

**CONSOLIDATED FINANCIAL STATEMENTS**

**CATHOLIC HEALTH SYSTEM, INC.  
AND SUBSIDIARIES**

---

**DECEMBER 31, 2016**

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## CONTENTS

---

	<u>Page</u>
<b>Independent Auditor's Report</b> .....	1 - 2
<b>Consolidated Financial Statements:</b>	
Consolidated Balance Sheets.....	3
Consolidated Statements of Operations and Changes in Net Assets .....	4 - 5
Consolidated Statements of Cash Flows.....	6
<b>Notes to the Consolidated Financial Statements</b> .....	7 - 45
<b>Independent Auditor's Report on Accompanying Supplementary Information</b> .....	46
<b>Supplemental Schedules:</b>	
Schedule of Net Cost of Providing Care of Persons Living in Poverty and Community Benefit Programs (Schedule of Social Accountability – Unaudited).....	47
Consolidating Financial Information.....	48 - 63



## **INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors of the  
Catholic Health System, Inc.  
Buffalo, New York

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Catholic Health System, Inc. and its subsidiaries (collectively, the System), 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 (collectively, the consolidated financial statements).

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditor's Responsibility**

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

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

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

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Catholic Health System, Inc. and its subsidiaries as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Freed Maxick CPAs, P.C.*

Buffalo, New York  
May 1, 2017

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(in thousands of dollars)

December 31,

<b>ASSETS</b>	<b>2016</b>	<b>2015</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 227,231	\$ 360,032
Patient/resident accounts receivable, net of allowance for doubtful accounts of \$25,493 (2015 - \$28,817)	125,202	142,365
Other receivables	9,293	15,234
Inventories	23,600	26,105
Prepaid expenses and other current assets	11,288	6,368
<b>Total current assets</b>	<b>396,614</b>	<b>550,104</b>
Assets limited as to use	38,059	89,558
Investments	179,045	16,681
Property and equipment, net	371,159	360,647
Other assets	111,489	101,723
<b>Total assets</b>	<b>\$ 1,096,366</b>	<b>\$ 1,118,713</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>Current liabilities:</b>		
Current portion of long-term obligations	\$ 15,312	\$ 13,945
Line of credit payable	4,310	13,496
Accounts payable	44,958	53,319
Accrued expenses	66,461	73,155
Due to third-party payors	47,881	43,371
<b>Total current liabilities</b>	<b>178,922</b>	<b>197,286</b>
Long-term obligations, net	195,760	239,806
Other long-term obligations, net	488,144	475,835
<b>Total liabilities</b>	<b>862,826</b>	<b>912,927</b>
<b>Net assets:</b>		
Unrestricted	225,122	198,063
Temporarily restricted	8,124	7,430
Permanently restricted	294	293
<b>Total net assets</b>	<b>233,540</b>	<b>205,786</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,096,366</b>	<b>\$ 1,118,713</b>

See accompanying notes.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**

(in thousands of dollars)

For the Years Ended December 31,

	<u>2016</u>	<u>2015</u>
<b>Unrestricted revenues and other support:</b>		
Net patient/resident service revenue	\$ 1,087,220	\$ 1,027,943
Provision for bad debts	(19,568)	(24,346)
Net patient/resident service revenue, less provision for bad debts	1,067,652	1,003,597
Other revenue	20,955	18,182
Net assets released from restrictions	230	128
<b>Total unrestricted revenues and other support</b>	<u>1,088,837</u>	<u>1,021,907</u>
<b>Expenses:</b>		
Salaries and wages	481,803	443,619
Employee benefits	149,199	145,158
Medical and professional fees	54,882	48,373
Purchased services	92,897	83,267
Supplies	206,061	192,190
Depreciation and amortization	46,015	43,297
Interest	9,875	11,307
Insurance	13,239	13,183
Other expenses	32,521	29,177
<b>Total expenses</b>	<u>1,086,492</u>	<u>1,009,571</u>
<b>Income from operations</b>	2,345	12,336
<b>Nonoperating revenues and losses:</b>		
Investment income (loss)	5,954	(70)
Other, net	2,316	14,758
<b>Total nonoperating revenues and losses</b>	<u>8,270</u>	<u>14,688</u>
<b>Excess of revenues over expenses</b>	<u>\$ 10,615</u>	<u>\$ 27,024</u>

See accompanying notes.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (CONTINUED)**

(in thousands of dollars)

For the Years Ended December 31,

	<b>2016</b>	<b>2015</b>
<b>Unrestricted net assets:</b>		
Excess of revenues over expenses	\$ 10,615	\$ 27,024
Change in unrealized loss on interest rate swap	1,262	(263)
Change in pension obligation, other than net periodic cost	12,382	25,657
Net assets released from restrictions used for capital	2,044	1,257
Grant revenue for capital expenditures	125	67
Contributions	136	185
Other	614	924
Increase in unrestricted net assets before effects of discontinued operations	27,178	54,851
Gain on sale of assets in discontinued operations	2,561	4,229
Loss from discontinued operations	(2,680)	(2,916)
Increase unrestricted net assets	27,059	56,164
<b>Temporarily restricted net assets:</b>		
Contributions	2,403	1,306
Investment income (loss)	85	(3)
Special events revenue, net	278	24
Change in temporarily restricted interest in related Foundation	(22)	-
Temporarily restricted net assets released from restrictions	(2,274)	(1,385)
Other	224	3,413
Increase in temporarily restricted net assets	694	3,355
<b>Permanently restricted net assets:</b>		
Contributions	1	1
Other	-	46
Increase in permanently restricted net assets	1	47
Increase in net assets	27,754	59,566
Net assets, beginning of year	205,786	146,220
Net assets, end of year	<u>\$ 233,540</u>	<u>\$ 205,786</u>

See accompanying notes.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands of dollars)

For the Years Ended December 31,

	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Increase in net assets	\$ 27,754	\$ 59,566
Loss in net assets from discontinued operations	2,680	2,916
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities		
Depreciation and amortization	46,015	43,297
Provision for bad debts	19,568	24,346
Gain on Mount St. Mary's acquisition	-	(13,567)
Gain on sale of LTC facilities	(2,561)	(4,229)
Change in minimum pension liability adjustment	(12,382)	(25,657)
Grant revenue for capital additions	(125)	(67)
Undistributed earnings in equity investees	(285)	(315)
Amortization of discount on debt issuance	62	62
Amortization of premium on debt issuance	(575)	(391)
Amortization of debt issuance costs	460	595
Gain on extinguishment of capital lease	(1,967)	-
Loss on sale of property and equipment	720	45
Change in unrealized (gain) loss on investments	(3,881)	471
Realized loss on investments	32	-
Realized (gain) loss on interest rate swap	(1,290)	270
Other	(108)	(253)
(Increase) decrease in assets		
Patient accounts receivables	(2,428)	(26,134)
Other receivables	5,964	(6,233)
Inventories	2,505	(2,120)
Prepaid expenses and other current assets	(4,929)	145
Other assets	159	(13,421)
(Decrease) increase in liabilities:		
Accounts payable	(5,680)	(969)
Accrued expenses	(3,409)	953
Due to third-party payors	4,510	3,172
Other liabilities	15,695	20,688
Net cash used in discontinued operations	(2,661)	(2,706)
<b>Net cash and cash equivalents provided by operating activities</b>	<b>83,843</b>	<b>60,464</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(56,154)	(35,403)
Proceeds from sale of property and equipment	9	32
Proceeds from sale of assets in discontinued operations	3,012	6,506
Purchase of assets limited as to use	-	(94,406)
Proceeds from sale of assets limited as to use	58,720	35,474
Change in investments, net	(587)	913
Purchase of investments	(166,573)	-
Net cash acquired (as part of acquisition)	-	6,737
<b>Net cash and cash equivalents used in investing activities</b>	<b>(161,573)</b>	<b>(80,147)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of long-term obligations, net	5,786	96,428
Premium on issuance	-	9,968
Repayments of current and long-term obligations	(60,982)	(50,405)
Proceeds of grant revenue for capital additions	125	67
<b>Net cash and cash equivalents (used in) provided by financing activities</b>	<b>(55,071)</b>	<b>56,058</b>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(132,801)</b>	<b>36,375</b>
Cash and cash equivalents - beginning of year	360,032	323,657
Cash and cash equivalents - end of year	<u><u>\$ 227,231</u></u>	<u><u>\$ 360,032</u></u>

See accompanying notes.



## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 1. ORGANIZATION

Catholic Health System, Inc. and Subsidiaries (CHS or the System) is an integrated healthcare delivery system in Western New York jointly sponsored by the Diocese of Buffalo, New York, Ascension Health Ministries and Catholic Health Ministries. Ascension Health, Trinity Health, and the Diocese of Buffalo, New York are the corporate members of CHS, with equal ownership interest.

CHS is the also the sole corporate member of the following subsidiaries:

**Acute Care Subsidiaries:** The Acute Care Subsidiaries (also collectively referred to as the Hospitals) include Mercy Hospital of Buffalo (MHB), Kenmore Mercy Hospital including KMH Homes Inc. and The McAuley Residence (KMH), Sisters of Charity Hospital of Buffalo, New York (SCH) and Mount St. Mary's Hospital and Health Center (MSM).

**Long-Term Care Subsidiaries:** The Long-term Care Subsidiaries include Western New York Catholic Long-Term Care, Inc. (Father Baker Manor), St. Elizabeth's Home (SEH) and St. Vincent's Home for the Aged (SVH) (both sold 2016), St. Francis Home of Williamsville (sold 2015), St. Francis Geriatric and Healthcare Services, Inc. (closed 2009), and Nazareth Home of the Franciscan Sisters of the Immaculate Conception (closed 2007).

**Home Care Subsidiaries and Other Subsidiaries:** The Home Care and Other Subsidiaries include Mercy Home Care of Western New York, Inc. (MHC), McAuley Seton Home Care (MSHC), Our Lady of Victory Renaissance Corporation (OLV Renaissance), Catholic Health Infusion Pharmacy, Continuing Care Foundation, Catholic Health System Program of All Inclusive Care for the Elderly, Inc. (LIFE) and Trinity Medical WNY, PC.

#### NOTE 2. AFFILIATION AGREEMENT

During 2015, CHS and Ascension Health executed an Affiliation Agreement (the Agreement) for Mount St. Mary's Hospital of Niagara Falls d/b/a Mount St. Mary's Hospital and Health Center (MSM), a 175 bed community hospital located in Niagara County, New York, whereby CHS would replace Ascension Health as the sole corporate member of MSM, integrating its operations with that of CHS, effective July 1, 2015.

As a result of the affiliation, CHS acquired approximately \$37,022 of total assets, consisting primarily of \$6,959 of net working capital, \$23,468 of property, plant and equipment, and \$6,595 of other non-operating assets. Consideration to Ascension Health included a cash payment of \$9,825, assumption of liabilities of approximately \$3,012, including \$527 of asset retirement obligations and \$2,485 of other long-term obligations, and recognition of a contingent liability related to potential performance payments CHS shall pay Ascension Health based on the financial performance of MSM and its subsidiary organizations. For the year ended December 31, 2016 and 2015, the fair market value of the contingent liability related to the potential performance payments was \$7,242 and \$7,159, respectively.

CHS applied the not-for-profit business acquisition accounting guidance, provided in FASB ASC 958-805. That guidance requires that the acquirer recognize an excess of the acquisition date net assets acquired over the fair value of the consideration transferred as a separate credit in its statement of operations and changes in net assets as of the acquisition date. Accordingly, CHS recognized total inherent contribution income of \$17,026, which was recognized as a non-operating gain of \$13,567, and as an increase to temporarily restricted net assets of \$3,413 and an increase to permanently restricted net assets of \$46 in its statement of operations and changes in net assets for the year ended December 31, 2015. The contribution income recognized is based on the fair market values of the net assets acquired less consideration paid, as described above.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 2. AFFILIATION AGREEMENT (CONTINUED)

During the year ended 2015, CHS recognized net patient service revenues, less provision for bad debts, for the six months after the acquisition on July 1, 2015, of approximately \$46,194 and deficiency of revenues over expenses of \$623, as well as an increase in unrestricted net assets of \$337, a decrease in temporarily restricted net assets of \$183 and an increase in permanently restricted net assets of \$1 related to MSM. If MSM had been consolidated as of January 1, 2015, CHS would have recognized additional net patient service revenues, less provision for bad debts of approximately \$46,015 and a deficiency of revenue over expenses of approximately \$711, as well as a decrease in unrestricted net assets of \$4,286 and a decrease in temporarily restricted net assets of \$199.

#### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in preparing the accompanying consolidated financial statements are summarized below:

**Principles of Consolidation:** The consolidated financial statements of the System include the accounts of CHS (commonly referred to as the Parent) and each of its wholly-owned or controlled subsidiaries. All significant intercompany balances and transactions have been eliminated to reflect the consolidated amounts.

At December 31, 2015, certain assets and liabilities of SEH and SVH met the criteria for classifying those assets and liabilities as held for sale and accordingly, the operating results were classified as discontinued within the statement of operations and changes in net assets. As further described in Note 16, the System executed purchase agreements for the sale of certain assets of St. Elizabeth's Home of Lancaster and St. Vincent Home for the Aged in March 2016. There were no assets and liabilities classified as held for sale at December 31, 2016.

**Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made by the System include, but are not limited to, the reserves for asset retirement obligations, reserve for bad debts, reserve for third-party payor contractual adjustments and allowances, the provision for estimated receivables and payables for final settlements with those payors, the insurance reserves for workers' compensation, health insurance, professional and general liability, and actuarial assumptions used in determining pension expense.

**Risks and Uncertainties:** Investment securities are exposed to various risks, such as interest rate, market and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is at least possible that changes in risks in the near term could materially affect the net assets of the System.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to third-party payment matters will change by a material amount in the near term.

**Cash and Cash Equivalents:** The System considers all highly liquid investments, generally with original maturities of three months or less when purchased, and short term investments, excluding amounts limited as to use, to be cash equivalents. The System maintains funds on deposit in excess of amounts insured by the Federal Depository Insurance limits.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

	<u>2016</u>	<u>2015</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 8,046	\$ 9,764
Non-cash investing and financing transactions:		
Assets acquired under capital lease obligations	\$ 3,890	\$ 3,081
Construction related payables	\$ (981)	\$ 7,578

**Other Receivables and Other Assets:** Other receivables consist primarily of managed care risk sharing receivables, physician loans, and other receivables. There is no allowance for doubtful accounts established against these receivables. Other non-current assets consist of insurance recoveries, investments in healthcare ventures, and other miscellaneous deferred charges.

The composition of current other receivables and other non-current assets is as follows at December 31:

<b>Current other receivables:</b>	<u>2016</u>	<u>2015</u>
Physician loans	\$ 4,148	\$ 4,111
Foundation receivables	1,499	3,212
Managed care risk receivable	-	1,539
Other	<u>3,646</u>	<u>6,372</u>
Other receivables	<u>\$ 9,293</u>	<u>\$ 15,234</u>
<b>Non-current other assets:</b>		
Insurance recoveries	\$ 106,930	\$ 97,291
Investments in healthcare ventures	1,402	1,116
Goodwill & other	<u>3,157</u>	<u>3,316</u>
Other assets	<u>\$ 111,489</u>	<u>\$ 101,723</u>

**Inventory Valuation:** Inventory consists primarily of drugs, medical supplies and food. These inventories are generally stated at the lower of cost (first-in, first-out) or market.

**Investments:** Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the consolidated balance sheets.

Investment income and gains restricted by a donor are reported as increases in unrestricted net assets if the restrictions are met (either by passage of time or by use) in the reporting period in which the income and gains are recognized. Investment income or loss (including realized gains or losses on investments, interest, and dividends) is included in the excess of revenues over expenses, unless their use is restricted by donor stipulations or law. Unrealized gains and losses on investments are included in the operating measure as the investments are trading securities.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

#### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Assets Limited as to Use:** Assets limited as to use include assets set aside for debt service as required by trustee or indenture agreements, and assets set aside by the Board of Directors for specific future purposes. The Board retains control of these funds and may at its discretion subsequently use for other purposes.

**Property and Equipment:** Property and equipment are stated at cost if purchased, or if contributed, at the fair value on the date contributed. Depreciation is computed using the straight-line method over useful lives ranging from three to forty years. Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements.

Gifts of long-lived assets such as land, building, 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. Expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

**Impairment of Long-Lived Assets:** The System evaluates its long-lived assets for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

The System evaluates the recoverability of long-lived assets not held for sale by measuring the carrying amount of the assets against the estimated undiscounted future cash flows associated with them. If such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values. Based on these evaluations, there are no adjustments to the carrying value of long-lived assets in 2016 and 2015.

**Asset Retirement Obligations:** The System accrues for asset retirement obligations in the period in which they are incurred if sufficient information is available to reasonably estimate the fair value of the obligation. Over time, the liability is accreted to its settlement value. Upon settlement of the liability, the System will recognize a gain or loss for any difference between the settlement amount and liability recorded. Accretion expense for the years ended December 31, 2016 and 2015 was \$556 and \$519, respectively.

**Other Long-Term Liabilities:** Other long-term liabilities consist primarily of insurance liabilities, long-term pension obligations, asset retirement obligations, interest rate swap liabilities, and other long-term liabilities. The composition of other long-term liabilities is as follows at December 31:

	<u>2016</u>	<u>2015</u>
Insurance liabilities	\$ 156,194	\$ 143,479
Long-term pension obligations	307,867	307,450
Asset retirement obligations	9,929	9,818
Interest rate swap	4,832	6,122
Contingent performance obligation & other	<u>9,322</u>	<u>8,966</u>
Other long-term liabilities	\$ <u>488,144</u>	\$ <u>475,835</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

---

NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Net Patient/Resident Service Revenue:** Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered including estimated adjustments under various reimbursement agreements with third-party payors. The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Third-party payors retain the right to review and propose adjustments to amounts recorded by the System. Such adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. CHS's Healthcare Assistance Program (HAP) provides discounts to patients based on need. In addition, the System will also assist patients with the application process for free or low-cost insurance. Those uninsured patients who do not qualify for the HAP or low-cost insurance and live in New York State, a state contiguous to New York State, or the state of Ohio, are provided an uninsured discount based on a service specific uninsured rate. This uninsured rate is similar in calculation method and amount to third party payor methods and rates.

