in thousands):

	2016		2015	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	$ 365,145	$ 365,164	$ 334,829	$ 334,952
U.S. government and agency securities	16,526	16,364	20,539	20,377
Corporate and other bonds	-	-	426	462
Domestic equity securities and mutual funds	20,094	22,760	20,235	22,550
Total	**$ 401,765**	**$ 404,288**	**$ 376,029**	**$ 378,341**

7. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability, or the exit price, in an orderly transaction between market participants at the measurement date. ASC Topic 820, "Fair Value Measurement," establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy distinguishes between market participant assumptions based on independent sources (observable inputs classified within Levels 1 and 2) and the reporting entity's own notions about market participant assumptions (unobservable inputs classified within Level 3). Transfers into and out of all levels of the fair value hierarchy are reflected at end-of-period fair value. The fair value levels are as follows:

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

- Level 2 inputs are other observable inputs for the assets or liabilities, either directly or indirectly. These may include quoted prices for similar assets and liabilities in active markets, interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals.

- Level 3 inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Fair value level assignment for assets and liabilities is based on the lowest level input that is significant to the fair value measurement in its entirety. IHS' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets and liabilities.

The following tables present IHS' assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015, respectively (in thousands). Certain assets such as open purchases and sales do not have fair values classified within a level in the valuation hierarchy. Alternative investments are accounted for under the equity method of accounting. As a result, these are excluded from fair value tables below.

	December 31, 2016	Level 1	Level 2
Assets:			
Cash and cash equivalents	$ 458,345	$ 458,345	$ -
U.S. government and agency securities	149,126	-	149,126
Corporate and other bonds			
- Asset-backed securities	188,595	-	188,595
- Corporate and other bonds	284,862	-	284,862
- Other government securities	70,360	-	70,360
Equity securities			
- Domestic	229,576	229,576	-
- International	334,662	334,662	-
Mutual fund / ETF			
- Equity	244,282	244,282	-
- Fixed Income and other	61,976	61,976	-
Total assets	**$ 2,021,784**	**$ 1,328,841**	**$ 692,943**
Liabilities:			
Interest rate swap liabilities	$ (2,846)	$ -	$ (2,846)
Total liabilities	**$ (2,846)**	**$ -**	**$ (2,846)**

7. Fair Value Measurements (continued)

	December 31, 2015	Level 1	Level 2
Assets:			
Cash and cash equivalents	$ 371,588	$ 371,588	$ -
U.S. government and agency securities	234,638	-	234,638
Corporate and other bonds			
- Asset-backed securities	196,577	-	196,577
- Corporate and other bonds	328,841	-	328,841
- Other government securities	52,770	-	52,770
Equity securities			
- Domestic	477,011	477,011	-
- International	389,946	389,946	-
Mutual fund / ETF			
- Equity	316,252	316,252	-
- Fixed Income and other	197,116	197,116	-
Total assets	**$ 2,564,739**	**$ 1,751,913**	**$ 812,826**
Liabilities:			
Interest rate swap liabilities	$ (22,767)	$ -	$ (22,767)
Total liabilities	**$ (22,767)**	**$ -**	**$ (22,767)**

The fair value of IHS' securities is determined by management using third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the securities are classified within Level 2.

Assets utilizing Level 1 inputs include: cash and cash equivalents, exchange-traded equity securities, equity and fixed income mutual funds and exchange-traded funds.

Assets and liabilities utilizing Level 2 inputs include: U.S. government and agency securities, corporate, convertible, and municipal bonds, certain mortgage-backed securities, asset-backed securities, and foreign government issued securities. IHS entered into interest rate swap agreements in conjunction with the issuance of variable rate bonds. The swap contracts are valued using models based on readily observable market parameters for all substantial terms of the contract. See Note 11 for additional information.

8. Investments in and Receivables from Affiliates

IHS makes strategic investments in corporations and other forms of businesses. IHS accounts for investments with 20% to 50% ownership under the equity method of accounting and includes IHS' net equity interest in investments in and receivables from affiliates in the consolidated balance sheets. Investments with less than 20% ownership are accounted for using the cost method.

IHS invested in a joint venture with Aetna that established Innovation Health ("IHealth"), a licensed health plan serving Northern Virginia. IHealth commenced operations in July 2013. IHealth provides employers and consumers access to more affordable, coordinated and integrated health care in the region. IHS holds a 50% interest in IHealth.

