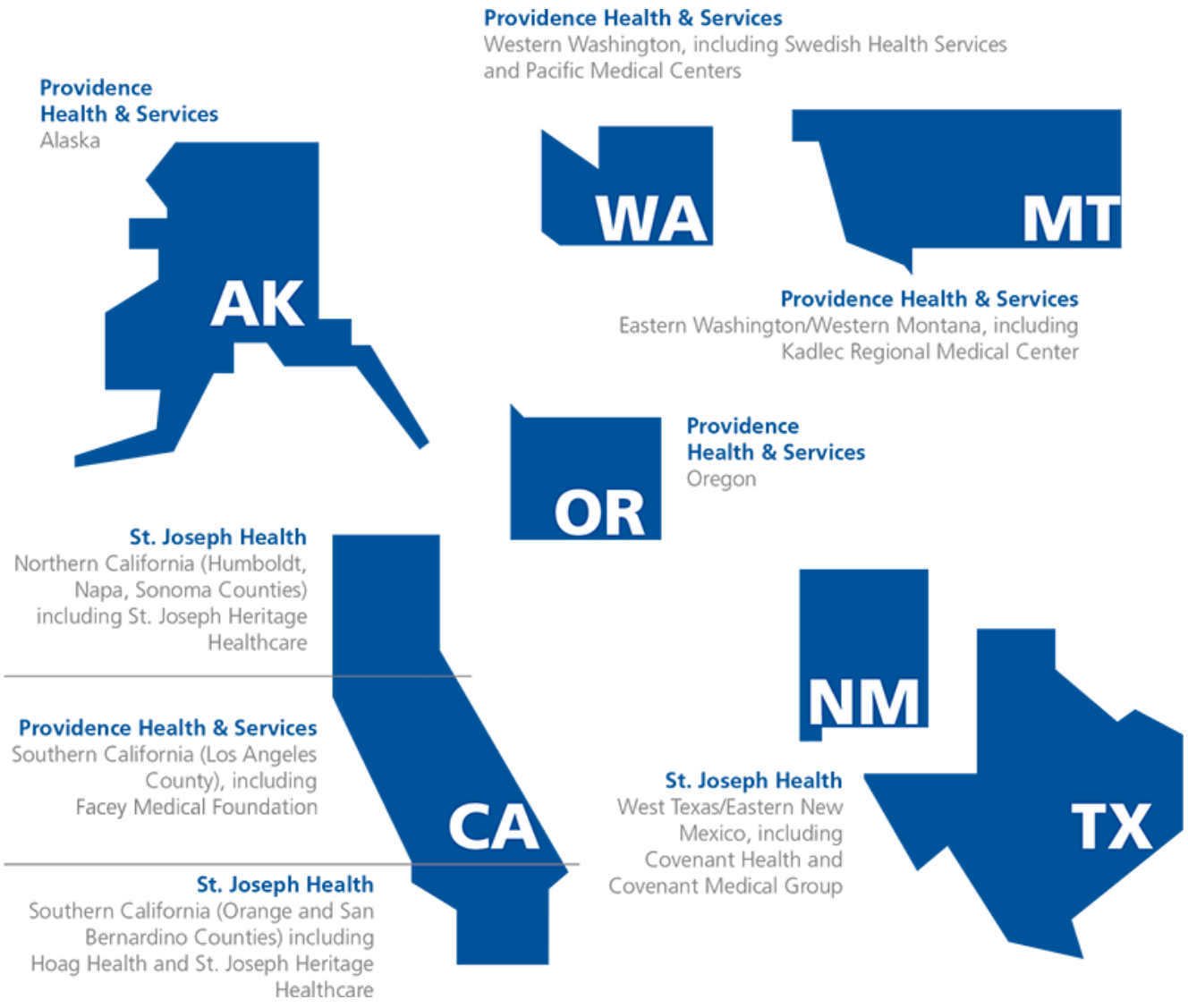
Providence St. Joseph Health

Management's Discussion and Analysis of Financial Condition and Results of Operations

Year ended December 31, 2016

About Providence St. Joseph Health

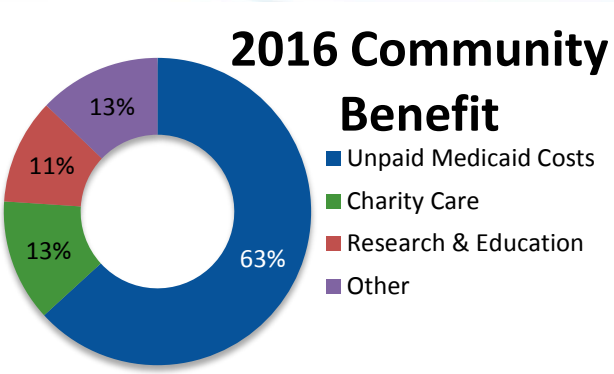
Effective July 1, 2016, Providence Health & Services and St. Joseph Health came together to serve more people in a partnership that joins two remarkable organizations with rich heritages. We are now connected by a new parent organization, Providence St. Joseph Health. Together, over 100,000 of our caregivers (employees) now serve in 50 hospitals, over 800 clinics and a comprehensive range of health and social services across Alaska, California, Montana, New Mexico, Oregon, Texas and Washington. All hospitals and other ministries will maintain their current names and identities. This parent structure allows our family of diverse organizations to work together to meet the needs of our communities both today and into the future.



Investing in our communities to improve health and increase access

Providence St. Joseph Health provided $1.6 billion in community benefit in 2016. Through programs and donations, health education, free care, medical research and more, our community benefit investments fulfill unmet needs in communities we serve across seven states.

In an environment of decreased reimbursement for government-sponsored medical care, community benefit spending related to the unpaid costs of Medicaid was more than $1 billion through the fourth quarter of 2016. Answering the call of our Mission to care for everyone, regardless of their ability to pay, we offered more than $210 million in free and discounted care for those in need.



Advocating for important health and social programs

We believe health care is a basic human right and are committed to expanded coverage that gives access to affordable care for all. With a special focus on serving those who are poor and vulnerable, we advocate for policies that will improve the health of entire communities and further facilitate innovation in care and payment models. During 2016 we helped advance legislation that supports primary care, care management and cognitive services, telehealth services and new care and payment models in Medicaid and Medicare.

Our commitment to mental health

In honor of the 143,000 caregivers, physicians, volunteers and board members who make up Providence St. Joseph Health, the System donated $1.43 million to organizations focused on improving awareness and care for those with mental illness. Donations were made to the Mental Health First Aid program, sponsored by the National Council for Behavioral Health, and the National Alliance on Mental Illness Family-to-Family program. The funds will support the training of more than 50,000 people living and working in Providence St. Joseph Health communities on skills such as understanding the signs of mental illness.

We also announced the Institute for Mental Health and Wellness' first chief executive, Tyler Norris, MDiv. The institute was founded as part of a larger commitment by Providence St. Joseph Health to address the growing mental health crisis in the U.S. The System made an initial seed endowment of $100 million to support advances in behavioral health, including awareness, diagnosis and treatment. In his new role, Norris will shape the institute's vision and strategic direction through community-based collaborations and partnerships.

Leading dynamic change through innovation

Extending relationships between episodes of care

Providence St. Joseph Health's Digital and Innovation Division aims to build meaningful relationships and serve as valuable partners in health. The group tests consumer innovations that are adjacent to our health care services and improve overall community health. Through these innovations, we decrease our population risk by creating a continuous relationship with consumers between episodes of care.

We are currently running new services in women's health (Circle™) and senior services (Optimal Aging™). The Circle™ women and children's app is built on a personalization platform which provides trusted answers to frequently asked questions about maternal and pediatric health. This service enables families to connect to the System and community resources conveniently, and is deploying across the System in 2017. Optimal Aging™ provides seniors affordable access to transportation, meals, home care, home maintenance and social connections. This service fulfills goals to support seniors' day-to-day living, improve the safety of their homes, and provide trusted planning and advice about aging optimally. Optimal Aging™ is currently is available in King and Snohomish counties, Wash., and looks forward to expanding to Portland, Ore. in 2017.

Introduction to Management's Discussion and Analysis

Management's discussion and analysis provides additional narrative explanation of the financial condition, operational results and cash flow of the System to increase understanding of the combined financial statements. The following information should be read in conjunction with the audited combined financial statements and related footnotes.

System overview

Effective July 1, 2016, Providence St. Joseph Health, a Washington nonprofit corporation, became the sole member of both Providence Health & Services, a Washington nonprofit corporation, and St. Joseph Health, a California nonprofit public benefit corporation, each of which were a multi-state health system, creating one of the largest health care systems in the United States. The System, headquartered in Renton, Washington, is structured with a centralized operating model and governed by a co-sponsorship council made up of members of its two sponsoring ministries, Providence Ministries and St. Joseph Health Ministry.

Providence Health & Services has a fiscal year ending December 31, and St. Joseph Health has a fiscal year ending June 30. The System has adopted a fiscal year ending December 31. To enable certain financial results to be presented on a consistent basis, notwithstanding the difference in fiscal years, unaudited pro forma combined financial results of the System are presented for the twelve-month periods ended December 31, 2016 and 2015.