Under the New York Health Care Reform Act (NYHCRA), hospitals are authorized to negotiate reimbursement rates with certain non-Medicare payors except for Medicaid, Workers' Compensation and No-Fault, which are regulated by New York State. These negotiated rates may take the form of rates per discharge, reimbursed costs, discounted charges or as per diem payments. Reimbursement rates for non-Medicare payors regulated by New York State are determined on a prospective basis. These rates also vary according to a patient classification system defined by the Health Care Reform Act (HCRA) that is based on clinical, diagnostic and other factors.

A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** Inpatient acute care services and outpatient services rendered to Medicare program 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. The System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare Administrative Contractor. Cost reports have been audited and finalized by the Medicare Administrative Contractor through December 31, 2011. Disproportionate Share (DSH), Indirect Medical Education (IME), Graduate Medical Education (GME), Paramedical Education and Meaningful Use (MU) are all reconciled through settlement processes. During 2012, the system began participation with Catholic Medical Partners (CMP) as an Accountable Care Organization (ACO). The ACO places a global budget on all traditional Medicare claims (excluding e.g. DSH, IME, DME, MU) for patients associated with CMP Primary Care physicians. Claims are processed through fee for service billing and reconciled to the global budget along with quality measurement at the end of the period.
- **Non-Medicare.** The New York Health Care Reform Act of 1996, as updated, governs payments to hospitals in New York State. Under this system, hospitals and all non-Medicare payors, except Medicaid, Workers' Compensation and No-Fault insurance programs, negotiate hospitals' payment rates. If negotiated rates are not established, payors are billed at hospitals established charges. Medicaid, Workers' Compensation and No-Fault payors pay hospital rates promulgated by the New York State Department of Health (DOH) on a prospective basis. Adjustments to current and prior years' rates for these payors will continue to be made in the future. Effective December 1, 2009, NYS implemented inpatient reimbursement reform. The reform updated the data utilized to calculate the NYS diagnosis related group rates and service intensity weights in order to utilize refined data and more current information in DOH promulgated rates. Similar type outpatient reforms were implemented effective December 1, 2008.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Amounts recognized in 2016 and 2015 related to prior years, including adjustments to prior year estimates, increased revenues approximately \$7,340 and \$4,731, respectively. These changes in estimates related to estimates for prior years cost report reopening, appeals, and tentative final cost reports, some of which are still subject to audit, additional reopening, and/or appeals.

Approximately 57% and 53% of net patient/resident service revenue was generated from services rendered to patients/residents under Medicare and Medicaid programs in 2016 and 2015, respectively. Approximately 36% of net patient/resident service revenue was generated from services rendered to patients under managed care programs in 2016 and 2015.

There are various proposals at the federal and state level that could, among other things, reduce payment rates. The outcome of these proposals, regulatory changes and other market conditions cannot presently be determined.

**Provision for Bad Debts:** The provision for bad debts is based upon management's assessment of expected net collections considering economic experience, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category, including those amounts not covered by insurance and history of cash collections. The results of this review are then used to make any modifications to the provision for bad debts expense to establish an appropriate allowance for uncollectible accounts. After satisfaction of amounts due from insurance and reasonable efforts to collect from the patient have been exhausted, the System follows established guidelines for placing certain past-due patient balances with the collection agencies, subject to terms of certain restrictions on collection efforts as determined by the System. Accounts receivable are written off after collection efforts have been followed in accordance with the System's policies.

Patient and resident service revenue, net of contractual allowances and discounts, recognized in the period from these major payor sources, is as follows for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Patient/resident service revenue (net of contractual allowances and discounts):		
Medicare	\$ 455,548	\$ 409,764
Medicaid	159,487	145,689
Other third party payors	457,945	455,144
Patients/residents	<u>14,240</u>	<u>17,346</u>
Total net patient/resident service revenue	1,087,220	1,027,943
Provision for bad debts	<u>(19,568)</u>	<u>(24,346)</u>
Net patient/resident service revenue less provision for bad debts	<u>\$ 1,067,652</u>	<u>\$ 1,003,597</u>

**Charity Care:** The System provides services to all patients regardless of ability to pay. A patient is classified as a charity patient based on income eligibility criteria as established by the HAP which is determined by presentation for care without insurance, while using an estimator, Payment Assistance Rank Ordering score (PARO), of each guarantor's ability to pay. Free care is determined at 200% of Federal Poverty Guidelines (FPG), whereas discounted care is also provided at 500% FPG.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Of the System's total expenses reported, an estimated \$9,299 and \$5,944 arose from providing services to charity patients in 2016 and 2015, respectively. Costing is a full step down methodology of cost from non-revenue producing departments to revenue producing departments, with assignment of cost to individual charge items based on relative value units. Additional costs for the Hospitals include required payments for a gross receipts assessment to New York State which is used to fund the New York State Medicaid program and the HCRA. Revenues that offset the costs of Charity Care include payments from the New York State Uncompensated Care Pools.

The Hospitals provide care to patients at no charge or at discounted rates who meet eligibility requirements under its HAP (charity care). In addition to charity care, the Hospitals provide services to patients covered by Medicaid. The payments received for services provided to patients covered by Medicaid may be at or below costs in addition to the cost of care for patients without insurance. The Hospitals are also required to pay a gross receipts assessment to New York State which is used to fund the New York State Medicaid program and the HCRA.

**Collective Bargaining Agreements:** The System has approximately 43% of its employees working under thirteen collective bargaining agreements. The agreements are set to expire beginning April 30, 2017 through December 1, 2020.

**Operating and Nonoperating Revenue and Losses:** The System's primary mission is dedicated to meeting the health care needs in the regions in which it operates. The System is committed to providing a broad range of general and specialized health care services including inpatient, primary care, long-term care, outpatient services, and other health care related services. Only those activities directly associated with the furtherance of this mission are considered to be operating activities. Such activities include operation of cafeterias, parking lots, rental real estate and other ancillary activities. Other activities that result in gains or losses unrelated to the System's primary mission are considered to be nonoperating.

**Electronic Health Record Incentive Payments:** The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 for eligible hospitals and professionals that adopt and meaningfully use certified electronic health record (EHR) technology. The System recognized income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when the eligible hospitals have demonstrated meaningful use of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

Medicaid EHR incentive calculations and related payment amounts are based upon prior period cost report information available at the time our eligible hospitals adopt, implement or demonstrate meaningful use of certified EHR technology for the applicable period, and are not subject to revision for cost report data filed for a subsequent period. Thus, incentive income recognition occurs at the point the eligible hospitals adopt, implement or demonstrate meaningful use of certified EHR technology for the applicable period, as the cost report information for the full cost report year that will determine the final calculation of the incentive payment is known at that time. Medicare EHR incentive calculations and related initial payment amounts are based upon the most current filed cost report information available at the time the eligible hospitals demonstrate meaningful use of certified EHR technology for the applicable period. However, unlike Medicaid, this initial payment amount will be adjusted based upon an updated calculation using the annual cost report information for the cost report period that began during the applicable payment year. Thus, incentive income recognition occurs at the point the eligible hospitals demonstrate meaningful use of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

The System recognized \$804 and \$731 of electronic health record incentive income related to Medicare and Medicaid incentive programs during the years ended December 31, 2016 and 2015, respectively, which is recorded in other revenue.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Other Revenue:** The composition of other revenue for the years ended December 31, is set forth in the following table:

	<u>2016</u>	<u>2015</u>
Cafeteria revenue	\$ 2,768	\$ 2,660
Parking revenue	1,175	1,068
Unrestricted donor contributions to the Foundations	2,199	4,614
Medicare and Medicaid meaningful use	804	731
DSRIP grant revenue	605	-
340(b) program revenue	1,490	644
Medicaid health home care coordination revenue	2,944	1,102
Other	<u>8,970</u>	<u>7,363</u>
Total other revenue	\$ <u>20,955</u>	\$ <u>18,182</u>

**Other Expenses:** The composition of other expenses for the years ended December 31, is set forth in the following table:

	<u>2016</u>	<u>2015</u>
Rents and operating leases	\$ 9,237	\$ 10,040
Dues	5,469	5,594
NYS DOH cash receipt assessment	5,541	5,331
Taxes, travel and miscellaneous other	<u>12,274</u>	<u>8,212</u>
Other expenses	\$ <u>32,521</u>	\$ <u>29,177</u>

**Other Nonoperating Income:** During the year ended December 31, 2015, the System recognized \$13,567 of inherent contribution income related to the affiliation with MSM. See note 2 for further detail regarding the affiliation agreement. There was no inherent contribution income recognized during 2016.

**Contributions:** Contributions received are recorded as unrestricted, temporary restricted or permanently restricted net assets depending on the existence and nature of any donor restrictions.

Contributions and pledges that are restricted by the donor are reported as an increase in unrestricted net assets if the restrictions expire, that is, when a stipulated time restriction ends or purpose restriction is accomplished in the reporting period in which the contribution is recognized. All other donor-restricted support is reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of operations and changes in net assets released from restrictions.

**Excess of Revenues over Expenses:** The consolidated statements of operations and changes in net assets includes excess of revenues over expenses, commonly referred to as the performance indicator. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), the effective portion of cash flow hedging derivatives, pension liability adjustments, and discontinued operations.

**Net assets:** Unrestricted net assets are available for the general operating purposes of the System and are not subject to any donor limitations.



## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Temporarily restricted net assets are those whose use is limited by donors to a specific period or purpose and includes the Hospitals' interest in the temporarily restricted net assets of the Mercy Hospital Foundation, Inc., Sisters Hospital Foundation, Inc., Kenmore Mercy Hospital Foundation, Inc., Mount St. Mary's Hospital Foundation (temporarily and unrestricted net assets) and Continuing Care Foundation, Inc. (collectively the Foundations). Temporarily restricted net assets are released to unrestricted net assets as restrictions are met, which can occur in the same period. Gifts whose restrictions are met in the same period in which they are received are recorded as an increase in unrestricted net assets. Such restrictions include purpose restrictions where donors have specified the purpose for which the net assets are to be spent, or time restrictions imposed by donors or implied by the nature of the gift, pledges to be paid in future periods, life income funds. Investment return is included in unrestricted net assets unless the return is restricted by donor or law.

Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

**Temporarily Restricted Net Assets:** Temporarily restricted net assets represent resources whose use is limited by donor-imposed stipulations that either expire by the passage of time or are met by specific actions of the Foundations. Specific-actions most often involve completion of expenditures for purposes consistent with the donor's stipulations. When such donor-imposed stipulations are met, temporarily restricted net assets are reclassified to unrestricted net assets and reported on the statements of operations and changes in net assets as net assets released from restrictions used for capital. Temporarily restricted net assets, which amounted to \$8,124 at December 31, 2016 (\$7,430 – 2015), consist primarily of contributions restricted for use towards various capital projects at the Hospitals. Proceeds from these contributions are included in the balance sheets under the caption of cash and cash equivalents and investments. Contributions receivable are included under the caption of other receivables within the balance sheets.

**Permanently Restricted Net Assets:** Include gifts which require, by donor restrictions, that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions. Permanently restricted net assets, which amounted to \$294 at December 31, 2016 (\$293 – 2015), consist primarily of endowments.

**Endowments:** For the years ended December 31, 2016 and 2015, the Mercy Hospital Foundation, Inc. and the Sisters Hospital Foundation Inc., had \$246 of permanently restricted net assets from the proceeds of a Charitable Remainder Unitrusts (CRUT). The CRUTs are included under the caption of cash and cash equivalents within the balance sheets. The Foundations segregated these permanently restricted funds to enable preservation of purchasing power, as well as to ensure maintenance of the donor's intent. Mount St. Mary's Hospital Foundation, Inc. had \$48 of permanently restricted net assets, from the proceeds of a trust, as of December 31, 2016 (\$47 – 2015). The trust is included under the caption of cash and cash equivalents within the balance sheets. Per the trust agreement, earnings shall be divided such that half of the earnings are to be temporarily restricted to be used by the Foundation and the other half is to be added to the principal and remain permanently restricted.

**Income Taxes:** The consolidated financial statements do not include a provision for income taxes, as the System is a tax-exempt organization under Section 501(c) (3) of the Internal Revenue Code. The tax-exempt organizations are subject to federal taxes on unrelated business income under section 511 of the Internal Revenue Code which are reported as other expenses in these financial statements.

**Transactions among Subsidiaries:** Common costs incurred by CHS are allocated to the subsidiaries on a pro-rata cost basis formula. The allocation of these costs is recorded as other revenue by CHS and are recorded by the subsidiaries as a component of the natural account classification. The related income and expense is eliminated in the consolidated financial statements. The respective assets and liabilities are also eliminated in the consolidated financial statements.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Capitalized Software Costs:** The System capitalizes certain costs that are incurred to purchase or to create and implement internal-use computer software, which includes software coding, installation, testing and certain data conversion from both internal and external providers in accordance with accounting guidance. These capitalized costs are amortized on a straight-line basis over ten years and reviewed for impairment on an annual basis. CHS capitalized software, computer equipment, and other external costs of \$3,089 during 2016 and \$4,656 during 2015. Capitalized project labor costs amounted to \$2,556 during 2016 and \$2,718 during 2015.

**Adoption of New Accounting Standards:** Effective for the year ended December 31, 2016, the System adopted FASB Accounting Standards Update (ASU) No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The ASU requires that unamortized debt issuance costs be presented on the balance sheet as a component of the related debt obligation liability. The ASU does not change the initial recognition criteria or subsequent amortization principles for such costs.

Accordingly, as of December 31, 2015, the System has retroactively reclassified on the accompanying balance sheet approximately \$6,649 of previously unamortized debt issuance costs from other noncurrent assets to long term obligations to conform with the adoption of this ASU.

**Reclassifications:** Certain prior year amounts were reclassified to conform to the 2016 consolidated financial statement presentation.

**Subsequent Events:** The System evaluated subsequent events through May 1, 2017, which was the date the financial statements were available to be issued.

### NOTE 4. ASSETS LIMITED AS TO USE

The composition of assets limited as to use is as follows at December 31:

	<u>2016</u>	<u>2015</u>
By Board for capital improvements:		
Funded depreciation:		
Cash and cash equivalents	\$ 7,184	\$ 9,515
U.S. government obligations	4,756	4,468
Interest receivable	22	15
	<u>11,962</u>	<u>13,998</u>
Held by Trustee under Indenture Agreement:		
Cash and cash equivalents	<u>17,039</u>	<u>65,025</u>
Held by Trustee under Letter of Credit Agreement:		
Cash and cash equivalents	<u>2,752</u>	<u>2,752</u>
Board Designated for long-term care reinvestment		
Cash and cash equivalents	<u>2,602</u>	<u>2,602</u>
Delivery System Reform Incentive Payment funds	<u>2,997</u>	<u>4,529</u>
Other	<u>707</u>	<u>652</u>
Assets limited as to use	<u>\$ 38,059</u>	<u>\$ 89,558</u>

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 5. INVESTMENTS**

Investments consisted of the following as of December 31:

	<u>2016</u>	<u>2015</u>
Investment in debt and equity securities:		
Fair value	\$ 179,045	\$ 16,681
Cost	<u>174,103</u>	<u>15,862</u>
Unrealized gain	\$ <u>4,942</u>	\$ <u>819</u>

Investment income is summarized as follows for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Interest and dividend income	\$ 2,105	\$ 401
Net unrealized and realized gains on investments	<u>3,849</u>	<u>(471)</u>
Total investment income (loss)	\$ <u>5,954</u>	\$ <u>(70)</u>

**NOTE 6. PROPERTY AND EQUIPMENT**

Property and equipment, recorded at cost, consists of the following at December 31:

	<u>2016</u>	<u>2015</u>
Land and land improvements	\$ 7,802	\$ 8,185
Buildings	268,732	274,966
Equipment	258,494	245,245
Capital leases	44,600	48,254
Leasehold improvements	<u>113,344</u>	<u>94,177</u>
	692,972	670,827
Accumulated depreciation	(298,860)	(309,490)
Accumulated amortization on capital leases	<u>(31,831)</u>	<u>(24,453)</u>
	362,281	336,884
Construction in progress	<u>8,878</u>	<u>23,763</u>
Property and equipment, net	\$ <u>371,159</u>	\$ <u>360,647</u>

Depreciation expense in 2016 and 2015 amounted to approximately \$39,880 and \$36,326, respectively. Amortization expense on equipment under capital leases amounted to \$5,591 and \$6,653 in 2016 and 2015, respectively. There were no fully depreciated or amortized assets and capital leases written-off for the years ended December 31, 2016 and 2015.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 7. LONG-TERM OBLIGATIONS**

Long-term obligations are comprised of the following at December 31:

	<u>2016</u>	<u>2015</u>
<b>Mercy Hospital of Buffalo</b>		
Series 2006 Revenue Bonds (a)	\$ 7,288	\$ 7,996
Series 2008 Revenue Bonds (b)	20,170	20,904
Series 2012 Revenue Bonds (c)	2,843	2,919
Series 2015 Revenue Bonds (d)	11,041	11,080
Cafeteria renovation loan with Aramark Healthcare, in monthly payments of \$3, matures August 2018	176	282
Capital lease obligations and other, at interest rates ranging from 2.87% to 4.63%, collateralized by equipment	10,335	11,293
	<u>51,853</u>	<u>54,474</u>
<b>Kenmore Mercy Hospital</b>		
Series 2006 Revenue Bonds (a)	7,377	8,465
Series 2012 Revenue Bonds (c)	13,021	13,378
Series 2015 Revenue Bonds (d)	3,874	3,888
Bridge loan financing (e)	5,822	-
Capital lease obligations and other, at various rates of interest ranging from 2.9% to 4.0%, collateralized by equipment	4,057	3,177
Other	17	26
	<u>34,168</u>	<u>28,934</u>
<b>Sisters of Charity Hospital</b>		
Series 2006 Revenue Bonds (a)	20,873	22,905
Series 2015 Revenue Bonds (d)	5,206	5,225
Capital lease obligations, at various rates of interest ranging from 2.99% to 4.87%, collateralized by equipment	7,019	7,835
	<u>33,098</u>	<u>35,965</u>
<b>Mount St. Mary's Hospital and Health Center</b>		
Capital lease obligations, at a 3.81% rate of interest, collateralized by equipment	190	373
<b>Father Baker Manor</b>		
Mortgage payable to Century Health Capital, Inc. (f)	5,097	5,575
<b>McAuley Seton Home Health Care Corporation</b>		
Loan payable to HSBC Bank (g)	517	994