8. Investments in and Receivables from Affiliates (continued)

IHS' ownership in significant nonconsolidated entities and the amounts included in IHS' consolidated financial statements as of December 31, 2016 and 2015 are as follows (in thousands):

	Carrying Value		Equity Method (Losses) Income	
	2016	2015	2016	2015
IHealth	$ 30,718	$ 36,135	$ (10,417)	$ 2,526
Other investments accounted for under equity met	10,597	11,940	(11,976)	(9,939)
Investments accounted for under cost method	493	493	-	-
Total investments in affiliates	**$ 41,808**	**$ 48,568**	**$ (22,393)**	**$ (7,413)**

The summarized financial positions and results of operations for investments accounted for under the equity method as of and for the years ended December 31, 2016 and 2015 are as follows (in thousands) (unaudited):

	2016	2015
Total Assets	$ 241,248	$ 209,622
Total Liabilities	132,131	97,569
Net Assets	109,117	112,053
Total revenues, net	470,910	401,122
Excess of expenses over revenue	(30,248)	(3,545)

9. Goodwill and Other Intangible Assets

The majority of goodwill and other intangible assets pertain to the acquisition of INTotal in 2012. A summary of goodwill and other intangible assets for the years ended December 31, 2016 and 2015 is as follows (in thousands):

	2016	2015
Provider network	$ 7,111	$ 10,500
Customer relations	6,705	9,900
Medicaid license	4,070	21,300
Other	7,843	4,274
Subtotal	25,729	45,974
Accumulated amortization	(7,310)	(4,991)
Total intangibles, net	18,419	40,983
Goodwill	44,053	53,959
Total Goodwill and Intangibles	$ 62,472	$ 94,942

9. Goodwill and Other Intangible Assets (continued)

Amortization expense of intangible assets was $2.3 million and $1.7 million, for the years ended December 31, 2016 and 2015, respectively. The estimated amortization expense for each of the succeeding five years is approximately $2.4 million.

On May 2, 2016, IHS acquired NOVA Medical and Urgent Care Center Inc. ("Nova Med"). The acquisition of Nova Med expanded the organization's comprehensive care and services to communities throughout its western service region. In September 2016, IHS acquired General Internal Medicine Group Inc. ("GIMG"), a physician practice with multiple primary care and urgent care locations. As a result, goodwill and intangible assets increased $14.7 million and $3.6 million, respectively.

In April 2015, IHS completed the acquisition of Radiology Imaging Associates. As a result goodwill increased $18.9 million.

A summary of the changes in goodwill for the years ended December 31, 2016 and 2015 is as follows:

	2016	2015
Beginning balance	$ 53,959	$ 34,978
Acquisitions	14,686	18,981
Impairment loss	(24,592)	-
Ending balance	$ 44,053	$ 53,959

Goodwill and intangible assets are tested for impairment as of October 1st each year. Due to certain Medicaid regulatory changes in the Commonwealth of Virginia, future operating profits and cash flows for INTotal were forecasted to be lower than originally anticipated by management. The revised forecasted amounts caused the estimated fair value of INTotal to drop below its carrying value as of October 1, 2016. As a result, an impairment loss was recognized by INTotal for goodwill and each of its intangible assets. The amount of impairment losses was determined based on the difference between the carrying value of goodwill and intangible assets when compared to the implied fair value of goodwill and estimated fair value intangible assets. A summary of impairment losses recognized during 2016 and the method of estimating fair value for goodwill and each intangible asset are as follows:

	Amount of Impairment Losses	Method of Estimating Fair Value
Provider network	$ 3,389	Discounted Cash Flows, Relief-from-Royalty Method
Customer relations	3,195	Discounted Cash Flows, With and Without Method
Medicaid license	17,230	Excess Earnings Method
	23,814	
Goodwill	24,592	Discounted Cash Flows, Income Method
Total impairment losses	$ 48,406	

The fair value measurements that were utilized in the calculation of the impairment loss associated with goodwill and intangible assets were based on unobservable inputs that are Level 3 within the fair value hierarchy. These inputs were principally forecasted profits and cash flows that relate solely to INTotal.