Financial performance

The results discussed in this document are presented on a pro forma basis for the System. Data was derived by combining the consolidated year-to-date results of Providence Health & Services and St. Joseph Health assuming that operations of the two organizations were combined as of January 1, 2015. Certain immaterial adjustments have been made to conform financial statement presentations. Pro forma data includes the impact of affiliation related transactions, such as asset write-ups and the related amortization/depreciation of these assets, prior to the affiliation date of July 1, 2016. Management believes this pro forma data is the most useful presentation for evaluating and discussing current year operations in comparison to the prior year.

Year-to-date results

Balance Sheet	Providence St. Joseph Health (Pro Forma)			
PRESENTED IN MILLIONS	12-31-16	12-31-2015	12 MONTH CHANGE	CHANGE %
Current Assets:				
Cash and Cash Equivalents	782	885	(103)	(12%)
Short-term Management Designated Investments	875	1,139	(264)	(23%)
Accounts Receivable, Net	2,206	2,153	53	2%
Other Current Assets	1,449	1,047	402	38%
Current Portion of Funds Held by Trustee	109	55	54	98%
Total Current Assets	**5,421**	**5,279**	**142**	**3%**
Assets Whose Use is Limited:				
Management Designated Cash and Investments	8,091	7,361	730	10%
Funds Held by Trustee, Gift, Annuity, and Other	641	512	129	25%
Total Assets Whose Use is Limited	**8,731**	**7,873**	**858**	**11%**
Property, Plant & Equipment	**11,022**	**10,477**	**545**	**5%**
Total Other Assets	**1,118**	**1,220**	**(102)**	**(8%)**
Total Assets	**26,292**	**24,849**	**1,443**	**6%**
Current Liabilities:				
Short-term Debt and Current Portion of Long-term Debt	353	471	(118)	(25%)
Accounts Payable	584	555	29	5%
Accrued Compensation	1,104	924	180	19%
Other Current Liabilities	1,911	1,446	465	32%
Total Current Liabilities	**3,952**	**3,396**	**556**	**16%**
Long-Term Debt, Net of Current Portion	6,396	6,009	387	6%
Other Long-term Liabilities	2,149	2,039	110	5%
Total Liabilities	**12,497**	**11,444**	**1,053**	**9%**
Net Assets:				
Unrestricted	12,759	12,539	220	2%
Restricted Net Assets	1,035	866	169	20%
Total Net Assets	**13,795**	**13,405**	**390**	**3%**
Total Liabilities and Net Assets	**26,292**	**24,849**	**1,443**	**6%**

Statement of Operations	Providence St. Joseph Health (Pro Forma)			
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	2016 ACTUAL	2015 ACTUAL	VARIANCE	VARIANCE %
Net Patient Revenue	17,296	16,575	721	4%
Premium and Capitation Revenue	3,773	3,116	657	21%
Other Revenue	1,088	1,050	38	4%
Total Revenue	**22,157**	**20,741**	**1,416**	**7%**
Salaries and Wages	8,926	8,145	781	10%
Depreciation	1,036	997	39	4%
Interest and Amortization	265	260	5	2%
Other Expenses	12,185	11,058	1,127	10%
Total Operating Expenses	**22,412**	**20,460**	**1,952**	**10%**
Excess of Revenues Over Expenses from Operations	**(255)**	**281**	**(536)**	**(191%)**
Net Nonoperating Gains (Losses)	5,485	(248)	5,733	(2312%)
Excess of Revenues Over Expenses	**5,230**	**33**	**5,197**	**15748%**
Operating EBIDA	**1,046**	**1,537**	**(491)**	**(32%)**

Key Financial Indicators	Providence St. Joseph Health (Pro Forma)			
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	2016 ACTUAL	2015 ACTUAL	YTD VAR	YTD VAR %
Operating Margin %	(1.2)	1.4	(2.6)	(186%)
Operating EBIDA Margin %	4.7	7.4	(2.7)	(36%)
Total Community Benefit	1,632	1,445	187	13%
Net Service Revenue / Case Mix Adj Admits (whole value)	11,817	12,118	(301)	(2%)
Expense/ Case Mix Adj Admits	11,976	11,932	44	0%
FTEs (presented in thousands)	102	96	6	6%

Lower reimbursement for services from changes in payor mix, payment rates and procedure mix remains the most significant challenge for the System. While volumes have continued to grow in comparison to the prior year, this growth has correlated with a higher percentage of Medicaid patients and increases in acuity levels as measured by case mix index. In addition to reimbursement challenges, the System has been facing increasing labor and supply costs. A competitive labor market has led to higher wage costs and increased vacancy, resulting in greater utilization and rates of agency staffing. These industry challenges have exerted financial pressure on the System, resulting in a year-to-date operating loss of $255 million.

Net income included a net gain of $5.1 billion in 2016 from the affiliation inherent contribution and one-time debt refinancing, which was primarily driven by the St. Joseph Health affiliation and subsequent debt restructuring. The inherent contribution is the result of the affiliation being a non-cash transaction. With the impact of the affiliation inherent contribution and debt refinancing removed, year-to-date net income was $122 million, up from $33 million in the prior year. The increase in adjusted net income was primarily the result of current year investment gains of $493 million, partially offset by operating losses and innovation related expenses.

Volumes

Key Volume Indicators	Providence St. Joseph Health (Pro Forma)			
DATA PRESENTED YEAR TO DATE; IN THOUSANDS UNLESS NOTED	2016 ACTUAL	2015 ACTUAL	YTD VAR	YTD VAR %
Inpatient Admissions	526	519	7	1%
Acute Adjusted Admissions	989	957	32	3%
Outpatient Visits	24,352	22,875	1,477	6%
Total Surgeries	567	545	22	4%
Providence Health Plan Members	639	513	126	25%

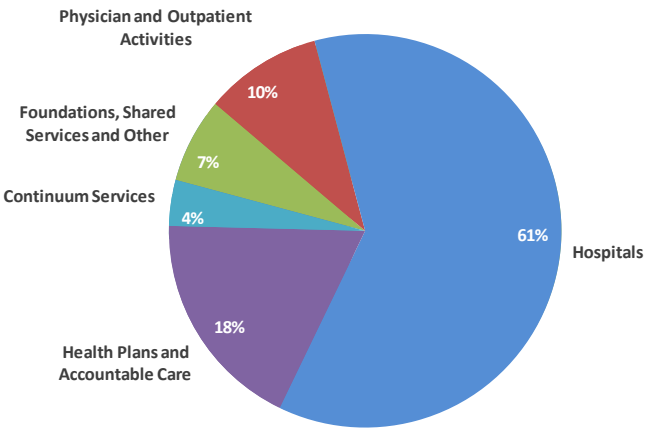
While the System has experienced volumes growth in 2016, trends in this growth have been highly influenced by the effects of the Affordable Care Act. Specifically, growth has been highest amongst Medicaid patients with an overall higher acuity level, which require additional resources to serve. Additionally, the System has experienced increases in ambulatory services at a rate that largely outpaced growth in acute and inpatient services. This increase in physician visits was attributed to employment of new physicians and advanced care practitioners in 2016, in addition to increased panel sizes for clinicians hired in 2015. Clinic expansion also continued through our partnership with Walgreens, opening 25 new clinics in 2016.

Surgery volumes also experienced higher growth in the outpatient setting as compared to the inpatient setting. Year-to-date inpatient surgeries increased 1 percent, while outpatient increased 6 percent as compared to the same period of 2015. Surgery increases are partially attributed to an exclusive contract with Group Health in Washington to provide inpatient services as well as improvements in integrated care networks.

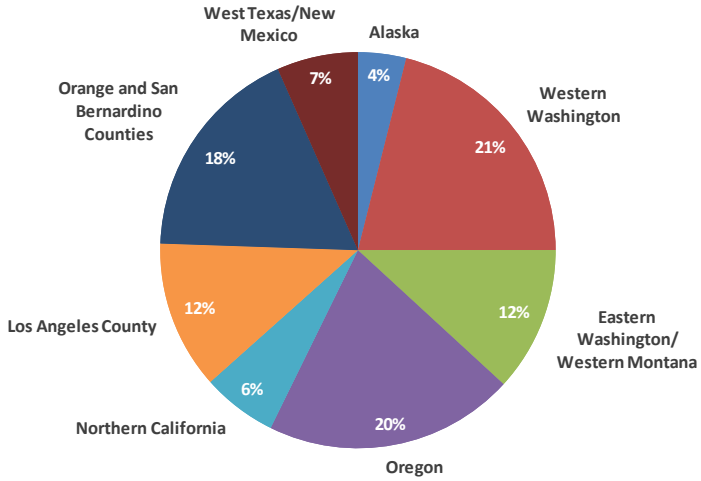
The Providence Health Plan enrollment growth has continued in 2016 through an expansion of services and coverage. Year-to-date connected lives member months, a measure of coverage for insured members, increased from 6.1 million member months in 2015 to 7.5 million member months in 2016.