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)**

	<u>2016</u>	<u>2015</u>
<b>Our Lady of Victory Renaissance Corporation</b>		
Series 2007A Variable Rate Demand Bonds (h)	8,140	8,450
Series 2007B Variable Rate Demand Bonds (h)	1,315	1,370
Loan payable with HSBC Bank for Data Center (i)	<u>120</u>	<u>1,416</u>
	<u>9,575</u>	<u>11,236</u>
<b>Catholic Health System (Parent)</b>		
Series 2015 Revenue Bonds (d)	82,014	83,200
Capital lease obligation for financing of VOIP telephone system, in monthly installments of \$22, including interest at 2.92%, collateralized by equipment	784	1,284
Capital lease obligation for Administrative & Regional Training Center (ARTC) (j)	<u>-</u>	<u>38,365</u>
	<u>82,798</u>	<u>122,849</u>
Total long-term obligations	217,296	260,400
Less: Deferred financing costs	(6,224)	(6,649)
Less: Current maturities	<u>(15,312)</u>	<u>(13,945)</u>
Long-term obligations, net	<u>\$ 195,760</u>	<u>\$ 239,806</u>

- a. In November 2006, the System executed a restructuring transaction related to its outstanding debt. The System formed the Catholic Health System Obligated Group (the Obligated Group), consisting of its three primary hospitals (Mercy Hospital of Buffalo, Sisters of Charity Hospital, and Kenmore Mercy Hospital) and CHS. No subsidiaries of CHS other than the Members of the Obligated Group were included in this offering. On November 29, 2006, \$68,820 of Dormitory Authority of the State of New York (DASNY) Catholic Health System Obligated Group Revenue Bonds, Series 2006 were issued. The bonds consisted of the following:

- Series 2006A Bonds for \$13,360 was loaned to MHB in order to finance the cost of MHB's operating room expansion, other expansions and improvements at MHB's facility.
- Series 2006B Bonds for \$30,295 was loaned to SCH for the purpose of refunding DASNY's SCH Insured Revenue Bonds, Series 2003, which bonds were issued for the purpose of refunding a series of bonds issued in 1991, the proceeds of which were applied to finance the construction and renovation of the SCH facilities and to refinance outstanding indebtedness. Series 2006D for \$8,435 was loaned to the former St. Joseph Hospital (SJH), which was merged into SCH in 2009, to finance the cost of the SJH emergency room expansion project.
- Series 2006C Bonds for \$16,730 was loaned to KMH for the purpose of refunding the NYS Medical Care Facilities Finance Agency FHA - Insured Mortgage Project Revenue Bonds, 1995 Series B which were applied to finance the construction of a three floor patient tower, certain renovations to the KMH facility and to refinance outstanding indebtedness.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)

In connection with the issuance of the Series 2006 Bonds, the Obligated Group entered into a Loan Agreement (the Loan Agreement) whereby the Obligated Group is required to pay funds sufficient in timing and amount to pay the principal and redemption price of the Series 2006 Bonds and related interest and administrative expenses as they come due. The Series 2006 Bonds pay interest at a variable remarketed rate and are collateralized by a letter of credit with HSBC Bank which expires on November 29, 2019. In the event the letter of credit is not renewed at expiration, and no event of default exists, then the outstanding Bonds, at the option of the members of the Obligated Group, would be subject to a mandatory tender and will convert to a five year (initial) Term Loan. Repayment of the principal of Initial Term Loan shall be identical to the scheduled principal payments on the Bonds with the remaining amount due at the end of the five year term.

The interest borne by the Series 2006 Bonds will be determined by the Remarketing Agent to be the lowest rate that, in the judgment of the Remarketing Agent, under prevailing financial market conditions, enables such Series 2006 Bonds to be sold at a price of par. The variable interest rate was 0.72% and 0.01% at December 31, 2016 and 2015, respectively.

Certain financial covenants must be maintained by the Obligated Group. Failure to comply with these covenants requires a formal consultant's report and quarterly progress reports demonstrating how the facility is progressing towards compliance. The Loan Agreement requires the Obligated Group to comply with certain financial covenants, including maintenance of (i) a minimum number of days cash on hand; (ii) long-term debt service coverage; and (iii) a maximum leverage ratio. The Obligated Group was in compliance with these covenants at December 31, 2016 and 2015.

- b. On November 19, 2008, \$24,700 of DASNY - Catholic Health System Obligated Group Revenue Bonds, Series 2008 was issued. Series 2008 was loaned to the Obligated Group for the purpose of financing the cost of an approximately 48,300 square foot addition (Mercy Hospital of Buffalo) for a new emergency department, new imaging facilities, construction of a new main entrance and lobby area, a new ambulance entrance, construction of a rooftop helipad, renovation of library space into conference rooms, other mechanical and electrical improvements and associated demolition and equipment costs. Proceeds of the Series 2008 Bonds were also applied to pay certain costs of issuing the Bonds. The discount on the bonds of \$322 will be accreted over the life of the bonds.

The Series 2008 Bonds were issued under the Master Trust Indenture that was created in 2006 pursuant to the formation of the Obligated Group. All material components of the Series 2008 issue mirror the Series 2006 issue. Among these items are the following: 1) a variable remarketed rate (determined by the Security Industry and Financial Markets Association (SIFMA)) collateralized by a letter of credit with HSBC Bank expiring November 18, 2018 (with the option of an initial term loan), 2) a security interest in and assignment of gross receipts of the Mercy Hospital of Buffalo, together with the Mercy Hospital of Buffalo's right to receive or collect the gross receipts, 3) consistent financial covenants, and 4) execution of an interest rate swap agreement (with HSBC Bank) consistent with the terms utilized in the 2006 swap agreement (see Note 8). The variable interest rate was 0.72% and 0.01% at December 31, 2016 and 2015, respectively.

- c. On July 12, 2012, \$17,315 of DASNY Catholic Health System Obligated Group Revenue Bonds, Series 2012 were issued. The Bonds consisted of the following:
  - Series 2012A Bonds for \$14,235 were loaned to KMH for the purpose of financing the cost of a new two-story addition, which includes approximately 19,000 square feet on the first floor for a new emergency department, an approximately 14,794 square feet shell space on the second floor, and an approximately 16,000 square feet basement, as well as the cost of renovating existing space, expanding the existing parking lot and related demolition, and other mechanical and infrastructure improvements. Proceeds of the Series 2012A Bonds were also applied to pay certain costs of issuing the Bonds. The discount and premium on the bonds of \$157 and \$159, respectively, are attributable to the difference between the stated interest rate on these bonds and will be amortized over the life of the bonds.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

#### NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)

- Series 2012B Bonds for \$3,080 were loaned to MHB for the purpose of funding the cost of improvements to MHB's existing approximately 381,000 square foot parking facility containing approximately 1,026 spaces. Proceeds of the Series 2012B Bonds were also applied to pay certain costs of issuing the Bonds. The discount and premium on the bonds of \$32 and \$46, respectively, are attributable to the difference between the stated interest rate on these bonds and will be amortized over the life of the bonds.

The Series 2012 Bonds were issued under the Master Trust Indenture that was created in 2006 pursuant to the formation of the Obligated Group. In connection with the issuance of the Series 2012 Bonds, the Obligated Group entered into a Loan Agreement whereby the Obligated Group is required to make monthly payments sufficient to pay, among other things, the principal and Sinking Fund Installments of and interest on the Series 2012 Bonds as they become due. The Series 2012 Bonds bear interest at a fixed rate. The interest rates, maturities, and aggregate principal amounts outstanding at December 31, 2016 are as follows:

3.00% Serial Bonds Due July 1, 2017	\$	360
4.00% Serial Bonds Due July 1, 2018		370
3.50% Term Bonds Due July 1, 2022		1,610
4.00% Term Bonds Due July 1, 2027		2,385
5.00% Term Bonds Due July 1, 2032 (i)		2,960
4.75% Term Bonds Due July 1, 2039		<u>5,530</u>
Total Series 2012A Bonds		<u>13,215</u>
3.50% Term Bonds Due July 1, 2022		710
5.00% Term Bonds Due July 1, 2032 (i)		1,160
4.75% Term Bonds Due July 1, 2039		<u>1,210</u>
Total Series 2012B Bonds		<u>3,080</u>
Total Series 2012 Bonds	\$	<u>16,295</u>

- (i) Optional redemption on July 1, 2022 at a redemption price of 100% of the principal amount of such Series 2012 Bonds or portions thereof to be redeemed, plus accrued interest to the redemption date.

The Series 2006, 2008 and 2012 Loan Agreements specifies that the Obligated Group shall continuously pledge, as security for the payment of all liabilities and the performance of all obligations of the Obligated Group pursuant to the Loan Agreement, a security interest in and assignment of the gross receipts of the Obligated Group, together with the Hospitals' right to receive or collect the gross receipts. Further, the Obligated Group delivered a mortgage to secure all obligations and liabilities of the Hospitals under the Loan Agreement. As further security to the Loan Agreement, the Obligated Group granted DASNY a security interest in such fixtures, furnishings and equipment as owned by the Obligated Group. In addition, a letter of credit in the amount of the bonds was entered into with HSBC Bank to provide security on the 2006 Bonds. The financial covenants required under the Loan Agreement are consistent with those of the Series 2006 Bonds and Series 2008 Bonds.

- d. On April 29, 2015, \$93,800 of Buffalo and Erie County Industrial Land Development Corporation Catholic Health System Obligated Group Revenue Bonds, Series 2015 were issued. Series 2015 was loaned to the Obligated Group for the purpose of financing the cost of improvements to the Labor & Delivery department, Pre/Post-Operative Holding areas, upgrading the electrical switchgear (Mercy Hospital of Buffalo), Ambulatory Surgery Center (Sisters Hospital, St. Joseph Campus), Operating Room Expansion (Kenmore Mercy Hospital), Enterprise Resource Planning software, leasehold improvements to the Administrative Regional Training Center, and purchase of the Administrative Regional Training Center (Catholic Health System). Proceeds of the Series 2015 Bonds were also applied to pay certain costs of issuing the Bonds. The premium on the bonds of \$9,968 is attributable to the difference between the stated interest rate on these bonds and will be amortized over the life of the bonds.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)***NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)**

The Series 2015 Bonds were issued under the Master Trust Indenture that was created in 2006 pursuant to the formation of the Obligated Group. In connection with the issuance of the Series 2015 Bonds, the Obligated Group entered into a Loan Agreement whereby the Obligated Group is required to make monthly payments sufficient to pay, among other things, the principal and Sinking Fund Installments of and interest on the Series 2015 Bonds as they become due. The Series 2015 Bonds bear interest at a fixed rate. The interest rates, maturities, and aggregate principal amounts outstanding at December 31, 2015 are as follows:

5.00% Serial Bonds Due July 1, 2017	\$	1,400
5.00% Serial Bonds Due July 1, 2018		3,520
5.00% Serial Bonds Due July 1, 2019		3,690
5.00% Serial Bonds Due July 1, 2020		3,870
5.00% Serial Bonds Due July 1, 2021		4,075
5.00% Serial Bonds Due July 1, 2022		4,265
5.00% Serial Bonds Due July 1, 2023		4,480
5.00% Serial Bonds Due July 1, 2024		4,705
5.00% Serial Bonds Due July 1, 2025		4,955
5.00% Serial Bonds Due July 1, 2026		1,900
5.00% Serial Bonds Due July 1, 2027		1,995
5.00% Serial Bonds Due July 1, 2028		2,095
5.00% Serial Bonds Due July 1, 2029		2,200
5.00% Serial Bonds Due July 1, 2030		2,305
5.25% Term Bonds Due July 1, 2035		13,440
5.00% Term Bonds Due July 1, 2040		17,275
4.00% Term Bonds Due July 1, 2045		<u>17,630</u>
Total Series 2015 Bonds	\$	<u>93,800</u>

- e. On December 30, 2016, KMH entered into a loan agreement with HSBC Bank in the amount of \$5,822. The term loan calls for monthly principal payments of \$45 plus interest (30-day LIBOR plus 200). The loan Matures December 30, 2021 with a balloon payment of the outstanding balance at that time.
- f. Mortgage payable to Century Health Capital (an FHA - Insured Mortgage). The mortgage is payable in monthly installments of \$64 including interest of 5.375%. Monthly payments continue through maturity in March 2025. The mortgage is collateralized by the building and equipment.
- g. MSHC entered into a term loan agreement with HSBC Bank in the amount of \$2,385. Outstanding borrowings under this agreement bear interest at a fixed rate of 2.62% at December 31, 2016. The term loan calls for monthly principal payments of \$40 plus interest and matures on December 28, 2017. Outstanding borrowings are secured by substantially all the revenues and receipts of MSHC. The term loan contains various loan covenants, including a debt service coverage ratio. MSHC was in compliance with all covenants as of December 31, 2016 and 2015.



**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

---

**NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)**

- h. On April 1, 2007, OLV Renaissance entered into agreements with the Erie County Industrial Development Agency (the Agency) for the purpose of obtaining revenue bonds used to finance construction of its SNF and PACE facilities. The agency took title to the facility through a lease agreement and simultaneously conveyed title back to OLV Renaissance through an installment sale of the lease interests. OLV Renaissance is obligated to make lease rental payments to the bond trustee, as the Agency's assignee, in amounts which correspond to the principal and interest payments on the bonds. At the expiration of the leases' term (April 2032), title fully reverts back to OLV Renaissance. On April 25, 2007, the Agency issued variable rate demand revenue bonds with an aggregate principal amount of \$11,860. The bond issue consists of two series of bonds: \$10,220 in variable rate demand Revenue Bonds Series 2007A (Series 2007A Bonds) and \$1,640 in variable rate demand Revenue Bonds Series 2007B (Series 2007B Bonds).

The Variable Interest Rate is determined by the remarketing agent based on (1) market interest rates for comparable securities; (2) other financial market rates and indices (including, but not limited to treasury bills, commercial paper, commercial bank prime rates, HUD project notes, federal fund rates and LIBOR); (3) general financial and credit market conditions; (4) credit rating and financial condition of OLV Renaissance; and (5) applicable tender provisions which may have bearing on the rate. The variable interest rate was 0.87% for the Series 2007A bonds and 1.40% for the Series 2007B bonds at December 31, 2016. See Note 8 regarding the interest rate swap agreement OLV Renaissance entered into with respect to the Series 2007A Revenue Bonds.

The bonds are subject to conversion to a fixed interest rate at the written direction of OLV Renaissance. Upon conversion, the remarketing agent shall determine the fixed interest rate as the lowest rate of interest that would be necessary to sell the bonds in the secondary market at par plus accrued interest, based on prevailing market conditions and the yields at which comparable securities are being sold.

The Series 2007A Revenue Bonds are subject to mandatory sinking fund redemptions in years 2016 to 2032 in amounts ranging from \$310 to \$740 at variable interest rates. The Series 2007B Revenue Bonds are subject to mandatory sinking fund redemptions in years 2016 to 2032 in amounts ranging from \$55 to \$115.

Under the terms of the financing documents, OLV Renaissance has guaranteed payment of all amounts due under the Bonds. Additionally, the bonds are secured by first mortgage liens on all buildings, improvements and equipment now owned or subsequently acquired by OLV Renaissance, all unrestricted accounts receivable and a right of setoff against OLV Renaissance's funds held by the trustee.

In accordance with the financing documents, at the option of the Issuer and upon notice given by OLV Renaissance, the Series 2007A Revenue Bonds are subject to optional redemption at 100%. In connection with the Bond financing, OLV Renaissance has executed an irrevocable direct pay letter of credit with a financial institution for a maximum amount of \$10,261. The letter of credit expires May 1, 2018. There is no outstanding amount at December 31, 2016 or 2015. OLV Renaissance is required to pay an annual fee of 1.25% to maintain the letter of credit which is calculated on maximum amount available.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)

The bond agreements require certain covenants including debt service coverage and debt to capitalization to be maintained. The covenants were in effect during the years ended December 31, 2016 and 2015. OLV Renaissance's primary tenant, MHB is also required to comply with a covenant to maintain minimum long-term debt service coverage and a minimum days cash on hand as of any testing date.

MHB was in compliance with this covenant as of December 31, 2016 and 2015. OLV Renaissance was in compliance with this covenant as of December 31, 2016, and failed the debt service coverage covenant for December 31, 2015. OLV Renaissance obtained a waiver from HSBC Bank for the December 31, 2015 covenant violation.

- i. On December 28, 2011, OLV Renaissance entered into a term loan agreement with HSBC Bank, for the construction of a Data Center on the OLV Renaissance Campus. OLV Renaissance is obligated to make payments each month until expiration on December 31, 2016. The term loan bears interest at 3.05% repayable in monthly installments ranging from \$95 to \$110 plus interest beginning January 2012 through December 2016.

Under the terms of the financing documents, OLV Renaissance has guaranteed payment of all amounts due under the loan. Additionally, the loan is secured by second mortgage liens on all buildings, improvements and equipment now owned or subsequently acquired by OLV Renaissance, all unrestricted accounts receivable and a right of setoff against OLV Renaissance's funds held by the trustee. The loan agreement requires certain covenants including debt service coverage to be maintained. OLV Renaissance was in compliance with the debt service coverage ratio for December 31, 2016 and 2015.

- j. During 2014, construction was completed on the Administrative and Regional Training Center (ARTC). At time of occupancy, a twenty-five year lease was entered into with the developer. During 2016, the lease agreement was terminated as the System purchased the building in February 2016 utilizing proceeds from the 2015 bond issuance to fund the purchase.