9. Goodwill and Other Intangible Assets (continued)

In conjunction with the impairment testing, management revised the estimated useful lives of INTotal's intangible assets. The effect of these changes on annual amortization expense is considered de minimis. A summary of the estimated useful lives of INTotal's intangible assets for the years ended December 31, 2016 and 2015 is as follows:

	Estimated Useful Life (Years) 2016	Estimated Useful Life (Years) 2015
Provider network	11	20
Customer relations	10	10
Medicaid license	7	Indefinite
Other	5	5

10. Long-Term Debt

	December 31, 2016	December 31, 2015
Long-term Debt of the IHS Obligated Group:		
1988A,B,C,D Variable Rate Demand Obligation Revenue Bonds; maturing 10/1/25; monthly interest at a variable rate and maximum of 15%	$ 11,700	$ 11,700
1993A Hospital Revenue Refunding Bonds; maturing 8/15/23; semi-annual interest at a fixed rate of 2.75% to 5.25%	51,395	57,360
2000 Variable Rate Demand Health Care Revenue Bonds; maturing 1/1/30; monthly interest at a variable rate and maximum of 12.0%	30,300	30,300
2005A Health Care Revenue Bonds; maturing 5/15/35; monthly interest at a variable rate and maximum of 12.0%	109,730	109,730
2005C Health Care Revenue Bonds; maturing 5/15/26; monthly interest at a variable rate and maximum of 12.0%	18,610	18,610
2009A Health Care Revenue Bonds; maturing 5/15/35; semi-annual interest at a fixed rate of 3.0% to 5.5%	132,400	256,350
2009C Health Care Revenue Bonds; maturing 5/15/25; semi-annual interest at a fixed rate of 2.0% to 5.0%	46,750	50,640
2010A-2 Health Care Revenue Bonds; maturing 5/15/39; monthly interest at a variable rate and maximum of 12.0%	95,000	95,000
2011 Health Care Revenue Bonds; maturing 8/1/2017; monthly interest at a fixed rate of 1.8%	6,054	15,136
2012A Health Care Revenue Bonds; maturing 5/15/42; semi-annual interest at a fixed rate of 2.25% to 5.0%	273,230	277,625
2012B Health Care Revenue Bonds; maturing 5/15/22; semi-annual interest at a fixed rate of 3.0% to 5.0%	60,000	60,000
2012C Health Care Revenue Bonds; maturing 5/15/42; monthly interest at a variable rate and maximum of 12%	-	141,045
2012D Health Care Revenue Bonds; maturing 5/15/29;semi-annual interest at a fixed rate of 3.0% to 5.0%	70,395	70,395
2013 Health Care Revenue Bonds; maturing 12/1/23; monthly interest at a fixed rate of 2.15%	79,530	79,530
2014A Health Care Revenue Bonds; maturing 5/15/44; semi-annual interest at a fixed rate of 2.5% to 5.0%	200,000	200,000
2016A Health Care Revenue Bonds; maturing 5/15/31; semi-annual interest at a fixed rate of 5.0%	111,880	-
2016B Health Care Revenue Bonds; maturing 5/15/26; semi-annual interest at a fixed rate of 5.0%	31,295	-
2016C Health Care Revenue Bonds; maturing 5/15/42; monthly interest at a variable rate and maximum of 12%	99,685	-
Total Long-term Debt of the IHS Obligated Group	**1,427,954**	**1,473,421**
Less: Current Portion of Long-term Debt	(155,605)	(199,132)
Net Original Issue Premium	72,771	41,686
Net Deferred Financing Costs	(7,657)	(7,319)
Net Long-term Debt of the IHS Obligated Group	**$ 1,337,463**	**$ 1,308,656**
Total Long-term Debt of Non-Obligated IHS Affiliates	6,070	8,100
Less: Current Portion of Long-term Debt	(1,184)	(3,419)
Net Long-term Debt of Non-Obligated IHS Affiliates	4,886	4,681
Total Net IHS Long-term Debt	**$ 1,342,349**	**$ 1,313,337**

The maturities of non-obligated IHS affiliates' debt range from January 15, 2017 to February 28, 2024 with rates ranging from 2.5% to 4.87%.

10. Long-Term Debt (continued)

The preponderance of IHS' debt is tax-exempt revenue bonds issued under a Master Trust Indenture, which defines the obligated subsidiaries and affiliates under the bonds. The Members of the IHS Obligated Group consist of the Foundation, IHCS and LHC. The financial statements presented for the Obligated Group include only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets or liabilities of any of those controlled, affiliated entities.

On May 11, 2016 the Industrial Development Authority issued $111.9 million of Series 2016A bonds for the benefit of the Obligated Group for the advanced refunding of Series 2009A bonds. The Series 2016A bonds are comprised of fixed rate term and coupon bonds with principal payment starting in the year 2020. Interest is payable semi-annually on May 15 and November 15 of each year, commencing November 15, 2016. The premium received was $26.5. The total proceeds from the offering were $138.3 million.

