Consolidated Financial Statements and Supplementary Information

Southwest Community Health System and Subsidiaries
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Southwest Community Health System and Subsidiaries

Consolidated Financial Statements
and Supplementary Information

Years Ended December 31, 2016 and 2015

Contents

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Report of Independent Auditors

The Board of Trustees
Southwest Community Health System

We have audited the accompanying consolidated financial statements of Southwest Community Health System and Subsidiaries, 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.

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Opinion

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

Ernst & Young LLP

April 26, 2017

Southwest Community Health System and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2016	**2015**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 29,410**	$ 20,746
Patient accounts receivable, net of allowances for bad debts of $32,357 in 2016 and $17,667 in 2015	**33,105**	35,070
Other receivables, net	**4,605**	6,461
Inventories	**7,555**	4,953
Prepaid expenses	**9,771**	8,082
Investments for current use	**6,252**	10,976
Total current assets	**90,698**	86,288
Investments:		
Board-designated assets	**184,410**	172,072
Self-insurance reserve funds	**10,388**	9,731
Bond trustee funds	**–**	5,857
	194,798	187,660
Property, plant, and equipment, net	**200,192**	205,301
Other assets	**5,699**	6,327
Total assets	**$ 491,387**	$ 485,576

	December 31	
	2016	**2015**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 16,718**	$ 15,431
Accrued compensation and related liabilities	**22,779**	16,458
Other accrued liabilities	**9,903**	13,368
Drawable credited earnings due to UHHS	**3,026**	3,073
Estimated amounts payable to third-party payors	**4,143**	5,054
Current portion of long-term liabilities	**2,826**	2,748
Total current liabilities	**59,395**	56,132
Long-term liabilities:		
Revenue bonds	**155,012**	157,395
Notes payable and capital leases	**2,081**	2,477
Accrued retirement benefits	**53,420**	55,622
Other liabilities	**18,546**	20,411
Total long-term liabilities	**229,059**	235,905
Total liabilities	**288,454**	292,037
Net assets:		
Unrestricted	**198,655**	186,420
Temporarily restricted	**4,090**	6,931
Permanently restricted	**188**	188
Total net assets	**202,933**	193,539
Total liabilities and net assets	**$ 491,387**	$ 485,576

See accompanying notes.

Southwest Community Health System and Subsidiaries

Consolidated Statements of Operations
and Changes in Net Assets

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Unrestricted revenue		
Net patient service revenue	**$ 353,464**	$ 335,123
Provision for bad debts	**(20,084)**	(17,092)
Net patient service revenue less provision for bad debts	**333,380**	318,031
Other revenue	**12,296**	11,040
Total unrestricted revenue	**345,676**	329,071
Expenses		
Salaries, wages, and benefits	**155,686**	156,945
Supplies, insurance, and other	**144,628**	134,215
Depreciation and amortization	**24,956**	22,936
Interest	**6,047**	5,947
Total expenses	**331,317**	320,043
Income from operations	**14,359**	9,028
Nonoperating gains (losses):		
Tax levy receipts	**789**	780
Investment income	**674**	6,210
Other – net	**(2,606)**	(3,088)
Total nonoperating (losses) gains, net	**(1,143)**	3,902
Excess of revenue over expenses before drawable credited earnings due to UHHS	**13,216**	12,930
Drawable credited earnings due to UHHS	**(3,026)**	(3,073)
Excess of revenue over expenses	**10,190**	9,857
Net change in unrealized gains on other-than-trading investments	**6,781**	(9,286)
Net assets released from restrictions for capital	**3,194**	638
Pension adjustment	**(7,930)**	(6,050)
Increase (decrease) in unrestricted net assets	**12,235**	(4,841)
Unrestricted net assets at beginning of year	**186,420**	191,261
Unrestricted net assets at end of year	**198,655**	186,420

Southwest Community Health System and Subsidiaries

Consolidated Statements of Operations
and Changes in Net Assets (continued)

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Temporarily restricted net assets		
Contributions	**$ 463**	$ 662
Net investment loss	**(84)**	(183)
Net assets released from restrictions	**(3,220)**	(678)
Decrease in temporarily restricted net assets	**(2,841)**	(199)
Temporarily restricted net assets at beginning of year	**6,931**	7,130
Temporarily restricted net assets at end of year	**4,090**	6,931
Permanently restricted net assets		
Permanently restricted net assets at beginning of year	**188**	188
Permanently restricted net assets at end of year	**188**	188
Net assets at end of year	**$ 202,933**	$ 193,539

See accompanying notes.

Southwest Community Health System and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Operating activities		
Increase (decrease) in net assets	**$ 9,394**	$ (5,040)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Net realized and unrealized gains on investments	**(3,114)**	10,038
Depreciation and amortization	**25,578**	23,511
Provision for bad debts	**20,084**	17,092
Pension adjustment	**7,930**	6,050
Restricted contributions	**(463)**	(662)
Changes in operating assets and liabilities:		
Patient accounts receivable	**(18,119)**	(19,430)
Other assets	**(2,435)**	(1,724)
Other noncurrent assets	**628**	2,021
Accrued retirement benefits	**(10,132)**	234
Accounts payable	**1,287**	(7,867)
Other current liabilities	**2,023**	849
Other long-term liabilities	**(1,865)**	7
Net cash provided by operating activities	**30,796**	25,079
Investing activities		
Purchases of property, plant, and equipment	**(20,469)**	(20,454)
Purchases of investments	**(183,129)**	(40,051)
Sales of investments	**183,829**	35,503
Net cash used in investing activities	**(19,769)**	(25,002)
Financing activities		
Proceeds from long-term borrowings	**–**	7,167
Principal payments on long-term debt	**(2,779)**	(2,455)
Restricted contributions	**463**	662
Drawable credited earnings due to/from UHHS	**(47)**	(2,015)
Net cash (used in) provided by financing activities	**(2,363)**	3,359
Net increase in cash and cash equivalents	**8,664**	3,436
Cash and cash equivalents at beginning of year	**20,746**	17,310
Cash and cash equivalents at end of year	**$ 29,410**	$ 20,746

See accompanying notes.

Southwest Community Health System and Subsidiaries

Notes to Consolidated Financial Statements
(Dollars in Thousands)

December 31, 2016

1. Summary of Affiliations and Accounting Policies

Southwest Community Health System's (the System) purpose is to participate in and promote activities related to the delivery of health care services and other services which are related to or supportive of these activities. The System is a not-for-profit corporation under federal income tax laws. A brief summary of each of the organizations for which the System is the sole member and parent organization follows:

Southwest General Health Center – Southwest General Health Center (the Health Center) is a not-for-profit corporation that was organized to establish, operate, and maintain a hospital and other health care facilities. The Health Center offers a full range of services at its main campus located in Middleburg Heights, Ohio and a wide variety of outpatient services at its nearby medical centers in Brunswick and Strongsville. The Health Center is the sole shareholder of Southwest General Medical Group, a physician corporation. A wholly owned subsidiary of the Health Center, Southwest Holdings, Inc. (Holdings), was incorporated to engage in for-profit activities. Holdings' main activity is operating a retail pharmacy on the hospital campus.