Operating Revenue

2016 NET OPERATING REVENUE BY LINE OF BUSINESS



2016 NET OPERATING REVENUE BY MARKET



Year-to-date operating revenue of $22.2 billion was 7 percent greater than the prior year. Approximately half of the increase was driven by a 21 percent rise in capitated and premium revenue. Total premium revenue of $2.8 billion was 41 percent higher than prior year as health plan member enrollment increased in 2016. Premium revenue grew at a slower rate than membership as a result of changes in business line mix. Capitated and premium revenue now represents 17 percent of the System's total operating revenue as compared to 15 percent in the prior year.

Patient service revenue grew by 4 percent which was less than the 6 percent volume increase as measured by case mix adjusted admissions. The lower service revenue growth was driven by changes in payor mix, payment rates and procedure mix. While higher acuity as measured by case mix index generally results in higher reimbursement, related increases in revenue were offset by unfavorable shifts in payor mix. Medicaid and Medicare revenues as a percentage of total net revenue grew by 1 percent to become 48 percent of the acute business.

Payor Mix -Net Patient Revenue	Providence St. Joseph Health (Pro Forma)			
DATA PRESENTED YEAR TO DATE;	2016 ACTUAL	2015 ACTUAL	YTD VAR	YTD VAR %
Commercial	51%	51%	0%	0%
Medicare	32%	31%	1%	3%
Medicaid	16%	16%	0%	0%
Self-pay	2%	1%	1%	100%
Other	(1%)	1%	(2%)	0%

Operating expenses

Year-to-date operating expenses grew by 10 percent over the prior year as a result of the costs from higher volumes, patient acuity levels, and rates to serve those volumes. Expenses from labor and supplies grew at a higher rate than volumes due to inflation and productivity deterioration, while the increase in purchased health care services correlated with higher health plan member enrollment. Year-to-date salaries and benefits grew by 7 percent over prior year. This unfavorable trend was driven by full-time equivalent (FTE) growth of 6 percent and rate growth of 3 percent from a competitive labor market.

Supply expense as a percentage of net service revenue is 6 percent higher than the prior year, representing a $299 million increase. This increase was primarily driven by growth of specialty, retail, ambulatory, and infusion center pharmacy costs. Overall supply costs have increased 10 percent over the prior year, primarily driven by pharmacy costs that have increased 14 percent over the same period.

Year-to-date purchased healthcare expenses were 51 percent higher than the prior year as a result of growth in enrolled members of the Providence Health Plan over the prior year.

Non-Operating Income

Non-operating income included a net gain of $5.1 billion in 2016 from the affiliation inherent contribution and one-time debt refinancing, which was primarily driven by the St. Joseph Health affiliation and subsequent debt restructuring. With the impact of the affiliation inherent contribution and debt refinancing removed, year-to-date non-operating gains were $377 million. This amount was driven by year-to-date

investment gains of $493 million in 2016, compared to year-to-date losses of $156 million in 2015. Investment income was partially offset by growth in other non-operating expenses such as pension settlement costs and innovation investments, which were $28 million and $44 million through December, respectively.

Capital and liquidity

Liquidity Indicators	Providence St. Joseph Health (Pro Forma)			
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	12-31-16 ACTUAL	12-31-15 ACTUAL	YTD VAR	YTD VAR %
Accounts Receivable Days	45	46	(1)	(2%)
Days of Cash on Hand	168	177	(9)	(5%)
Long-term Debt to Capitalization	33.9	32.9	1.0	3%
Debt Service Coverage	1.8	3.2	(1.4)	(44%)
Cash to Debt Ratio	148.8	152.7	(3.9)	(3%)
Cash to Total Net Asset Ratio	0.76	0.75	0.01	1%

Unrestricted cash reserves totaled $9.7 billion as of December 31, 2016, up from $9.2 billion as of December 31, 2015. The increase was driven by cash generated from operations, investment gains and proceeds from financing transactions, partially offset by payments related to pension obligations, debt, and capital expenditures. Despite cash growth from prior year, higher costs associated with servicing additional volumes resulted in an overall four day decline in days of cash on hand.

In the third quarter of 2016, the System initiated a series of bond offerings which included the refinancing of certain tax-exempt bonds held by St. Joseph Health prior to the affiliation, executing on a plan to create a single obligated group. The aggregate offering included $448 million of California tax-exempt fixed rate bonds, $286 million of California tax-exempt fixed rate put bonds, $680 million of taxable fixed rate bonds, $100 million of taxable variable rate bonds and a few privately placed direct purchases with staggered tender dates. The offering unified the debt structures of the System at a more favorable cost of capital. While retirement of the existing debt resulted in $60 million in one-time losses on extinguishment of debt, the overall transaction will generate more than $25 million in annual interest savings.

Prior to the debt offering but subsequent to the affiliation of Providence Health & Services and St. Joseph Health, the three national credit rating agencies conducted their annual review process of the newly formed Providence St. Joseph Health. The agencies issued the following credit ratings:

- Fitch: "AA-"
- Standard and Poor's: "AA-"
- Moody's: "Aa3"

All three agencies issued a stable outlook based on the System’s favorable enterprise profile and strong financial position. As further evidence of the System's financial strength, the recent bond offering demonstrated ample demand throughout the pricing process from investors.

Subsequent Events

Effective February 23, 2017 the Health System and Catholic Health Initiatives entered into an agreement with Laboratory Corporation of America to sell all of its ownership interest in Pathology Associates Medical Laboratories and its affiliated joint ventures.

In October 2016 Providence St. Joseph Health reached a tentative settlement to resolve an outstanding law suit regarding the Church Plan designation of the Providence Cash Balance Retirement Plan (the Plan). Terms of the settlement included a commitment to contribute $350M over a seven year period and payment of up to $6.5M in plaintiff attorney fees. As a condition of the settlement the Health System will retain the Church Plan designation of the Plan. The settlement is in the process of court approval and class notification. If approved, the settlement will not have a material adverse effect on financial condition of Providence St. Joseph Health.

The System versus St. Joseph Health financial performance crosswalk

As noted previously, the results discussed in this document are presented on a pro forma basis for the System. The tables below represent a comparison of the combined pro forma data for 2016 and 2015 versus audited results of the System, which includes St. Joseph Health financial results from the effective date of the affiliation of July 1, 2016.

Statement of Operations	2016	
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	Providence St. Joseph Health (Pro Forma)	Providence St. Joseph Health Audited Results
Net Patient Revenue	17,296	14,769
Premium and Capitation Revenue	3,773	3,104
Other Revenue	1,088	1,005
Total Revenue	**22,157**	**18,878**
Salaries and Wages	8,926	7,788
Depreciation	1,036	851
Interest and Amortization	265	215
Other Expenses	12,185	10,274
Total Operating Expenses	**22,412**	**19,128**
Excess of Revenues Over Expenses from Operations	**(255)**	**(250)**
Net Nonoperating Gains (Losses)	5,485	5,480
Excess of Revenues Over Expenses	**5,230**	**5,230**

Statement of Operations	2015	
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	Providence St. Joseph Health (Pro Forma)	Providence St. Joseph Health Audited Results
Net Patient Revenue	16,575	11,784
Premium and Capitation Revenue	3,116	1,862
Other Revenue	1,050	788
Total Revenue	**20,741**	**14,434**
Salaries and Wages	8,145	5,984
Depreciation	997	631
Interest and Amortization	260	154
Other Expenses	11,058	7,403
Total Operating Expenses	**20,460**	**14,172**
Excess of Revenues Over Expenses from Operations	**281**	**262**
Net Nonoperating Gains (Losses)	(248)	(185)
Excess of Revenues Over Expenses	**33**	**77**

PROVIDENCE ST. JOSEPH HEALTH

Combined Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Directors
Providence St. Joseph Health:

We have audited the accompanying combined financial statements of Providence St. Joseph Health, which comprise the combined balance sheets as of December 31, 2016 and 2015, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these combined 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 audits to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Providence St. Joseph Health as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Seattle, Washington
March 22, 2017

PROVIDENCE ST. JOSEPH HEALTH

Combined Balance Sheets

December 31, 2016 and 2015

(In millions of dollars)

Assets		2016	2015
Current assets:			
Cash and cash equivalents	$	1,000	729
Accounts receivable, less allowance for bad debts of $271 in 2016 and $344 in 2015		2,206	1,570
Supplies inventory		279	195
Other current assets		1,169	540
Current portion of assets whose use is limited		766	256
Total current assets		5,420	3,290
Assets whose use is limited		8,731	5,298
Property, plant, and equipment, net		11,022	6,581
Other assets		1,118	540
Total assets	$	26,291	15,709
Current liabilities:			
Current portion of long-term debt	$	200	245
Master trust debt classified as short-term		153	138
Accounts payable		584	428
Accrued compensation		1,104	641
Other current liabilities		1,911	878
Total current liabilities		3,952	2,330
Long-term debt, net of current portion		6,396	3,696
Pension benefit obligation		1,120	1,064
Other liabilities		1,027	583
Total liabilities		12,495	7,673
Net assets:			
Unrestricted:			
Controlling interest		12,560	7,542
Noncontrolling interest		200	45
Temporarily restricted		816	325
Permanently restricted		220	124
Total net assets		13,796	8,036
Total liabilities and net assets	$	26,291	15,709

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Operations

Years ended December 31, 2016 and 2015

(In millions of dollars)