On May 11, 2016 the Industrial Development Authority issued $31.3 million of Series 2016B bonds for the benefit of the Obligated Group for the refunding of Series 2012C bonds. The Series 2016B bonds are comprised of fixed rate term and coupon bonds with principal payment starting in the year 2026. Interest is payable semi-annually on May 15 and November 15 of each year, commencing November 15, 2016. The premium received was $8.7million. The total proceeds from the offering were $40.0 million.

On May 11, 2016 the Industrial Development Authority issued $99.7 million of Series 2016C bonds for the benefit of the Obligated Group for the refunding of Series 2012C bonds. The Series 2016C bonds are comprised of variable rate term and coupon bonds with principal payment starting in the year 2017 with interest payable monthly. The initial rate was set at 0.10% and is supported by Inova's self-liquidity.

On October 29, 2015, IHS Obligated Group caused the mandatory tender and interest rate conversion of Series 2005A-1 and 2005A-2 bonds. Commencing on the mandatory tender date, the Series 2005A-1 bonds were purchased by TD Bank, N.A. in the Index Interest Rate Mode through September 30, 2023 and the Series 2005A-2 bonds were purchased by BB&T Community Holdings Co. in the Index Interest Rate Mode through October 15, 2025. The final maturity for each subseries of the Series 2005A bonds is May 15, 2035.

The 2016A, 2016B, and 2016C Series bonds were issued to advance refund the 2009A Series fixed rate bonds and currently refund all of the 2012C Series variable rate bonds. IHS recognized an $18 million loss on extinguishment of debt related to this transaction, which is in included in the balance of non-operating revenues (expenses) in the accompanying consolidated statements of operations and changes in net assets.

Also effective as of the mandatory tender date, the liquidity facility for the Series 2005A-1 bonds previously provided by TD Bank, N.A. and the self-liquidity facility for the Series 2005A-2 bonds previously provided by IHS were each terminated.

On August 13, 2015, the mandatory tender date for the Series 2010A-2 bonds held by TD Bank, N.A. was extended from September 1, 2021 to September 1, 2024.

IHS Obligated Group debts are secured by an interest in all funds held by the Bond Trustee for purposes of debt service, construction and equipment acquisition. Each Member of the IHS Obligated Group covenants that it will not pledge or grant a security interest in (except as may be otherwise provided in the Master Trust Indenture) any of its property. The Master Trust Indenture for the IHS Obligated Group requires that certain minimum financial ratios be met. IHS is in compliance with the financial ratio requirements.

10. Long-Term Debt (continued)

IHS estimates the December 31, 2016 and 2015 fair value of its long-term debt, based on mid-market estimate, a market bid and/or ask, or any other price or estimate within a market spread, to be approximately $1,518 million and $1,584 million, respectively, compared with the face value of approximately $1,506 million and $1,523 million, respectively. The fair value of all financial instruments other than investments and debt is estimated by management to approximate or equal their reported carrying value.

The interest rate on the variable rate bonds ranged between 0.02% and 0.96% in 2016 and 0.01% and 0.26% in 2015. The variable rate bonds include an optional tender feature that allows the bond holder to tender the bonds on a weekly interest payment date.

IHS maintains SBPAs and LOCs to support the optional tender features on the VRDO bonds excluding the 2005A-1 and 2005A-2 bonds. The liquidity providers are summarized as follows as of December 31, 2016 (in thousands):

Liquidity Provider	Bond Series	Amount	Expiration Date
Branch Bank & Trust	2000	$30,300	12/31/2018
Northern Trust	1988ABCD, 2005C-1, and 2005C-2	30,310	12/18/2017
Total		**$60,610**	

In the event of a failed remarketing, the banks are obligated to extend credit to purchase the tendered bonds. The banks may subsequently remarket the bonds and if the bonds are not remarketed, they are subject to mandatory redemption in quarterly installments by IHS. The SBPAs and LOC agreements include a provision which specifies re-payment of advances made by the bank will begin in the 13th calendar month after the bonds are acquired by the bank. This provision ensures that tendered bonds do not become an obligation for IHS for at least one year. Accordingly, the underlying debt is not classified as current liabilities except for principal amounts due within twelve months.

The tender feature of the 2016C Bonds and certain variable rate bonds requires IHS to maintain current assets of $129.9 million and $171.3 million as of December 31, 2016 and 2015, respectively, to provide for redemption of the tendered bonds. These assets are included in the current portion of assets whose use is limited.