Southwest Community Health Foundation – Southwest Community Health Foundation (the Foundation) is a not-for-profit corporation that was organized to develop and operate fund-raising activities, capital-giving programs, deferred-giving programs, and to support community health care projects.

The consolidated financial statements include the accounts of the Health Center (the Obligated Group) and the Foundation (the Non-Obligated Group), which has no liability under the Master Trust Indenture amended and restated as of December 1, 2012, between the Health Center and the Huntington National Bank, as Trustee. All significant intercompany accounts and transactions are eliminated upon consolidation.

A summary of significant accounting policies of the System follows:

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

1. Summary of Affiliations and Accounting Policies (continued)

Concentration of Credit Risk – The Health Center provides patient care services primarily to residents of Cuyahoga and Medina counties, Ohio. Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of patients and payors. Patient accounts receivable consist of amounts due from government programs, commercial insurance companies, private pay patients, and other insurance programs. Medicare and Medicaid represented approximately 32% and 6%, respectively, at December 31, 2016, and 39% and 6%, respectively, at December 31, 2015, of patient accounts receivable. One commercial payor represented approximately 15% of patient accounts receivable at both December 31, 2016 and 2015. Excluding these payors, no one payor source represents more than 10% of patient accounts receivable at December 31, 2016 and 2015.

Net Patient Service Revenue – Net patient service revenue is stated at the estimated net realizable amounts from patients, third-party payors and others, including retroactive adjustments under reimbursement agreements with third-party payors. The Health Center has agreements with certain third-party payors that provide for payments to the Health Center at amounts different from its established rates.

The Health Center is paid a prospectively determined rate for the majority of inpatient acute care, transitional care, and certain outpatient services provided. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Provision for estimated retroactive adjustments, if any, resulting from changes in diagnostic related group (DRG) assignment, regulatory matters, or other retroactive adjustments under reimbursement agreements are accrued on an estimated basis in the period the related services are provided. Any changes in these estimated amounts are recorded in operations as final settlements are determined. There were no changes in estimated final third-party settlements in 2016 and 2015.

Certain other Medicare and Medicaid outpatient services are reimbursed at established fee schedules. The Health Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Health Center and audits thereof by the Medicare and Medicaid Administrative Contractors.

1. Summary of Affiliations and Accounting Policies (continued)

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Health Center believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Health Center also enters into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payments to the Health Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided.

For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts as determined by the System. An estimated provision for bad debts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The System has determined, based on an assessment at the consolidated level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for bad debts related to patient service revenue is recorded as a deduction from patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

1. Summary of Affiliations and Accounting Policies (continued)

Bad Debt – The Health Center maintains an allowance for bad debts based on the expected collectibility of patient accounts receivable. The allowance for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverages, and other collection indicators. Periodically through the year, management assesses the adequacy of the allowance for bad debts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for bad debts to establish an appropriate allowance for the uncollectible receivables. After satisfaction of amounts due from insurance, the Health Center follows established guidelines for placing certain past due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the Health Center.

Electronic Health Record Incentive Program – The Center for Medicare and Medicaid Services (CMS) implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The System utilizes a grant accounting model to recognize EHR incentive revenue. The System records EHR incentive revenue when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The System met the meaningful use objectives beginning in 2012. The System recorded EHR incentive revenue of $0 and $750 from Medicare for 2016 and 2015, respectively. The EHR incentive revenues are included in other unrestricted revenue in the consolidated statements of operations and changes in net assets.

1. Summary of Affiliations and Accounting Policies (continued)

Charity Care and Community Benefit – The Health Center treats all patients requiring hospital care regardless of their ability to pay. The Health Center provides care to patients who meet certain criteria under its charity care assistance policy without charge or at amounts less than its established rates. Because the Health Center does not pursue collection of amounts determined to qualify for charity care, they are not reported as revenue. The cost of charity care provided in 2016 and 2015 approximated $1,259 and $1,261, respectively. The Health Center estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. In addition to providing direct charity care to patients in furtherance of its exempt purpose to benefit the community, the Health Center operates an Emergency Trauma Center 24 hours a day; operates a free clinic for the working uninsured; provides various community screenings for detection of disease and to promote health and wellness; and operates a community outreach program to bring health care services and support to homes. In addition, the Health Center has a second emergency department in Brunswick, Ohio that is open 24 hours a day.

Cash and Cash Equivalents – The System considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, excluding investments held by Board designation or other arrangements.

Inventories – Inventories (primarily supplies and pharmaceuticals) are stated at the lower of cost, determined on the first-in, first-out method, or net realizable value.

Investments and Investment Income – Investments in equity securities and mutual funds with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investment income or loss (including realized gains and losses on investments determined by the average cost method, other-than-temporary losses on other-than-trading investments due to declines in investment market values, interest, and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law. Changes in the unrealized gains and losses on investments which are classified as other-than-trading are excluded from the excess of revenue over expenses.

1. Summary of Affiliations and Accounting Policies (continued)

The System reviews other-than-trading investments for impairment conditions that indicate that an other-than-temporary decline in market value has occurred and an unrealized investment loss should be recognized. In conducting this review, various factors are considered, which individually or in combination, indicate that a decline is other-than-temporary. These factors include specific information pertaining to an individual company or a particular industry, general market conditions that reflect prospects for the economy as a whole, the recommendations of advisors, the length of time and extent to which the market value has been less than cost and the intent and ability of management to hold such investments until value has returned. There were no losses recorded for other-than-temporary decline in the value of investments in 2016 and 2015.

As part of its investment portfolio, the System has an approximate 3.28% and 2.95% ownership interest at December 31, 2016 and 2015, respectively, in a limited partnership (LP) that invests in publicly traded equities with readily determinable values. The System's investment in the LP is $6,669 and $5,540 at December 31, 2016 and 2015, respectively, and is included in board-designated assets in the consolidated balance sheets. The System accounts for its investment in the LP using the equity method of accounting based on net asset value information provided by the partnership and has recorded its share of the LP's net gain (loss) of $1,129 and $($382) in 2016 and 2015, respectively, in investment income.

Fair Value Measurement – Fair value measurements are defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The framework for measuring fair value is comprised of a three-level valuation hierarchy based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

1. Summary of Affiliations and Accounting Policies (continued)

- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Property, Plant, and Equipment – Property, plant, and equipment are recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets which range from 3 to 40 years. Depreciation on the Health Center's medical office buildings of $837 in 2016 and $943 in 2015, is classified as a component of nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Leased equipment is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment.

Unamortized Financing Costs – Unamortized financing costs include debt issuance costs on long-term obligations, which are being amortized over the life of the respective debt using the bonds outstanding method.

Excess of Revenue Over Expenses – The consolidated statements of operations and changes in net assets include excess of revenue over expenses, which is the System's performance indicator. Changes in unrestricted net assets which are excluded from the excess of revenue over expenses, consistent with industry practice, include change in unrealized gains and losses on other-than-trading investments, certain pension adjustments, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Derivative Instruments – The System recognizes all derivative instruments in the financial statements at fair value. The System participates in interest rate swap contracts that are considered derivative financial instruments. The interest rate swap contracts are not designated as hedges. Changes in fair value of the derivative financial instruments are recognized in the consolidated statements of operations and changes in net assets as a component of investment income.

