Consolidated Financial Statements and Independent Auditors' Report

Palmetto Health and Subsidiaries

September 30, 2016 and 2015

DIXON HUGHES GOODMAN LLP

Palmetto Health and Subsidiaries

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DIXON HUGHES GOODMAN LLP

Independent Auditors' Report

The Board of Directors
Palmetto Health and Subsidiaries

We have audited the accompanying consolidated financial statements of Palmetto Health and Subsidiaries ("Palmetto Health"), comprised of the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these 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.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Palmetto Health'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 Palmetto Health'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 Palmetto Health and Subsidiaries as of September 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Dixon Hughes Goodman LLP

Greenville, South Carolina
December 16, 2016

Palmetto Health and Subsidiaries

Consolidated Balance Sheets
September 30, 2016 and 2015

(dollars in thousands)

	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$ 41,807	$ 47,533
Assets limited as to use	22,131	24,414
Patient accounts receivable, net	312,031	237,048
Other receivables	26,647	13,067
Inventories	29,269	22,270
Other current assets	20,218	13,027
Total current assets	452,103	357,359
Assets limited as to use	806,011	752,493
Property and equipment, net	682,937	599,900
Other assets	84,782	63,579
	$ 2,025,833	$ 1,773,331
Liabilities and Net Assets		
Current liabilities:		
Current portion of long-term debt	$ 17,016	$ 19,903
Current portion of capital lease obligations	872	829
Accounts payable	67,660	50,236
Accrued salaries and benefits	74,051	73,286
Other current liabilities	34,511	24,610
Total current liabilities	194,110	168,864
Long-term debt, net	780,540	662,769
Capital lease obligations, net	18,256	19,128
Other noncurrent liabilities	150,433	90,091
Total liabilities	1,143,339	940,852
Net assets:		
Unrestricted	836,368	793,293
Temporarily restricted	30,112	28,794
Permanently restricted	16,014	10,392
Total net assets	882,494	832,479
	$ 2,025,833	$ 1,773,331

The accompanying notes are integral to these consolidated financial statements.

Palmetto Health and Subsidiaries

Consolidated Statements of Operations
For the Years Ended September 30, 2016 and 2015

(dollars in thousands)

	2016	2015
Unrestricted revenue, gains and other support:		
Net patient service revenue	$ 1,784,186	$ 1,426,127
Provision for uncollectible accounts	(294,295)	(250,458)
Net patient service revenue less provision for uncollectible accounts	1,489,891	1,175,669
Other revenue	118,503	91,345
Total unrestricted revenue, gains and other support	1,608,394	1,267,014
Expenses:		
Salaries and benefits	867,466	679,379
Supplies and other expenses	613,468	475,819
Depreciation and amortization	79,337	67,700
Interest expense	30,243	26,943
Total expenses	1,590,514	1,249,841
Operating income	17,880	17,173
Nonoperating income (expenses):		
Investment income, net	31,368	26,923
COPA – Community health improvement projects	(4,925)	(4,410)
Total nonoperating income	26,443	22,513
Revenue and gains greater than expenses and losses before net change in unrealized (loss) gain on derivative financial instruments and trading investments and loss on debt extinguishment	44,323	39,686
Net change in unrealized loss on derivative financial instruments	(27,982)	(21,528)
Net change in unrealized gain (loss) on trading investments	16,007	(24,499)
Loss on debt extinguishment	-	(430)
Revenue and gains greater (less) than expenses and losses	$ 32,348	$ (6,771)

The accompanying notes are integral to these consolidated financial statements.

Palmetto Health and Subsidiaries

Consolidated Statements of Changes in Net Assets
For the Years Ended September 30, 2016 and 2015

(dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balance as of September 30, 2014	$ 799,955	$ 27,382	$ 7,919	$ 835,256
Revenue and gains less than expenses and losses	(6,771)	-	-	(6,771)
(Decrease) increase in interest in Affiliated Foundations	(899)	(2,240)	2,473	(666)
Subsidiary equity transaction	(419)	-	-	(419)
Net adjustment for defined benefit plans	1,261	-	-	1,261
Contributions and grants	-	15,583	-	15,583
Net assets released from restrictions used for capital	166	(166)	-	-
Net assets released from restrictions used for operations	-	(11,765)	-	(11,765)
(Decrease) increase in net assets	(6,662)	1,412	2,473	(2,777)
Balance as of September 30, 2015	793,293	28,794	10,392	832,479
Revenue and gains greater than expenses and losses	32,348	-	-	32,348
Increase (decrease) in interest in Affiliated Foundations	6,151	(807)	5,326	10,670
Net adjustment for defined benefit plans	(2,794)	-	-	(2,794)
Excess of net assets acquired over consideration transferred	8,983	2,774	5,337	17,094
Contributions to Affiliated Foundations	(2,978)	-	(5,041)	(8,019)
Contributions and grants	-	9,375	-	9,375
Net assets released from restrictions used for capital	1,365	(1,365)	-	-
Net assets released from restrictions used for operations	-	(8,659)	-	(8,659)
Increase in net assets	43,075	1,318	5,622	50,015
Balance as of September 30, 2016	$ 836,368	$ 30,112	$ 16,014	$ 882,494

The accompanying notes are integral to these consolidated financial statements.

Palmetto Health and Subsidiaries

Consolidated Statements of Cash Flows
For the Years Ended September 30, 2016 and 2015

(dollars in thousands)

	2016	2015
Cash flows from operating activities:		
Increase (decrease) in net assets	$ 50,015	$ (2,777)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Change in interest in Affiliated Foundations	(10,670)	666
Gain (loss) on equity method investments	3,550	(486)
Net change in unrealized loss on derivative financial instruments	27,982	21,528
Depreciation and amortization	79,337	67,700
Provision for uncollectible accounts	294,295	250,458
Loss (gain) on the disposal of property and equipment	1	(464)
Loss on extinguishment of debt	-	430
Excess of net assets acquired over consideration transferred	(17,094)	-
Net adjustment for defined benefit plans	2,794	(1,261)
Changes in operating assets and liabilities:		
Patient accounts receivable	(339,742)	(273,061)
Other receivables	(9,055)	7,319
Accounts payable and accrued salaries and benefits	(2,422)	25,109
Other assets	(2,007)	239
Other liabilities	9,881	6,365
Other, net	(14,652)	(9,789)
Net cash provided by operating activities before trading investments	72,213	91,976
Trading investments	(36,564)	642
Net cash provided by operating activities	35,649	92,618
Cash flows from investing activities:		
Additions to property and equipment	(76,038)	(66,705)
Acquisition of subsidiary, net of cash and Affiliated Foundation Beneficial Interest received	(80,025)	-
Proceeds from sale of property and equipment	589	464
Net cash used in investing activities	(155,474)	(66,241)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	135,498	28,247
Proceeds from line of credit	100,000	-
Long-term debt payments	(20,570)	(40,580)
Payments of line of credit	(100,000)	-
Capital lease obligation payments	(829)	(794)
Net cash provided by (used in) financing activities	114,099	(13,127)
Net (decrease) increase in cash and cash equivalents	(5,726)	13,250
Cash and cash equivalents, beginning of year	47,533	34,283
Cash and cash equivalents, end of year	$ 41,807	$ 47,533

The accompanying notes are integral to these consolidated financial statements.