Costs incurred in the issuance or conversion of long-term debt are deferred and amortized over the life of the related debt using the principal balance outstanding method.

Certain bonds are subject to mandatory sinking fund redemption and to earlier redemption under certain circumstances as defined in the respective bond indenture agreements. Maturities of long-term debt for the five years succeeding December 31, 2016 are as follows (in thousands):

	2017	2018	2019	2020	2021	There-after	Total
Scheduled Maturities	$ 27,159	$ 30,302	$ 31,358	$ 32,570	$ 33,694	$ 1,149,311	$ 1,304,394
Bonds under remarketing agreement and subject to mandatory tender	129,630	-	-	-	-	-	129,630
Total	$ 156,789	$ 30,302	$ 31,358	$ 32,570	$ 33,694	$ 1,149,311	$ 1,434,024

10. Long-Term Debt (continued)

IHS issued $100.0 million of taxable commercial paper ("CP") under a program authorized for borrowings up to $100.0 million with maturity dates from one to 270 days. Proceeds from this issuance were used for a variety of working capital requirements. IHS maintains a self-liquidity program that would be used to repurchase any CP that is not remarketed. All outstanding CP is included in notes payable and other liabilities in the current liabilities section of the accompanying consolidated balance sheets. As of December 31, 2016 and 2015, the amount of CP outstanding was $100.0 million.

On August 2, 2016 IHS entered into a new $100.0 million unsecured line of credit. As of December 31, 2016 IHS maintains unsecured lines of credit with three large commercial banks with a combined available principal amount of $237.5 million. There were no amounts outstanding on these credit lines as of December 31, 2016 or 2015, respectively. The $100 million line of credit is scheduled to expire on August 1, 2017. Management intends to renew the line of credit.

11. Derivative Financial Instruments

IHS entered into interest rate swap agreements in order to hedge the variability of cash flows related to changes in market interest rates on underlying variable rate debt. The swap agreements effectively converted the variable rate debt to a fixed rate for the remaining life of the outstanding debt. These swap agreements initially qualified and were designated as cash flow hedges, and the effectiveness of the hedges was periodically evaluated. The effective portion of the change in fair value of the swap agreements was reported on the accompanying statements as a change in unrestricted net assets, and the ineffective portion was recorded in investment income and other, net. The effective hedges' maturity dates ranged from years 2030 to 2035. At December 31, 2016 there were three non-hedging swaps with a total notional of $144.5 million and fair value of $(2.8) million. These amounts include a $69.5 million notional forward-starting interest rate swap that was entered into on March 3, 2016. At December 31, 2015 there were two non-hedging swaps with a total notional of $100.0 million and a fair value of $(22.8) million. In the consolidated statements of operations, for the years ended December 31, 2016 and 2015, realized gains and (losses) were $19.9 million and $7.0 million, respectively, in the Investment income and other, net, line.

Each of the swap agreements includes a credit support provision which requires the posting of collateral with the counter-party for liability positions in excess of specified thresholds. At December 31, 2016 and 2015, no collateral posting was required.

12. Retirement Obligations

The IHS Retirement Income Plan (the "IHS Plan") is a defined benefit pension plan that covers substantially all full-time employees of IHS. During 2016, management settled all obligations under the plan. The settlement resulted in a non-cash loss of $64.5 million.

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended December 31, 2016 and 2015 and the accumulated benefit obligation at December 31, 2016 and 2015 is as follows (in thousands):

	2016	2015
Projected Benefit Obligation:		
Beginning of year	$ 490,041	$ 577,440
Service Cost	5,000	5,000
Interest Cost	19,274	20,935
Actuarial (gain) loss	49,320	(50,466)
Benefits payments	(563,635)	(62,868)
End of year	**$ -**	**$ 490,041**
Fair Value of Plan Assets:		
Beginning of year	$ 542,980	$ 608,180
Actual return on plan assets	16,766	(7,332)
Employer contributions	3,889	5,000
Benefits payments	(563,635)	(62,868)
End of year	**$ -**	**$ 542,980**
Funded status at end of year	**$ -**	**$ 52,939**

	2016	2015
Amounts recognized in the consolidated balance sheets consist of:		
Noncurrent assets	$ -	$ 52,939
Amounts recognized in Unrestricted Net Assets consist of:		
Actuarial loss	$ -	$ 17,846
Accumulated benefit obligation:		
End of year	$ -	$ 490,041
Net periodic benefit cost:		
Service cost	$ 5,000	$ 5,000
Interest cost	19,274	20,935
Expected return on plan assets	(15,714)	(22,155)
Recognized actuarial loss	1,619	4,135
Recognized settlement loss	64,494	3,809
Net periodic benefit cost	**$ 74,673**	**$ 11,724**

12. Retirement Obligations (continued)

For the year ended December 31, 2015, IHS recognized an increase in unrestricted net assets related to the change in plan assets and benefit obligations of the pension plan of approximately $28.9 million related to an increase in discount rate.