Aggregate maturities of long-term debt, including capital lease obligations, considering obligations subject to short-term remarketing as due according to their long-term amortization schedule, subsequent to December 31, 2016 are as follows:

	<u>Long-Term Debt</u>	<u>Capital Leases</u>	<u>Total</u>
2017	\$ 10,768	\$ 6,184	\$ 16,952
2018	11,309	4,715	16,024
2019	11,411	3,412	14,823
2020	11,902	2,605	14,507
2021	12,693	1,524	14,217
Thereafter	<u>137,610</u>	<u>5,741</u>	<u>143,351</u>
	195,693	24,181	219,874
Less: Deferred financing costs	(6,224)	-	(6,224)
Less: Interest	<u>-</u>	<u>(2,578)</u>	<u>(2,578)</u>
Long-term obligations	<u>\$ 189,469</u>	<u>\$ 21,603</u>	<u>\$ 211,072</u>

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

#### NOTE 7. LONG-TERM OBLIGATIONS (CONTINUED)

At December 31, 2016 and 2015, the System had a revolving line of credit of \$20,000 of which \$4,310 and \$13,496 was outstanding as of December 31, 2016 and 2015, respectively. The variable interest rate was 2.61% and 2.42% at December 31, 2016 and 2015, respectively.

**Operating Leases:** Future minimum lease payments under noncancelable operating leases for equipment and property (net of sublease rentals) are as follows at December 31, 2016:

2017	\$	9,981
2018		7,922
2019		6,820
2020		6,330
2021		6,057
Thereafter		<u>4,662</u>
		41,772
Less: Minimum sublease rental		<u>(1,848)</u>
	\$	<u>39,924</u>

Total expense for rents and operating type leases for equipment and property was approximately \$13,048 and \$9,029 for 2016 and 2015, respectively.

#### NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS

In connection with the Series 2006 and 2008 Bonds and execution of the Loan Agreement, the Hospitals entered into interest rate swap agreements (derivative agreements) with HSBC Bank USA, NA and JP Morgan Chase (the Financial Institutions) for purposes of mitigating risk posed by the Bonds accruing interest at a variable rate. Further, the Hospitals agreed not to take or omit to take any action that could reasonably be expected to result in the termination of the derivative agreement unless otherwise approved by the Financial Institutions, provided, however, that termination of the derivative agreement shall not constitute an event of default for purposes of the Loan Agreement, but upon any such termination of the derivative agreement, the Financial Institutions may require that the Hospitals direct the Series 2006 or Series 2008 Bonds be converted to bonds that bear a fixed rate of interest. The interest rate swap agreements outstanding on the Series 2006 Bonds were settled in 2014. Termination costs in the amount of \$5,772 will be amortized over the remaining life of the bonds. Amortization expense related to the termination costs was \$869 and \$951 for 2016 and 2015, respectively.

The terms of the Series 2008 swap require the Hospitals to pay 3.785% on the notional amount (\$20,785 at December 31, 2016) and in exchange, the Hospitals will receive a variable rate payment based upon the SIFMA, calculated weekly. The 2008 swap agreement was executed on November 19, 2008 and expires on July 1, 2034. These dates correlate to the issue date and due date of the Bonds. The instrument qualifies for hedge treatment and is designated a cash flow hedge of future interest payments. The effective portion of the hedge has been excluded from excess of revenues over expenses and recorded within changes to net assets.

During 2007, OLV Renaissance entered into a hedging agreement with respect to interest rate exposure on the Series 2007A Revenue Bond. OLV Renaissance uses the interest rate swap agreement to reduce its exposure to interest rate changes. The interest rate swap fixes the interest rate paid by OLV Renaissance at 4.143% over the life of the bond, which matures in April 2032. The instrument qualifies for hedge treatment and is designated a cash flow hedge of future interest payments. The effective portion of the hedge has been excluded from excess of revenues over expenses and recorded within changes to net assets.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of derivative instruments at December 31 is as follows:

(in thousands of dollars)	2016		2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate contracts floating to fixed	Long-term liabilities	\$ 4,832	Long-term liabilities	\$ 6,122

The effects of derivative instruments on the consolidated statements of operations and changes in net assets for 2016 and 2015 are as follows:

(in thousands of dollars)	Ineffective portion in Statement of Operations		Effective portion in Net Assets	
	2016	2015	2016	2015
Change in fair value of interest rate swaps	\$ 28	\$ (7)	\$ 1,262	\$ (263)

The Hospitals measure their interest rate swaps at fair value on a recurring basis. The fair value of the interest rate swaps is determined based on financial models that consider current and future market interest rates and adjustments for nonperformance risk. The inputs utilized in the valuation process of the interest rate swaps are considered to be Level 2 within the fair value hierarchy defined in Note 14.

### NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION

In November 2006, the System formed the Obligated Group, consisting of its four primary hospitals (MHB, SCH, St. Joseph Hospital (SJH), and KMH) and the Parent. In 2006, the System issued \$68,820 of DASNY Catholic Health System Obligated Group Revenue Bonds, Series 2006. In 2008, \$24,700 of DASNY - Catholic Health System Obligated Group Revenue Bonds, Series 2008. In 2012, the System issued \$17,315 of DASNY - Catholic Health System Obligated Group Revenue Bonds, Series 2012. In 2015, the System issued \$93,800 of Buffalo and Erie County Industrial Land Development Corporation Revenue Bonds, Series 2015. These Revenue Bonds are joint and several obligations of the members of the Obligated Group. No affiliate of CHS, other than Members of the Obligated Group, is obligated for amounts due under the Series 2006, Series 2008, Series 2012, and Series 2015 Obligations. Management has determined that certain immaterial subsidiaries (Mercy Hospital Foundation, Inc., Sisters Hospital Foundation, Inc., Kenmore Mercy Hospital Foundation, Inc., and KMH Homes, Inc.) should be excluded from the Obligated Group financial information. Additionally, the gain on affiliation of Mount St. Mary's Hospital recognized by CHS in 2015 is also excluded from Obligated Group financial information.

The following supplemental consolidating financial information for the Obligated Group presents the balance sheets as of December 31, 2016 and 2015 and statements of operations and changes in net assets, and cash flows for the years then ended December 31, 2016 and 2015.

**These statements do not represent the results of the System.**

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Balance Sheet  
December 31, 2016

ASSETS	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Current assets:</b>						
Cash and cash equivalents	\$ 40,750	\$ 48,531	\$ 57,712	\$ 35,580	\$ -	\$ 182,573
Patient/resident accounts receivable, net of estimated uncollectibles of \$21,427	-	46,269	35,114	20,169	-	101,552
Other receivables	690	2,685	3,928	617	-	7,920
Inventories	-	11,570	6,725	2,815	-	21,110
Prepaid expenses and other current assets	4,448	3,157	1,633	766	-	10,004
Due from affiliates	88,819	49	1,104	301	(84,466)	5,807
<b>Total current assets</b>	<u>134,707</u>	<u>112,261</u>	<u>106,216</u>	<u>60,248</u>	<u>(84,466)</u>	<u>328,966</u>
Assets limited as to use	15,630	2,682	3,476	2,740	-	24,528
Investments	-	29,667	88,160	21,170	-	138,997
Property and equipment, net	87,721	102,371	68,154	68,202	-	326,448
Due from affiliates	6,636	-	10,303	1,457	(16,876)	1,520
Other assets	11,328	45,684	37,177	15,987	-	110,176
<b>Total Assets</b>	<u>\$ 256,022</u>	<u>\$ 292,665</u>	<u>\$ 313,486</u>	<u>\$ 169,804</u>	<u>\$ (101,342)</u>	<u>\$ 930,635</u>
<b>LIABILITIES AND NET ASSETS</b>						
<b>Current liabilities:</b>						
Current portion of long-term obligations	\$ 2,783	\$ 4,070	\$ 4,260	\$ 2,536	\$ -	\$ 13,649
Line of credit payable	4,310	-	-	-	-	4,310
Accounts payable	6,649	14,593	10,680	7,408	-	39,330
Accrued expenses	20,502	14,485	14,681	6,854	-	56,522
Due to third-party payors	-	16,789	12,355	6,763	-	35,907
Due to affiliates	452	15,109	29,574	23,239	(67,819)	555
<b>Total current liabilities</b>	<u>34,696</u>	<u>65,046</u>	<u>71,550</u>	<u>46,800</u>	<u>(67,819)</u>	<u>150,273</u>
Long-term obligations, net	77,789	46,300	27,992	30,489	-	182,570
Other long-term liabilities	70,406	208,856	130,852	55,250	(11,760)	453,604
<b>Total liabilities</b>	<u>182,891</u>	<u>320,202</u>	<u>230,394</u>	<u>132,539</u>	<u>(79,579)</u>	<u>786,447</u>
<b>Net assets (deficit)</b>						
Unrestricted	73,131	(27,537)	83,092	37,265	(21,763)	144,188
<b>Total net assets (deficit)</b>	<u>73,131</u>	<u>(27,537)</u>	<u>83,092</u>	<u>37,265</u>	<u>(21,763)</u>	<u>144,188</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 256,022</u>	<u>\$ 292,665</u>	<u>\$ 313,486</u>	<u>\$ 169,804</u>	<u>\$ (101,342)</u>	<u>\$ 930,635</u>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Statement of Operations  
and Changes in Net Assets  
For the Year Ended December 31, 2016

	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Unrestricted revenues, gains and other support:</b>						
Net patient/resident service revenue	\$ -	406,659	\$ 328,488	\$ 170,876	\$ (80)	\$ 905,943
Provision for bad debts	-	(5,823)	(6,773)	(3,052)	-	(15,648)
Net patient/resident service revenue less provision for bad debts	-	400,836	321,715	167,824	(80)	890,295
Other revenue	150,353	4,901	11,383	1,406	(138,006)	30,037
<b>Total unrestricted revenues, gains and other support</b>	<b>150,353</b>	<b>405,737</b>	<b>333,098</b>	<b>169,230</b>	<b>(138,086)</b>	<b>920,332</b>
<b>Expenses:</b>						
Salaries and wages	70,905	169,673	145,760	70,113	(62,342)	394,109
Employee benefits	21,163	57,503	44,147	20,470	(19,071)	124,212
Medical and professional fees	4,613	18,279	13,272	4,744	(3,226)	37,682
Purchased services	34,568	39,629	31,822	15,232	(32,518)	88,733
Supplies	831	86,209	58,852	39,884	(667)	185,109
Depreciation and amortization	7,700	16,588	14,582	8,766	(7,641)	39,995
Interest	3,461	3,736	2,764	2,154	(2,987)	9,128
Insurance	527	5,121	4,580	2,303	(478)	12,053
Other expenses	9,148	17,145	10,136	5,187	(11,750)	29,866
<b>Total expenses</b>	<b>152,916</b>	<b>413,883</b>	<b>325,915</b>	<b>168,853</b>	<b>(140,680)</b>	<b>920,887</b>
<b>Income (loss) from operations</b>	<b>(2,563)</b>	<b>(8,146)</b>	<b>7,183</b>	<b>377</b>	<b>2,594</b>	<b>(555)</b>
<b>Nonoperating revenues and losses:</b>						
Investment income	51	875	462	213	-	1,601
Other	2,512	875	3,108	890	(2,594)	4,791
<b>Total nonoperating revenues and losses:</b>	<b>2,563</b>	<b>1,750</b>	<b>3,570</b>	<b>1,103</b>	<b>(2,594)</b>	<b>6,392</b>
<b>Excess (deficiency) of revenues over expenses</b>	<b>\$ -</b>	<b>\$ (6,396)</b>	<b>\$ 10,753</b>	<b>\$ 1,480</b>	<b>\$ -</b>	<b>\$ 5,837</b>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Statement of Operations  
and Changes in Net Assets (Continued)

For the Year Ended December 31, 2016

	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Unrestricted net assets:</b>						
Excess (deficiency) of revenues over expenses	\$ -	\$ (6,396)	\$ 10,753	\$ 1,480	\$ -	\$ 5,837
Change in unrealized loss on interest rate swap	-	887	-	-	-	887
Change in pension obligation, other than net periodic cost	1,122	3,839	3,941	1,439	-	10,341
Grant revenue for capital expenditures	-	125	-	-	-	125
Transfers to/from parent or affiliate	25,433	(12,853)	(9,569)	(3,029)	-	(18)
Contributions and other	136	528	635	651	-	1,950
Valuation allowance on intercompany receivables	-	-	-	-	(3,571)	(3,571)
Increase (decrease) in unrestricted net assets	<u>26,691</u>	<u>(13,870)</u>	<u>5,760</u>	<u>541</u>	<u>(3,571)</u>	<u>15,551</u>
Increase (decrease) in net assets	26,691	(13,870)	5,760	541	(3,571)	15,551
Net assets (deficit), beginning of year	<u>46,440</u>	<u>(13,667)</u>	<u>77,332</u>	<u>36,724</u>	<u>(18,192)</u>	<u>128,637</u>
Net assets (deficit), end of year	<u>\$ 73,131</u>	<u>\$ (27,537)</u>	<u>\$ 83,092</u>	<u>\$ 37,265</u>	<u>\$ (21,763)</u>	<u>\$ 144,188</u>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Balance Sheet  
December 31, 2015

ASSETS	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Current assets:</b>						
Cash and cash equivalents	\$ 27,945	\$ 93,254	\$ 133,879	\$ 50,088	\$ -	\$ 305,166
Patient/resident accounts receivable, net of estimated uncollectibles of \$22,215	-	54,046	42,508	24,037	-	120,591
Other receivables	3,424	3,758	3,239	1,015	-	11,436
Inventories	-	13,616	7,130	2,949	-	23,695
Prepaid expenses and other current assets	3,799	997	540	382	-	5,718
Due from affiliates	86,341	311	1,112	1,085	(82,549)	6,300
<b>Total current assets</b>	<u>121,509</u>	<u>165,982</u>	<u>188,408</u>	<u>79,556</u>	<u>(82,549)</u>	<u>472,906</u>
Assets limited as to use	59,447	6,703	5,008	4,969	-	76,127
Property and equipment, net	81,273	96,669	73,899	63,147	-	314,988
Due from affiliates	7,295	-	10,303	1,456	(16,876)	2,178
Other assets	11,814	40,226	32,925	16,469	-	101,434
<b>Total Assets</b>	<u>\$ 281,338</u>	<u>\$ 309,580</u>	<u>\$ 310,543</u>	<u>\$ 165,597</u>	<u>\$ (99,425)</u>	<u>\$ 967,633</u>
<b>LIABILITIES AND NET ASSETS</b>						
<b>Current liabilities:</b>						
Current portion of long-term obligations	\$ 787	\$ 4,283	\$ 3,938	\$ 2,152	\$ -	\$ 11,160
Line of credit payable	13,496	-	-	-	-	13,496
Accounts payable	7,034	17,297	13,770	10,728	-	48,829
Accrued expenses	24,111	13,830	16,682	6,645	-	61,268
Due to third-party payors	-	17,368	12,493	6,636	-	36,497
Due to affiliates	678	20,912	27,385	21,289	(69,473)	791
<b>Total current liabilities</b>	<u>46,106</u>	<u>73,690</u>	<u>74,268</u>	<u>47,450</u>	<u>(69,473)</u>	<u>172,041</u>
Long-term obligations, net	119,710	48,615	31,092	25,593	-	225,010
Other long-term liabilities	69,082	200,942	127,851	55,830	(11,760)	441,945
<b>Total liabilities</b>	<u>234,898</u>	<u>323,247</u>	<u>233,211</u>	<u>128,873</u>	<u>(81,233)</u>	<u>838,996</u>
<b>Net assets (deficit)</b>						
Unrestricted	46,440	(13,667)	77,332	36,724	(18,192)	128,637
<b>Total net assets (deficit)</b>	<u>46,440</u>	<u>(13,667)</u>	<u>77,332</u>	<u>36,724</u>	<u>(18,192)</u>	<u>128,637</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 281,338</u>	<u>\$ 309,580</u>	<u>\$ 310,543</u>	<u>\$ 165,597</u>	<u>\$ (99,425)</u>	<u>\$ 967,633</u>



CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Statement of Operations  
and Changes in Net Assets

For the Year Ended December 31, 2015

	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Unrestricted revenues, gains and other support:</b>						
Net patient/resident service revenue	\$ -	402,769	\$ 322,140	\$ 173,115	\$ (36)	\$ 897,988
Provision for bad debts	-	(9,167)	(7,834)	(3,877)	-	(20,878)
Net patient/resident service revenue less provision for bad debts	-	393,602	314,306	169,238	(36)	877,110
Other revenue	139,672	5,805	6,548	2,159	(135,316)	18,868
<b>Total unrestricted revenues, gains and other support</b>	<b>139,672</b>	<b>399,407</b>	<b>320,854</b>	<b>171,397</b>	<b>(135,352)</b>	<b>895,978</b>
<b>Expenses:</b>						
Salaries and wages	62,343	162,030	144,053	69,999	(58,486)	379,939
Employee benefits	19,517	59,542	46,108	21,595	(18,708)	128,054
Medical and professional fees	5,859	14,338	13,232	5,498	(4,683)	34,244
Purchased services	30,230	35,520	31,123	15,599	(30,629)	81,843
Supplies	866	84,317	55,895	37,400	(789)	177,689
Depreciation and amortization	7,022	17,014	15,573	7,757	(6,899)	40,467
Interest	4,483	4,033	3,095	2,528	(3,760)	10,379
Insurance	377	4,492	4,915	2,795	(367)	12,212
Other expenses	9,503	15,890	9,708	4,782	(11,583)	28,300
<b>Total expenses</b>	<b>140,200</b>	<b>397,176</b>	<b>323,702</b>	<b>167,953</b>	<b>(135,904)</b>	<b>893,127</b>
<b>Income (loss) from operations</b>	<b>(528)</b>	<b>2,231</b>	<b>(2,848)</b>	<b>3,444</b>	<b>552</b>	<b>2,851</b>
<b>Nonoperating revenues and losses:</b>						
Investment income	34	290	151	69	(32)	512
Other	396	404	831	78	(520)	1,189
<b>Total nonoperating revenues and losses:</b>	<b>430</b>	<b>694</b>	<b>982</b>	<b>147</b>	<b>(552)</b>	<b>1,701</b>
<b>Excess (deficiency) of revenues over expenses</b>	<b>\$ (98)</b>	<b>\$ 2,925</b>	<b>\$ (1,866)</b>	<b>\$ 3,591</b>	<b>\$ -</b>	<b>\$ 4,552</b>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

Consolidating Statement of Operations  
and Changes in Net Assets (Continued)