1. Summary of Affiliations and Accounting Policies (continued)

Temporarily Restricted Net Assets – Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the System. Temporarily restricted gifts, grants, and bequests are recorded as an addition to temporarily restricted net assets in the period received, less related allowances provided for uncollectible amounts. Resources restricted by donors or grantors for specific operating purposes are reported in unrestricted revenue to the extent expended within the period. Temporarily restricted net assets are primarily restricted for health care programs, capital expenditures, research and education, and community benefit programs.

Permanently Restricted Net Assets – Permanently restricted net assets are held in perpetuity, as restricted by donors and are restricted for health care programs.

Donations Other Than Cash – Donated supplies, securities, and equipment are recorded at fair market value at the date of donation. No amounts have been reflected in the consolidated financial statements for donated services. The System pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the System with various programs.

Nonoperating Gains (Losses), Net – Gains and losses not directly related to the ongoing operations of the System are reported as nonoperating. Other net nonoperating gains (losses) are summarized as follows:

	Year Ended December 31	
	2016	**2015**
Medical office buildings, net of rental revenue of $1,523 in 2016 and $1,480 in 2015	**$ (1,778)**	$ (2,215)
Payments to counterparty on swap agreements	**(354)**	(337)
Community outreach services	**(474)**	(536)
	$ (2,606)	$ (3,088)

1. Summary of Affiliations and Accounting Policies (continued)

Recent Accounting Pronouncements – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and requires significantly expanded disclosures about revenue recognition. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchanges for those goods or services. The guidance is effective for the System as of January 1, 2018. The System is currently evaluating the impact on the consolidated financial statements and the options of adopting using either a full retrospective or a modified approach.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which requires an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. This update is effective for annual periods ending after December 15, 2016. The System adopted ASU 2014-15 in 2016. The adoption of this standard had no impact on the consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Imputation of Interest, Simplifying the Presentation of Debt Issuance Costs*. This ASU requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability, consistent with the presentation of a debt discount. This amends current guidance that requires debt issuance costs to be presented as assets on the balance sheet. ASU 2015-03 is effective for the System for reporting periods beginning after December 15, 2015. The System adopted the provisions of ASU 2015-03 on January 1, 2016 and retrospectively adjusted all periods presented in the consolidated financial statements. The System has $1,385 and $1,465 at December 31, 2016 and 2015, respectively, that have been reclassified under the new guidance.

1. Summary of Affiliations and Accounting Policies (continued)

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU eliminates the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share as a practical expedient. Disclosures about investments in certain entities that calculate net asset value per share are limited under ASU 2015-07 to those investments for which the entity has elected to estimate the fair value using the net asset value practical expedient. The System has commingled equity funds and hedge funds that are valued using net asset value per share as a practical expedient. The System adopted the provisions of ASU 2015-07 for the year ended December 31, 2016 and retrospectively adjusted all periods presented in the consolidated financial statements. As a result of the adoption, commingled investment funds and hedge funds that are valued using net asset value as a practical expedient are no longer reported in the table measuring financial instruments at fair value on a recurring basis in Note 4, *Fair Value*, and Note 10, *Retirement Plan*. The adoption of ASU 2015-07 had no impact on previously reported excess of revenue over expenses or net assets.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU requires lessees to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. This amends current guidance that requires only capital leases to be recognized on the lessee balance sheet. ASU 2016-02 will also require additional disclosures on the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective for the System for reporting periods beginning after December 15, 2018 with early adoption permitted. The System is currently evaluating the impact that ASU 2016-02 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

1. Summary of Affiliations and Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statement of Not-for-Profit Entities*. Under the provisions of ASU 2016-14, not-for-profit entities will no longer be required to distinguish between resources with temporary and permanent restrictions on the face of their financial statements, meaning net assets will be presented in two classes instead of three. Not-for-profit entities will be required to present expenses by their natural and functional classification and present investment returns net of external and direct internal investment expenses. Not-for-profit entities also will be required to provide more information about their available resources and liquidity. The guidance is effective for the System for reporting periods beginning after December 15, 2017 with early adoption permitted. The System is currently evaluating the impact that ASU 2016-14 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. ASU 2017-07 is effective for the System for annual reporting periods beginning after December 15, 2018 and interim periods within annual reporting periods after December 15, 2019 with early adoption permitted in the first quarter of 2017. Upon adoption, the System is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements, except for the guidance limiting the capitalization of net periodic benefit costs in assets which is required to be applied prospectively. The System will adopt the provisions of ASU 2017-07 in the first quarter of 2017. The impact of adopting ASU 2017-17 for the System when applied retrospectively to the year ended December 31, 2016 will decrease salaries, wages and benefits expense on the consolidated statement of operations as presented herein by $1,969, with a corresponding increase to operating income and increase to net nonoperating losses. As a result, for the year ended December 31, 2016 operating income will be $16,328 and total nonoperating losses, net will be ($3,112) upon retrospective adoption of ASU 2017-07. The adoption of ASU 2017-07 will have no impact on excess of revenue over expenses or net assets.

2. Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for bad debts by major payor source for the years ended December 31, 2016 and 2015, are as follows:

	2016		2015	
Medicare	**$ 132,654**	**37%**	$ 121,442	36%
Medicaid	**23,615**	**7**	18,559	6
Managed care and commercial	**191,812**	**54**	177,700	53
Self-pay	**5,383**	**2**	17,422	5
	$ 353,464	**100%**	$ 335,123	100%

For patient accounts receivable associated with self-pay patients, including patients with deductible and copayment balances for which third-party coverage provides for a portion of the services provided, the System records an estimated provision for bad debts in the year of service. The allowance for bad debts for self-pay patients as a percentage of self-pay accounts receivable increased from 65% at December 31, 2015 to 83% at December 31, 2016. Self-pay write-offs were $5,394 in 2016 and $11,301 in 2015. Although the allowance for bad debts for self-pay patients as a percentage of self-pay accounts receivable increased from December 31, 2015 to December 31, 2016, write-offs decreased due to a change in the timing of processing write-offs when self-pay balances are placed with collections agencies. The System does not maintain a material allowance for bad debts from third-party payors.

3. Investments

The composition of investments at December 31 was as follows:

	2016	2015
Investments:		
Cash	**$ 8,894**	$ 9,844
Money market funds	**5,581**	4,914
Fixed income securities:		
U.S. treasuries	**–**	1,001
U.S. government agencies	**34,613**	23,841
U.S. corporate	**23,995**	23,963
Commercial paper	**–**	9,000
Common stocks:		
U.S.	**7,844**	6,990
Mutual funds:		
Fixed income	**39,840**	54,400
Equity	**65,706**	51,139
Commingled funds	**7,908**	8,004
Limited partnership	**6,669**	5,540
Total investments	**$ 201,050**	$ 198,636

Total investment return is comprised of the following for the years ended December 31:

	2016	2015
Nonoperating gains (losses):		
Interest income and dividends	**$ 3,850**	$ 6,080
Net realized (losses) gains on sales of investments	**(4,494)**	882
Equity method investment income (loss)	**1,633**	(199)
Change in unrealized gains on trading investments	**(382)**	(1,006)
Derivative gain	**67**	453
Total investment income	**674**	6,210
Other changes in net assets:		
Net change in unrealized gains on other-than-trading investments and restricted investment income	**6,697**	(9,469)
Total investment return	**$ 7,371**	$ (3,259)

3. Investments (continued)

With the exception of certain board-designated mutual funds, all investments are managed by professional asset managers. Because the asset managers have discretion to buy and sell individual securities, these investments are accounted for as trading securities. Investments not managed by professional asset managers are controlled by the System and are accounted for as other-than-trading. Net unrealized gains on other-than-trading investments (34 funds with a fair value of $110,011) were $8,611 at December 31, 2016. Net unrealized gains on other-than-trading investments (33 funds with a fair value of $109,949) were $1,914 at December 31, 2015.