Palmetto Health and Subsidiaries

Consolidated Statements of Cash Flows
For the Years Ended September 30, 2016 and 2015

(dollars in thousands)

	2016	2015
Supplemental information – Cash paid during the year for interest	$ 31,393	$ 30,759
Noncash investing and financing activities:		
Accrued capital expenditures	$ 2,767	$ 6,147

On January 1, 2016 Palmetto Health acquired Tuomey (Note 20). A summary of the noncash activities related to this transaction are as follows:

Assets acquired	155,427
Liabilities assumed	(50,197)
Net assets assumed	(3,070)

Note 1 - Description of Organization and Summary of Significant Accounting Policies

Organization and Business

In 1998, Richland Memorial Hospital (Richland) and Baptist Healthcare System of South Carolina, Inc. (Baptist) formed Palmetto Health through the execution of a joint operating agreement. Palmetto Health is composed of substantially all of the assets and liabilities of Richland and Baptist. In 2014 Palmetto Health opened Palmetto Health Baptist Parkridge Hospital (Parkridge Hospital). On January 1, 2016, Palmetto Health acquired substantially all of the assets and assumed certain liabilities of Tuomey Healthcare System and Tuomey Medical Professionals (collectively, "Tuomey") (see Note 20) and formed a new entity known as Palmetto Health Tuomey. The operations of Palmetto Health Tuomey are included in these consolidated financial statements from the date of acquisition.

Palmetto Health is organized as a South Carolina nonprofit public benefit corporation exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). The governance of Palmetto Health consists of a 19-member board of directors, with six directors appointed by Richland, six by Baptist, three by Palmetto Health Tuomey, three by the board of Palmetto Health, and the Palmetto Health Chief Executive Officer who serves as an ex officio voting member of the Board. Richland, Baptist and Palmetto Health Tuomey each elect at least one director each of whom is a licensed physician or dentist, and the Chair of the Board of Trustees of each is a director without term limit. The consolidated financial presentation of Palmetto Health also includes its for-profit, wholly owned subsidiaries HealthSource, Inc., and Premier Practice Management-Carolina, Inc. (PPM) and its not-for-profit, wholly owned subsidiary Palmetto Health Quality Collaborative, LLC. Palmetto Health and its Subsidiaries are referred to herein as "Palmetto Health."

Principles of Consolidation

The consolidated financial statements include all accounts of Palmetto Health. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in affiliates that Palmetto Health does not control are accounted for either at cost or using the equity method.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates and assumptions.

Significant estimates include, but are not limited to, accounts receivable allowances, third-party payer receivables and payables, useful lives assigned to capital assets, professional liability and other self-insurance accruals, and pension and other post-retirement plan assumptions.

In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates associated with these programs will change by a material amount in the near term.

Costs of Borrowing

Deferred financing costs and bond discounts are amortized over the period related obligations are outstanding using the effective interest method. Palmetto Health follows Accounting Standards Update (ASU) 2015-03, which requires debt issuance costs to be treated as a direct deduction to the carrying amount of the related debt liability, consistent with debt discounts.

Interest costs incurred on borrowed funds during the period of construction of capital assets, net of investment earnings on related trusteed funds, are capitalized as a component of the cost of acquiring those assets when significant.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

Palmetto Health maintains bank accounts at financial institutions which are insured from loss by the Federal Depository Insurance Corporation (FDIC). At September 30, 2016, $1,837 is subject to FDIC coverage, while the remaining $44,750 is in excess of the FDIC limit of $250 per institution. Management selects high-quality financial institutions for deposit maintenance and Palmetto Health has never experienced a loss in its FDIC-uninsured deposits.

Other Receivables

Other receivables include amounts due to the Medicare and Medicaid programs for settlement of cost report filings and funding associated with the State of South Carolina disproportionate share program (the DSH program) (see Note 5). Palmetto Health recognizes revenue monthly based on the provisions of the DSH program, which follows the state fiscal year of July 1 through June 30. Therefore, included in other receivables is an accrual for the estimated funds earned from the program that have not yet been collected during the periods reported.

Inventories

Inventories, consisting principally of medical supplies and pharmaceuticals, are determined using the first-in, first-out method and are stated at the lower of cost or market.

Assets Limited as to Use

Assets limited as to use include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors, primarily for future capital improvements, over which the Board retains control and may, at its discretion, use for other purposes. Amounts required to meet associated current liabilities have been classified as current assets.

Assets limited as to use are comprised of cash and investments. Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value in the accompanying consolidated balance sheets. Interest and dividend income and realized gains and losses are reported as nonoperating gains or losses in the accompanying consolidated statements of operations, except for investment income on funds held by trustee, which is included in other revenue. Investment income and realized gains or losses on investments of donor-restricted funds are also included in other revenue unless the income or loss is restricted by donors, in which case the investment income is recorded directly to temporarily or permanently restricted net assets in accordance with donor wishes.

Palmetto Health has designated and reported its entire investment portfolio as a trading portfolio – as defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320, "Investments – Debt and Equity Securities." All changes in unrealized gains and losses on investments are included within revenue and gains greater (less) than expenses and losses ("the performance indicator").

Property and Equipment

Palmetto Health capitalizes property and equipment with a cost of over $2.5 and an estimated life of two years or more. All property and equipment transferred from Richland and Baptist, either by long-term lease in the case of real property or by conveyance of title in the case of personal property, has been recorded at the historical book values of Richland and Baptist. Although the title to the real property noted above has been retained by Richland and Baptist, the operating rights of the real property and improvements thereon have been conveyed to Palmetto Health. In addition, under the leases of real property, improvements on or to leased real property are covered under the lease. Real property under the leases cannot be sold without the prior consent of Richland and Baptist.

Property and equipment acquired in the Tuomey transaction are recognized using current best estimates of fair value of those long-term assets (see Note 20).

Remaining property and equipment is stated at cost or, if donated, at fair value at time of donation. Additions and improvements are capitalized and depreciated over the estimated remaining useful lives of the related assets, primarily using the straight-line method.

A summary of estimated useful lives follows:

Buildings and improvements	5 to 40 years
Land improvements	3 to 8 years
Equipment and furniture	2 to 20 years

Other Noncurrent Liabilities

Other noncurrent liabilities include the fair value of derivatives in a liability position with maturities due in more than one year (see Note 12), deferred revenue, certain compensation accruals, pension and postretirement obligations (Notes 15-17) and professional and general liability accruals (see Note 14). Deferred revenue represents third-party payer reimbursement received but unearned as of the consolidated balance sheet date.

Donor-restricted Gifts

Unconditional promises to give cash and other assets are reported at estimated fair value at the date the promise is received. Conditional promises to give are recognized when the conditions are substantially met, and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restrictions. To the extent that restricted resources from multiple donors are available for the same purpose, Palmetto Health expends such gifts on a first-in, first-out basis.