	2016	2015
Operating revenues:		
Net patient service revenues	$ 14,972	11,969
Provision for bad debts	(203)	(186)
Net patient service revenues less provision for bad debts	14,769	11,783
Premium revenues	2,240	1,464
Capitation revenues	865	399
Other revenues	1,005	788
Total operating revenues	18,879	14,434
Operating expenses:		
Salaries and benefits	9,599	7,341
Supplies	2,788	2,072
Purchased healthcare services	1,917	1,045
Interest, depreciation, and amortization	1,066	785
Purchased services, professional fees, and other	3,758	2,929
Total operating expenses	19,128	14,172
(Deficit) excess of revenues over expenses from operations	(249)	262
Net nonoperating gains (losses):		
Contributions from affiliations	5,167	—
Loss on extinguishment of debt	(60)	—
Investment income (losses), net	403	(114)
Other	(30)	(71)
Total net nonoperating gains (losses)	5,480	(185)
Excess of revenues over expenses	$ 5,231	77

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Changes in Net Assets

Years ended December 31, 2016 and 2015

(In millions of dollars)

	Unrestricted: controlling interest	Unrestricted: noncontrolling interest	Temporarily restricted	Permanently restricted	Total net assets
Balance, December 31, 2014	$ 7,492	45	305	106	7,948
Excess of revenues over expenses	72	5	—	—	77
Contributions, grants, and other	(15)	(5)	89	18	87
Net assets released from restriction	20	—	(69)	—	(49)
Pension related changes	(27)	—	—	—	(27)
Increase in net assets	50	—	20	18	88
Balance, December 31, 2015	7,542	45	325	124	8,036
Excess of revenues over expenses	5,093	138	—	—	5,231
Restricted contributions from affiliations	—	—	405	91	496
Contributions, grants, and other	(13)	17	145	5	154
Net assets released from restriction	19	—	(59)	—	(40)
Pension related changes	(81)	—	—	—	(81)
Increase in net assets	5,018	155	491	96	5,760
Balance, December 31, 2016	$ 12,560	200	816	220	13,796

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Cash Flows

Years ended December 31, 2016 and 2015

(In millions of dollars)

	2016	2015
Cash flows from operating activities:		
Increase in net assets	$ 5,760	88
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Contributions from affiliations	(5,663)	—
Depreciation and amortization	860	631
Provision for bad debt	203	186
Loss on extinguishment of debt	60	—
Restricted contributions and investment income received	(150)	(113)
Net realized and unrealized (gains) losses on investments	(316)	179
Changes in certain current assets and current liabilities	13	(485)
Change in certain long-term assets and liabilities	26	111
Net cash provided by operating activities	793	597
Cash flows from investing activities:		
Property, plant, and equipment additions	(967)	(637)
Sales (purchases) of trading securities, net	68	(242)
Purchases of alternative investments and commingled funds	(466)	(360)
Proceeds from sales of alternative investments and commingled funds	153	44
Cash acquired through affiliations	367	—
Other investing activities	49	(77)
Net cash used in investing activities	(796)	(1,272)
Cash flows from financing activities:		
Proceeds from restricted contributions and restricted income	150	113
Debt borrowings	3,606	453
Debt payments	(3,474)	(400)
Other financing activities	(8)	1
Net cash provided by financing activities	274	167
Increase (decrease) in cash and cash equivalents	271	(508)
Cash and cash equivalents, beginning of year	729	1,237
Cash and cash equivalents, end of year	$ 1,000	729
Supplemental disclosure of cash flow information:		
Cash paid for interest (net of amounts capitalized)	$ 191	142

See accompanying notes to combined financial statements.

(1) Basis of Presentation and Significant Accounting Policies

(a) Reporting Entity

Providence Health & Services (PHS), a Washington nonprofit corporation, is a Catholic healthcare system sponsored by the public juridic person, Providence Ministries.

Effective July 1, 2016, Providence St. Joseph Health (the Health System), a Washington nonprofit corporation, became the sole corporate member of both PHS and St. Joseph Health System (SJHS). SJHS, a California nonprofit public benefit corporation, is a Catholic healthcare system sponsored by the public juridic person, St. Joseph Health Ministry. Due to the circumstances of the business combination between PHS and SJHS, through the alignment under the Health System, the transaction qualified for acquisition accounting with PHS as the acquirer of SJHS.

The Health System seeks to improve the health of the communities it serves, especially the poor and vulnerable. The Health System operations includes 50 hospitals and a comprehensive range of services provided across Alaska, California, Montana, New Mexico, Oregon, Texas, and Washington. The Health System also provides population health management through various affiliated licensed insurers and other risk-bearing entities.

The Health System has filed for an Internal Revenue Service determination letter and believes that it is exempt from federal income tax as a charitable organization under Section 501(c)(3). PHS, SJHS, and substantially all of the various corporations within the Health System have been granted exemptions from federal income tax as charitable organizations under Section 501(c)(3) of the Internal Revenue Code.

The accompanying combined balance sheets and related combined statements of operations, statements of changes in nets assets, and statements of cash flows reflect the PHS financial position and results of operations as of and for the year ended December 31, 2015 and the Health System financial position and results of operations as of and for the year ended December 31, 2016. The Health System results of operations for the year ended December 31, 2016 include twelve months of results of operations for PHS and six months of results of operations for SJHS.

(b) Basis of Presentation

The accompanying combined financial statements of the Health System were prepared in accordance with U.S. generally accepted accounting principles and include the assets, liabilities, revenues, and expenses of all wholly owned affiliates, majority-owned affiliates over which the Health System exercises control, and, when applicable, entities in which the Health System has a controlling financial interest.

Intercompany balances and transactions have been eliminated in combination.

(c) Performance Indicator

The performance indicator is the excess of revenues over expenses. Changes in unrestricted net assets that are excluded from the performance indicator include net assets released from restriction for the purchase of property plant and equipment, certain changes in funded status of pension and other postretirement benefit plans, restricted contributions from affiliations, net changes in noncontrolling interests in combined joint ventures, and certain other activities.

(d) Operating and Nonoperating Activities

The Health System's primary mission is to meet the healthcare needs in its market areas through a broad range of general and specialized healthcare services, including inpatient acute care, outpatient services, physician services, long-term care, population health management, and other healthcare and health insurance services. Activities directly associated with the furtherance of this mission are considered to be operating activities. Other activities that result in gains or losses peripheral to the Health System's primary mission are considered to be nonoperating. Nonoperating activities include investment earnings, gains or losses from debt extinguishment, contributions from affiliations, and certain other activities.

(e) Use of Estimates and Assumptions

The preparation of the combined financial statements in conformity with U.S. generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but not limited to: (1) allowance for contractual revenue adjustments; (2) allowance for doubtful accounts; (3) fair value of acquired assets and assumed liabilities in business combinations; (4) useful lives of depreciable and amortizable assets; (5) fair value of investments; (6) reserves for self-insured healthcare plans; (7) reserves for professional, workers' compensation and general insurance liability risks; (8) reserves for underwritten prepaid healthcare contracts including managed care contracts and capitation agreements, and (9) contingency and litigation reserves.

The accounting estimates used in the preparation of the combined financial statements will change as new events occur, additional information is obtained or the operating environment changes. Assumptions and the related estimates are updated on an ongoing basis and external experts may be employed to assist in the evaluation, as considered necessary. Actual results could materially differ from those estimates.

(f) Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original or remaining maturity of three months or less when acquired.

(g) Supplies Inventory

Supplies inventory is stated at the lower of cost (first-in, first-out) or market.

(In millions of dollars)

(h) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Improvements and replacements of plant and equipment are capitalized, maintenance and repairs are expensed. The provision for depreciation is determined by the straight-line method, which allocates the cost of tangible property equally over its estimated useful life or lease term. Impairment of property, plant, and equipment is assessed when there is evidence that events or changes in circumstances have made recovery of the net carrying value of assets unlikely.

Interest capitalized on amounts expended during construction is a component of the cost of additions to be allocated to future periods through the provision for depreciation. Capitalization of interest ceases when the addition is substantially complete and ready for its intended use.

Property, plant, and equipment and the total accumulated depreciation at December 31, 2016 and 2015 are shown below:

	Approximate useful life (years)	2016	2015
Land	—	$ 1,419	757
Buildings and improvements	5–60	8,638	5,834
Equipment:			
Fixed	5–25	1,127	1,056
Major movable and minor	3–20	5,466	4,406
Rental property	15–40	941	914
Construction in progress	—	888	275
		18,479	13,242
Less accumulated depreciation		7,457	6,661
Property, plant, and equipment, net		$ 11,022	6,581

Construction in progress primarily represents renewal and replacement of various facilities in the Health System's operating divisions, as well as costs capitalized to software development.

(i) Other Assets

Other assets primarily consist of investments in nonconsolidated joint ventures, beneficial interest in noncontrolled foundations, notes receivable, goodwill, and other intangible assets.