4. Fair Value

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable are reasonable estimates of fair value due to the short-term nature of these financial instruments. Investments, other than the limited partnership investment, are recorded at their fair value. At December 31, 2016 and 2015, the fair value of the System's long-term debt as estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for credit was $166,045 and $170,401, respectively (see Note 8). Long-term debt would be classified as Level 2 in the fair value hierarchy. Other noncurrent assets and liabilities have carrying values that approximate fair value.

4. Fair Value (continued)

The following tables present the financial instruments carried at fair value on a recurring basis at December 31 by valuation hierarchy:

	2016		
	Level 1	**Level 2**	**Total**
Assets			
Investments:			
Cash	**$ 8,894**	**$ –**	**$ 8,894**
Money market funds	**–**	**5,581**	**5,581**
Fixed income securities:			
U.S. government agencies	**–**	**34,613**	**34,613**
U.S. corporate	**–**	**23,995**	**23,995**
Common stocks:			
U.S.	**7,844**	**–**	**7,844**
Mutual funds:			
Fixed income	**39,840**	**–**	**39,840**
Equity	**65,706**	**–**	**65,706**
Total assets at fair value	**$ 122,284**	**$ 64,189**	**$ 186,473**
Liabilities			
Interest rate swap	**$ –**	**$ 3,109**	**$ 3,109**
Total liabilities at fair value	**$ –**	**$ 3,109**	**$ 3,109**

4. Fair Value (continued)

	2015		
	Level 1	**Level 2**	**Total**
Assets			
Investments:			
Cash	$ 9,844	$ –	$ 9,844
Money market funds	–	4,914	4,914
Fixed income securities:			
U.S. treasuries	1,001	–	1,001
U.S. government agencies	–	23,841	23,841
U.S. corporate	–	23,963	23,963
Commercial paper	–	9,000	9,000
Common stocks:			
U.S.	6,990	–	6,990
Mutual funds:			
Fixed income	54,400	–	54,400
Equity	51,139	–	51,139
Total assets at fair value	$ 123,374	$ 61,718	$ 185,092
Liabilities			
Interest rate swap	$ –	$ 3,176	$ 3,176
Total liabilities at fair value	$ –	$ 3,176	$ 3,176

Financial instruments at December 31 are reflected in the consolidated balance sheets as follows:

	2016	**2015**
Investments measured at fair value	**$ 186,473**	$ 185,092
Commingled funds measured at net asset value	**7,908**	8,004
Limited partnership investment accounted for under the equity method	**6,669**	5,540
Total investments	**$ 201,050**	$ 198,636

4. Fair Value (continued)

The following is a description of the System's valuation methodologies for assets and liabilities measured at fair value:

Fair value for Level 1 is based upon quoted market prices.

Fair value for Level 2 U.S. government agencies and U.S. corporate securities are valued on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. Fair value for Level 2 money market funds and commercial paper are valued using broker quotes that utilize observable market inputs.

The fair values of interest rate swaps were determined based on the present value of future cash flows using discount rates appropriate with the risks involved and adjusted for credit. The valuations include a credit spread adjustment to market interest rate curves to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market.

The System held no assets or liabilities at fair value which would be subject to Level 3 measurements as of December 31, 2016 or 2015.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

5. Property, Plant, and Equipment

Property, plant, and equipment at December 31 consist of the following:

	2016	2015
Land and land improvements	**$ 15,345**	$ 15,727
Buildings and fixed equipment	**309,590**	295,835
Movable equipment	**151,709**	141,089
Construction in progress	**6,374**	14,417
	483,018	467,068
Accumulated depreciation	**282,826**	261,767
	$ 200,192	$ 205,301

6. Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets at December 31 are available for the following purposes:

	2016	2015
Health care programs	**$ 221**	$ 297
Capital expenditures	**3,069**	5,790
Research and education	**241**	267
Other	**747**	765
	$ 4,278	$ 7,119

7. Partnering Agreement With University Hospitals Health System, Inc.

Effective July 1, 1997, the System (excluding the Foundation) entered into a Partnering Agreement (the Partnering Agreement) with University Hospitals Health System, Inc. (UHHS). UHHS owns and operates a large integrated delivery system. Under a five-year Partnering Agreement, UHHS brought the Rainbow Babies and Children, MacDonald Women's and Seidman Cancer programs (UHHS Programs) to the Health Center's facilities. Upon the closing of the Partnering Agreement in 1997, UHHS transferred $20 million of unrestricted funds to the Health Center. At the end of the initial five-year term, the Partnering Agreement was automatically extended for an additional ten-year term. Under the Partnering Agreement, UHHS obtained 50% representation on the Health Center's Board of Directors, and the System obtained two seats on UHHS's Board of Directors. If at such time the System (excluding the Foundation) votes to merge with UHHS, an additional $20 million, as adjusted (Additional Commitment Amount), shall be transferred to the System even if the community delegates reject the merger recommendation. Effective January 1, 2011, the System's Partnering Agreement with UHHS was renewed for an additional ten years. At the end of the ten-year renewal term, 2020, UHHS or the System may terminate the Partnering Agreement. Upon termination of the Partnering Agreement, the System is required to return all funds transferred by UHHS or provide certain assets of equal value, pay any outstanding drawable credited earnings, and cease using the names associated with the UHHS Programs.

On an annual basis, UHHS shares 50% of the annual net income or loss of the Health Center (exclusive of tax levy receipts), one-half of which is immediately due and payable. The remaining one-half of earnings is credited against (losses added to) the Additional Commitment Amount. The Additional Commitment Amount bears interest at a rate of 6% per annum, compounded annually. The Additional Commitment Amount at December 31 is as follows:

	2016	**2015**
Balance, beginning of year	**$ 6,762**	$ 9,279
Interest	**406**	556
Credited earnings	**(3,026)**	(3,073)
Balance, end of year	**$ 4,142**	$ 6,762

Drawable credited earnings due to UHHS were $3,026 and $3,073 at December 31, 2016 and 2015, respectively.