Operating Income

The following items are excluded from operating income: nonoperating income (expense), net change in unrealized loss on derivative financial instruments, net change in unrealized gain (loss) on trading investments and loss on debt extinguishment. Nonoperating income (expenses) includes net investment income and the Certificate of Public Advantage (COPA) commitment. The change in unrestricted net assets includes (decrease) increase in interest in Affiliated Foundations, contributions received and expended for capital purposes, subsidiary equity transaction, excess of net assets acquired over consideration transferred in the Tuomey transaction (see Note 20), contributions to Affiliated Foundations, and net adjustment for defined benefit plans.

Revenue and Gains Greater (Less) Than Expenses and Losses

Changes in unrestricted net assets are excluded from the performance indicator consistent with relevant accounting principles and industry practice (see Operating Income above for description of items excluded from the performance indicator).

Unrestricted Revenue, Gains and Other Support

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive 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.

Other revenue includes certain capitated arrangements (of which none of the related contracts are projected to be in a loss position), contributions from donors, grants, rental income, rebates, equity investee income, Baptist Easley Hospital (BEH) service contract revenue (see Notes 8 and 18), and certain investment income and other miscellaneous income.

Charity Care

Palmetto Health provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than its established rates. Charity care is provided primarily to residents of Palmetto Health's primary service area (Richland, Lexington, Fairfield and Sumter counties) who meet asset limits and have income less than 100% of the Federal Poverty Guidelines. Because Palmetto Health does not pursue the collection of amounts determined to qualify as charity care, such amounts are not reported as net patient service revenue. Palmetto Health determines its estimated costs of providing charity care based on a calculation that applies the ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on Palmetto Health's total operating expenses (less bad debt expense) divided by gross patient service charges.

Palmetto Health maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policies.

Income Taxes

Palmetto Health qualifies as an organization exempt from federal and state income taxes on related income under Internal Revenue Code Section 501(c)(3). Palmetto Health has two taxable subsidiaries, Healthsource, Inc. and PPM. As of September 30, 2016, Palmetto Health has determined that it does not have any material unrecognized tax benefits or obligations nor is income tax accounting significant with respect to taxable subsidiaries.

Derivative Instruments

Palmetto Health strategically enters into interest rate protection agreements to mitigate changes in interest rates on variable rate borrowings. The notional amounts of such agreements are used to measure the interest to be paid or received and do not represent the amount of exposure to loss. None of these agreements are used for speculative or trading purposes.

Palmetto Health recognizes all derivatives as either assets or liabilities in the consolidated balance sheets and measures those instruments at their fair value.

None of Palmetto Health's derivative instruments are designated as hedging instruments, and therefore net unrealized gains and losses arising from related fair value changes are included in the performance indicator.

All of Palmetto Health's derivative instruments involve elements of credit and market risk. The counterparty to the financial instruments is a major financial institution, which was rated BBB+ by Standard & Poor's and Baa1 by Moody's Investors Service as of September 30, 2016. Palmetto Health monitors its positions with and the credit quality of the counterparty to these financial instruments. Palmetto Health does not anticipate nonperformance by the counterparty.

Impairment of Long-lived Assets

Long-lived assets, such as property and equipment, identifiable intangibles and goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the carrying amount of the asset exceeds the fair value of the asset. If applicable, assets to be disposed of are separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the appropriate asset and liability sections of the consolidated balance sheets. Based on management's assessments, none of Palmetto Health's long-lived assets were impaired at either September 30, 2016 or September 30, 2015.

Commitments and Contingencies

Liabilities for loss contingencies, including costs arising from claims, assessments, litigation, fines and penalties and other sources, are recorded when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Palmetto Health has been limited by donors to a specific time period or purpose. Permanently restricted net assets, generally representing specified endowments, have been restricted by donors to be maintained by Palmetto Health in perpetuity. Temporarily restricted net assets are generally available to fund designated capital expenditures and specific health care programs of Palmetto Health, which include the Children's Hospital, Cancer Programs, Hospice and Camp Kemo.

Asset Retirement Obligations

The fair value of a liability for legal obligations associated with asset retirements is recorded in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statement of operations. Such liabilities are not significant to the consolidated financial statements at either September 30, 2016 or 2015 (Note 10).

Fair Value of Financial Instruments

The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents, patient accounts receivable, other receivables, other current assets, accounts payable, accrued salaries and benefits, and other current liabilities, approximate fair value due to the relatively short maturity of the respective instruments or because there is no ready market for such instruments.

Functional Expenses

Palmetto Health does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Further, since Palmetto Health receives substantially all of its resources from providing health care services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

Recently Issued Accounting Standards

ASU 2016-14 was recently issued to improve the presentation of financial statements of not-for-profit entities. This is the first major change to the nonprofit financial statement model in over 20 years, which is intended to provide more useful information to donors, grantors and other users. The standard addresses key qualitative and quantitative matters including net asset classes, investment return, expenses, liquidity and availability of resources, and presentation of operating cash flows. The amendments in ASU 2016-14 are effective for annual financial statements issued for fiscal years beginning after December 15, 2017. Early adoption is permitted. Entities presenting comparative financial statements must apply the amendments retrospectively, although certain optional practical expedients are available for periods prior to adoption. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2016-02 will require the inclusion of lease obligations, both financing and operating, on the balance sheets of companies and other organizations subject to the standard. The FASB decided that for private conduit municipal debt issuers (a definition that includes Palmetto Health), the standard will be effective for annual periods beginning after December 15, 2018. Early adoption will be permitted for all companies and organizations upon issuance of the standard. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2015-14 defers the effective date of Update 2014-09 for all entities by one year. ASU 2014-9 provides a five-step analysis of transactions to determine when and how revenue is recognized that consists of: i) identify the contract with the customer; ii) identify the performance obligations in the contract; iii) determine the transaction price; iv) allocate the transaction price to the performance obligations, and v) recognize revenue when or as each performance obligation is satisfied. The changes are intended to increase comparability, as well as simplify preparation of financial statements and provide more useful information to users through improved disclosures. The standard is effective for annual reporting periods beginning after December 15, 2017. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016. Palmetto Health has not determined any impacts on the consolidated financial statements that might result from application of this new standard.

ASU 2014-15 sets forth management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. These amendments are intended to reduce diversity in the timing and content of footnote disclosures. The standard is effective for the annual period ending after December 15, 2016 with early application permitted. Palmetto Health adopted the standard as required, with no effect on results of operations, cash flows or financial position as a result of such guidance.

Note 2 - Joint Operating Agreement and COPA

The State of South Carolina issued a COPA in connection with the Joint Operating Agreement arising from Palmetto Health's formation. Among other conditions, the COPA requires Palmetto Health to:

- Provide an annual report to the South Carolina Department of Health and Environmental Control (DHEC).
- Generally provide 10% of revenue and gains greater than expenses and losses to fund public health initiatives and community outreach programs. These terms will be re-evaluated should revenue and gains greater than expenses and losses as a percent of gross revenue escalate or decline to a point where Palmetto Health's commitment to public health and other community benefits becomes unbalanced as it relates to Palmetto Health's profitability or to a point where there is little or no commitment.
- Report on the nature, sources and amount of operational savings and capital cost reductions from avoided capital expenditures.
- Provide a single level of care to patients without regard to ability to pay and continue to provide indigent/charity care.
- Provide patients with access to competing facilities for those services not offered by Palmetto Health facilities.
- Maintain mission statements that are substantially similar to those of Baptist and Richland.