(In millions of dollars)

Other assets at December 31, 2016 and 2015 are as follows:

	2016	2015
Investment in nonconsolidated joint ventures	$ 285	141
Intangible assets	253	58
Goodwill	158	112
Beneficial interest in noncontrolled foundations	146	128
Other	276	101
Total other assets	$ 1,118	540

Goodwill is recorded as the excess of cost over fair value of the acquired net assets. Indefinite-lived intangible assets are recorded at fair value using various methods depending on the nature of the intangible asset. Both goodwill and indefinite-lived intangible assets are tested at least annually for impairment. Definite-lived intangible assets are amortized using the straight-line method over the estimated useful lives of the assets.

The Health System recorded impairment of $36 and $0 during the years ended December 31, 2016 and 2015, respectively. The goodwill impairment recognized during the year ended December 31, 2016 was attributable to medical foundation acquisitions made in previous years.

(j) Investments Including Assets Whose Use Is Limited

The Health System has designated all of its investments in debt and equity securities, hedge funds, and commingled funds as trading securities. These investments are reported on the combined balance sheets at fair value on a trade-date basis.

Investment sales and purchases initiated prior to and settled subsequent to the combined balance sheet date result in amounts due from and to brokers. As of December 31, 2016, the Health System recorded a receivable of $136 for investments sold but not settled and a payable of $375 for investments purchased but not settled in other current assets and other current liabilities, respectively, in the accompanying combined balance sheets.

Assets whose use is limited primarily include assets held by trustees under indenture agreements, self-insurance funds, funds held for the payment of health plan medical claims and other statutory reserve requirements, assets held by related foundations, and designated assets set aside by management of the Health System for future capital improvements and other purposes, over which management retains control.

(In millions of dollars)

Investment income from investments including assets whose use is limited are included in net nonoperating gains (losses) and are comprised of the following for the years ended December 31, 2016 and 2015:

		2016	2015
Interest and dividend income	$	87	65
Net realized (losses) gains on sale of trading securities		(9)	25
Change in net unrealized gains (losses) on trading securities		325	(204)
Investment income (losses), net	$	403	(114)

(k) Derivative Instruments

The Health System uses derivative financial instruments (interest rate swaps) to manage its interest rate exposure and overall cost of borrowing. As of December 31, 2016, the Health System has interest rate swap contracts with a total current notional amount totaling $480 with varying expiration dates. The Health System had no interest rate swap contracts as of December 31, 2015.

Derivative financial instruments are recorded at fair value taking into consideration the Health System's and the counterparties' nonperformance risk. As of December 31, 2016, the fair value of outstanding interest rate swaps was in a net liability position of $104 and is included in other liabilities in the accompanying combined balance sheets. As of December 31, 2016, collateral posted in connection with the outstanding swap agreements was $5 and is included in other assets in the accompanying combined balance sheets.

The interest rate swap agreements do not meet the criteria for hedge accounting and all changes in the valuation are recognized as a component of net nonoperating gains (losses) in the accompanying combined statements of operations. Settlements related to these agreements are recognized as a component of interest expense in the accompanying combined statements of operations. For the year ended December 31, 2016, the change in valuation was a $52 gain and settlements recognized as a component of interest expense were $7.

(Continued)

(In millions of dollars)

The Health System also allows certain investment managers to use derivative financial instruments (futures and forward currency contracts) to manage interest rate risk related to the Health System's fixed-income holdings. The investment managers have executed master netting arrangements with the counterparties of the futures and forward currency purchase and sale contracts whereby the financial instruments held by the same counterparty are legally offset as the instruments are settled. The following table presents gross investment derivative assets and liabilities reported on a net basis at fair value included in assets whose use is limited in the combined balance sheets:

		2016	2015
Derivative assets:			
Futures contracts	$	394	405
Forward currency and other contracts		80	42
Total derivative assets	$	474	447
Derivative liabilities:			
Futures contracts	$	(394)	(405)
Forward currency and other contracts		(76)	(42)
Total derivative liabilities	$	(470)	(447)

(l) Self-Insurance Liabilities

The Health System has established self-insurance programs for professional and general liability and workers' compensation insurance coverage. These programs provide insurance coverage for healthcare institutions associated with the Health System. The Health System also operates insurance captives, Providence Assurance, Inc. and American Unity Group, Ltd., to self-insure or reinsure certain layers of professional and general liability risk.

The Health System accrues estimated self-insured professional and general liability and workers' compensation insurance claims based on management's estimate of the ultimate costs for both reported claims and actuarially determined estimates of claims incurred but not reported. Insurance coverage in excess of the per occurrence self-insured retention has been secured with insurers or reinsurers for specified amounts for professional, general, and workers' compensation liabilities. Decisions relating to the limit and scope of the self-insured layer and the amounts of excess insurance purchased are reviewed each year, subject to management's analysis of actuarial loss projections and the price and availability of acceptable commercial insurance.

At December 31, 2016 and 2015, the estimated liability for future costs of professional and general liability claims was $302 and $216, respectively. At December 31, 2016 and 2015, the estimated workers' compensation obligation was $306 and $163, respectively, both are recorded in other current liabilities and other liabilities in the accompanying combined balance sheets.

(Continued)

(In millions of dollars)

(m) Net Assets

Unrestricted net assets are those that are not subject to donor-imposed stipulations. Amounts related to the Health System's noncontrolling interests in certain joint ventures are included in unrestricted net assets. Temporarily restricted net assets are those whose use by the Health System has been limited by donors to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Health System in perpetuity. Unless specifically stated by donors, gains and losses on permanently restricted net assets are recorded as temporarily restricted.

Temporarily restricted net assets are available for the following purposes at December 31, 2016 and 2015:

		2016	2015
Program support	$	570	184
Capital acquisition		144	60
Low-income housing and other		102	81
Total temporarily restricted net assets	$	816	325

(n) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Health System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the promise to give is no longer conditional. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as other operating revenues in the combined statements of operations or as net assets released from restriction for donations of capital in the combined statements of changes in net assets.

(o) Net Patient Service Revenues

The Health System has agreements with governmental and other third-party payors that provide for payments to the Health System at amounts different from established charges. Payment arrangements for major third-party payors may be based on prospectively determined rates, reimbursed cost, discounted charges, per diem payments, or other methods.

Net patient service revenues are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with governmental payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as appropriate. Adjustments from finalization of prior years' cost reports and other third-party settlement estimates resulted in a decrease in net patient service revenues of $1 for the year ended December 31, 2016 and an increase in net patient service revenues of $45 for the years ended December 31, 2015, respectively.

(Continued)

(In millions of dollars)

The composition of payors for the years ended December 31, 2016 and 2015, as a percentage of net patient service revenues, is as follows:

	2016	2015
Commercial	49%	48%
Medicare	32	32
Medicaid	16	17
Self-pay and other	3	3
	100%	100%

Various states in which the Health System operates have instituted a provider tax on certain patient service revenues at qualifying hospitals to increase funding from other sources and obtain additional Federal funds to support increased payments to providers for Medicaid services. The taxes are included in purchased services, professional fees, and other expenses in the accompanying combined statements of operations and were $495 and $528 for the years ended December 31, 2016 and 2015, respectively. These programs resulted in enhanced payments from these states in the way of lump-sum payments and per claim increases. These enhanced payments are included in net patient service revenues in the accompanying combined statements of operations and were $616 and $612 for the years ended December 31, 2016 and 2015, respectively.

(p) Allowance for Bad Debts

The Health System provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Health System estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Health System. The Health System records a provision for bad debts in the period of services on the basis of past experience, which has historically indicated that many patients are unresponsive or are otherwise unwilling to pay the portion of their bill for which they are financially responsible.

(In millions of dollars)

The estimates made and changes affecting those estimates for the years ended December 31, 2016 and 2015 are summarized below:

		2016	2015
Changes in allowance for bad debts:			
Allowance for doubtful accounts at beginning of year	$	344	290
Write-off of uncollectible accounts, net of recoveries		(276)	(132)
Provision for bad debts		203	186
Allowance for bad debts at end of year	$	271	344

(q) Charity Care and Community Benefit

The Health System provides community benefit activities that address significant health priorities within its geographic service areas. These activities include Medicaid and Medicare shortfalls, community health services, education and research, and free and low-cost care (charity care).

Charity care is reported at cost and is determined by multiplying the charges incurred at established rates for services rendered by the Health System's cost-to-charge ratio. The cost of charity care provided by the Health System for the years ended December 31, 2016 and 2015 was $174 and $180, respectively.

(r) Premium and Capitation Revenues

Premium and capitation revenues are received on a prepaid basis and are recognized as revenue during the month for which the enrolled member is entitled to healthcare services. Premium and capitation revenues received for future months are recorded as unearned premiums.

(s) Functional Expenses

The Health System provides healthcare services to residents within its geographic service areas. Expenses related to providing these services for the years ended December 31, 2016 and 2015 are as follows:

		2016	2015
Healthcare expenses	$	13,567	10,700
Purchased healthcare expenses		1,917	1,045
General and administrative expenses		3,644	2,427
Total operating expenses	$	19,128	14,172

(Continued)

(t) Subsequent Events

Effective February 23, 2017 the Health System and Catholic Health Initiatives entered into an agreement with Laboratory Corporation of America to sell all of its ownership interest in Pathology Associates Medical Laboratories and its affiliated joint ventures.

The Health System has performed an evaluation of subsequent events through, March 22, 2017, the date the accompanying combined financial statements were issued.