8. Debt

A summary of long-term debt at December 31, is as follows:

	Type	2016	2015
Series 2012A revenue bonds	Fixed	**$ 51,690**	$ 52,355
Series 2012B revenue bonds	Variable	**12,450**	13,409
Series 2012C revenue bonds	Variable	**16,015**	16,449
Series 2012D revenue bonds	Variable	**7,605**	7,605
Series 2012E revenue bonds	Variable	**7,240**	7,240
Series 2011 revenue bonds	Fixed	**62,635**	62,870
Notes payable and capital leases		**2,497**	2,933
		160,132	162,861
Less:			
Unamortized premium		**(1,172)**	(1,224)
Unamortized debt issuance costs		**1,385**	1,465
Current portion		**2,826**	2,748
		$ 157,093	$ 159,872

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued $54,355 of Hospital Facilities Revenue and Refunding Bonds, Series 2012A (Series 2012A Bonds). The Series 2012A Bonds are payable from the general revenue of the Health Center. A portion of the proceeds from the issuance of the Series 2012A Bonds were used to reimburse the Health Center for prior capital expenditures. The remaining portion of the proceeds from the sale of the Series 2012A Bonds were used to partially fund the second phase of the master facility project to build a private-room patient bed tower. The Series 2012A Bonds bear fixed interest rates which will average 4.47% and have a final maturity of 2047.

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued $16,282 of Series 2012B Bonds. The Series 2012B Bonds are payable from the general revenue of the Health Center. The private placement bonds were purchased by a bank. The proceeds from the issuance of the Series 2012B Bonds were used to extinguish the outstanding variable rate Series 2009 Bonds. The Series 2012B Bonds bear variable interest rates based upon LIBOR and have interest payments due semiannually and principal payments due annually. At December 31, 2016, the interest rate was 1.19%. The Series 2012B Bonds have a final maturity of 2028.

8. Debt (continued)

In November 2012, the Health Center through the City of Middleburg Heights, Ohio, issued $16,878 of Series 2012C Bonds. The Series 2012C Bonds are payable from the general revenue of the Health Center. The private placement bonds were purchased by a bank. The proceeds from the issuance of the Series 2012C Bonds will be used to partially fund the second phase of the master facility project to build a private-room patient bed tower. The Series 2012C Bonds bear variable interest rates based upon LIBOR. At December 31, 2016, the interest rate was 1.28%. The Bonds include a Disbursement Agreement that allows for the Health Center to draw on the funds as needed at future dates. As of December 31, 2016, $16,878 has been drawn on the Series 2012C Bonds.

In November 2012, the Health Center through the County of Medina, Ohio, executed $7,605 of Series 2012D Bonds and $7,240 of Series 2012E Bonds to refinance the Variable Rate Demand Revenue Bonds, Series 2007A (Series 2007A Bonds) and of Variable Rate Demand Taxable Revenue Bonds, Series 2007B (Series 2007B Bonds) which were used to finance construction of the Brunswick Medical Center. The Series 2012D Bonds and the Series 2012E Bonds are payable from the general revenue of the Health Center as were the Series 2007A Bonds and the Series 2007B Bonds. The private placement bonds were purchased by a national bank. The Series 2012D Bonds and Series 2012E Bonds bear variable interest rates that are based on LIBOR. The Series 2012D and Series 2012E Bonds have a semiannual interest payment schedule and an annual principal payment schedule. The 15 annual principal payments commence August 1, 2023. At December 31, 2016, the interest rates for the Series 2012D and Series 2012E Bonds were 1.23% and 1.55%, respectively.

In December 2011, the Health Center through the City of Middleburg Heights, Ohio, issued $63,045 of Hospital Facilities Revenue and Refunding Bonds, Series 2011 (Series 2011 Bonds) to advance refund the Health Center's Series 1995 Bonds. The Series 2011 Bonds are payable from the general revenue of the Health Center. A portion of the proceeds from the sale of the Series 2011 Bonds were used to refund the outstanding fixed-rate Series 1995 Bonds. The remaining portion of the proceeds from the sale of the Series 2011 Bonds were used to fund the facility project to expand the emergency department and critical care unit. The Series 2011 Bonds bear fixed interest rates which will average 5.19% and have a final maturity of 2041.

8. Debt (continued)

The System is subject to certain restrictive covenants, including provisions relating to maintaining certain debt ratios and other matters. The System is in compliance with debt covenants at December 31, 2016.

Combined current aggregate maturities of bonds payable and capital leases, the Series 2012A, 2012B, 2012C, 2012D, 2012E, and the Series 2011 Bonds for five years subsequent to December 31, 2016, are as follows: 2017 – $2,826; 2018 – $2,860; 2019 – $2,949; 2020 – $3,031; 2021 – $3,227.

The System paid interest of $6,037 in 2016 and $5,918 in 2015.

In March 2013, the System executed a bank agreement for a $7,000 line of credit. There have not been any draws on the line of credit and the amount due under the line of credit is $0 at December 31, 2016 and 2015.

9. Interest Rate Swap

The System utilizes interest rate swaps to manage the overall cost of debt and risk profile related to its long-term debt. The swaps utilized include (i) fixed payor swaps, whereby the System receives a floating rate and pays a fixed rate to either hedge against rising interest rates or achieve a lower overall cost of debt relative to traditional fixed-rate structures and (ii) basis swaps whereby the System receives a floating rate based on a taxable index (LIBOR) and pays a floating rate based on a tax-exempt index (SIFMA) designed to reduce interest costs associated with its traditional fixed rate debt. The fair value of all interest rate swap agreements is determined by relevant factors such as dealer price quotations and valuation pricing models. As of December 31, 2016 and 2015, the pledged collateral posted against the swap liability as required by the swap agreements was $0. The swap agreements are not designated as hedging instruments.

9. Interest Rate Swap (continued)

The following table summarizes the System's interest rate swap agreements:

Swap Type	Expiration Date	System Pays	System Receives	Notional Amount at December 31, 2016	Notional Amount at December 31, 2015
Fixed-payor	2037	3.49%	70% of LIBOR	**$ 7,605**	$ 7,605
Fixed-payor	2037	4.925%	100% of LIBOR	**7,240**	7,240
Fixed spread basis	2041	SIFMA index	67% of LIBOR +.72596%	**31,318**	31,435
				$ 46,163	$ 46,280

The following table summarizes the location and fair value for the System's interest rate swap agreements:

	Derivatives Liability			
	December 31, 2016		December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments				
Interest rate swap agreements	Other long-term liabilities	**$ (4,063)**	Other long-term liabilities	$ (4,516)
	Other assets	**954**	Other assets	1,340

The following table summarizes the location and amounts of cash settlements and changes in fair value on the System's interest rate swap agreements:

	Location of Gain (Loss) Recognized	Year Ended December 31 2016	2015
Derivatives not designated as hedging instruments			
Payments to counterparty	Other net nonoperating gains (losses)	**$ (354)**	$ (337)
Changes in fair value	Investment income (loss)	**67**	453

10. Retirement Plan

The System has a noncontributory defined benefit retirement plan covering substantially all System employees. Benefits for employees are based on a percentage of annual compensation and years of service. The System's funding policy is to contribute amounts sufficient to provide for future benefits and to meet minimum Employee Retirement Income Security Act of 1974 (ERISA) funding requirements.