Unexpended funds totaling $6,662 and $5,049 at September 30, 2016 and 2015, respectively, were included in other current liabilities in the accompanying consolidated balance sheets pending expenditure in accordance with COPA requirements. Compliance with COPA restrictions is the responsibility of Palmetto Health management and is subject to monitoring by DHEC. At September 30, 2016 and 2015, respectively, Board designated funds of $8,735 and $6,767 were set aside by Palmetto Health in a separate bank account equal to accrued but unexpended funds disclosed above plus an estimate of one year's future COPA obligation.

Note 3 - Net Patient Service Revenue and Patient Accounts Receivable

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

Medicare

Inpatient acute care and most outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Inpatient nonacute services, certain outpatient services, and certain defined capital and medical education costs related to Medicare beneficiaries are paid based on formula/cost reimbursement methodologies. Additionally, Medicare program reimbursement is increasingly subject to adjustment for Palmetto Health's demonstrated delivery of defined "value" across multiple domains, including experience related to certain readmissions and hospital-acquired conditions. While Palmetto Health's historical performance in this area has not subjected Palmetto Health to extraordinary penalties, it is the current intent of the Medicare program to require that future reimbursement be increasingly subject to potential penalties or other payment model change associated with delivery of value to the program, the impact of which on the consolidated financial statements is not currently determinable.

Palmetto Health is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after the submission of annual cost reports by Palmetto Health and audits thereof by the Medicare fiscal intermediary. The Medicare cost reports of Palmetto Health have been audited and final settled by the Medicare fiscal intermediary through the fiscal years ended September 30, 2011 for Palmetto Health Tuomey, through September 30, 2012 for Richland and through September 30, 2013 for Baptist. No final settlements have yet occurred for Parkridge Hospital. Net revenue from the Medicare program approximated 26% of Palmetto Health's net patient service revenue for both the years ended September 30, 2016 and 2015.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries through September 30, 2012 were reimbursed on an interim basis at either a prospectively determined rate per discharge or specific rate for each inpatient day and then final settled at cost, while outpatient services were reimbursed on a fee schedule and then final settled at cost. For the fiscal year ended September 30, 2013 and forward all Medicaid services are reimbursed on a prospective basis. The Medicaid cost reports of Palmetto Health have been audited and final settled by Medicaid through the fiscal year ending September 30, 2011. Net revenue from the Medicaid program approximated 18% and 17% of Palmetto Health's net patient service revenue for the fiscal years ended September 30, 2016 and 2015, respectively.

State Medicaid funding (and especially DSH program funding) is a vital source of revenue for Palmetto Health. Palmetto Health recognized net revenue from its participation in the DSH program totaling approximately $26,707 and $16,469 in fiscal years 2016 and 2015, respectively. There can be no assurance that Palmetto Health will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified. Any material reduction in such funding would have a correspondingly material adverse effect on Palmetto Health's financial position and results of operations.

DSH program payments are subject to audit and a final settlement process. The South Carolina Department of Health and Human Services (SCDHHS) has selected the option to redistribute all DSH program funds for fiscal year 2012 and forward to/from all hospitals based on final audit findings. Audit results and redistribution by facility for fiscal year 2012 were communicated by SCDHHS to each facility during 2016. Included in the fiscal 2016 DSH reimbursement of $26,707 disclosed above is $4,157 of incremental DSH funds arising from the 2012 redistribution. Without the receipt of final audit results of all hospitals in the state by SCDHHS for each particular year and the related calculation of facility-specific redistribution, Palmetto Health is unable to predict settlements at this time for any years subsequent to fiscal 2012. Palmetto Health anticipates recognition of DSH program audit results in the period of notification of such findings and anticipated settlements from SCDHHS, which may result in significant impacts to net patient service revenue in the year of recognition.

Other

Palmetto Health has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, Medicaid managed care organizations and preferred provider organizations. The basis for payment to Palmetto Health under these agreements is primarily prospectively determined rates per discharge and prospectively determined daily rates.

During the years ended September 30, 2016 and 2015, Palmetto Health recognized changes in the prior year third party settlement estimates that resulted in an increase of approximately $6,355 and $2,415 in net patient service revenues, respectively.

For the year ended September 30, 2015, Palmetto Health recorded net revenue of $4,300 for participating in the "Rural Floor" appeal to the Centers for Medicare and Medicaid Services (CMS). CMS understated the standardized amounts required by the Budget Neutrality Adjustment included in the 1997 Balanced Budget Act, which resulted in DRG underpayments from 1998 through 2011. As a result, many healthcare providers across the nation filed appeals and reached agreement with CMS on related settlements.

(dollars in thousands)

In addition, for the year ended September 30, 2015, Palmetto Health recognized revenue of $3,827 as a result of a settlement from CMS related to the Recovery Audit program, a Department of Health and Human Services program that utilizes Recovery Auditors to identify certain Medicare overpayments and underpayments to health care providers. On August 29, 2014, in order to lower its backlog of contentious payment disputes, CMS offered to pay acute-care and critical-access hospitals 68% of inpatient-status claims lingering at various stages within the Office of Medicare Hearings and Appeals; in return, providers were required to withdraw their appeals.

Net patient service revenue is comprised of the following:

	2016	2015
Revenue at established charges	$ 5,391,178	$ 4,390,431
Contractual adjustments	(3,412,313)	(2,787,918)
Charity care	(221,386)	(192,855)
Disproportionate share funding (see Note 3)	26,707	16,469
Net patient service revenue	$ 1,784,186	$ 1,426,127

The estimated cost for Palmetto Health of providing charity services was $61,417 and $56,518 for the years ended September 30, 2016 and 2015, respectively.

The following table summarizes Palmetto Health's net patient service revenue by payer source:

	2016	2015
Medicare	26%	26%
Medicaid	18%	17%
Commercial/managed care/other third-party payers	50%	50%
Self-pay	3%	3%
All other	3%	4%
	100%	100%

Palmetto Health grants credit to its patients, most of whom are local residents. Palmetto Health generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, preferred provider arrangements and commercial insurance policies). The mix of net receivables from patients and third-party payers follows:

	2016	2015
Medicare	28%	23%
Medicaid	19%	14%
Commercial/managed care/other third-party payors	48%	50%
Self-pay	5%	13%
	100%	100%

(dollars in thousands)

The composition of patient accounts receivable follows:

	2016	2015
Accounts receivable	$ 654,232	$ 605,441
Less – Allowance for uncollectible accounts	(342,201)	(368,393)
Patient accounts receivable, net	$ 312,031	$ 237,048

In evaluating the collectability of accounts receivable, Palmetto Health analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowances and provisions for uncollectible accounts, as well as performing a detail review of high dollar accounts on a case by case basis. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

For receivables associated with services provided to patients who have third-party coverage, Palmetto Health analyzes contractually due amounts and provides both an allowance and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments which remain unpaid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for a portion of the services provided), Palmetto Health records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients do not pay the portion of their bills for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for uncollectible accounts.