(u) New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. (ASU) 2014-09, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. The Health System is currently evaluating the impact of ASU 2014-09, including the methods of implementation, which is effective for the fiscal year beginning on January 1, 2018.

In March 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This update changes the presentation of debt issuance costs in the financial statements to present such costs in the balance sheet as a direct deduction from the recognized liability rather than as an asset. Amortization of the costs is reported as interest expense. The Health System adopted the standard effective January 1, 2016 and the prior year amount of $35 has been reclassified in accordance with ASU 2015-03.

In May 2015, the FASB issued ASU 2015-07*, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, which eliminates the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value per share, or its equivalent (NAV), using the practical expedient in the FASB's fair value measurement guidance. The Health System elected to early adopt this standard effective December 31, 2015. As a result of the adoption of the standard, the Health System modified its fair value hierarchy disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to recognize a lease liability and a right of use asset for all lease obligations with exception to short-term leases. The lease liability will represent the lessee's obligation to make lease payments arising from the lease measured on a discounted basis and the right of use asset will represent the lessee's right to use or control the use of a specified asset for a lease term. The lease guidance also simplifies accounting for sale-leaseback transactions. Because of the number of leases the Health System utilizes to support its operations, the adoption of ASU 2016-02 is expected to have a significant impact on the Health System's combined financial position and results of operations. The Health System is currently evaluating the extent of the anticipated impact of the adoption of ASU 2016-02, which is effective for the fiscal year beginning on January 1, 2019 with retrospective application to the earliest presented period.

(Continued)

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities,* with the intent of reducing diversity in reporting practice, reduce complexity, and enhance understandability of not-for-profit (NFP) financial statements. This ASU contains the following key aspects; (A) Reduces the number of net asset classes presented from three to two: *with donor restrictions* and *without donor restrictions*; (B) Requires all NFPs to present expenses by their functional and their natural classifications in one location in the financial statements; (C) Requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date; and (D) Retains the options to present operating cash flows in the statement of cash flows using either the direct or indirect method. The Health System is currently evaluating the impact of ASU 2016-14, including the methods of implementation, which is effective for the fiscal year beginning January 1, 2018.

(v) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

(2) Affiliations

On July 1, 2016, PHS and SJHS entered into a business combination agreement, the purpose of which was to better serve both organizations' communities, maintain strong traditions of Catholic healthcare, and provide greater affordability and access to healthcare services. As part of the business combination, PHS and SJHS aligned under a single parent corporation, Providence St. Joseph Health, with a consolidated board of directors and cosponsorship from the public juridic persons Providence Ministries and St. Joseph Health Ministry.

SJHS provides a full range of care facilities including 16 acute care hospitals, home health agencies, hospice care, outpatient services, skilled nursing facilities, community clinics, and physician groups spanning California, west Texas, and eastern New Mexico. The results of operations of these entities have been included in the combined statements of operations of the Health System since July 1, 2016, the effective date of the business combination.

The transition was accounted for as an acquisition under Accounting Standards Codification (ASC) 958-805, *Not-for-Profit Entities – Business Combinations*. The affiliation did not involve consideration and resulted in an excess of assets acquired over liabilities assumed, reported as a contribution of net assets from SJHS to the Health System of approximately $5,644. The unrestricted portion of the contribution of $5,163 is included in net nonoperating gains in the accompanying combined statement of operations for the year ended December 31, 2016. The remaining $481 of the contribution was restricted and is recorded in restricted net assets in the combined statement of changes in net assets for the year ended December 31, 2016.

(In millions of dollars)

The following table summarizes the fair value estimate of the SJHS assets acquired and liabilities assumed as of July 1, 2016:

Cash and cash equivalents	$	359
Accounts receivable, net		607
Supplies inventory		66
Other current assets		290
Assets whose use is limited		3,372
Property, plant, and equipment, net		4,388
Other assets		555
Accounts payable		(146)
Accrued compensation		(344)
Other current liabilities		(569)
Long-term debt		(2,486)
Other liabilities		(448)
Total contribution of net assets	$	5,644

The following are the financial results of SJHS included in the Health System's 2016 combined statement of operations during the six-month period from the date of the affiliation through December 31, 2016:

Total operating revenues	$	3,520
Excess of revenue over expenses from operations		46
Excess of revenues over expenses		130

(Continued)

(In millions of dollars)

The following unaudited pro forma combined financial information presents the Health System's results as if the affiliation had been reported as of the beginning of the Health System's fiscal year of January 1, 2015:

	2016			2015		
	Actual	Pro forma (unaudited)		Actual	Pro forma (unaudited)	
Total operating revenues	$ 18,879	22,157	(1)	14,434	20,741	
(Deficit) excess of revenues over expenses from operations	(249)	(265)	(1)(2)	262	260	(2)
Excess of revenues over expenses	5,231	57	(1)	77	5,175	(3)

(1) Includes the historical results of SJHS for the six-month period ended June 30, 2016 prior to the affiliation, including the impact of purchase accounting adjustments.
(2) Includes additional depreciation related to the fair value adjustments and useful life adjustments recorded related to the affiliation.
(3) Includes the net contribution from the affiliation, in accordance with applicable accounting guidance.

Effective April 1, 2016, the Health System entered into a business combination agreement with the Institute for Systems Biology (ISB). The transaction was accounted for as an acquisition under ASC 958-805. The affiliation resulted in an excess of assets acquired over liabilities assumed, reported as a contribution from ISB to the Health System of approximately $19. The unrestricted portion of the contribution of $4 is included in net nonoperating gains in the accompanying combined statement of operations for the year ended December 31, 2016. The remaining $15 of the contribution was restricted and is recorded in restricted net assets in the combined statement of changes in net assets for year ended December 31, 2016.

(3) Fair Value Measurements

ASC Topic 820 (Topic 820), *Fair Value Measurements*, requires a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs include quoted prices (unadjusted) in active markets for identical assets or liabilities that the Health System has the ability to access at the measurement date.
- Level 2 inputs include inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

(In millions of dollars)

(a) Assets Whose Use Is Limited

The fair value of assets whose use is limited, other than those investments measured using NAV as a practical expedient for fair value, is estimated using quoted market prices or other observable inputs when quoted market prices are unavailable.

The composition of assets whose use is limited at December 31, 2016 is set forth in the following table:

	December 31, 2016	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Management-designated cash and investments:				
Cash and cash equivalents	$ 572	572	—	—
Equity securities:				
Domestic	1,000	1,000	—	—
Foreign	280	280	—	—
Mutual funds	828	828	—	—
Domestic debt securities:				
State and federal government	1,518	1,011	507	—
Corporate	766	—	766	—
Other	503	—	503	—
Foreign debt securities	172	—	172	—
Commingled funds	575	575	—	—
Other	32	20	12	—
Investments measured using NAV	2,752			
Total management-designated cash and investments	8,998			
Gift annuities, trusts, and other	131	32	11	88
Funds held by trustee:				
Cash and cash equivalents	147	147	—	—
Domestic debt securities	198	68	130	—
Foreign debt securities	23	—	23	—
Total funds held by trustee	368			
Total assets whose use is limited	$ 9,497			

(Continued)

(In millions of dollars)

The composition of assets whose use is limited at December 31, 2015 is set forth in the following table:

	December 31, 2015	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Management-designated cash and investments:				
Cash and cash equivalents	$ 615	615	—	—
Equity securities:				
Domestic	526	526	—	—
Foreign	68	68	—	—
Mutual funds	488	488	—	—
Domestic debt securities:				
State and federal government	1,029	717	312	—
Corporate	644	—	644	—
Other	255	—	255	—
Foreign debt securities	105	—	105	—
Commingled funds	216	216	—	—
Other	1	1	—	—
Investments measured using NAV	1,186			
Total management-designated cash and investments	5,133			
Gift annuities, trusts, and other	94	24	8	62
Funds held by trustee:				
Cash and cash equivalents	177	177	—	—
Domestic debt securities	134	64	70	—
Foreign debt securities	16	—	16	—
Total funds held by trustee	327			
Total assets whose use is limited	$ 5,554			

The Health System participates in various funds that are not actively marketed on an open exchange. These investments consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Due to the nature of these funds the NAV per share, or its equivalent, reported by each fund manager is used as a practical expedient to estimate the fair value of the Health System's interest therein. Management believes that the carrying amounts of these financial instruments, provided by the fund managers, are reasonable estimates of fair value.

(Continued)

(In millions of dollars)

The following table presents information, including unfunded commitments as of December 31, 2016, for investments where the NAV was used to estimate the value of the investments as of December 31:

	Fair value		Unfunded commitments	Redemption frequency	Redemption notice period
	2016	2015			
Hedge funds:					
Equity hedge	$ 537	175	—	Monthly, quarterly, or annually	30–120 days
Multistrategy	364	331	—	Monthly or quarterly	5–90 days
Market dependent	184	99	—	Monthly or quarterly	2–60 days
Fund of funds	141	—	—	Quarterly or annually	90 days
Event driven	114	—	—	Monthly, quarterly, or annually	45–150 days
Commingled funds	1,022	572	—	Monthly, quarterly, or annually	6–90 days
Private equity	210	9	135	Not applicable	Not applicable
Private real estate and real assets	180	—	54	Not applicable	Not applicable
Total	$ 2,752	1,186	189		

The following is a summary of the nature of these investments and their associated risks:

Hedge funds are portfolios of investments that use advanced investment strategies such as leveraged, long, short, and derivative positions in both domestic and international markets with the goal of diversifying portfolio risk and generating return. The Health System's investments in hedge funds include certain funds with provisions that limit the Health System's ability to access assets invested. These provisions include lockup terms that range up to three years from the subscription date or are continuous and determined as a percent of total assets invested. The Health System is in various stages of the lockup periods dependent on hedge fund and period of initial investments.