For year-end 2016, the System adopted a change in the method it will use to estimate the interest cost component of net periodic benefit cost for its defined benefit pension plan. Historically, the interest cost component was estimated using a single weighted-average discount rate derived from the yield curve used to measure the benefit obligation at the beginning of the period. Beginning in 2017, the System will use a spot rate approach by applying the specific spot rates along the yield curve to the relevant projected cash flows in the estimation of the interest components of benefit cost, resulting in a more precise measurement. This change does not affect the measurement of total benefit obligations. The change will be accounted for as a change in estimate that is inseparable from change in accounting principle and, accordingly, will be accounted for prospectively starting in 2017. The spot rates used to determine interest costs ranged from 1.27% to 4.49% for the plan. The reductions in interest costs for 2017 associated with this change in estimate are expected to be approximately $1,000. The defined benefit retirement plan was completely frozen as of December 31, 2015 and will no longer provide any future benefit accruals and will therefore not have a service cost component as part of the net periodic benefit cost.

Included in unrestricted net assets are unrecognized actuarial losses that have not yet been recognized in net periodic benefit cost of $75,651 and $67,721 at December 31, 2016 and 2015, respectively. The actuarial loss expected to be recognized during the year ending December 31, 2017 is $2,457.

Changes in plan assets and benefit obligations recognized in unrestricted net assets during December 31 included:

	2016	**2015**
Changes recognized in unrestricted net assets:		
Current year actuarial gain (loss)	**$ 10,019**	$ (9,403)
Amortization of actuarial loss	**(2,089)**	5,148
Amortization of prior service credit	**–**	(1,708)
Special event prior service cost curtailment	**–**	(7,511)
Special event loss settlement	**–**	7,424
Total	**$ 7,930**	$ (6,050)

10. Retirement Plan (continued)

A summary of the changes in the benefit obligation and plan assets and the resulting funded status of the pension plan are as follows:

	December 31	
	2016	**2015**
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 154,815**	$ 166,588
Service cost	**–**	3,203
Interest cost	**6,823**	6,921
Actuarial losses	**4,346**	535
Benefits paid	**(5,942)**	(2,887)
Settlements	**–**	(19,545)
Benefit obligation at end of year	**160,042**	154,815
Change in plan assets:		
Fair value of plan assets at beginning of year	**99,193**	117,250
Actual return on plan assets	**1,271**	(3,198)
Employer contributions	**12,100**	5,000
Benefits paid	**(5,942)**	(2,887)
Settlements	**–**	(16,972)
Fair value of plan assets at end of year	**106,622**	99,193
Underfunded status of the plan	**(53,420)**	(55,622)
Accrued retirement benefits	**$ (53,420)**	$ (55,622)
Accumulated benefit obligation	**$ 160,042**	$ 154,815

Effective January 1, 2015, the plan benefit formula changed from a final average compensation formula to a cash balance for participants whose age plus years of service are 75 or more as of January 1, 2009 (grandfathered group). The grandfathered group employees' final averages compensation benefit was frozen at December 31, 2014, with the cash balance formula starting January 1, 2015.

10. Retirement Plan (continued)

As of December 31, 2015, the plan was completely frozen (i.e., no future cash balance compensation credits will be provided to participants). As a result, a curtailment credit of $7,511 was recognized as of December 31, 2015, and represents acceleration of the net prior service credit as of that date.

In 2015, approximately 500 deferred vested participants elected to receive their full benefit as a lump sum. Elections for eligible participants expired in 2015 and all of the distributions occurred prior to the end of 2015. As a result of this transaction, along with additional lump-sum payments made in 2015 according to plan terms, the System recorded a decrease of $19.5 million to the benefit obligation and a settlement charge of $7,424 for the year ended December 31, 2015, which is recorded in salaries, wages, and benefits in the accompanying consolidated statement of operations and changes in net assets.

	Year Ended December 31	
	2016	**2015**
Components of net periodic benefit cost:		
Service cost	**$ –**	$ 3,203
Interest cost	**6,823**	6,921
Expected return on assets	**(6,942)**	(8,242)
Amortization of prior service credit	**–**	(1,708)
Amortization of net actuarial loss	**2,088**	5,148
Curtailments	**–**	(7,511)
Settlements	**–**	7,424
	$ 1,969	$ 5,235

	December 31	
	2016	**2015**
Weighted-average assumptions used to determine the benefit obligation at year-end:		
Discount rate	**4.16%**	4.50%
Expected return on plan assets	**6.25**	7.00
Rate of compensation increase	**N/A**	3.00

10. Retirement Plan (continued)

	December 31	
	2016	**2015**
Weighted-average assumptions used to determine net periodic benefit cost for the year ended:		
Discount rate	**4.50%**	4.15%
Expected return on plan assets	**6.25**	7.00
Rate of compensation increase	**N/A**	3.00

Plan assets by investment category are as follows:

	December 31	
	2016	**2015**
Cash and cash equivalents	**1%**	2%
Equity investments	**53**	55
Fixed income investments	**34**	27
Alternative investments	**12**	16
	100%	100%

The plan's investment strategy is long-term oriented, which the plan manages through a target investment allocation. Plan assets are selected by various professional asset managers following System investment guidelines. The plan's investment guidelines target allocation ranges of the investment pool to various asset classes including equity investments (40% to 70% target), fixed income investments (20% to 40% target), alternative investments (5% to 25% target) and cash and cash equivalents (0% target) and are designed to diversify the portfolio in a way that achieves an efficient trade-off between long-term return and risk while providing adequate liquidity to meet near-term expenses and obligations. The plan's expected long-term rate of return is determined based upon its historical returns as well as expected future returns based upon targeted long-term returns of 9% to 11% for equity securities and 3% to 5% for debt securities. The System expects to contribute approximately $5,000 to the plan in 2017.

Future expected benefits payments during the years ending December 31 are as follows: 2017 – $5,657; 2018 – $6,213; 2019 – $6,951; 2020 – $7,344; 2021 – $7,789; and 2022 through 2026 – $44,936.

10. Retirement Plan (continued)

The following tables present the financial instruments in the defined benefit pension as of December 31, 2016 and 2015, measured at fair value on a recurring basis based on the fair value hierarchy:

	December 31, 2016		
	Level 1	**Level 2**	**Total**
Assets			
Cash and investments:			
Money market funds	**$ –**	**$ 2,215**	**$ 2,215**
Fixed income securities:			
U.S. treasuries	**487**	**–**	**487**
U.S. government agencies	**–**	**18,258**	**18,258**
U.S. corporate	**–**	**17,230**	**17,230**
Common stocks:			
U.S.	**5,062**	**–**	**5,062**
Mutual funds:			
Equity	**41,471**	**–**	**41,471**
Total assets at fair value	**$ 47,020**	**$ 37,703**	**$ 84,723**

10. Retirement Plan (continued)

	December 31, 2015		
	Level 1	**Level 2**	**Total**
Assets			
Cash and investments:			
Money market funds	$ –	$ 1,572	$ 1,572
Fixed income securities:			
U.S. treasuries	735	–	735
U.S. government agencies	–	10,668	10,668
U.S. corporate	–	13,578	13,578
Common stocks:			
U.S.	4,547	–	4,547
Mutual funds:			
Fixed income	2,368	–	2,368
Equity	39,677	–	39,677
Total assets at fair value	$ 47,327	$ 25,818	$ 73,145

Total plan assets in the defined benefit pension as of December 31, 2016 and 2015 are comprised of the following:

	2016	**2015**
Investments measured at fair value	**$ 84,723**	$ 73,145
Commingled funds measured at net asset value	**9,291**	10,257
Alternative investments measured at net asset value	**12,608**	15,791
Total investments	**$ 106,622**	$ 99,193

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 4.