Palmetto Health's allowance for uncollectible accounts for self-pay patients was 89.0% and 88.7% of self-pay accounts receivable at September 30, 2016 and 2015, respectively. Effective January 1, 2014, Palmetto Health changed its charity care and uninsured discount policies to align with new requirements of the Affordable Care Act. Charity is now limited primarily to patients whose income and resources are less than 100% of Federal Poverty Guidelines, live in Palmetto Health's primary service area (Richland, Lexington or Fairfield counties), and who are not eligible for any other coverage including that offered through the Health Insurance Marketplace. Self-pay patients not eligible for charity care are provided a 20% discount from gross charges. Effective January 1, 2016, Palmetto expanded its primary service area to include Sumter County as a result of the formation of Palmetto Health Tuomey. Palmetto Health does not maintain a material allowance for uncollectible accounts from third-party payers, nor has it generally incurred significant write-offs from third-party payers.

Note 4 - Other Revenue

Other revenue includes a capitated arrangement for Palmetto Senior Care, whereby member premiums received are based on a per-member, per-month basis, regardless of the related utilization. Revenue recorded in connection with this arrangement was $18,582 and $16,507 for the years ended September 30, 2016 and 2015, respectively.

(dollars in thousands)

Note 5 - Other Receivables

Components of other receivables follow:

	2016	2015
Residents FICA refund receivable	$ 5,061	$ -
Settlement amounts due from third-party payers	2,641	750
Flood daim receivable (see Note 22)	2,800	-
Amounts due from the DSH program	-	1,458
Amounts due from graduate medical education arrangements	606	451
Interest receivable	893	1,103
Grant receivables	1,344	950
Due from BEH (see Note 18)	1,514	1,466
Other	11,788	6,889
	$ 26,647	$ 13,067

In August 2014, Palmetto Health filed a civil action against the United States of America seeking recovery of FICA taxes erroneously paid by Palmetto Heath for the taxable years 1996, 1998, 1999 and 2000. The suit sought refunds for contributions made on behalf of medical residents who had furnished consents. In September 2016, Palmetto Health and the government reached a final settlement on the matter of $2,384 plus interest. In November 2016 Palmetto Health received $5,061 payment for the principal and interest, which is included in current receivables. Palmetto Health has recorded $3,544 in current liabilities (see Note 10) for the portion of the settlement due to the medical residents.

(dollars in thousands)

Note 6 - Assets Limited as to Use

The composition of Palmetto Health's assets limited as to use follows:

September 30, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
By board primarily for capital improvements:				
U.S. Treasury and government agencies	$ 24,783	$ 332	$ (1,083)	$ 24,032
Cash and short-term investments	8,838	-	-	8,838
Mutual funds	360,801	22,705	(6,027)	377,479
Common stocks and options	48,394	9,810	(2,105)	56,099
Corporate bonds, mortgage and asset-backed securities, and other	143,488	3,953	(5,454)	141,987
Alternative investments	75,843	15,799	-	91,642
	662,147	52,599	(14,669)	700,077
By trustee primarily under indenture and collateral agreements:				
U.S. Treasury and government agencies	57,430	1,031	-	58,461
Cash and short-term investment	39,467	23	-	39,490
Corporate bonds, mortgage and asset-backed securities, and other	30,199	-	(85)	30,114
	127,096	1,054	(85)	128,065
	$ 789,243	$ 53,653	$ (14,754)	$ 828,142

September 30, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
By board primarily for capital improvements:				
U.S. Treasury and government agencies	$ 23,227	$ 1,400	$ (766)	$ 23,861
Cash and short-term investments	16,720	-	-	16,720
Mutual funds	349,606	9,554	(12,102)	347,058
Common stocks and options	67,331	14,351	(4,773)	76,909
Corporate bonds, mortgage and asset-backed securities, and other	160,148	4,183	(4,759)	159,572
Alternative investments	67,872	16,340	(152)	84,060
	684,904	45,828	(22,552)	708,180
By trustee primarily under indenture and collateral agreements:				
U.S. Treasury and government agencies	39,386	18	(300)	39,104
Cash and short-term investment	13,786	-	-	13,786
Corporate bonds, mortgage and asset-backed securities, and other	15,939	-	(102)	15,837
	69,111	18	(402)	68,727
	$ 754,015	$ 45,846	$ (22,954)	$ 776,907

(dollars in thousands)

The composition of net investment income is as follows:

	2016	2015
In other revenue – interest income	$ 191	$ 96
In nonoperating (expenses) income:		
Interest and dividend income	$ 20,628	$ 29,256
Realized (losses) gains, net	10,740	(2,333)
	$ 31,368	$ 26,923

Note 7 - Property and Equipment

The components of property and equipment are as follows:

	2016	2015
Land and improvements	$ 65,239	$ 52,979
Buildings and improvements	760,652	685,650
Equipment and furniture	820,732	753,739
	1,646,623	1,492,368
Accumulated depreciation	(990,189)	(913,539)
Construction-in-progress	26,503	21,071
Property and equipment, net	$ 682,937	$ 599,900

Depreciation expense was $78,628 and $67,068 for the years ended September 30, 2016 and 2015, respectively.

At September 30, 2016, Palmetto Health had committed to expend an additional $23,967 for the construction of various projects and purchase of other miscellaneous equipment over the next several years.

Note 8 - Other Assets

The components of other assets follow:

	2016	2015
Interest in net assets of Affiliated Foundations (Note 18)	$ 45,490	$ 29,026
Cash surrender value, prepaids, deposits and other receivables	28,343	14,113
Notes receivable, net	1,413	1,415
Investment in affiliates	26,198	28,675
Other	3,556	3,377
	105,000	76,606
Less – Current portion	(20,218)	(13,027)
Other assets, noncurrent	$ 84,782	$ 63,579

(dollars in thousands)

The following investments in affiliates are reported using the equity method of accounting:

Name of Investee	Ownership Percentage	2016	2015
BEH	50.00%	$ 24,079	$ 25,220
Carolina Home Therapeutics	49.00%	548	2,174
Hospital Services, Inc.	26.47%	1,006	855
Initiant	20.00%	-	25
Radiation Oncology, LLC	51.00%	565	401
		$ 26,198	$ 28,675

BEH operates as a nonprofit entity consisting of two equal members: Palmetto Health and Greenville Health Corporation (GHC). The Board is appointed equally by Palmetto Health and GHC or an affiliate of GHC. Palmetto Health accounts for its investment in BEH under the equity method of accounting. See Note 18 for further discussion on services rendered to BEH by Palmetto Health.

Palmetto Health does not control any of the above affiliate organizations.