Assumptions	2016	2015
Weighted-average assumptions used to determine benefit obligations at December 31:		
Discount rate	N/A	4.05%
Rate of compensation increase	N/A	N/A
Weighted-average assumptions used to determine net periodic benefit costs for the years ended December 31:		
Discount rate	4.05%	3.72%
Rate of compensation increase	3.00%	3.50%
Expected long-term return on plan assets	3.50%	3.75%

IHS also sponsors the Inova Health System Retirement Savings Plan ("401K Plan") that covers the same groups covered under the IHS Plan. Employees may contribute to the 401K Plan and IHS may contribute to this plan in varying amounts. As a result of the pension freeze, management approved an increase in the 401K match from 3% to 5% effective January 1, 2015. Defined contribution benefit expense was $47.3 million and $42.0 million in 2016 and 2015, respectively.

13. Professional and Other Insurance Liabilities

IHS maintains coverage for professional and general liability through claims-made policies issued by InovaCap, LLC ("InovaCap"). InovaCap is a wholly owned captive insurance company domiciled in Vermont. Because InovaCap is a wholly owned subsidiary of IHS, its assets, liabilities, revenues and expenses are fully consolidated in the accompanying financial statements.

InovaCap retains risk of $2.25 million per claim and $19.0 million in annual aggregate for professional liability. Additional risk is reinsured in umbrella forms through Lloyds of London, other European companies, Zurich North American, and CNA, together providing limits of $50.0 million per claim, and $50.0 million in the aggregate, in excess of the InovaCap retention. The consolidated balance sheets at December 31, 2016 and 2015 include in other non-current obligations $25.6 million and $26.9 million, respectively, based on actuarial estimates of payments to be made under its professional liability insurance programs for known claims, as well as for estimated losses on unfiled claims, which relate to events occurring in 2015 and prior years. The liabilities are discounted at 1.48% and 1.6% at December 31, 2016 and 2015, respectively. InovaCap also recorded a liability of $2.5 million and $1.7 million as of December 31, 2016 and 2015, respectively, for reinsurance of certain health plan obligations.

Investments and other assets held by InovaCap of $106.6 million and $96.2 million at December 31, 2016 and 2015, respectively, are restricted by statute from being transferred to another subsidiary or obligated for any other purpose and accordingly are included as assets whose use is limited in the consolidated balance sheets.

14. Fairfax County Leases

The land upon which the majority of Inova Fairfax Hospital and the entirety of Inova Mount Vernon Hospital are located and the related buildings and equipment are leased to IHS by the Board of Supervisors of Fairfax County, Virginia ("County"), under an agreement that was partially amended in 2010 (the "County Lease"). The 2010 agreement included sale of property whereby a portion of the Inova Fairfax Hospital campus land was taken out of the County Lease and ownership of that land was conveyed to IHS. There is also land owned by IHS, off-site of the hospital campus that was conveyed to Fairfax County. Effective as of December 3, 2010, the 2010 agreement extends the County Lease for the residual land for a term of 99 years and, thus, the County Lease now expires in December 2109. Under the County Lease, the property and equipment leased from the County are recorded as leasehold interests at the cost to construct or acquire. Upon termination of the County Lease, such property, including leasehold improvements and equipment will revert to the County, subject to all related long-term liabilities of IHS incurred to finance the construction and acquisition of such property, buildings and equipment.

The County Lease also requires IHS to set aside funds in an amount at least equal to the depreciation expense on the related leasehold interests. Such funds may be expended by IHS for major repairs or alterations, construction of or additions to buildings, or the purchase or replacement of equipment. IHS' Board of Trustees has also designated additional funds for the purpose of plant expansion.