For the Year Ended December 31, 2015

	Parent	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Eliminations	Total
<b>Unrestricted net assets:</b>						
Excess (deficiency) of revenues over expenses	\$ (98)	\$ 2,925	\$ (1,866)	\$ 3,591	\$ -	\$ 4,552
Change in unrealized loss on interest rate swap	-	(224)	-	-	-	(224)
Change in pension obligation, other than net periodic cost	3,728	11,857	6,932	2,365	-	24,882
Grant revenue for capital expenditures	-	11	56	-	-	67
Transfers to/from parent or affiliate	19,755	(10,238)	(6,570)	(3,443)	-	(496)
Contributions and other	(459)	526	680	1,682	-	2,429
Valuation allowance on intercompany receivables	-	-	-	-	(2,752)	(2,752)
Increase (decrease) in unrestricted net assets	<u>22,926</u>	<u>4,857</u>	<u>(768)</u>	<u>4,195</u>	<u>(2,752)</u>	<u>28,458</u>
Increase (decrease) in net assets	22,926	4,857	(768)	4,195	(2,752)	28,458
Net assets, beginning of year	<u>23,514</u>	<u>(18,524)</u>	<u>78,100</u>	<u>32,529</u>	<u>(15,440)</u>	<u>100,179</u>
Net assets (deficit), end of year	<u>\$ 46,440</u>	<u>\$ (13,667)</u>	<u>\$ 77,332</u>	<u>\$ 36,724</u>	<u>\$ (18,192)</u>	<u>\$ 128,637</u>

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands of dollars)

**NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)**

**Consolidating Statement of Cash Flows**

For the Year Ended December 31, 2016 and 2015

	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Increase in net assets	\$ 15,551	\$ 28,458
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	39,995	40,467
Provision for bad debts	15,648	20,878
Change in pension obligation, other than periodic cost	(10,341)	(24,882)
Grant revenue for capital additions	(125)	(67)
Valuation allowance of intercompany receivables	3,571	2,752
Unrealized and realized loss on investments	(2,759)	-
Change in unrealized gain on interest rate swap	(904)	229
Gain on extinguishment of capital leases	(1,967)	-
Undistributed earnings in equity investees	(240)	(10,184)
Amortization of discount on debt issuance	62	62
Amortization of premium on debt issuance	(575)	(391)
Amortization of debt issuance costs	392	518
(Increase) decrease in assets	729	29
Patient accounts receivables	3,391	(24,509)
Other receivables	3,516	(1,656)
Inventories	2,585	(1,900)
Prepaid expenses and other current assets	(4,286)	(78)
Due from affiliates	(2,420)	(2,426)
Other assets	14	229
Increase (decrease) in liabilities:		
Accounts payable	(6,818)	(229)
Accrued expenses	(1,561)	2,115
Due to affiliate	(236)	91
Due to third-party payors	(590)	1,629
Other liabilities	13,851	19,490
<b>Total net cash and cash equivalents provided by operating activities</b>	<b>66,483</b>	<b>50,625</b>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(50,647)	(31,334)
Proceeds from sale of property and equipment	9	31
Purchase of assets limited as to use	-	(94,406)
Proceeds from sale of assets limited as to use	50,067	34,900
Purchase of investments	(136,238)	-
<b>Net cash and cash equivalents used in investing activities</b>	<b>(136,809)</b>	<b>(90,809)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of long-term obligations, net	5,786	96,428
Premium on issuance	-	9,968
Proceeds of grant revenue for capital additions	125	67
Repayments of current and long-term obligations	(58,178)	(47,812)
<b>Net cash and cash equivalents (used in) provided by financing activities</b>	<b>(52,267)</b>	<b>58,651</b>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(122,593)</b>	<b>18,467</b>
Cash and cash equivalents - beginning of year	305,166	286,699
Cash and cash equivalents - end of year	<u>\$ 182,573</u>	<u>\$ 305,166</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the year for interest	\$ 7,820	\$ 8,919
<b>Non-cash transactions:</b>		
Assets acquired under capital lease obligations	\$ 1,990	\$ 2,864
Construction Related Payables	\$ (981)	\$ 7,578

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 9. OBLIGATED GROUP FINANCIAL INFORMATION (CONTINUED)

The Obligated Group provides healthcare services to residents within its geographic region. Expenses related to providing these services for the year ended December 31, are as follows:

	<u>2016</u>	<u>2015</u>
Healthcare services	\$ 776,184	\$ 753,972
General and administrative	<u>144,703</u>	<u>139,155</u>
	<u>\$ 920,887</u>	<u>\$ 893,127</u>

### NOTE 10. EMPLOYEE BENEFIT PLANS

**Pension Arrangements:** Effective January 1, 2001, the System began maintaining a qualified defined benefit pension plan covering substantially all of its employees at its constituent hospitals. As of that date, active participants in the KMH, MHB, and SCH plans who were employed at the Hospitals are covered under the Retirement Plan of the Catholic Health System (the Plan). Effective January 1, 2002, all other entities in the System, with the exception of the Nazareth Home, began participation in the Plan. Pension assets and liabilities from legacy plans, if any, were transferred to the Plan on September 25, 2002.

Effective January 1, 2001 or 2002, as applicable, all nonunion employees who had met the age and service requirements under their previous plan were given the option of choosing to participate in the cash balance feature of the Plan. Those who choose not to participate in the cash balance feature accrue benefits under the same formula as their previous plan. All nonunion employees who become participants after that date automatically participate under the cash balance formula.

The Plan bases benefits upon both years of service and earnings. Participants under the Hospitals formula earn benefits under a final average formula or a career average formula. The cash balance formula is a hypothetical account balance formula. A participant's benefit obligation is assigned to the location at which the person works. As participants transfer within the System to other CHS subsidiaries, the obligations and a proportional amount of the plan's assets transfer, accordingly.

**Funded Status:** The following tables summarize changes in the projected benefit obligation, the plan assets and the funded status of the CHS pension plan as well as the components of net periodic benefit costs, including key assumptions as of December 31.

	<u>2016</u>	<u>2015</u>
<b>Projected Benefit Obligations</b>		
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 605,150	\$ 609,885
Service cost	22,295	22,313
Interest cost	27,659	25,222
Amendments	-	15
Expenses	(444)	(516)
Benefits paid	(18,698)	(17,412)
Actuarial (gains) losses	<u>415</u>	<u>(34,357)</u>
Projected benefit obligation at end of year	<u>\$ 636,377</u>	<u>\$ 605,150</u>
<b>Accumulated benefit obligations at end of year</b>	<u>\$ 576,683</u>	<u>\$ 541,035</u>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 10. EMPLOYEE BENEFIT PLANS (CONTINUED)

	<u>2016</u>	<u>2015</u>
<b>Plan Assets</b>		
Change in plan assets:		
Fair value of assets at beginning of year	\$ 298,106	\$ 294,914
Actual return on plan assets	25,294	(2,387)
System contribution	24,343	23,507
Expenses	(444)	(516)
Benefits paid	<u>(18,698)</u>	<u>(17,412)</u>
Fair value of plan assets at end of year	<u>\$ 328,601</u>	<u>\$ 298,106</u>
<b>Funded status at end of year</b>	<u>\$ (307,776)</u>	<u>\$ (307,044)</u>
<b>Amounts recognized in the consolidated balance sheets:</b>		
Non-current liabilities	<u>\$ (307,776)</u>	<u>\$ (307,044)</u>
Net amounts recognized	<u>\$ (307,776)</u>	<u>\$ (307,044)</u>
<b>Amounts recognized in unrestricted net assets consists of:</b>		
Actuarial net loss	\$ (172,219)	\$ (184,544)
Prior service cost	<u>(309)</u>	<u>(368)</u>
Total amount recognized	<u>\$ (172,528)</u>	<u>\$ (184,912)</u>
<b>Other changes recognized in unrestricted net assets:</b>		
Net loss (gain) arising during the period	\$ 28,374	\$ 98,952
Amortization of prior service cost	(129)	(229)
Amortization of loss	<u>(15,861)</u>	<u>(8,565)</u>
Total amount recognized	<u>\$ 12,384</u>	<u>\$ 90,158</u>
<b>Components of net periodic benefit cost:</b>		
Service cost	\$ 22,295	\$ 22,313
Interest cost	27,659	25,222
Expected return on plan assets	(23,830)	(22,250)
Amortization of prior service cost or (credit)	59	129
Recognized actuarial loss	<u>11,276</u>	<u>15,868</u>
Net periodic pension cost	<u>\$ 37,459</u>	<u>\$ 41,282</u>

The System's estimated prior service cost of \$57 and net loss of \$9,411 will be amortized from unrestricted net assets into net periodic pension cost over the next fiscal year.

The Plan's investment policies and strategies were used to develop the expected long-term rate of return on risk-free investment (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return of each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 10. EMPLOYEE BENEFIT PLANS (CONTINUED)

The Plan's target asset allocation and the actual asset allocation percentages for 2016 and 2015 are as follows at the respective measurement dates:

<u>Asset Category</u>	<u>Target</u>	<u>Actual</u>	
		<u>2016</u>	<u>2015</u>
Equities	70%	70%	65%
Fixed income	25	25	25
Other	<u>5</u>	<u>5</u>	<u>10</u>
	<u>100%</u>	<u>100%</u>	<u>100%</u>

The portfolio is diversified among a mix of assets including large and small cap, domestic and foreign equities, fixed income, alternatives (a fund of hedge funds), and cash. Asset mix is targeted to a specific allocation that is established by evaluating expected return, standard deviation, and correlation of various assets against the plan's long-term objectives. Asset performance is monitored quarterly and rebalanced if asset classes exceed explicit ranges. The Statement of Policy and Investment Objectives governs permitted types of investments, and outlines specific benchmarks and performance percentiles. The Catholic Health Benefit Plan Committee oversees the pension investment program and monitors investment performance. Risk is closely monitored through the evaluation of portfolio holdings and tracking the beta and standard deviation of the portfolio performance. The use of derivative financial instruments as an investment vehicle is specifically limited.

Accounting Standards Codification Topic 820 allows for the use of a practical expedient for the estimation of fair value of investments in investment companies for which the investment does not have a readily determinable fair value. For investments in non-unitized investments, the equivalent is the Plan's proportionate share of the partner's capital of the investment partnerships as reported by the general partners. Through its monitoring activities, the Plan believes that the carrying amounts of these financial instruments are reasonable estimates of fair value.

The assets or liability's fair value measurement level with the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2016 and 2015:

**Cash and cash equivalents** – Include certain instruments in highly liquid debt instruments with original maturities of three months or less at date of purchase.

**Equity Securities** – Equity securities are valued at the closing price reported on the applicable exchange on which the security is traded, or are estimated using quoted market prices for similar securities.

**Debt Securities** – Debt securities are valued using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve as well as other relevant economic measures.

**Mutual Funds** – Mutual funds are valued using the net asset value based on the value of the underlying assets owned by the fund, minus liabilities, divided by the number of shares outstanding, and multiplied by the number of shares owned.

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 10. EMPLOYEE BENEFIT PLANS (CONTINUED)**

**Commingled Funds** – Commingled funds are developed for investment by institutional investors only and therefore do not require registration with the Securities and Exchange Commission. Commingled funds are recorded at fair value based on either the underlying investments that have a readily determinable market value or based on net asset value, which is calculated using the most recent fund financial statements.

**Hedge Funds** – Hedge funds utilize either a direct or a “fund-of-funds” approach resulting in diversified multi-strategy, multi-manager investments. Underlying investments in these funds may include equities, fixed income securities, commodities, currencies and derivatives. These funds are valued at net asset value, which is calculated using the most recent fund financial statements.

The preceding methods described may produce a fair value calculation that may not be indicative of the net realizable value or reflective of future fair values. Furthermore, although the Plan 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 fair value measurement at the reporting date.

The following table presents the Plan's financial instruments as of December 31, 2016, measured at fair value on a recurring basis using the fair value hierarchy defined in Note 14.

<b>At December 31, 2016</b>	<b><u>Level I</u></b>	<b><u>Level II</u></b>	<b><u>Level III</u></b>	<b><u>Total</u></b>
<b>Pension Plans:</b>				
Cash and cash equivalents	\$ 12,507	\$ -	\$ -	\$ 12,507
Equity securities	31,909	-	-	31,909
Debt securities:				
Government and government agency obligations	-	17,246	-	17,246
Corporate bonds	-	49,964	-	49,964
Asset backed securities	-	6,025	-	6,025
Mutual funds:				
Equity mutual funds	36,273	-	-	36,273
Fixed mutual funds	<u>22,898</u>	<u>-</u>	<u>-</u>	<u>22,898</u>
Subtotal	<u>103,587</u>	<u>73,235</u>	<u>-</u>	<u>176,822</u>
<b>Investment measured at net asset value:</b>				
Commingled funds:				
Equity commingled funds				137,414
Fixed income commingled funds				591
Hedge funds				<u>13,774</u>
<b>Total</b>				<b>\$ <u>328,601</u></b>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands of dollars)

NOTE 10. EMPLOYEE BENEFIT PLANS (CONTINUED)

At December 31, 2015	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
<b>Pension Plans:</b>				
Cash and cash equivalents	\$ 15,185	\$ -	\$ -	\$ 15,185
Equity securities	25,499	-	-	25,499
Debt securities:				
Government and government agency obligations	-	15,326	-	15,326
Corporate bonds	-	51,145	-	51,145
Asset backed securities	-	6,281	-	6,281
Mutual funds:				
Equity mutual funds	31,963	-	-	31,963
Fixed mutual funds	<u>22,140</u>	<u>-</u>	<u>-</u>	<u>22,140</u>
Subtotal	<u>94,787</u>	<u>72,752</u>	<u>-</u>	<u>167,539</u>
<b>Investment measured at net asset value:</b>				
Commingled funds:				
Equity commingled funds				119,231
Fixed income commingled funds				558
Hedge funds				<u>10,778</u>
<b>Total</b>				<b>\$ <u>298,106</u></b>

**Contributions:** Contributions to the Plan are made to make benefit payments to plan participants. The funding policy is to contribute amounts to the trusts sufficient to meet minimum funding requirements plus such additional amounts as may be determined to be appropriate. Contributions are made to benefit plans for the sole benefit of plan participants.

The System is expected to contribute an aggregate amount of approximately \$33,131 to the pension plan trust in 2017 to be allocated amongst participating entities.

**Benefit Payments:** Estimated future benefit payments by the System are as follows as of December 31:

2017	\$ 22,327
2018	\$ 24,355
2019	\$ 26,989
2020	\$ 29,381
2021	\$ 32,105
2022 - 2026	\$ 196,492



**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands of dollars)*

**NOTE 10. EMPLOYEE BENEFIT PLANS (CONTINUED)**

	<u>2016</u>	<u>2015</u>
<b>Weighted average assumptions used to determine end of the year benefit obligations:</b>		
Discount rate	4.40%	4.65%
Rate of compensation increase	Age Based*	3.50%
<b>Weighted average assumptions used to determine net periodic pension cost:</b>		
Discount rate	4.65%	4.20%
Expected long-term rate of return on plan assets	7.50%	7.50%
Measurement date	12/31/2016	12/31/2015

\*The System has updated the rate of compensation increase from 3.5% to an age based rate for all ages of benefit recipients during 2016, as expected salary increases ranged from 3.1% to 4.5%.

**NOTE 11. INSURANCE ARRANGEMENTS**

**Professional and General Liability Arrangements**

The System participates in the Trinity Health insurance program which provides coverage for healthcare professional (medical malpractice) and general liability exposures. The primary limits were \$20,000 per occurrence for healthcare professional liability and general liability for the years ending December 31 2016 and 2015. Professional and general liabilities are insured by Trinity Assurance, Ltd. ("TAL"), formerly Venzke Insurance Company, Ltd. (Venzke). TAL is a Cayman-domiciled insurer wholly-owned by Trinity Health. Excess coverage was also provided to the System, and this excess coverage is fully reinsured with nonaffiliated commercial insurance companies.

The coverage provided is on a claims-made basis. The System therefore retains the liability for unasserted claims resulting from incidents that occurred on services provided prior to the financial statement date. The System has independent actuaries estimate the ultimate costs of such unasserted claims, which were discounted at 3% in 2016 and 2015. The System's reserve for unpaid and incurred but not reported claims at December 31, 2016 and 2015 is \$86,250 and \$77,514, respectively, and is included within other noncurrent liabilities. The charges to expenses for professional and general liability for 2016 and 2015 approximated \$11,274 and \$11,563, respectively, which has been included in insurance expense. The required claims liability and any anticipated insurance recoveries are to be reported on a gross basis. Amounts recognized as insurance receivables related to the claims approximated \$74,921 and \$66,873 at December 31, 2016 and 2015, respectively and is included in other non-current assets. Insurance recoveries are measured on the same basis as the liability subject to the need for a valuation allowance on uncollectible amounts.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 11. INSURANCE ARRANGEMENTS (CONTINUED)

##### **Workers Compensation Arrangements**

The System's insurance program for workers' compensation has a deductible of \$750 per occurrence in 2016 and 2015. Claims in excess of the deductible are fully insured. Losses from asserted claims and from unasserted claims identified under the System's incident reporting programs were accrued on a discounted basis based upon actuarial estimates of the settlement of such claims. The discount rate applied is 3% in 2016 and 2015, respectively. The System's current portion of liabilities for unpaid and incurred but not reported claims at December 31, 2016 and 2015 is \$10,241 and \$9,440, respectively, and is included in accrued expenses. The System's long term portion of liabilities for unpaid and incurred but not reported claims at December 31, 2016 and 2015 is \$69,944 and \$65,965, respectively, and is included in other long-term liabilities.

The charges to expenses for workers' compensation costs approximated \$11,532 and \$12,041 in 2016 and 2015, respectively, which has been included in employee benefits expense. The required claims liability and any anticipated insurance recoveries are to be reported on a gross basis. Amounts recognized as insurance receivables related to the claims approximated \$32,009 and \$30,418 at December 31, 2016 and 2015, respectively and is included in other non-current assets. Insurance recoveries are measured on the same basis as the liability subject to the need for a valuation allowance for uncollectible amounts.