A summary of combined unaudited financial information of the above mentioned affiliates as of and for the years ended September 30, 2016 and 2015 follows:

	2016	2015
Revenues	$ 140,224	$ 140,705
Net income	1,582	6,214
Assets	87,852	87,218
Equity	55,003	60,394

Note 9 - Operating Leases

Palmetto Health leases certain business space and equipment under non-cancelable operating leases. Rental expense totaled approximately $29,976 and $23,222 for the years ended September 30, 2016 and 2015, respectively. Future minimum rental payments, reduced by minimum sublease rentals, required under non-cancelable leases that have remaining lease terms in excess of one year as of September 30, 2016, follow:

For the year ended:	
2017	$ 18,511
2018	15,073
2019	10,128
2020	9,258
2021	8,874
Thereafter	54,921
	$ 116,765

(dollars in thousands)

Note 10 – Other Liabilities

The composition of other liabilities follows:

	2016	2015
Fair value of derivatives (see Note 12)	$ 90,523	$ 62,541
Accrued medical malpractice losses (see Note 14)	16,488	13,390
Workers compensation liability (see Note 14)	5,537	5,063
Deferred compensation liability (see Note 15)	3,727	5,865
Post-retirement benefit obligations (see Note 16)	9,051	11,397
Pension retirement benefit obligation (see Note 17)	34,975	-
Funds restricted for COPA (see Note 2)	6,662	5,049
Accrued interest	5,116	4,511
Resident FICA refund liability (see Note 5)	3,544	-
Health Insurance Exchange collaborative liability	3,000	-
Settlement amounts due to third parties	3,082	3,131
Asset retirement obligation	1,142	1,142
Other	2,097	2,612
	184,944	114,701
Less – Current portion	(34,511)	(24,610)
Other liabilities, noncurrent	$ 150,433	$ 90,091

In 2016 Palmetto Health entered a multi-year agreement with a third-party insurer to create a joint product offering for Health Insurance Exchange ("HIX") participants in Palmetto Health's defined service area. The objective of the agreement is to create an arrangement that reduces overall health care cost through more effective clinical activities, including case management and care coordination protocols, while improving the quality of outcomes to the subject HIX members. Palmetto Health recorded a $3,000 liability to other current liabilities for its estimated share of losses related to the 2016-2017 contract for the nine months ended September 30, 2016, which is limited to $4,000 for the twelve months ended December 31, 2016. Actual payments under the contract, if required, are due annually eight months after the end of each contract year (calendar year basis) with a final settlement 15 months after the end of the contract year. It is well-publicized that HIX losses are emerging for participating health plans, so Palmetto Health's intent is to support the important need for HIX product in Palmetto Health' defined service area. Payments under the contract, if required, would be associated with Palmetto Health's 50% sharing of defined loss experience under the contract, if such emerges.

(dollars in thousands)

Note 11 - Long-term Debt

Long-term debt of Palmetto Health consists of the following:

	2016	2015
Bonds payable:		
2016 Series current interest paying bonds, payable annually beginning in 2036 and maturing on various dates through August 1, 2042 in varying amounts, with an optional call on August 1, 2022 and mandatory tender on August 1, 2031, and with interest at 3.7% due semi-annually	$ 120,000	$ -
2014 Series current interest paying serial bonds, payable annually beginning in 2023 and maturing on various dates through August 1, 2032 in varying amounts, with a mandatory tender on December 1, 2020, and with monthly interest at 67% of LIBOR plus 0.95% (1.30% as of September 30, 2016 and 1.33% at September 30, 2015)	18,085	18,085
2013 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2030, in varying amounts with interest due semi-annually with rates ranging from 2.50% to 5.25%	113,130	120,270
2011 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2039, in varying amounts with interest rates ranging from 3.00% to 6.50%	82,055	83,000
2010 Series A current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 67% of one month LIBOR plus 0.95% (1.30% at September 30, 2016 and 1.47% at September 30, 2015)	63,288	64,743
2010 Series B current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 68% of one month LIBOR plus 0.75% (1.11% at September 30, 2016 and 1.47% at September 30, 2015)	44,535	45,560
2010 Series C current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 67% of one month LIBOR plus 0.95% (1.30% at September 30, 2016 and 1.47% at September 30, 2015)	9,375	9,590
2010 Series D current interest paying serial bonds, payable annually beginning in August 2014, maturing on various dates through December 31, 2043, with a mandatory tender on August 3, 2020, and quarterly interest on the drawn balance at 68% of one month LIBOR plus 0.75% (1.11% at September 30, 2016 and 1.47% at September 30, 2015)	86,085	72,577
2009 Series current interest paying serial bonds, payable annually and maturing on various dates through August 1, 2039, in varying amounts with interest rates ranging from 3.00% to 5.90%	89,010	91,985
2005 Series A current interest paying bonds, payable annually and maturing on August 1, 2035, in varying amounts with interest rates ranging from 3.25% to 5.00% (4.84% at September 30, 2016 and 4.87% at September 30, 2015)	184,775	189,600
Less – Unamortized premiums, discounts and issuance costs	(12,782)	(12,738)
Total bonds payable	797,556	682,672
Less – Current portion	(17,016)	(19,903)
	$ 780,540	$ 662,769

(dollars in thousands)

Future maturities of long-term debt follow:

	Maturities	Net Amortization of Premiums, Discounts and Issuance Costs	Payments
2017	$ 17,016	$ 754	$ 17,770
2018	17,859	736	18,595
2019	18,802	688	19,490
2020	19,718	647	20,365
2021	20,733	632	21,365
Thereafter	703,428	9,325	712,753
	$ 797,556	$ 12,782	$ 810,338

The estimated fair value of Palmetto Health's long-term debt as of September 30, 2016 and September 30, 2015 was approximately $864,062 and $749,313, respectively. Fair values are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

In April 2016, Palmetto Health issued the 2016 Series A bonds for $120,000, while simultaneously entering into a total return swap for the same amount (see Note 12). The bonds were issued to (i) refinance the $90,000 taxable bridge financing that Palmetto Health utilized in December 2015 in anticipation of the January 1, 2016 Tuomey transaction (see Note 20), (ii) finance capital additions and improvements to Palmetto Health's existing hospital facilities, and (iii) pay certain expenses incurred in connection with the issuance of the 2016 Series A bonds.

The $90,000 taxable bridge financing mentioned above was a line of credit from a bank. The line of credit requires collateralization that can take the form of cash held in safekeeping by a third-party bank or by liens on certain types of investments owned by Palmetto Health. As of September 30, 2016, there was no outstanding balance on the line of credit. After the refinancing transaction described above, Palmetto Health maintained the line of credit but reduced the available line from $90,000 to $30,000.

In December 2014, Palmetto Health issued the 2014 Series bonds for $18,085. The bonds were issued to refinance the same amount of 2009 bonds that Palmetto Health purchased in August 2014 pursuant to call in accordance with their terms.

Palmetto Health's historical bond transaction activity is generally consistent with capital financing strategies and related capital requirements evidenced by most larger not-for-profit U.S. health systems. The bonds described above were all issued under the August 1, 2003 Master Trust Indenture and related amendments and supplements issued thereafter ("the MTI"). Per the MTI definitions, Palmetto Health is the sole member of the defined Obligated Group.

Borrowings under the MTI are subject to certain financial covenants, restrictions on indebtedness, financial guarantees, and business combinations, and other terms which are usual and customary for such agreements.