10. Retirement Plan (continued)

Fixed income securities include debt obligations of the U.S. government and various agencies, U.S. corporations and other fixed income instruments such as mortgage-backed and asset-backed securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined fixed income indexes such as the Barclays Capital U.S. Aggregate Index.

Equity securities include investments of publicly traded common stocks of U.S. corporations, the majority of which represent actively traded and liquid securities that are traded on many of the world's major exchanges and include large-, mid-, and small-capitalization securities. The composition of these securities represent an expected return and risk profile that is commensurate with broadly defined equity indexes such as the Russell 1000 Index, the Russell 2500 Index and the Morgan Stanley Capital International (MSCI) EAFE (Europe, Australasia, Far East) Index.

Alternative investments include hedge funds that are meant to provide equity-like returns with fixed-income-like levels of risk. Included in this category are investments that are diversified across various strategies and may consist of long/short equity funds and other opportunistic funds. The underlying investments in such funds may include publicly traded and privately held equity and debt instruments issued by U.S. and international corporations as well as various derivatives based on these securities. No significant redemption restrictions or remaining investment commitments apply to the System's investments in these funds; however, the Fund Manager would evaluate such features or restrictions, as applicable, to estimate fair value.

The System offers a defined contribution plan. Under the plan, employees voluntarily contribute a percentage of their annual salary. In 2016 and 2015, the System matched 50% of the employee's contributions up to an additional 6% of the employee's annual salary. Benefit expense in connection with the defined contribution plan was $2,206 in 2016 and $2,088 in 2015.

11. Self-Insurance

Prior to August 1, 2011, the System provided coverage for professional liability, general liability and workers' compensation through a combination of self-insured retentions and commercial insurance policies. Effective August 1, 2011, the System entered into a participation agreement with Western Reserve Assurance Co., Ltd., an offshore captive insurance company (Western Reserve) which is a wholly owned subsidiary of UHHS. The System consolidates the assets and liabilities held in its segregated portfolio operated by Western Reserve on the System's behalf. Segregated portfolios, by law, do not have access or rights to the assets of any other segregated portfolio operated by Western Reserve. The participation agreement with Western Reserve provides for primary professional liability and primary general liability insurance coverage on a claims-made basis for substantially all of the System. The System purchases commercial insurance policies for automobile liability; heliport operations liability; commercial property liability; and excess workers' compensation. Western Reserve provides excess liability for the above risks through reinsurance agreements in place with unrelated commercial insurance companies. The System has stop-loss insurance for workers' compensation and employee health care claims.

Assets have been placed in trust funds for the payment of the Health Center's professional liability claims, expenses, and settlements based on actuarial funding recommendations. The provision for estimated self-insured professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. Liability claims have been asserted that are in various stages of processing or are in litigation and are discounted at a rate of 0% for 2016 and 2015. There may also be incurred but unreported incidents, which may result in the assertion of additional claims. The System's recorded reserve for professional liability, including both the Health Center and Southwest General Medical Group, was $15,790 and $18,387 at December 31, 2016 and 2015, respectively, and is included in other accrued liabilities and other liabilities on the consolidated balance sheets. The System's recorded reserve for workers' compensation claims was $699 and $779 at December 31, 2016 and 2015, respectively, and is included in other accrued liabilities and other liabilities on the consolidated balance sheets. The System's recorded reserve for employee health care was $1,476 and $1,574 at December 31, 2016 and 2015, respectively, and is included in other accrued liabilities on the consolidated balance sheets.

12. Commitments

The System leases certain office space and equipment, which are accounted for as operating leases.

Rental expense, including items rented on a month-to-month basis, under operating leases was $3,011 in 2016 and $1,851 in 2015. Future minimum rental payments under noncancelable operating leases are as follows: 2017 – $2,179; 2018 – $2,218; 2019 – $2,084; 2020 – $678; and 2021 – $692.

Total minimum lease rentals, exclusive of System occupied space in System-owned medical office buildings, to be received under current noncancelable leases as of December 31, 2016, are $767 in 2017, $409 in 2018, $212 in 2019 and insignificant thereafter. Rental revenue of $1,523 in 2016 and $1,480 in 2015 is included in other net nonoperating gains (losses).

13. Income Taxes

The System has been granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and therefore is not subject to federal income taxes on related income. Management is not aware of any situation that would have an adverse impact on the System's tax-exempt status.

14. Functional Expenses

The System provides general health care services to patients within its geographic location. Functional expenses related to providing these services are as follows:

	Year Ended December 31	
	2016	**2015**
Health care services	**$ 275,327**	$ 267,664
General and administrative	**55,990**	52,379
	$ 331,317	$ 320,043

15. Subsequent Events

The System evaluated events and transactions occurring subsequent to December 31, 2016 through April 26, 2017, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

Supplementary Information

Building a better working world

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Report of Independent Auditors on Supplementary Information

The Board of Trustees
Southwest Community Health System

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

Ernst & Young LLP

April 26, 2017

Southwest Community Health System and Subsidiaries

Consolidating Balance Sheet

December 31, 2016

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
		(In Thousands)		
Assets				
Current assets:				
Cash and cash equivalents	**$ 28,498**	**$ 912**	**$ –**	**$ 29,410**
Patient accounts receivable, net	**33,105**	**–**	**–**	**33,105**
Other receivables, net	**4,231**	**374**	**–**	**4,605**
Due from affiliated organizations	**–**	**35**	**(35)**	**–**
Inventories	**7,507**	**48**	**–**	**7,555**
Prepaid expenses	**9,771**	**–**	**–**	**9,771**
Investments for current use	**6,252**	**–**	**–**	**6,252**
Total current assets	**89,364**	**1,369**	**(35)**	**90,698**
Investments:				
Board-designated assets	**181,480**	**2,930**	**–**	**184,410**
Self-insurance reserve funds	**10,388**	**–**	**–**	**10,388**
Bond trustee funds	**–**	**–**	**–**	**–**
	191,868	**2,930**	**–**	**194,798**
Property, plant, and equipment, net	**200,169**	**23**	**–**	**200,192**
Other assets	**4,464**	**1,235**	**–**	**5,699**
Total assets	**$ 485,865**	**$ 5,557**	**$ (35)**	**$ 491,387**

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
		(In Thousands)		
Liabilities and net assets				
Current liabilities:				
Accounts payable	**$ 16,692**	**$ 26**	**$ –**	**$ 16,718**
Due to affiliated organizations	**35**	**–**	**(35)**	**–**
Accrued compensation and related liabilities	**22,690**	**89**	**–**	**22,779**
Other accrued liabilities	**9,890**	**13**	**–**	**9,903**
Drawable credited earnings due to UHHS	**3,026**	**–**	**–**	**3,026**
Estimated amounts payable to third-party payors	**4,143**	**–**	**–**	**4,143**
Current portion of long-term liabilities	**2,826**	**–**	**–**	**2,826**
Total current liabilities	**59,302**	**128**	**(35)**	**59,395**
Long-term liabilities:				
Revenue bonds	**155,012**	**–**	**–**	**155,012**
Notes payable and capital leases	**2,081**	**–**	**–**	**2,081**
Accrued retirement benefits	**53,420**	**–**	**–**	**53,420**
Other liabilities	**18,546**	**–**	**–**	**18,546**
Total long-term liabilities	**229,059**	**–**	**–**	**229,059**
Total liabilities	**288,361**	**128**	**(35)**	**288,454**
Net assets:				
Unrestricted	**197,426**	**1,229**	**–**	**198,655**
Temporarily restricted	**78**	**4,012**	**–**	**4,090**
Permanently restricted	**–**	**188**	**–**	**188**
Total net assets	**197,504**	**5,429**	**–**	**202,933**
Total liabilities and net assets	**$ 485,865**	**$ 5,557**	**$ (35)**	**$ 491,387**