##### **Employee Health Arrangements**

The System's insurance for employee health costs is self-insured up to \$350 per claim. Claims in excess of self-insurance levels are fully insured. Claims are accrued based upon the System's estimates of the aggregate liability for claims incurred using certain actuarial assumptions used in the insurance industry and based on the System's experience. The System's liability for unpaid health insurance claims, which has been included in accrued expenses at December 31, 2016 and 2015, was \$7,280 and \$8,555, respectively.

#### NOTE 12. LEGAL MATTERS

The System is involved in litigation and regulatory investigations arising in the course of business. The health care industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at the time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed under Medicare and Medicaid programs in the current and preceding years. While certain regulatory inquiries have been made at December 31, 2016, compliance with such laws and regulations is currently subject to government review and interpretation as well as regulatory actions unknown and/or unasserted at this time. Management believes it is in compliance with such laws and regulations and no unknown or unasserted claims were known at this time, which could have a material adverse affect on the System's future financial position, results from operations or cash flows.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

#### NOTE 13. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of who are residents of Western New York and are insured under third-party agreements. The mix of receivables from patients and third-party payors at December 31 are as follows:

	<u>2016</u>	<u>2015</u>
Medicare	30%	33%
Medicaid	19	18
Blue Cross	9	7
Other third-party payors	30	30
Patients/residents	<u>12</u>	<u>12</u>
	<u>100%</u>	<u>100%</u>

The System maintains funds in excess of amounts insured by the Federal Depository Insurance limits. The System has diversified its deposit amounts in a variety of institutions to reduce the level of concentrated credit risk.

#### NOTE 14. FAIR VALUE MEASUREMENTS

The System's consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets and liabilities measured at fair value on a recurring basis on the System's consolidated balance sheets include cash and cash equivalents, equity securities, exchange traded funds, debt securities, mutual funds, commingled funds and interest rate swaps. Liabilities measured at fair value on a recurring basis for disclosure only include debt.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value should be based on assumptions that market participants would use, including a consideration of non-performance risk.

To determine fair value, the System uses various valuation methodologies based on market inputs. For many instruments, pricing inputs are readily observable in the market; the valuation methodology is widely accepted by market participants and involves little to no judgment. For other instruments, pricing inputs are less observable in the marketplace. These inputs can be subjective in nature and involve uncertainties and matters of considerable judgment. The use of different assumptions, judgments and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The System assesses the inputs used to measure fair value using a three level hierarchy based on the extent to which inputs used in measuring fair value are observable in the market. The fair value hierarchy is as follows:

Level 1 – Quoted (unadjusted) prices for identical instruments in active markets.

Level 2 – Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar instruments in active markets;
- Quoted prices for identical or similar instruments in non-active markets (few transactions, limited information, non-current prices, high variability over time, etc.);
- Inputs other than quoted prices that are observable for the instrument (interest rates, yield curves, volatilities, default rates, etc.); and

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 14. FAIR VALUE MEASUREMENTS (CONTINUED)

- Inputs that are derived principally from or corroborated by other observable market data.

Level 3 – Unobservable inputs that cannot be corroborated by observable market data.

Valuation Methodologies - Exchange-traded securities whose fair value is derived using quoted prices in active markets are classified as Level 1.

In instances where quoted market prices are not readily available, fair value is estimated using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve as well as other relevant economic measures. The inputs to these models depends on the type of security being priced but are typically benchmark yields, credit spreads, prepayment speeds, reported trades and broker-dealer quotes, all with reasonable levels of transparency. Generally, significant changes in any of those inputs in insolation would result in a significantly different fair value measurement, respectively. The System classifies these securities as Level 2 within the fair value hierarchy.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

Following is a description of the valuation methodologies the System used for instruments recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

**Cash and cash equivalents:** The carrying amounts reported in the consolidated balance sheets approximate their fair value. Certain cash and cash equivalents are included in investments and assets limited or restricted as to use in the consolidated balance sheets. The system considers all highly liquid investments, generally with original maturities of three months or less when purchased, and short term investments excluding amounts limited as to use, to be cash equivalents.

**Equity Securities:** Equity securities are valued at the closing price reported on the applicable exchange on which the security is traded, or are estimated using quoted market prices for similar securities.

**Exchange-traded securities:** Exchange traded funds are valued at the closing price reported on the applicable exchange on which the security traded is tracked.

**Debt Securities:** Debt securities are valued using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve as well as other relevant economic measures.

**Mutual Funds:** Mutual funds are valued using the net asset value based on the value of the underlying assets owned by the fund, minus liabilities, divided by the number of shares outstanding, and multiplied by the number of shares owned.

**Investment in the Ascension Alpha Fund, LLC:** This fund is wholly owned subsidiary of Ascension Health and includes pooled short term investment funds, equity securities, and fixed income securities. The fund's investments also include alternative investments and other investments, which are valued at the net asset value of the investments.

# CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

### NOTE 14. FAIR VALUE MEASUREMENTS (CONTINUED)

**Commingled Funds:** Commingled funds are developed for investment by institutional investors only and therefore do not require registration with the Securities and Exchange Commission. Commingled funds are recorded at fair value based on either the underlying investments that have a readily determinable market value or based on net asset value, which is calculated using the most recent fund financial statements.

**Hedge Funds:** Hedge funds utilize either a direct or a "fund-of-funds" approach resulting in diversified multi-strategy, multi-manager investments. Underlying investments in these funds may include equities, fixed income securities, commodities, currencies and derivatives. These funds are valued at net asset value, which is calculated using the most recent fund financial statements.

**Equity Method Investments:** The System has a 1% ownership interest in equity method investments which are maintained in a Trinity Health corporate pooled investment program at December 31, 2016.

**Interest Rate Swap:** The fair value of the interest rate swap is determined based on financial models that consider current and future market interest rates and adjustments for nonperformance risk. The fair value of these interest rate derivatives are based on quoted prices for similar instruments from a commercial bank, and therefore, the interest rate derivative is considered a Level 2 item in the fair value hierarchy.

**Long-Term Debt:** The fair value of the long-term debt is based on current rates offered for similar issues with similar security terms and maturities, or estimated using a discount rate that a market participant would demand. The carrying value of the long-term debt approximates fair value as of December 31, 2016 and 2015. Long-term debt would be classified as Level 2 in the fair value hierarchy.

The following tables summarize the fair values, by input hierarchy, of financial instruments measured at fair value on a recurring basis at December 31, 2016:

At December 31, 2016	Level I	Level II	Level III	Total
<b>Assets limited as to use:</b>				
Cash and cash equivalents	\$ 31,415	\$ -	\$ -	\$ 31,415
Equity securities	9	-	-	9
Government and government agency obligations	5,714	899	-	6,613
Subtotal	<u>37,138</u>	<u>899</u>	<u>-</u>	<u>38,037</u>
Interest receivable				<u>22</u>
<b>Total</b>				<u>\$ 38,059</u>
<b>Investments:</b>				
Cash and cash equivalents	\$ 633	\$ -	\$ -	\$ 633
Equity securities	11,503	-	-	11,503
Debt securities	895	1,262	-	2,157
Exchange traded funds	4,951	-	-	4,951
Other	-	484	-	484
Subtotal	<u>17,982</u>	<u>1,746</u>	<u>-</u>	<u>19,728</u>
<b>Investment measured at net asset value:</b>				
Investment in Ascension Alpha Fund, LLC				<u>159,317</u>
<b>Total</b>				<u>\$ 179,045</u>
Interest rate swap liability	\$ -	\$ 4,832	\$ -	\$ 4,832

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands of dollars)

**NOTE 14. FAIR VALUE MEASUREMENTS (CONTINUED)**

<b>At December 31, 2015</b>	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>	<b>Total</b>
<b>Assets limited as to use:</b>				
Cash and cash equivalents	\$ 83,296	\$ -	\$ -	\$ 83,296
Equity securities	10	-	-	10
Government and government agency obligations	5,422	815	-	6,237
Subtotal	<u>88,728</u>	<u>815</u>	<u>-</u>	<u>89,543</u>
Interest receivable				<u>15</u>
<b>Total</b>				<b>\$ <u>89,558</u></b>
<b>Investments:</b>				
Cash and cash equivalents	\$ 1,426	\$ -	\$ -	\$ 1,426
Equity securities	9,240	1	-	9,241
Debt securities	774	2,493	-	3,267
Exchange traded funds	1,521	-	-	1,521
Mutual Funds	209	-	-	209
Other	-	477	-	477
Subtotal	<u>13,170</u>	<u>2,971</u>	<u>-</u>	<u>16,141</u>
<b>Investment measured at net asset value:</b>				
Commingled funds				166
Hedge funds				155
Equity method investments				<u>219</u>
<b>Total</b>				<b>\$ <u>16,681</u></b>
Interest rate swap liability	\$ <u>-</u>	\$ <u>6,122</u>	\$ <u>-</u>	\$ <u>6,122</u>

**NOTE 15. RELATED PARTY TRANSACTIONS**

Trinity Health charged the System dues for participation in certain programs and governance matters. Amounts charged to expense related to these dues amounted to approximately \$4,200 in 2016 and 2015, and are included as a component of other expenses.

CIPA WNY IPA "DBA" Catholic Medical Partners was incorporated in 1996 to establish managed care contracts that support clinical integration and provider accountability for cost and quality. The hospitals, long-term care, and home care subsidiaries are members of Catholic Medical Partners. The System has four of its executive staff on the Catholic Medical Partners' Board of Directors.

As discussed in Note 11, the System obtains insurance coverage from Trinity Health.

Caritas Medical Arts Building L.L.C. is a joint venture between Sisters of Charity Hospital and Ciminelli Development Company. In 2009, Caritas Medical Arts Building, L.L.C. refinanced its mortgage. As of December 31, 2016, there was \$1,762 of debt outstanding, of which SCH has guaranteed \$588. Per the guaranty agreement, SCH's obligation shall decrease on a dollar for dollar basis as the principal amount of the obligation is paid down.

Marian Professional Center Associates, L.P. is a joint venture between Ciminelli Development Company, MHB, Alsace Abbott Corporation (a wholly owned Corporation of MHB), and three other joint venture partners. In 2007, Marian Professional Center Associates, L.P. refinanced its mortgage. As of December 31, 2016, there was \$4,193 of debt outstanding, of which MHB has guaranteed \$2,097. Per the guaranty agreement, MHB's obligation shall decrease on a dollar for dollar basis as the principal amount of the obligation is paid down.

## CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (in thousands of dollars)

---

#### NOTE 16. DISCONTINUED OPERATIONS

The following subsidiaries, which have been closed or sold as referenced, have been accounted for within discontinued operations: St. Francis Geriatric Healthcare Services, Inc. (closed 2009), Nazareth Home of the Franciscan of the Immaculate Conception (closed 2007), St. Francis Home of Williamsville (sold 2015), St. Elizabeth's Home and St. Vincent's Home for the Aged (both sold 2016).

The residual assets (net of inter-company receivables), liabilities and net assets (deficit) of these discontinued operations were \$16,978, \$23,538 and (\$2,877), respectively, as of December 31, 2016 and are included within their natural classifications in the accompanying consolidated balance sheets. For the subsidiaries listed above that were closed prior to 2016, the residual assets (net of inter-company receivables), liabilities and net assets (deficit) of these discontinued operations were and \$13,839, \$15,444 and (\$125), respectively, as of December 31, 2015.

In March 2016 the assets of SVH were sold to a third party. The sales price for the facility approximated \$635. After deducting asset value and other closing costs, the net gain from the sale was approximately \$640.

In March 2016 the assets of SEH were sold to a third party. The sales price for the facility approximated \$2,011. After deducting asset value and other closing costs, the net gain from the sale was approximately \$1,921.

In April 2015 the assets of SFHW were sold to a third party. The sales price for the facility approximated \$6,000. After deducting asset value and other closing costs, the net gain from the sale was \$3,681.

In May 2015 the assets of Nazareth Home of the Franciscan of the Immaculate Conception were sold to a third party. The sales price for the facility approximated \$1,000. After deducting asset value and other closing costs, the net gain from the sale was \$548.

The aggregate loss from discontinued operations for assets held for sale as well as the closed facilities was approximately \$2,680 and \$2,916 in 2016 and 2015, respectively. Assets held for sale related to discontinued operations were \$0 and \$553 in 2016 and 2015, respectively.

#### NOTE 17. FUNCTIONAL EXPENSES

The System provides general health care services to residents within its geographic region. Expenses related to providing these services for the years ended December 31 are as follows:

	<u>2016</u>	<u>2015</u>
Healthcare services	\$ 936,748	\$ 867,727
General and administrative	<u>149,744</u>	<u>141,844</u>
	<u>\$ 1,086,492</u>	<u>\$ 1,009,571</u>



## INDEPENDENT AUDITOR'S REPORT ON ACCOMPANYING SUPPLEMENTARY INFORMATION

To the Board of Directors  
Catholic Health System, Inc.  
Buffalo, New York

We have audited the consolidated financial statements of Catholic Health System, Inc. and its subsidiaries (together the System) as of December 31, 2016 and 2015 and for the years then ended and our report thereon appears on page 1 of this document. These audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The Schedule of Net Cost of Providing Care of Persons Living in Poverty and Community Benefit Programs (Schedule of Social Accountability) is the responsibility of management and is provided for purposes of additional analysis of the consolidated financial statements. Such information is unaudited and therefore, we do not express an opinion on the Schedule of Net Cost of Providing Care of Persons Living in Poverty and Community Benefit Programs (Schedule of Social Accountability).

The consolidating information for Catholic Health System, Inc. and its subsidiaries, presented on pages 48 through 60, and the consolidating information for Kenmore Mercy Hospital and subsidiaries, presented on pages 61 through 63, is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating 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 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 of America. In our opinion, the 2016 and 2015 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Freed Maxick CPAs, P.C.*

Buffalo, New York  
May 1, 2017



**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**

**SCHEDULE OF NET COST OF PROVIDING CARE OF PERSONS LIVING IN POVERTY AND  
COMMUNITY BENEFIT PROGRAMS (SCHEDULE OF SOCIAL ACCOUNTABILITY – UNAUDITED)  
Years Ended December 31, 2016 and 2015**

---

*(in thousands of dollars)*

The total net costs related to the care of the poor and benefits for the broader community as of December 31 are set forth in the following table:

	<u>2016</u>	<u>2015</u>
Charity care	\$ 9,299	\$ 5,944
Cost of community benefit programs	42,174	37,425
Unpaid cost of Medicaid programs	<u>63,526</u>	<u>56,141</u>
	<u>\$ 114,999</u>	<u>\$ 99,510</u>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

(in thousands of dollars)

December 31, 2016

ASSETS	Parent	Acute Care Subsidiaries	Long-term Care Subsidiaries	Home Care Subsidiaries	Other Subsidiaries	Eliminations	Total
<b>Current assets:</b>							
Cash and cash equivalents	\$ 40,750	\$ 150,243	\$ 13,389	\$ 11,486	\$ 11,363	\$ -	\$ 227,231
Patient/resident accounts receivable, net of allowance for doubtful accounts of \$25,493	-	112,145	3,553	9,330	174	-	125,202
Other receivables	690	8,521	44	-	38	-	9,293
Inventories	-	22,836	41	723	-	-	23,600
Prepaid expenses and other current assets	4,448	5,943	22	802	73	-	11,288
Due from affiliates	88,819	1,069	1,567	-	7	(91,462)	-
<b>Total current assets</b>	<b>134,707</b>	<b>300,757</b>	<b>18,616</b>	<b>22,341</b>	<b>11,655</b>	<b>(91,462)</b>	<b>396,614</b>
Interest in net assets of related Foundation	-	-	228	-	223	(451)	-
Assets limited as to use	15,630	8,898	12,543	-	988	-	38,059
Investments	-	158,724	-	20,321	-	-	179,045
Property and equipment, net	87,721	263,822	4,576	786	14,254	-	371,159
Other assets	28,353	99,676	5,007	5,176	310	(27,033)	111,489
Due from affiliates	6,636	11,759	2,123	781	59	(21,358)	-
<b>Total assets</b>	<b>\$ 273,047</b>	<b>\$ 843,636</b>	<b>\$ 43,093</b>	<b>\$ 49,405</b>	<b>\$ 27,489</b>	<b>\$ (140,304)</b>	<b>\$ 1,096,366</b>
<b>LIABILITIES AND NET ASSETS</b>							
<b>Current liabilities:</b>							
Current portion of long-term obligations	\$ 2,783	\$ 11,040	\$ 467	\$ 517	\$ 505	\$ -	\$ 15,312
Line of credit payable	4,310	-	-	-	-	-	4,310
Accounts payable	6,649	34,802	331	917	2,283	(24)	44,958
Accrued expenses	20,502	41,156	2,047	2,157	599	-	66,461
Due to third-party payors	-	38,950	4,335	1,444	3,152	-	47,881
Due to affiliates	452	69,103	18,617	635	3,140	(91,947)	-
<b>Total current liabilities</b>	<b>34,696</b>	<b>195,051</b>	<b>25,797</b>	<b>5,670</b>	<b>9,679</b>	<b>(91,971)</b>	<b>178,922</b>
Long-term obligations, net	77,789	104,796	4,332	-	8,843	-	195,760
Due to affiliates, net	13,883	-	213	1,179	5,574	(20,849)	-
Other long-term liabilities	56,523	406,406	12,018	10,693	2,504	-	488,144
<b>Total liabilities</b>	<b>182,891</b>	<b>706,253</b>	<b>42,360</b>	<b>17,542</b>	<b>26,600</b>	<b>(112,820)</b>	<b>862,826</b>
<b>Net assets (deficit):</b>							
Unrestricted	86,697	129,521	505	31,863	103	(23,567)	225,122
Temporarily restricted	3,413	7,568	228	-	786	(3,871)	8,124
Permanently restricted	46	294	-	-	-	(46)	294
<b>Total net assets (deficit)</b>	<b>90,156</b>	<b>137,383</b>	<b>733</b>	<b>31,863</b>	<b>889</b>	<b>(27,484)</b>	<b>233,540</b>
<b>Total liabilities and net assets (deficit)</b>	<b>\$ 273,047</b>	<b>\$ 843,636</b>	<b>\$ 43,093</b>	<b>\$ 49,405</b>	<b>\$ 27,489</b>	<b>\$ (140,304)</b>	<b>\$ 1,096,366</b>

CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

(in thousands of dollars)

For the Year Ended December 31, 2016

	Parent	Acute Care Subsidiaries	Long-term Care Subsidiaries	Home Care Subsidiaries	Other Subsidiaries	Eliminations	Total
<b>Unrestricted revenues other support:</b>							
Net patient/resident service revenue	\$ -	\$ 1,004,805	\$ 15,018	\$ 58,958	\$ 18,052	\$ (9,613)	\$ 1,087,220
Provision for bad debts	-	(18,243)	(281)	(872)	(172)	-	(19,568)
Net patient/resident service revenue, less provision for bad debts	-	986,562	14,737	58,086	17,880	(9,613)	1,067,652
Other revenue	150,353	23,273	63	24	4,601	(157,359)	20,955
Net assets released from restrictions	-	230	-	-	-	-	230
<b>Total unrestricted revenues and other support</b>	<b>150,353</b>	<b>1,010,065</b>	<b>14,800</b>	<b>58,110</b>	<b>22,481</b>	<b>(166,972)</b>	<b>1,088,837</b>
<b>Expenses:</b>							
Salaries and wages	70,905	436,911	10,381	31,920	2,124	(70,438)	481,803
Employee benefits	21,163	136,921	3,087	8,605	586	(21,163)	149,199
Medical and professional fees	4,613	39,627	232	596	13,449	(3,635)	54,882
Purchased services	34,568	98,371	943	1,947	1,587	(44,519)	92,897
Supplies	831	198,145	1,171	7,327	269	(1,682)	206,061
Depreciation and amortization	7,700	43,150	484	724	1,657	(7,700)	46,015
Interest	3,461	8,667	356	342	543	(3,494)	9,875
Insurance	527	12,583	527	79	50	(527)	13,239
Other expenses	9,148	36,242	369	2,243	1,072	(16,553)	32,521
<b>Total expenses</b>	<b>152,916</b>	<b>1,010,617</b>	<b>17,550</b>	<b>53,783</b>	<b>21,337</b>	<b>(169,711)</b>	<b>1,086,492</b>
<b>(Loss) income from operations</b>	<b>(2,563)</b>	<b>(552)</b>	<b>(2,750)</b>	<b>4,327</b>	<b>1,144</b>	<b>2,739</b>	<b>2,345</b>
<b>Nonoperating revenues and losses:</b>							
Investment income	51	5,410	78	415	-	-	5,954
Other, net	2,512	2,420	9	77	37	(2,739)	2,316
<b>Total nonoperating revenues and losses</b>	<b>2,563</b>	<b>7,830</b>	<b>87</b>	<b>492</b>	<b>37</b>	<b>(2,739)</b>	<b>8,270</b>
<b>Excess (deficiency) of revenues over expenses</b>	<b>\$ -</b>	<b>\$ 7,278</b>	<b>\$ (2,663)</b>	<b>\$ 4,819</b>	<b>\$ 1,181</b>	<b>\$ -</b>	<b>\$ 10,615</b>

**CATHOLIC HEALTH SYSTEM, INC. AND SUBSIDIARIES**
**CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (CONTINUED)**

(in thousands of dollars)

For the Year Ended December 31, 2016

	Parent	Acute Care Subsidiaries	Long-term Care Subsidiaries	Home Care Subsidiaries	Other Subsidiaries	Eliminations	Total
<b>Unrestricted net assets:</b>							
Excess (deficiency) of revenues over expenses	\$ -	\$ 7,278	\$ (2,663)	\$ 4,819	\$ 1,181	\$ -	\$ 10,615
Change in unrealized loss on interest rate swap	-	887	-	-	375	-	1,262
Change in pension obligation, other than net periodic cost	1,122	8,842	1,413	963	42	-	12,382
Net assets released from restrictions	-	2,044	-	-	-	-	2,044
Grant revenue for capital expenditures	-	125	-	-	-	-	125
Contributions	136	-	-	-	-	-	136
Other	25,433	(24,804)	(25)	-	10	-	614
Increase (decrease) in unrestricted net assets before effects of discontinued operations	26,691	(5,628)	(1,275)	5,782	1,608	-	27,178
Gain on sale of assets in discontinued operations	-	-	2,561	-	-	-	2,561
Loss from discontinued operations	-	-	(2,680)	-	-	-	(2,680)
Increase (decrease) in unrestricted net assets	26,691	(5,628)	(1,394)	5,782	1,608	-	27,059
<b>Temporarily restricted net assets:</b>							
Contributions and other	-	2,371	-	-	32	-	2,403
Investment income	-	85	-	-	-	-	85
Special events revenue, net	-	278	-	-	-	-	278
Change in temporarily restricted interest in related Foundation	-	-	6	-	(24)	(4)	(22)
Temporarily restricted net assets released from restrictions	-	(2,274)	-	-	-	-	(2,274)
Other	-	224	-	-	-	-	224
Increase (decrease) in temporarily restricted net assets	-	684	6	-	8	(4)	694
<b>Permanently restricted net assets:</b>							
Contributions	-	1	-	-	-	-	1
Increase in permanently restricted net assets	-	1	-	-	-	-	1
Increase (decrease) in net assets	26,691	(4,943)	(1,388)	5,782	1,616	(4)	27,754
Net assets (deficit), beginning of year	63,465	142,326	2,121	26,081	(727)	(27,480)	205,786
Net assets, end of year	<u>\$ 90,156</u>	<u>\$ 137,383</u>	<u>\$ 733</u>	<u>\$ 31,863</u>	<u>\$ 889</u>	<u>\$ (27,484)</u>	<u>\$ 233,540</u>

CATHOLIC HEALTH SYSTEM - ACUTE CARE SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

(in thousands of dollars)

December 31, 2016

ASSETS	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Mount St. Mary's Hospital	Total
<b>Current assets:</b>					
Cash and cash equivalents	\$ 49,277	\$ 58,531	\$ 35,632	\$ 6,803	\$ 150,243
Patient/resident accounts receivable, net of allowance for doubtful accounts of \$20,488	46,269	35,114	20,169	10,593	112,145
Other receivables	2,338	4,920	763	500	8,521
Inventories	11,629	6,725	2,814	1,668	22,836
Prepaid expenses and other current assets	3,159	1,663	768	353	5,943
Due from affiliates	23	981	46	19	1,069
<b>Total current assets</b>	<u>112,695</u>	<u>107,934</u>	<u>60,192</u>	<u>19,936</u>	<u>300,757</u>
Assets limited as to use	2,682	3,476	2,740	-	8,898
Investments	31,597	96,326	25,618	5,183	158,724
Property and equipment, net	102,373	68,165	68,204	25,080	263,822
Other assets	45,684	37,177	15,996	819	99,676
Due from affiliates	-	10,303	1,456	-	11,759
<b>Total assets</b>	<u>\$ 295,031</u>	<u>\$ 323,381</u>	<u>\$ 174,206</u>	<u>\$ 51,018</u>	<u>\$ 843,636</u>
<b>LIABILITIES AND NET ASSETS</b>					
<b>Current liabilities:</b>					
Current portion of long-term obligations	4,070	4,260	\$ 2,535	\$ 175	\$ 11,040
Accounts payable	14,615	10,698	7,421	2,068	34,802
Accrued expenses	14,487	14,740	6,860	5,069	41,156
Due to third-party payors	16,789	12,355	6,763	3,043	38,950
Due to affiliates	15,150	29,591	23,264	1,098	69,103
<b>Total current liabilities</b>	<u>65,111</u>	<u>71,644</u>	<u>46,843</u>	<u>11,453</u>	<u>195,051</u>
Long-term obligations, net	46,300	27,992	30,489	15	104,796
Other long-term liabilities	208,855	130,852	55,250	11,449	406,406
<b>Total liabilities</b>	<u>320,266</u>	<u>230,488</u>	<u>132,582</u>	<u>22,917</u>	<u>706,253</u>
<b>Net (deficit) assets:</b>					
Unrestricted	(26,120)	88,731	41,559	25,351	129,521
Temporarily restricted	762	4,039	65	2,702	7,568
Permanently restricted	123	123	-	48	294
<b>Total net (deficit) assets</b>	<u>(25,235)</u>	<u>92,893</u>	<u>41,624</u>	<u>28,101</u>	<u>137,383</u>
<b>Total liabilities and net assets</b>	<u>\$ 295,031</u>	<u>\$ 323,381</u>	<u>\$ 174,206</u>	<u>\$ 51,018</u>	<u>\$ 843,636</u>

CATHOLIC HEALTH SYSTEM - ACUTE CARE SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT)

(in thousands of dollars)

For the Year Ended December 31, 2016

	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Mount St. Mary's Hospital	Total
<b>Unrestricted revenues other support:</b>					
Net patient/resident service revenue	\$ 406,659	\$ 328,488	\$ 170,876	\$ 98,782	\$ 1,004,805
Provision for bad debts	(5,825)	(6,794)	(3,068)	(2,556)	(18,243)
Net patient/resident service revenue, less provision for bad debts	400,834	321,694	167,808	96,226	986,562
Other revenue	5,658	11,938	1,991	3,686	23,273
Net assets released from restrictions	68	140	-	22	230
<b>Total unrestricted revenues and other support</b>	<b>406,560</b>	<b>333,772</b>	<b>169,799</b>	<b>99,934</b>	<b>1,010,065</b>
<b>Expenses:</b>					
Salaries and wages	169,944	146,023	70,308	50,636	436,911
Employee benefits	57,582	44,216	20,518	14,605	136,921
Medical and professional fees	18,308	13,305	4,765	3,249	39,627
Purchased services	39,744	32,052	15,327	11,248	98,371
Supplies	86,350	58,996	39,889	12,910	198,145
Depreciation and amortization	16,590	14,592	8,766	3,202	43,150
Interest	3,736	2,765	2,154	12	8,667
Insurance	5,121	4,580	2,303	579	12,583
Other expenses	17,233	10,309	5,249	3,451	36,242
<b>Total expenses</b>	<b>414,608</b>	<b>326,838</b>	<b>169,279</b>	<b>99,892</b>	<b>1,010,617</b>
<b>(Loss) income from operations</b>	<b>(8,048)</b>	<b>6,934</b>	<b>520</b>	<b>42</b>	<b>(552)</b>
<b>Nonoperating revenues and losses:</b>					
Investment income	1,506	2,777	907	220	5,410
Other, net	299	1,411	508	202	2,420
<b>Total nonoperating revenues</b>	<b>1,805</b>	<b>4,188</b>	<b>1,415</b>	<b>422</b>	<b>7,830</b>
<b>(Deficiency) excess of revenues over expenses</b>	<b>\$ (6,243)</b>	<b>\$ 11,122</b>	<b>\$ 1,935</b>	<b>\$ 464</b>	<b>\$ 7,278</b>

CATHOLIC HEALTH SYSTEM - ACUTE CARE SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT) (CONTINUED)

(in thousands of dollars)

For the Year Ended December 31, 2016

	Mercy Hospital	Sisters Hospital	Kenmore Mercy Hospital	Mount St. Mary's Hospital	Total
<b>Unrestricted net assets:</b>					
(Deficiency) excess of revenues over expenses	\$ (6,243)	\$ 11,122	\$ 1,935	\$ 464	\$ 7,278
Change in unrealized gain on interest rate swap	887	-	-	-	887
Change in pension obligation, other than net periodic cost	3,839	3,942	1,439	(378)	8,842
Net assets released from restrictions	371	161	158	1,354	2,044
Grant revenue for capital expenditures	125	-	-	-	125
Other	(12,683)	(9,299)	(2,828)	6	(24,804)
(Decrease) Increase in unrestricted net assets	(13,704)	5,926	704	1,446	(5,628)
<b>Temporarily restricted net assets:</b>					
Contributions and other	352	1,229	-	790	2,371
Investment loss	58	-	-	27	85
Special events revenue, net	51	179	15	33	278
Temporarily restricted net assets released from restrictions	(439)	(301)	(158)	(1,376)	(2,274)
Other	2	221	1	-	224
Increase (decrease) in temporarily restricted net assets	24	1,328	(142)	(526)	684
<b>Permanently restricted net assets:</b>					
Contributions	-	-	-	1	1
Increase in permanently restricted net assets	-	-	-	1	1
(Decrease) increase in net assets	(13,680)	7,254	562	921	(4,943)
Net (deficit) assets, beginning of year	(11,555)	85,639	41,062	27,180	142,326
Net (deficit) assets, end of year	<u>\$ (25,235)</u>	<u>\$ 92,893</u>	<u>\$ 41,624</u>	<u>\$ 28,101</u>	<u>\$ 137,383</u>

CATHOLIC HEALTH SYSTEM - LONG-TERM CARE SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

(in thousands of dollars)

December 31, 2016

	Discontinued Operations						
	Father Baker Manor	St. Francis Geriatric	St. Francis Home	St. Elizabeth's Home	St. Vincent's Home	Nazareth Home	Total
<b>ASSETS</b>							
<b>Current assets:</b>							
Cash and cash equivalents	\$ 539	\$ 1,273	\$ 7,414	\$ 2,161	\$ 598	\$ 1,404	\$ 13,389
Resident accounts receivable, net of allowance for doubtful accounts of \$2,910	3,406	147	-	-	-	-	3,553
Other receivables	6	-	38	-	-	-	44
Inventories	41	-	-	-	-	-	41
Prepaid expenses and other current assets	22	-	-	-	-	-	22
Due from affiliates	7	-	1	-	-	1,559	1,567
<b>Total current assets</b>	<u>4,021</u>	<u>1,420</u>	<u>7,453</u>	<u>2,161</u>	<u>598</u>	<u>2,963</u>	<u>18,616</u>
Interest in net assets of related Foundations	99	-	68	60	1	-	228
Assets limited as to use	11,475	-	1,068	-	-	-	12,543
Property and equipment, net	4,576	-	-	-	-	-	4,576
Other assets	2,261	7	2,674	36	29	-	5,007
Due from affiliates	-	-	-	2,123	-	-	2,123
<b>Total assets</b>	<u>\$ 22,432</u>	<u>\$ 1,427</u>	<u>\$ 11,263</u>	<u>\$ 4,380</u>	<u>\$ 628</u>	<u>\$ 2,963</u>	<u>\$ 43,093</u>
<b>LIABILITIES AND NET ASSETS</b>							
<b>Current liabilities:</b>							
Current portion of long-term obligations	\$ 467	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 467
Accounts payable	331	-	-	-	-	-	331
Accrued expenses	1,588	7	408	35	9	-	2,047
Due to third-party payors	1,758	-	2,577	-	-	-	4,335
Due to affiliates	4,899	-	8,311	3,914	1,493	-	18,617
<b>Total current liabilities</b>	<u>9,043</u>	<u>7</u>	<u>11,296</u>	<u>3,949</u>	<u>1,502</u>	<u>-</u>	<u>25,797</u>
Long-term obligations, net	4,332	-	-	-	-	-	4,332
Due to affiliates, net	-	-	-	-	-	213	213
Other long-term liabilities	5,447	-	5,404	900	267	-	12,018
<b>Total liabilities</b>	<u>18,822</u>	<u>7</u>	<u>16,700</u>	<u>4,849</u>	<u>1,769</u>	<u>213</u>	<u>42,360</u>
<b>Net assets (deficit):</b>							
Unrestricted	3,511	1,420	(5,505)	(529)	(1,142)	2,750	505
Temporarily restricted net assets	99	-	68	60	1	-	228
<b>Total net assets (deficit)</b>	<u>3,610</u>	<u>1,420</u>	<u>(5,437)</u>	<u>(469)</u>	<u>(1,141)</u>	<u>2,750</u>	<u>733</u>
<b>Total liabilities and net assets</b>	<u>\$ 22,432</u>	<u>\$ 1,427</u>	<u>\$ 11,263</u>	<u>\$ 4,380</u>	<u>\$ 628</u>	<u>\$ 2,963</u>	<u>\$ 43,093</u>



CATHOLIC HEALTH SYSTEM - LONG-TERM CARE SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT)

(in thousands of dollars)

For the Year Ended December 31, 2016

	Discontinued Operations						
	Father Baker Manor	St. Francis Geriatric	St. Francis Home	St. Elizabeth's Home	St. Vincent's Home	Nazareth Home	Total
<b>Unrestricted revenues other support:</b>							
Net resident service revenue	\$ 15,018	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 15,018
Provision for bad debts	(281)	-	-	-	-	-	(281)
Net resident service revenue, less provision for bad debts	14,737	-	-	-	-	-	14,737
Other revenue	63	-	-	-	-	-	63
<b>Total unrestricted revenues and other support</b>	<b>14,800</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14,800</b>
<b>Expenses:</b>							
Salaries and wages	10,381	-	-	-	-	-	10,381
Employee benefits	3,087	-	-	-	-	-	3,087
Medical and professional fees	232	-	-	-	-	-	232
Purchased services	943	-	-	-	-	-	943
Supplies	1,171	-	-	-	-	-	1,171
Depreciation and amortization	484	-	-	-	-	-	484
Interest	356	-	-	-	-	-	356
Insurance	527	-	-	-	-	-	527
Other expenses	369	-	-	-	-	-	369
<b>Total expenses</b>	<b>17,550</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17,550</b>
<b>Loss from operations</b>	<b>(2,750)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2,750)</b>
<b>Nonoperating revenues and losses:</b>							
Interest income	78	-	-	-	-	-	78
Other	9	-	-	-	-	-	9
<b>Total nonoperating revenues and losses</b>	<b>87</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>87</b>
<b>Deficiency of revenues over expenses</b>	<b>\$ (2,663)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (2,663)</b>
<b>Unrestricted net assets:</b>							
Deficiency of revenues over expenses	\$ (2,663)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (2,663)
Change in pension obligation, other than net periodic cost	179	-	1,003	63	168	-	1,413
Other	(25)	36	-	-	-	(36)	(25)
(Decrease) increase in unrestricted net assets before effects of discontinued operations	(2,509)	36	1,003	63	168	(36)	(1,275)
Gain on sale of assets in discontinued operations	-	-	-	1,921	640	-	2,561
Gain (loss) from discontinued operations	-	8	(2,154)	(460)	(75)	1	(2,680)
(Decrease) increase unrestricted net assets	(2,509)	44	(1,151)	1,524	733	(35)	(1,394)
<b>Temporarily restricted net assets:</b>							
Change in temporarily restricted interest in related foundations	6	-	-	-	-	-	6
Increase decrease in temporarily restricted net assets	6	-	-	-	-	-	6
(Decrease) increase in net assets	(2,503)	44	(1,151)	1,524	733	(35)	(1,388)
Net assets (deficit), beginning of year	6,113	1,376	(4,286)	(1,993)	(1,874)	2,785	2,121
Net assets (deficit), end of year	<u>\$ 3,610</u>	<u>\$ 1,420</u>	<u>\$ (5,437)</u>	<u>\$ (469)</u>	<u>\$ (1,141)</u>	<u>\$ 2,750</u>	<u>\$ 733</u>