Palmetto Health's bonds payable are collateralized by the Obligated Group's pledged assets and all revenues, receipts and income derived in connection with the ownership and operation of the Obligated Group's property and equipment.

Note 12 - Derivative Financial Instruments

Palmetto Health has entered into interest rate swap agreements, some of which contain interest rate caps and call features. These instruments, which are not designated as accounting hedges, have notional amounts tied to bond issuance principal balances.

(dollars in thousands)

When the total fair value of certain swaps exceeds a liability of $15,000, Palmetto Health is required to provide collateralization for the excess. The collateralization can take the form of cash held in safekeeping by a third-party bank or by liens on investments in treasuries or government sponsored entities owned by Palmetto Health. As of September 30, 2016 and 2015, there was $62,426 and $37,075, respectively, set aside for such collateral, reported in assets limited as to use. The amount required changes on a weekly basis.

On November 19, 2015, Palmetto Health terminated its $144,000 notional basis swap while simultaneously modifying the effective date of its $142,000 notional fixed payor swap from April 1, 2016 to January 23, 2017.

On August 26, 2016, Palmetto Health terminated its $275,000 notional basis swap while simultaneously modifying the effective date of its $142,000 notional fixed payor swap from January 23, 2017 to February 20, 2020.

On April 28, 2016, Palmetto Health entered into a $120,000 notional total return swap in connection with the 2016 bond issuance. A total return swap is an agreement in which one party makes payments based on a set rate, either fixed or variable, while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. The underlying asset in Palmetto Health's total return swap is the 2016 Series A bonds.

The $90,523 and $62,541 net fair value of all the derivative instruments at September 30, 2016 and September 30, 2015 is recorded in other liabilities (see Note 10) in the accompanying consolidated financial statements. The following is a summary of the fair value of the instruments outstanding, excluding any net settlement differential receivable/payable, at September 30, 2016 and September 30, 2015:

At September 30, 2016

Type	Notional Amount	Effective Date	Maturity Date	Rate Paid	Rate Received	Increase (decrease) in Interest Expense	Swap Fair Value Liability
Basis swap*	$ 144,000	8/1/03	5/9/18	0.358%	0.834%	$ 120	$ -
Basis swap**	275,000	9/9/05	9/12/30	0.170%	0.500%	1,263	-
Fixed payor	43,675	8/1/13	7/26/35	3.540%	0.632%	(648)	(11,996)
Total return swap	120,000	4/28/16	4/28/21	1.237%	3.700%	1,252	(875)
Fixed payor	4,325	4/1/16	12/1/43	3.725%	0.633%	(57)	(13,275)
Fixed payor	142,000	2/20/20	12/1/43	3.477%	0.295%	-	(64,377)
Totals for derivative instruments						$ 1,930	$ (90,523)

* Terminated this swap in November 2015 as discussed above.
** Terminated this swap in August 2016 as discussed above.

At September 30, 2015

Type	Notional Amount	Effective Date	Maturity Date	Rate Paid	Rate Received	Decrease in Interest Expense	Swap Fair Value Asset (Liability)
Basis swap	$ 144,000	8/1/03	5/9/18	0.170%	0.610%	$ (1,738)	$ 3,901
Basis swap	275,000	9/9/05	9/14/15	0.170%	0.500%	(1,722)	6,433
Fixed payor	3,350	4/1/16	12/1/43	3.725%	0.426%	-	(8,448)
Fixed payor	142,000	4/1/16	12/1/43	3.477%	0.133%	-	(54,985)
Fixed payor	46,250	4/1/16	7/26/35	3.540%	0.426%	-	(9,442)
Totals for derivative instruments						$ (3,460)	$ (62,541)

(dollars in thousands)

Note 13 - Capital Lease Obligations

Capital Lease Obligation to Richland County

Concurrent with the transfer of substantially all Richland net assets to Palmetto Health, the operating rights of associated real property and improvements thereon were also conveyed to Palmetto Health via lease. In exchange for an annual lease payment (including a fixed portion and other expenses assumed by Palmetto Health from Richland County), Richland County and Richland leased to Palmetto Health all of the real property recorded on the Richland property records as of the date Palmetto Health was formed. Real property includes all land, buildings and the building systems. The terms of the leases include a 35-year period with three five-year options, of which all three have been exercised. Upon completion of the 35-year original lease period at December 31, 2033, the remaining lease payments will be treated as an operating lease and such payments are therefore included in the operating lease disclosure in Note 9.

The lease payment to the County includes a fixed payment of $1,693 per year. The 35 years of annual payments of $1,693 have been discounted using a 5.5% interest rate to their present value and recorded as a capital lease obligation. In addition, Palmetto Health reimburses Richland County an amount from operations equal to the County's annual responsibility for the Medically Indigent Assistance Program (MIAP) as determined by the State of South Carolina.

Capital Lease Obligations to Third Parties

Palmetto Health also has capital lease obligations with other third parties for equipment.

Maturities on the long-term capital lease obligations for the next five years and the aggregate are as follows:

For the year ended:	Related Party	Third Parties	Total
2017	$ 1,693	$ 204	$ 1,897
2018	1,693	153	1,846
2019	1,693	-	1,693
2020	1,693	-	1,693
2021	1,693	-	1,693
Thereafter	20,739	-	20,739
Total minimum payments	29,204	357	29,561
Amount representing interest	(10,426)	(7)	(10,433)
Obligations under capital leases	18,778	350	19,128
Obligations due within one year	(674)	(198)	(872)
Long-term obligations under capital leases	$ 18,104	$ 152	$ 18,256

(dollars in thousands)

Assets under capital lease are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation and amortization in the consolidated statements of operations.

The gross amounts of assets under capital lease and accumulated amortization at September 30, 2016 and September 30, 2015 are summarized as follows:

	2016			2015		
	Related Party	Third Parties	Total	Related Party	Third Parties	Total
Gross amount of assets under capital lease	$ 26,447	$ 964	$ 27,411	$ 26,447	$ 964	$ 27,411
Less: Accumulated amortization	(7,669)	(614)	(8,283)	(7,034)	(420)	(7,454)
	$ 18,778	$ 350	$ 19,128	$ 19,413	$ 544	$ 19,957

Note 14 - Insurance Coverage and Litigation

Medical Malpractice Claims

Palmetto Health purchases professional medical liability insurance coverage for medical malpractice claims. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. Palmetto Health uses independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice losses totaling $16,488 and $13,390, discounted at 3%, are included in other liabilities as of September 30, 2016 and 2015, respectively, and, in management's opinion, provide an adequate reserve for related loss contingencies.