Southwest Community Health System and Subsidiaries

Consolidating Statement of Operations and Changes in Unrestricted Net Assets

Year Ended December 31, 2016

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
		(In Thousands)		
Unrestricted revenue				
Net patient service revenue	**$ 353,464**	**$ –**	**$ –**	**$ 353,464**
Provision for bad debts	**(20,084)**	**–**	**–**	**(20,084)**
Net patient service revenue less provision for bad debts	**333,380**	**–**	**–**	**333,380**
Other revenue	**11,288**	**1,008**	**–**	**12,296**
Total unrestricted revenue	**344,668**	**1,008**	**–**	**345,676**
Expenses				
Salaries, wages, and benefits	**155,314**	**372**	**–**	**155,686**
Supplies, insurance, and other	**144,322**	**306**	**–**	**144,628**
Depreciation and amortization	**24,948**	**8**	**–**	**24,956**
Interest	**6,047**	**–**	**–**	**6,047**
Total expenses	**330,631**	**686**	**–**	**331,317**
Income from operations	**14,037**	**322**	**–**	**14,359**
Nonoperating gains (losses):				
Tax levy receipts	**789**	**–**	**–**	**789**
Investment income	**674**	**–**	**–**	**674**
Other – net	**(2,606)**	**–**	**–**	**(2,606)**
Total nonoperating (losses) gains, net	**(1,143)**	**–**	**–**	**(1,143)**
Excess of revenue over expenses before drawable credited earnings due to UHHS	**12,894**	**322**	**–**	**13,216**
Drawable credited earnings due to UHHS	**(3,026)**	**–**	**–**	**(3,026)**
Excess of revenue over expenses	**9,868**	**322**	**–**	**10,190**
Net change in unrealized gains on other-than-trading investments	**6,810**	**(29)**	**–**	**6,781**
Net assets released from restrictions for capital	**3,194**	**–**	**–**	**3,194**
Pension adjustment	**(7,930)**	**–**	**–**	**(7,930)**
Contributions to Foundation from Southwest General Health Center	**–**	**–**	**–**	**–**
Increase in unrestricted net assets	**11,942**	**293**	**–**	**12,235**
Unrestricted net assets at beginning of year	**185,484**	**936**	**–**	**186,420**
Unrestricted net assets at end of year	**$ 197,426**	**$ 1,229**	**$ –**	**$ 198,655**

Southwest Community Health System and Subsidiaries

Consolidating Balance Sheet

December 31, 2015

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
		(In Thousands)		
Assets				
Current assets:				
Cash and cash equivalents	$ 20,168	$ 578	$ –	$ 20,746
Patient accounts receivable, net	35,070	–	–	35,070
Other receivables, net	6,011	450	–	6,461
Due from affiliated organizations	22	–	(22)	–
Inventories	4,916	37	–	4,953
Prepaid expenses	8,081	1	–	8,082
Investments for current use	10,976	–	–	10,976
Total current assets	85,244	1,066	(22)	86,288
Investments:				
Board-designated assets	166,540	5,532	–	172,072
Self-insurance reserve funds	9,731	–	–	9,731
Bond trustee funds	5,857	–	–	5,857
	182,128	5,532	–	187,660
Property, plant, and equipment, net	205,270	31	–	205,301
Other assets	4,850	1,477	–	6,327
Total assets	$ 477,492	$ 8,106	$ (22)	$ 485,576

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
		(In Thousands)		
Liabilities and net assets				
Current liabilities:				
Accounts payable	$ 15,420	$ 11	$ –	$ 15,431
Due to affiliated organizations	–	22	(22)	–
Accrued compensation and related liabilities	16,379	79	–	16,458
Other accrued liabilities	13,355	13	–	13,368
Drawable credited earnings due to UHHS	3,073	–	–	3,073
Estimated amounts payable to third-party payors	5,054	–	–	5,054
Current portion of long-term liabilities	2,748	–	–	2,748
Total current liabilities	56,029	125	(22)	56,132
Long-term liabilities:				
Revenue bonds	157,395	–	–	157,395
Notes payable and capital leases	2,477	–	–	2,477
Accrued retirement benefits	55,622	–	–	55,622
Other liabilities	20,411	–	–	20,411
Total long-term liabilities	235,905	–	–	235,905
Total liabilities	291,934	125	(22)	292,037
Net assets:				
Unrestricted	185,484	936	–	186,420
Temporarily restricted	74	6,857	–	6,931
Permanently restricted	–	188	–	188
Total net assets	185,558	7,981	–	193,539
Total liabilities and net assets	$ 477,492	$ 8,106	$ (22)	$ 485,576

Southwest Community Health System and Subsidiaries

Consolidating Statement of Operations and Changes in Unrestricted Net Assets

Year Ended December 31, 2015

	Obligated Group	Non-Obligated Group	Consolidating Eliminations	Consolidated Total
	(In Thousands)			
Unrestricted revenue				
Net patient service revenue	$ 335,123	$ –	$ –	$ 335,123
Provision for bad debts	(17,092)	–	–	(17,092)
Net patient service revenue less provision for bad debts	318,031	–	–	318,031
Other revenue	10,440	600	–	11,040
Total unrestricted revenue	328,471	600	–	329,071
Expenses				
Salaries, wages, and benefits	156,427	518	–	156,945
Supplies, insurance, and other	133,998	217	–	134,215
Depreciation and amortization	22,928	8	–	22,936
Interest	5,947	–	–	5,947
Total expenses	319,300	743	–	320,043
Income (loss) from operations	9,171	(143)	–	9,028
Nonoperating gains (losses):				
Tax levy receipts	780	–	–	780
Investment income	6,210	–	–	6,210
Other – net	(3,088)	–	–	(3,088)
Total nonoperating gains (losses), net	3,902	–	–	3,902
Excess (deficiency) of revenue over expenses before drawable credited earnings due to UHHS	13,073	(143)	–	12,930
Drawable credited earnings due to UHHS	(3,073)	–	–	(3,073)
Excess (deficiency) of revenue over expenses	10,000	(143)	–	9,857
Net change in unrealized gains on other-than-trading investments	(9,259)	(27)	–	(9,286)
Net assets released from restrictions for capital	638	–	–	638
Pension adjustment	(6,050)	–	–	(6,050)
Contributions to Foundation from Southwest General Health Center	(194)	194	–	–
(Decrease) increase in unrestricted net assets	(4,865)	24	–	(4,841)
Unrestricted net assets at beginning of year	190,349	912	–	191,261
Unrestricted net assets at end of year	$ 185,484	$ 936	$ –	$ 186,420

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