The terms of the County Lease outline an indigent care policy to assure all individuals in the County have access to medically necessary care. Patients' payment obligations under the policy are determined using a sliding income scale which is based on the federal poverty guidelines. During the term of the County Lease, IHS has agreed to notify the County of any intent to incur additional debt in excess of $1.0 million. IHS has also agreed to notify the County of any intent to enter into contractual agreements for the management or operation of Inova Fairfax Hospital or Inova Mount Vernon Hospital by persons other than IHS, or any intent to change hospital rates.

15. Other Leases and Financing Obligation

IHS leases equipment, office space and certain facilities. Included in the operating expenses of IHS are lease expenses of approximately $36.6 million and $31.1 million in 2016 and 2015, respectively. Future minimum payments under non-cancellable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2016 (in thousands):

	Operating Leases
2017	$ 35,195
2018	34,536
2019	29,820
2020	21,784
2021	16,232
Thereafter	42,831
Total lease payments	180,398
Less: minimum lease income from non-cancellable subleases	(1,929)
Total	**$ 178,469**

15. Other Leases and Financing Obligation (continued)

On February 5, 2015, IHS entered into a 99-year lease agreement for rights to 117 acres of land and 1.2 million square feet of office space. This large corporate campus is adjacent to its flagship hospital in Fairfax, Virginia. Inova took possession of the site on October 1, 2015. The lease agreement provides the lessor with a put option to sell the property to IHS upon 90 days written notice for $180.0 million at any time during the first 5 years of the lease. Starting in year 6, the lease payments decline by 50% assuming IHS makes certain capital investments on the site and the lessor becomes responsible for the property taxes. Because of these provisions in the lease, IHS believes that the lessor will exercise the put option on or before October 1, 2020. This transaction is accounted for as a long term debt financing due in part to IHS' assumption of certain obligations typically associated with ownership.

Future minimum payments under this agreement with the remaining terms of one year or more consisted of the following at December 31, 2016 (in thousands):

	Financing Obligation
2017	$ 6,750
2018	7,750
2019	8,875
2020	8,750
2021	5,000
Thereafter	1,249,533
Total	**$ 1,286,658**

16. Other Commitments and Contingencies

IHS has entered into several contracts for the acquisition of equipment and for the construction of facilities. Future commitments under these contracts at December 31, 2016 were approximately $153.3 million. IHS currently anticipates that these projects will be financed with a combination of bond proceeds, funds generated from earnings and donations. These projects include expansion and renovation of Fairfax, Mt. Vernon, Loudoun, Alexandria and Fair Oaks hospitals and the buildout of the new cancer center on the Inova Center for Personalized Health campus.

IHS is subject to various legal claims and contingencies arising in the ordinary course of its business. While the outcomes of such matters are uncertain, management believes that their ultimate resolution will not have a material adverse effect on IHS' financial position or on the changes in its net assets or cash flows.

17. Functional Expenses

IHS provides various health care services to patients within its geographic region. Operating expenses related to providing these services for the years ended December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Health care services	$ 2,737,308	$ 2,398,215
General and administrative	387,340	352,479
Total	**$ 3,124,648**	**$ 2,750,694**

Building a better working world

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Report of Independent Auditors on Other Supplementary Information

The Board of Trustees
Inova Health System

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

Ernst & Young LLP

March 24, 2017

Inova Health System Obligated Group
Consolidated Balance Sheets
December 31, 2016 and 2015
(In thousands)

	2016	2015
Assets		
Current Assets		
Cash and cash equivalents	$ 236,802	$ 207,027
Assets whose use is limited, current	129,985	171,345
Patient accounts receivable less allowance for doubtful accounts	290,039	268,708
Other current assets	94,249	87,687
Total Current Assets	751,075	734,767
Property, Equipment and Leasehold Interests, net	1,928,089	1,905,804
Assets Whose Use Is Limited, non-current		
Held by bond trustee	22,039	87,502
By board for plant replacement and expansion	4,035,863	3,558,135
By board for liquidity	189,985	326,172
By donor	91,967	82,422
	4,339,854	4,054,231
Less amounts required to meet current obligations	(129,985)	(171,345)
Total Assets Whose Use Is Limited, non-current	4,209,869	3,882,886
Other Assets		
Investments in and receivables from affiliates	188,474	195,370
Prepaid pension asset	-	52,939
Other long-term assets	138,406	97,470
Total Other Assets	326,880	345,779
TOTAL ASSETS	$ 7,215,913	$ 6,869,236
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and other accrued expenses	$ 315,513	$ 306,808
Third-party settlements	46,822	45,511
Notes payable and other liabilities	120,170	114,279
Current portion of long-term debt	156,067	199,132
Total Current Liabilities	638,572	665,730
Non-current Liabilities		
Long-term debt, less current portion	1,337,464	1,308,656
Interest rate swap liability	2,846	22,767
Financing obligation	183,409	181,968
Other non-current obligations	54,109	55,714
Total Non-current Liabilities	1,577,828	1,569,105
Net Assets		
Unrestricted	4,890,634	4,540,127
Temporarily restricted	77,379	63,097
Permanently restricted	31,500	31,177
Total Net Assets	4,999,513	4,634,401
TOTAL LIABILITIES AND NET ASSETS	$ 7,215,913	$ 6,869,236