**CATHOLIC HEALTH SYSTEM - HOME CARE SUBSIDIARIES**

**CONSOLIDATING BALANCE SHEET**

(in thousands of dollars)

December 31, 2016

	Mercy Home Care	McAuley Seton Home Care	Infusion Pharmacy	Total
<b>ASSETS</b>				
<b>Current assets:</b>				
Cash and cash equivalents	\$ 1,768	\$ 8,023	\$ 1,695	\$ 11,486
Patient accounts receivable, net of allowance for doubtful accounts of \$1,709	327	7,683	1,320	9,330
Inventories	-	53	670	723
Prepaid expenses and other current assets	5	89	708	802
<b>Total current assets</b>	<u>2,100</u>	<u>15,848</u>	<u>4,393</u>	<u>22,341</u>
Investments	-	20,321	-	20,321
Property and equipment, net	-	694	92	786
Other assets	631	3,962	583	5,176
Due from affiliates	527	171	83	781
<b>Total assets</b>	<u>\$ 3,258</u>	<u>\$ 40,996</u>	<u>\$ 5,151</u>	<u>\$ 49,405</u>
<b>LIABILITIES AND NET ASSETS</b>				
<b>Current liabilities:</b>				
Current portion of long-term obligations	\$ -	517	-	\$ 517
Accounts payable	459	377	81	917
Accrued expenses	-	1,840	317	2,157
Due to third-party payors	22	1,351	71	1,444
Due to affiliates	7	370	258	635
<b>Total current liabilities</b>	<u>488</u>	<u>4,455</u>	<u>727</u>	<u>5,670</u>
Due to affiliates, net	-	1,179	-	1,179
Other long-term liabilities	2,095	8,188	410	10,693
<b>Total liabilities</b>	<u>2,583</u>	<u>13,822</u>	<u>1,137</u>	<u>17,542</u>
<b>Net assets:</b>				
Unrestricted	675	27,174	4,014	31,863
<b>Total liabilities and net assets</b>	<u>\$ 3,258</u>	<u>\$ 40,996</u>	<u>\$ 5,151</u>	<u>\$ 49,405</u>

**CATHOLIC HEALTH SYSTEM - HOME CARE SUBSIDIARIES**

**CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS**

(in thousands of dollars)

For the Year Ended December 31, 2016

	<b>Mercy Home Care</b>	<b>McAuley Seton Home Care</b>	<b>Infusion Pharmacy</b>	<b>Total</b>
<b>Unrestricted revenues other support:</b>				
Net resident service revenue	\$ 6,709	\$ 41,375	\$ 10,874	\$ 58,958
Provision for bad debts	(26)	(550)	(296)	(872)
Net resident service revenue, less provision for bad debts	6,683	40,825	10,578	58,086
Other revenue	16	-	8	24
<b>Total unrestricted revenues and other support</b>	<b>6,699</b>	<b>40,825</b>	<b>10,586</b>	<b>58,110</b>
<b>Expenses:</b>				
Salaries and wages	4,470	25,110	2,340	31,920
Employee benefits	1,168	7,157	280	8,605
Medical and professional fees	-	542	54	596
Purchased services	363	1,360	224	1,947
Supplies	20	1,276	6,031	7,327
Depreciation and amortization	18	668	38	724
Interest	26	311	5	342
Insurance	13	58	8	79
Other expenses	257	1,523	463	2,243
<b>Total expenses</b>	<b>6,335</b>	<b>38,005</b>	<b>9,443</b>	<b>53,783</b>
<b>Income from operations</b>	<b>364</b>	<b>2,820</b>	<b>1,143</b>	<b>4,327</b>
<b>Nonoperating revenue:</b>				
Investment income	6	409	-	415
Other	9	59	9	77
<b>Total nonoperating revenue</b>	<b>15</b>	<b>468</b>	<b>9</b>	<b>492</b>
<b>Excess revenue over expenses</b>	<b>\$ 379</b>	<b>\$ 3,288</b>	<b>\$ 1,152</b>	<b>\$ 4,819</b>
<b>Unrestricted net assets:</b>				
Excess revenue over expenses	\$ 379	\$ 3,288	\$ 1,152	\$ 4,819
Change in pension obligation, other than net periodic cost	58	879	26	963
Increase in net assets	437	4,167	1,178	5,782
Net asset, beginning of year	238	23,007	2,836	26,081
Net assets, end of year	<b>\$ 675</b>	<b>\$ 27,174</b>	<b>\$ 4,014</b>	<b>\$ 31,863</b>

CATHOLIC HEALTH SYSTEM - OTHER SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

(in thousands of dollars)

December 31, 2016

ASSETS	OLV Renaissance Corp.	Continuing Care Foundation	LIFE	Trinity	Total
<b>Current assets:</b>					
Cash and cash equivalents	\$ 1,477	\$ 538	\$ 9,252	\$ 96	\$ 11,363
Patient accounts receivable, net of allowance for doubtful accounts of \$385	-	-	174	-	174
Other receivables	-	25	-	13	38
Prepaid expenses and other current assets	24	-	49	-	73
Due from affiliates	-	7	-	-	7
<b>Total current assets</b>	<u>1,501</u>	<u>570</u>	<u>9,475</u>	<u>109</u>	<u>11,655</u>
Interest in net assets of related Foundations	223	-	-	-	223
Assets limited as to use	289	-	699	-	988
Property and equipment, net	13,447	1	216	590	14,254
Other assets	300	-	10	-	310
Due from affiliates	59	-	-	-	59
<b>Total assets</b>	<u>\$ 15,819</u>	<u>\$ 571</u>	<u>\$ 10,400</u>	<u>\$ 699</u>	<u>\$ 27,489</u>
<b>LIABILITIES AND NET ASSETS</b>					
<b>Current liabilities:</b>					
Current portion of long-term obligations	505	\$ -	\$ -	\$ -	\$ 505
Accounts payable	-	-	2,283	-	2,283
Accrued expenses	599	-	-	-	599
Due to third-party payors	-	-	3,152	-	3,152
Due to affiliates	-	2	516	2,622	3,140
<b>Total current liabilities</b>	<u>1,104</u>	<u>2</u>	<u>5,951</u>	<u>2,622</u>	<u>9,679</u>
Long-term obligations, net	8,843	-	-	-	8,843
Due to affiliates, net	5,574	-	-	-	5,574
Other long-term liabilities	2,126	-	378	-	2,504
<b>Total liabilities</b>	<u>17,647</u>	<u>2</u>	<u>6,329</u>	<u>2,622</u>	<u>26,600</u>
<b>Net (deficit) assets:</b>					
Unrestricted	(2,050)	5	4,071	(1,923)	103
Temporarily restricted	222	564	-	-	786
<b>Total net (deficit) assets</b>	<u>(1,828)</u>	<u>569</u>	<u>4,071</u>	<u>(1,923)</u>	<u>889</u>
<b>Total liabilities and net assets</b>	<u>\$ 15,819</u>	<u>\$ 571</u>	<u>\$ 10,400</u>	<u>\$ 699</u>	<u>\$ 27,489</u>

CATHOLIC HEALTH SYSTEM - OTHER SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT)

(in thousands of dollars)

For the Year Ended December 31, 2016

	OLV Renaissance Corp.	Continuing Care Foundation	LIFE	Trinity	Total
<b>Unrestricted revenues other support:</b>					
Net patient/resident service revenue	\$ -	\$ -	\$ 18,052	\$ -	\$ 18,052
Provision for bad debts	-	-	(172)	-	(172)
Net patient/resident service revenue, less provision for bad debt	-	-	17,880	-	17,880
Other revenue	4,583	18	-	-	4,601
<b>Total unrestricted revenues and other support</b>	<b>4,583</b>	<b>18</b>	<b>17,880</b>	<b>-</b>	<b>22,481</b>
<b>Expenses:</b>					
Salaries and wages	264	24	1,836	-	2,124
Employee benefits	90	10	486	-	586
Medical and professional fees	22	-	13,417	10	13,449
Purchased services	1,574	8	-	5	1,587
Supplies	49	-	-	220	269
Depreciation and amortization	1,618	-	39	-	1,657
Interest	510	-	-	33	543
Insurance	50	-	-	-	50
Other expenses	49	-	1,011	12	1,072
<b>Total expenses</b>	<b>4,226</b>	<b>42</b>	<b>16,789</b>	<b>280</b>	<b>21,337</b>
<b>Income (loss) from operations</b>	<b>357</b>	<b>(24)</b>	<b>1,091</b>	<b>(280)</b>	<b>1,144</b>
<b>Nonoperating revenue and losses:</b>					
Other, net	39	-	(2)	-	37
<b>Total nonoperating revenue and losses</b>	<b>39</b>	<b>-</b>	<b>(2)</b>	<b>-</b>	<b>37</b>
<b>Excess (deficiency) of revenues over expenses</b>	<b>\$ 396</b>	<b>\$ (24)</b>	<b>\$ 1,089</b>	<b>\$ (280)</b>	<b>\$ 1,181</b>

**CATHOLIC HEALTH SYSTEM - OTHER SUBSIDIARIES**

**CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT) (CONTINUED)**

(in thousands of dollars)

For the Year Ended December 31, 2016

	<b>OLV Renaissance Corp.</b>	<b>Continuing Care Foundation</b>	<b>LIFE</b>	<b>Trinity</b>	<b>Total</b>
<b>Unrestricted net assets:</b>					
Excess (deficiency) of revenues over expenses	\$ 396	\$ (24)	\$ 1,089	\$ (280)	\$ 1,181
Change in unrealized gain on interest rate swap	375	-	-	-	375
Change in pension obligation, other than net periodic cost	-	-	42	-	42
Other	14		(4)	-	10
Increase (decrease) unrestricted net assets	<u>785</u>	<u>(24)</u>	<u>1,127</u>	<u>(280)</u>	<u>1,608</u>
<b>Temporarily restricted net assets:</b>					
Contributions and other	-	32	-	-	32
Change in temporarily restricted interest in related Foundations	(4)	(20)			(24)
(Decrease) increase in temporarily restricted net assets	<u>(4)</u>	<u>12</u>	<u>-</u>	<u>-</u>	<u>8</u>
Increase (decrease) in net assets	<u>781</u>	<u>(12)</u>	<u>1,127</u>	<u>(280)</u>	<u>1,616</u>
Net (deficit) assets, beginning of year	<u>(2,609)</u>	<u>581</u>	<u>2,944</u>	<u>(1,643)</u>	<u>(727)</u>
Net (deficit) assets, end of year	<u>\$ (1,828)</u>	<u>\$ 569</u>	<u>\$ 4,071</u>	<u>\$ (1,923)</u>	<u>\$ 889</u>

**CATHOLIC HEALTH SYSTEM INC. AND SUBSIDIARIES**  
**(KENMORE MERCY HOSPITAL AND SUBSIDIARIES)**  
**CONSOLIDATING BALANCE SHEETS**  
**December 31, 2016**

<b>ASSETS</b>	<b>Kenmore Mercy Hospital</b>	<b>The McAuley Residence</b>	<b>The Kenmore Mercy Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Current assets:</b>					
Cash and cash equivalents	\$ 29,869	\$ 5,711	\$ 52	\$ -	\$ 35,632
Patient/resident accounts receivable, net of allowance for doubtful accounts of \$4,020	16,664	3,505	-	-	20,169
Other receivables	605	13	145	-	763
Inventories	2,814	-	-	-	2,814
Prepaid expenses and other current assets	759	7	2	-	768
Due from affiliates	302	13	2	(271)	46
<b>Total current assets</b>	<b>51,013</b>	<b>9,249</b>	<b>201</b>	<b>(271)</b>	<b>60,192</b>
Interest in net assets of affiliated Foundations	4,350	-	-	(4,350)	-
Assets limited as to use	1,585	1,155	-	-	2,740
Investments	21,169	-	4,449	-	25,618
Property and equipment, net	58,635	9,568	1	-	68,204
Other assets	12,963	4,630	-	(1,597)	15,996
Due from affiliates	1,456	-	-	-	1,456
<b>Total assets</b>	<b>\$ 151,171</b>	<b>\$ 24,602</b>	<b>\$ 4,651</b>	<b>\$ (6,218)</b>	<b>\$ 174,206</b>
<b>LIABILITIES AND NET ASSETS</b>					
<b>Current liabilities:</b>					
Current portion of long-term obligations	\$ 2,535	\$ -	\$ -	\$ -	\$ 2,535
Accounts payable	7,186	222	13	-	7,421
Accrued expenses	4,661	2,193	6	-	6,860
Due to third-party payors	5,180	1,583	-	-	6,763
Due to affiliates	7,775	15,478	283	(272)	23,264
<b>Total current liabilities</b>	<b>27,337</b>	<b>19,476</b>	<b>302</b>	<b>(272)</b>	<b>46,843</b>
Long-term obligations, net	30,489	-	-	-	30,489
Long-term portion of insurance liabilities	17,064	6,174	-	-	23,238
Pension obligation	28,054	3,498	-	-	31,552
Asset retirement obligation	180	-	-	-	180
Other long term liabilities	280	-	-	-	280
<b>Total liabilities</b>	<b>103,404</b>	<b>29,148</b>	<b>302</b>	<b>(272)</b>	<b>132,582</b>
<b>Net assets (deficit):</b>					
Unrestricted	47,711	(4,555)	4,293	(5,890)	41,559
Temporarily restricted	56	9	56	(56)	65
<b>Total net assets (deficit)</b>	<b>47,767</b>	<b>(4,546)</b>	<b>4,349</b>	<b>(5,946)</b>	<b>41,624</b>
<b>Total liabilities and net assets</b>	<b>\$ 151,171</b>	<b>\$ 24,602</b>	<b>\$ 4,651</b>	<b>\$ (6,218)</b>	<b>\$ 174,206</b>

**CATHOLIC HEALTH SYSTEM INC. AND SUBSIDIARIES**  
**(KENMORE MERCY HOSPITAL AND SUBSIDIARIES)**  
**CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT)**  
**For the Year Ended December 31, 2016**

	<b>Kenmore Mercy Hospital</b>	<b>The McAuley Residence</b>	<b>The Kenmore Mercy Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Unrestricted revenue and other support:</b>					
Net patient/resident service revenue	\$ 154,141	\$ 16,735	\$ -	\$ -	\$ 170,876
Provision for bad debts	(2,826)	(226)	(16)	-	(3,068)
Net patient/resident service revenue, less provision for bad debts	151,315	16,509	(16)	-	167,808
Other revenue	1,362	44	585	-	1,991
<b>Total unrestricted revenue and other support</b>	152,677	16,553	569	-	169,799
<b>Expenses:</b>					
Salaries and wages	59,137	10,976	195	-	70,308
Employee benefits	17,442	3,028	48	-	20,518
Medical and professional fees	4,487	234	44	-	4,765
Purchased services	14,182	1,050	95	-	15,327
Supplies	38,527	1,357	5	-	39,889
Depreciation and amortization	8,153	613	-	-	8,766
Interest	1,984	170	-	-	2,154
Insurance	2,102	201	-	-	2,303
Other expenses	4,716	470	514	(451)	5,249
<b>Total expenses</b>	150,730	18,099	901	(451)	169,279
<b>Income (loss) from operations</b>	1,947	(1,546)	(332)	451	520
<b>Nonoperating revenues:</b>					
Investment income	569	2	336	-	907
Other, net	483	25	-	-	508
<b>Total nonoperating revenues</b>	1,052	27	336	-	1,415
<b>Excess (deficiency) of revenues over expenses</b>	\$ 2,999	\$ (1,519)	\$ 4	\$ 451	\$ 1,935



**CATHOLIC HEALTH SYSTEM INC. AND SUBSIDIARIES**  
**(KENMORE MERCY HOSPITAL AND SUBSIDIARIES)**  
**CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS (DEFICIT) (CONTINUED)**  
**For the Year Ended December 31, 2016**

	<b>Kenmore Mercy Hospital</b>	<b>The McAuley Residence</b>	<b>The Kenmore Mercy Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Unrestricted net assets:</b>					
Excess (deficiency) of revenues over expenses	\$ 2,999	\$ (1,519)	\$ 4	\$ 451	\$ 1,935
Change in unrestricted interest in KMH Foundation	162	-	-	(162)	-
Change in pension obligation, other than net periodic cost	1,390	49	-	-	1,439
Distributions and transfers to parents and affiliates	(3,029)	-	-	-	(3,029)
Net assets released from restrictions	-	-	158	-	158
Other	652	-	-	(451)	201
Increase (decrease) in unrestricted net assets	<u>2,174</u>	<u>(1,470)</u>	<u>162</u>	<u>(162)</u>	<u>704</u>
<b>Temporarily restricted net assets:</b>					
Special events revenue	-	-	15	-	15
Temporarily restricted net assets released from restriction	-	-	(158)	-	(158)
Change in temporarily restricted interest in the KMH Foundation, Inc.	(143)	-	-	143	-
Other	-	1	-	-	1
(Decrease) increase in temporarily restricted net assets	<u>(143)</u>	<u>1</u>	<u>(143)</u>	<u>143</u>	<u>(142)</u>
Increase (decrease) in net assets	2,031	(1,469)	19	(19)	562
Net assets (deficit) - beginning of year	<u>45,736</u>	<u>(3,077)</u>	<u>4,330</u>	<u>(5,927)</u>	<u>41,062</u>
Net assets (deficit) - end of year	<u>\$ 47,767</u>	<u>\$ (4,546)</u>	<u>\$ 4,349</u>	<u>\$ (5,946)</u>	<u>\$ 41,624</u>