Commingled funds are funds that pursue diversification of domestic and foreign equity and fixed-income securities. The Health System's investments in commingled funds have no lockup provisions or other restrictions, other than those outlined in the table above, that limit its ability to access cash.

Private equity, private real estate, and real asset funds are funds that make opportunistic investments that are primarily private in nature. These investments cannot be redeemed by the Health System; rather the Health System has committed an amount to invest in the private funds over the respective commitment periods. After the commitment period has ended, the nature of the investments in this category is that the distributions are received through the liquidation of the underlying assets.

(b) Derivative Instruments

The fair value of the interest rate swaps is based on independent valuations obtained and are determined by calculating the value of the discounted cash flows of the differences between the fixed interest rate of the interest rate swaps and the counterparty's forward London Interbank Offered Rate curve, which is the input used in the valuation, taking also into account any nonperformance risk. Collateral posted for the interest rate swaps consist of cash and U.S. government securities, which are both categorized as Level 1 financial instruments.

(In millions of dollars)

The following table presents the fair value of swaps and related collateral as of December 31, 2016:

	December 31, 2016	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Cash collateral held by swap counterparty	$ 5	5	—	—
Liabilities under interest rate swaps	104	—	104	—

(c) Debt

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. The carrying value and fair value of long-term debt was $6,749 and $6,980, respectively, as of December 31, 2016, and $4,079 and $4,368, respectively, as of December 31, 2015.

(d) Assets Measured Using Significant Unobservable Inputs

The following table presents the Health System's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in Topic 820 for the years ended December 31, 2016 and 2015:

Balance at December 31, 2014	$	27
Total realized and unrealized gains (losses), net		—
Total purchases		30
Total sales		(2)
Transfers into Level 3		11
Transfers out of Level 3		(4)
Balance at December 31, 2015		62
Level 3 assets acquired through affiliation		8
Total realized and unrealized gains (losses), net		1
Total purchases		16
Total sales		(3)
Transfers into Level 3		4
Transfers out of Level 3		—
Balance at December 31, 2016	$	88

(Continued)

There were no significant transfers between assets classified as Level 1 and Level 2 during the years ended December 31, 2016 and 2015.

Level 3 assets include charitable remainder trusts, real property, and equity investments in healthcare technology start-ups through the Health System's innovation venture capital fund. Fair values of real property were estimated using a market approach. Fair values of charitable remainder trusts were estimated using an income approach. Fair value of equity investments in healthcare technology start-ups were estimated using a combination of income and market approach.

(4) Debt

(a) Short-Term and Long-Term Debt

The Health System has borrowed master trust debt issued through the following:

- California Health Facilities Financing Authority (CHFFA)
- Alaska Industrial Development and Export Authority (AIDEA)
- Washington Health Care Facilities Authority (WHCFA)
- Montana Facility Finance Authority (MFFA)
- Lubbock Health Facilities Development Corp (LHFDC)
- Oregon Facilities Authority (OFA)

(Continued)

(In millions of dollars)

Short-term and long-term unpaid principal at December 31, 2016 and 2015 consists of the following:

	Maturing through	Coupon rates	Unpaid principal 2016	Unpaid principal 2015
Master trust debt:				
Fixed rate:				
Series 1997, Direct Obligation Notes	2017	7.70%	$ 1	2
Series 2005, Direct Obligation Notes	2030	4.31 – 5.39%	42	45
Series 2006A, WHCFA Revenue Bonds	2036	4.50 – 5.00%	—	211
Series 2006B, MFFA Revenue Bonds	2026	4.00 – 5.00%	—	54
Series 2006C, WHCFA Revenue Bonds	2033	5.25%	69	69
Series 2006D, WHCFA Revenue Bonds	2033	5.25%	69	69
Series 2006E, WHCFA Revenue Bonds	2033	5.25%	26	26
Series 2006H, AIDEA Revenue Bonds	2036	5.00%	—	52
Series 2008B, LHFDC Revenue Bonds	2023	4.00 – 5.00%	46	—
Series 2008C, CHFFA Revenue Bonds	2038	3.00 – 6.50%	12	16
Series 2009A, Direct Obligation Notes	2019	5.05 – 6.25%	100	165
Series 2009A, CHFFA Revenue Bonds	2039	5.50 – 5.75%	185	—
Series 2009B, CHFFA Revenue Bonds	2039	5.50%	150	150
Series 2009B, CHFFA Revenue Bonds	2021	3.00 – 5.25%	42	—
Series 2009C, CHFFA Revenue Bonds	2034	5.00%	91	—
Series 2009D, CHFFA Revenue Bonds	2034	1.70%	40	—
Series 2010A, WHCFA Revenue Bonds	2039	4.88 – 5.25%	174	174
Series 2011A, AIDEA Revenue Bonds	2041	5.00 – 5.50%	123	123
Series 2011B, WHCFA Revenue Bonds	2021	2.00 – 5.00%	51	59
Series 2011C, OFA Revenue Bonds	2026	3.50 – 5.00%	17	18
Series 2012A, WHCFA Revenue Bonds	2042	2.00 – 5.00%	489	498
Series 2012B, WHCFA Revenue Bonds	2042	4.00 – 5.00%	100	100
Series 2013A, OFA Revenue Bonds	2024	2.00 – 5.00%	61	67
Series 2013A, CFHHA Revenue Bonds	2037	4.00 – 5.00%	325	—
Series 2013B, CFHHA Revenue Bonds	2043	4.15 – 4.26%	110	—
Series 2013C, CFHHA Revenue Bonds	2043	4.15 – 4.26%	110	—
Series 2013D, Direct Obligation Notes	2023	4.38%	252	252
Series 2013D, CFHHA Revenue Bonds	2043	4.15 – 4.26%	110	—
Series 2014A, CHFFA Revenue Bonds	2038	2.00 – 5.00%	273	274
Series 2014B, CHFFA Revenue Bonds	2044	4.25 – 5.00%	119	119
Series 2014C, WHCFA Revenue Bonds	2044	4.00 – 5.00%	92	92
Series 2014D, WHCFA Revenue Bonds	2041	5.00%	179	179
Series 2015A, WHCFA Revenue Bonds	2045	4.00%	78	78
Series 2015C, OFA Revenue Bonds	2045	4.00 – 5.00%	71	71
Series 2016A, CHFFA Revenue Bonds	2047	2.50 – 5.00%	448	—
Series 2016B, CHFFA Revenue Bonds	2036	1.25 – 4.00%	286	—
Series 2016H, Direct Obligation Bonds	2036	2.75%	300	—
Series 2016I, Direct Obligation Bonds	2047	3.74%	400	—
Total fixed rate			5,041	2,963

(Continued)

(In millions of dollars)

	Maturing through	Effective interest rate (1) 2016	Effective interest rate (1) 2015	Unpaid principal 2016	Unpaid principal 2015
Variable rate:					
Series 2012C, WHCFA Revenue Bonds	2042	0.43%	0.05%	$ 80	80
Series 2012D, WHCFA Revenue Bonds	2042	0.43	0.05	80	80
Series 2012E, Direct Obligation Notes	2042	0.57	0.17	231	234
Series 2013C, OFA Revenue Bonds	2022	1.41	1.08	117	135
Series 2013E, Direct Obligation Notes	2017	4.79	3.00	100	200
Series 2016C, LHFDC Revenue Bonds	2030	0.24	—	39	—
Series 2016D, WHCFA Revenue Bonds	2036	1.04	—	106	—
Series 2016E, WHCFA Revenue Bonds	2036	0.96	—	106	—
Series 2016F, MFFA Revenue Bonds	2026	0.93	—	50	—
Series 2016G, Direct Obligation Notes	2047	0.76	—	100	—
Total variable rate				1,009	729
Commercial Paper, Series 2015B	2016	0.42	0.21	—	125
U.S. Bank Credit Facility	2016	0.92	0.56	—	13
Wells Fargo Credit Facility	2021	1.22	—	252	—
Unpaid principal, master trust debt				6,302	3,830
Premiums, discounts, and unamortized financing costs, net				167	83
Master trust debt, including premiums and discounts, net				6,469	3,913
Other long-term debt				280	166
Total debt				$ 6,749	4,079

(1) Variable rate debt, commercial paper, and credit facilites carry floating interest rates attached to indexes, which are subject to change based on market conditions.