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets or liabilities of any of those controlled, affiliated entities.

Inova Health System Obligated Group
Consolidated Statements of Operations and Changes in Unrestricted Net Assets
For the Years Ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Operating Revenues		
Net patient service revenue	$ 2,880,683	$ 2,603,423
Provision for bad debts	(137,543)	(97,532)
Net Patient Service Revenue Less Provision for Bad Debts	2,743,140	2,505,891
Other operating revenue	85,691	91,958
Total Operating Revenues	2,828,831	2,597,849
Operating Expenses		
Salaries and benefits	1,383,546	1,225,132
Other operating expenses	1,082,741	982,197
Depreciation and amortization	205,502	170,035
Interest	51,559	27,310
Total Operating Expenses	2,723,348	2,404,674
Operating Income before Loss on Settlement of Defined Benefit Pension Plan and Loss on Extinguishment of Debt and Swap Termination	**105,483**	**193,175**
Loss on settlement of defined benefit pension plan	64,494	-
Total Loss on Settlement of Defined Benefit Pension Plan and	64,494	-
Operating Income	40,989	193,175
Non-Operating Revenues (Expenses)		
Investment (loss) income and other, net	288,707	7,053
Excess of Revenues Over Expenses	329,696	200,228
Unrealized (loss)/gain on investments, net	(137)	2,427
Loss on extinguishment of swap termination	1,853	-
Capital reimbursements for grants	2,048	-
Change in plan assets and benefit obligations of pension	16,463	28,923
Other	584	509
Increase in Unrestricted Net Assets	$ 350,507	$ 232,087

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets or liabilities of any of those controlled, affiliated entities.

Inova Health System Obligated Group
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2016 and 2015
(In thousands)

	2016	2015
Operating Activities		
Change in net assets	$ 365,112	$ 238,348
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation and amortization	205,502	170,035
Change in plan assets and benefit obligations of pension	(16,463)	(28,923)
Loss on extinguishment of debt	18,000	-
Net realized and unrealized (gains)/losses on investments	(225,560)	83,507
Change in fair value of interest rate swaps	(2,164)	398
Equity investment losses, net	10,289	(10,555)
Increase in accounts receivable and third-party settlements, net	(20,968)	(24,948)
Increase/(Decrease) in accounts payable and other current liabilities	14,551	(17,674)
Decrease in pension asset	69,402	6,724
Increase/(Decrease) in estimated professional liability and other deferred liability items	(264)	(5,056)
Increase in intangibles and other assets	(26,053)	(29,715)
Restricted contributions and investment income	(24,950)	(17,898)
Net Cash Provided by Operating Activities	366,434	364,243
Investing Activities		
Capital expenditures	(226,166)	(290,092)
Investments in and advances to joint ventures and affiliates	(21,936)	(24,421)
Purchases of marketable securities	(3,072,706)	(1,506,025)
Proceeds from sale of marketable securities	3,012,644	1,432,022
Other	-	7,966
Net Cash Used in Investing Activities	(308,164)	(380,550)
Financing Activities		
Principal payments on long-term debt	(28,830)	(28,322)
Proceeds from issuance of long-term debt	276,049	-
Refunding of long-term debt	(279,400)	-
Swap termination and modification payments	(17,757)	(7,398)
Restricted contributions and investment income	24,840	17,898
Other	(3,397)	(2,455)
Net Cash Used in by Financing Activities	(28,495)	(20,277)
Net Increase/(Decrease) in Cash and Cash Equivalents	29,775	(36,584)
Cash and cash equivalents at beginning of year	207,027	243,611
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 236,802	$ 207,027
Supplemental Disclosure of Non-cash Activities		
Financing obligation used to purchase capital lease assets	$ -	$ 184,413

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets or liabilities of any of those controlled, affiliated entities.