In September and November 2016, the Health System issued $1,835 Series 2016A through 2016I revenue bonds and direct obligation notes. The intended uses of funds included refinancing legacy SJHS and PHS master trust debt and repayment of outstanding lines of credit and commercial paper. Certain issues within the 2016 series debt included remarketing provisions for which the Health System purchased supporting credit facilities that allow the Health System to treat the obligations as noncurrent though remarketing may occur within less than one year.

In August and September 2015, the Health System issued $149 of Series 2015A and 2015C fixed rate revenue bonds. The intended use of funds was to cover certain capital investment.

In connection with the Series 2016A-I issuances and the Series 2015A-C issuances, the Health System recorded losses due to extinguishment of debt of $60 and $0 in the year ended December 31, 2016 and 2015, respectively, which were recorded in net nonoperating gains (losses) in the accompanying combined statements of operations.

(Continued)

(In millions of dollars)

The following table reflects classification of long-term debt obligations in the accompanying combined balance sheets as of December 31:

		2016	2015
Current portion of long-term debt	$	200	245
Short-term master trust debt		153	138
Long-term debt, classified as a long-term liability		6,396	3,696
Total debt	$	6,749	4,079

Short-term master trust debt represents debt issues with remarketing provisions unsupported by credit facilities with mandatory redemption within one year of the December 31, 2016 and 2015.

(b) Other Long-Term Debt

Other long-term debt primarily includes capital leases, notes payable, and bonds that are not under the master trust indenture. Other long-term debt at December 31, 2016 and 2015 consists of the following:

		2016	2015
Capital leases	$	107	104
Notes payable		154	47
Bonds not under master trust indenture and other		19	15
Total other long-term debt	$	280	166

(c) Debt Service

Scheduled principal payments of long-term debt, considering all obligations under the master trust indenture as due according to their long-term amortization schedule, for the next five years and thereafter are as follows:

		Master trust	Other	Total
2017	$	182	18	200
2018		88	11	99
2019		192	8	200
2020		98	8	106
2021		355	9	364
Thereafter		5,387	226	5,613
Scheduled principal payments of long-term debt	$	6,302	280	6,582

(Continued)

(In millions of dollars)

(5) Retirement Plans

(a) Defined Benefit Plans

The Health System sponsors various frozen defined benefit retirement plans. The measurement dates for the defined benefit plans are December 31, 2016 and 2015. A rollforward of the change in projected benefit obligation and change in the fair value of plan assets for the defined benefit plans is as follows:

		2016	2015
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	2,600	2,827
Service cost		22	25
Interest cost		94	114
Actuarial loss (gain)		140	(135)
Benefits paid and other		(176)	(231)
Projected benefit obligation at end of year		2,680	2,600
Change in fair value of plan assets:			
Fair value of plan assets at beginning of year		1,535	1,782
Actual return on plan assets		119	(106)
Employer contributions		81	90
Benefits paid and other		(176)	(231)
Fair value of plan assets at end of year		1,559	1,535
Funded status		(1,121)	(1,065)
Unrecognized net actuarial loss		552	470
Unrecognized prior service cost		4	5
Net amount recognized	$	(565)	(590)
Amounts recognized in the combined balance sheets consist of:			
Current liabilities	$	(1)	(1)
Noncurrent liabilities		(1,120)	(1,064)
Unrestricted net assets		556	475
Net amount recognized	$	(565)	(590)
Weighted average assumptions:			
Discount rate		4.40%	4.58%
Rate of increase in compensation levels		3.50	3.50
Long-term rate of return on assets		6.90	6.80

(Continued)

(In millions of dollars)

Net periodic pension cost for the defined benefit plans for 2016 and 2015 includes the following components:

	2016	2015
Components of net periodic pension cost:		
Service cost	$ 22	25
Interest cost	94	114
Expected return on plan assets	(107)	(116)
Amortization of prior service cost	1	1
Recognized net actuarial loss	19	26
Net periodic pension cost	$ 29	50
Special recognition – settlement expense	$ 28	33

Certain plans sponsored by the Health System allow participants to receive their benefit through a lump-sum distribution upon election. When lump-sum distributions exceed the combined total of service cost and interest cost during a reporting period settlement expense is recognized. Settlement expense represents the proportional recognition of unrecognized actuarial loss and prior service cost. Settlement expense for the years ended December 31, 2016 and 2015 is included in net nonoperating gains (losses) in the accompanying combined statements of operations.

The accumulated benefit obligation was $2,628 and $2,556 at December 31, 2016 and 2015, respectively.

The following pension benefit payments reflect expected future service. Payments expected to be paid over the next 10 years are as follows:

2017	$ 183
2018	191
2019	195
2020	199
2021–2026	1,106
	$ 1,874

The Health System expects to contribute approximately $96 to the defined benefit plans in 2017.

The expected long-term rate of return on plan assets is the expected average rate of return on the funds invested currently and on funds to be invested in the future in order to provide for the benefits included in the projected benefit obligation. The Health System used 6.9% and 6.8% in calculating the 2016 and 2015 expense amounts, respectively. This assumption is based on capital market assumptions and the plan's target asset allocation.

(Continued)

(In millions of dollars)

The Health System continues to monitor the expected long-term rate of return. If changes in those parameters cause 6.9% to be outside of a reasonable range of expected returns, or if actual plan returns over an extended period of time, suggest that general market assumptions are not representative of expected plan results, the Health System may revise this estimate prospectively.

The target asset allocation and expected long-term rate of return on assets (ELTRA) for the years ended December 31, 2016 and 2015, respectively, were as follows:

	2016 Target	2016 ELTRA	2015 Target	2015 ELTRA
Cash and cash equivalents	1%	1%–3%	2%	1%–3%
Equity securities	42	5%–9%	47	5%–8%
Debt securities	35	2%–5%	35	2%–6%
Other securities	22	5%–9%	16	5%–8%
Total	100%	6.90%	100%	6.80%

The following table presents the Health System's defined benefit plan assets measured at fair value at December 31, 2016:

	December 31 2016	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	$ 58	58	—	—
Equity securities:				
Domestic	192	192	—	—
Foreign	37	37	—	—
Mutual funds	104	104	—	—
Domestic debt securities:				
State and government	251	173	78	—
Corporate	115	—	115	—
Other	15	—	15	—
Foreign debt securities	30	—	30	—
Commingled funds	157	157	—	—
Investments measured using NAV	663			
Transactions pending settlement, net	(63)			
Total	$ 1,559			

(Continued)

(In millions of dollars)

The following table presents the Health System's defined benefit plan assets measured at fair value at December 31, 2015:

	December 31, 2015	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	$ 64	64	—	—
Equity securities:				
Domestic	262	262	—	—
Foreign	37	37	—	—
Mutual funds	31	31	—	—
Domestic debt securities:				
State and government	242	169	73	—
Corporate	116	—	116	—
Other	8	—	8	—
Foreign debt securities	15	—	15	—
Commingled funds	154	—	154	—
Other	8	—	8	—
Investments measured using NAV	623			
Transactions pending settlement, net	(25)			
Total	$ 1,535			

The Health System's defined benefit plans participate in various funds that are not actively marketed on an open exchange. These investments consist of shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Due to the nature of these funds the NAV per share, or its equivalent, reported by each fund manager is used as a practical expedient to estimate the fair value of the Health System's interest therein. Management believes that the carrying amounts of these financial instruments provided by the fund managers are reasonable estimates of fair value.

The following table presents information for investments where either the NAV per share or its equivalent was used to value the investments as of December 31:

	Fair value		Redemption frequency	Redemption notice period
	2016	2015		
Hedge funds:				
Multistrategy	$ 162	173	Monthly or quarterly	5 – 90 days
Equity hedge	74	93	Monthly or quarterly	30 – 65 days
Fund of funds	1	4	Monthly	30 days
Commingled funds	426	353	Monthly	6 – 30 days
Total	$ 663	623		

(Continued)

(In millions of dollars)

(b) Defined Contribution Plans

The Health System sponsors various defined contribution retirement plans that cover substantially all employees. The plans provide for employer matching contributions in an amount equal to a percentage of employee pretax contributions, up to a maximum amount. In addition, the Health System makes contributions to eligible employees based on years of service. Retirement expense related to these plans was $440 and $323 in 2016 and 2015, respectively, and is reflected in salaries and benefit expense in the accompanying combined statements of operations.

(6) Commitments and Contingencies

(a) Commitments

Firm purchase commitments, primarily related to construction and equipment and software acquisition, at December 31, 2016 are approximately $249.

(b) Operating Leases

Leases

The Health System leases various medical and office equipment and buildings under operating leases. Future minimum lease commitments under noncancelable operating leases for the next five years and thereafter are as follows:

2017	$	216
2018		205
2019		187
2020		168
2021		148
Thereafter		896
	$	1,820

Rental expense, including month-to-month leases and contingent rents, was $302 and $217 for the years ended December 31, 2016 and 2015, respectively, and is included in other expenses ins the accompanying combined statements of operations.

(c) Litigation

The healthcare industry is subject to numerous laws and regulations from 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 this time. Government monitoring and enforcement activity continues with respect to investigations and allegations concerning possible violations by healthcare providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of patient services previously billed. Institutions within the Health System are subject to similar regulatory reviews.

Management is aware of certain asserted and unasserted legal claims and regulatory matters arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System’s combined financial statements.