Palmetto Health's self-insured retention is funded through a multi-provider, cell-based captive insurance arrangement. Palmetto Health participates as a voting member of the captive, but does not control the related corporation. Premiums for primary, primary excess and contingent excess coverage amounted to $1,558 and $1,383 for the years ended September 30, 2016 and 2015, respectively. Palmetto Health has a per-claim self-insured retention of $600 for the years ended September 30, 2016 and 2015. The annual aggregate self-insured retention (based on potential multiple claims at the per-claim self-insured retention) was $10,000 for the year ended September 30, 2016 and was unlimited for the year ended September 30, 2015. Additionally, Palmetto Health is contingently liable for up to 100% of cumulative premiums incurred for primary coverage, or $39,686 at September 30, 2016 (the Potential Premium Assessment). As of September 30, 2016, management believes the likelihood of any Potential Premium Assessment is not probable; hence, no related amounts have been accrued at September 30, 2016. Palmetto Health has provided two letters of credit with commercial banks in a maximum amount of approximately $5,863 (expiring January 2017) and $409 (expiring July 2017) to secure a portion of the maximum obligation for the Potential Premium Assessment. Management anticipates an updated renewal of this facility under substantially the same terms and conditions at expiration.

Workers' Compensation and Employee Health

Palmetto Health is self-insured for workers' compensation claims and has a stop-loss insurance policy for claims in excess of $750. Palmetto Health has provided a letter of credit with a commercial bank in a maximum amount of $3,850 (expiring October 2017) related to the self-insurance of workers' compensation. Palmetto Health has recorded estimated accruals in other current liabilities and other liabilities totaling $5,537 and $5,063, at September 30, 2016 and 2015, respectively, for the self-insurance portion of workers' compensation and maintains customary excess coverages with commercial insurers for exposures above self-insured retentions. Palmetto Health is also self-insured for its employee group health insurance. Palmetto Health has recorded estimated accruals related to health insurance in other accrued salaries and benefits totaling $4,738 and $3,497, at September 30, 2016 and 2015, respectively.

Litigation

As a not-for-profit corporation, Palmetto Health is the beneficiary of certain liability caps established under South Carolina Charitable Immunity statutes. The laws of the State limit damage recoveries for medical services rendered by the facility or the facility's employees to $300 per claim with a maximum of $600 per occurrence, with liability caps for employed physicians at $1,200 per occurrence. From time to time, Palmetto Health is involved in litigation and regulatory investigations arising in the normal course of business. Based on consultation with legal counsel and given available insurance coverages and related accruals, management believes that these matters will be resolved without a material adverse effect on Palmetto Health's financial position or results of operations

Note 15 - Retirement Plans

Palmetto Health Retirement Savings Plan (Savings Plan) is a defined contribution retirement plan. Employees are eligible to participate in the pretax salary reduction portion of the Savings Plan beginning with the first payroll after employment. Employees are eligible for the Palmetto Health match after the completion of 12 months of service in which the employee works 1,000 hours and after reaching the age of 21. Palmetto Health matches up to 140% of employee contributions up to 3.5% of the employee's eligible compensation. The ultimate level of this employer match is based on years of service. Benefits are vested 20% annually beginning with the second year of employment with employees becoming fully vested after six years. The Savings Plan credits all previous years of vesting service with Baptist and Richland from the date of hire.

With the formation of Palmetto Health, certain Richland employees remained Richland employees and Richland entered into an arrangement with Palmetto Health whereby those employees were then leased to Palmetto Health. Those employees continue to participate in the State of South Carolina Retirement System. The plan requires contributions by employers who elect or are required to participate in the plan. Richland has funded all contributions required by the plan. Information specific to the portion of the South Carolina Retirement System's assets and vested and non-vested benefits applicable to Richland employees is not available.

Palmetto Health expensed $14,001 and $12,119 related to the above retirement plans in fiscal years 2016 and 2015, respectively.

Palmetto Health has an unfunded defined benefit supplemental executive retirement plan for certain members of senior management. The participants become eligible to receive benefit payments in the month coinciding with the later of their respective 62nd or 65th birthdays, dependent upon the participant, or 36 months of participation.

(dollars in thousands)

The changes in the associated benefit obligation follow as of and for the years ended September 30:

	2016	2015
Benefit obligation at beginning of year	$ 5,865	$ 5,347
Service cost	318	296
Interest cost	243	222
Actuarial loss	284	-
Amendments	(2,983)	-
Total benefit obligation, end of year	$ 3,727	$ 5,865
Amounts recognized in unrestricted net assets consist of:		
Unrecognized actuarial loss	$ (477)	$ (193)
Unrecognized prior service cost	2,106	(1,274)
	$ 1,629	$ (1,467)

The components of net periodic benefit cost and other pension accounting follow as of and for the years ended September 30:

	2016	2015
Service cost	$ 318	$ 296
Interest cost	243	222
Amortization of prior service cost	397	397
Net periodic postretirement benefit cost	958	915
Adjustment to liability recognized in unrestricted net assets consist of:		
Prior service cost	(397)	(397)
Total benefit cost and other charges recognized in unrestricted net assets	$ 561	$ 518
Amounts expected to be recognized in net periodic benefit costs in the following year:		
Unrecognized actuarial loss	$ (586)	$ 397

The measurement dates were as of September 30 for both fiscal 2016 and fiscal 2015. The weighted average discount rates used to determine benefit obligations were 3.5% and 4.15% for the years ended September 30, 2016 and 2015, respectively. The rate of compensation increase used to determine benefit obligations at both September 30, 2016 and 2015 was 4.0%. Participants included in the valuation were three and five for September 30, 2016 and 2015, respectively.

In December 2015, Palmetto Health also entered into split-dollar life insurance arrangements with certain members of senior management. Under the agreements, Palmetto Health will receive all premiums paid, plus a fixed rate of return, and a portion of the death benefits at the mortality events of the participating members of senior management. Palmetto Health's interests are secured by the cash values of the life insurance policies. The participating members of senior management retain all other life insurance policy benefits. An asset of $7,205 has been recognized in other assets by Palmetto Health as of September 30, 2016 equal to the premiums paid plus accrued rate of return, subject to an adjustment for cash values of the life insurance policies and other associated assets (Note 8).

(dollars in thousands)

Note 16 - Postretirement Benefits Plans

Palmetto Health currently provides defined unfunded health care and drug benefits for certain retired employees. Additionally, certain active employees are eligible for future benefits. Employees who retire with Palmetto Health on and after October 1, 2004, pay the full cost of retiree medical coverage. Palmetto Health has elected to record the unrecognized transition obligation as an operating expense on a prospective basis as part of the future annual benefit cost. The changes in the associated benefit obligation follow as of and for the years ended September 30:

	2016	2015
Benefit obligation at beginning of year	$ 11,397	$ 12,387
Interest cost	325	449
Actuarial gain	(1,890)	(262)
Benefits paid	(1,197)	(1,177)
Total benefit obligation, end of year	$ 8,635	$ 11,397
Amounts recognized in the unrestricted net assets consist of:		
Unrecognized actuarial loss (gain)	1,540	(134)
Unrecognized prior service credit	271	322
Unrecognized net transition obligation	(1,031)	(1,684)
	$ 780	$ (1,496)

The components of net periodic postretirement benefit cost and other related accounting follow as of and for the years ended September 30:

	2016	2015
Interest cost on accumulated postretirement benefit obligation	$ 325	$ 449
Amortization of transition obligation	653	653
Amortization of unrecognized prior service cost	(51)	(51)
Amortization of net gain	(216)	-
Net periodic postretirement benefit cost	711	1,051
Adjustment to liability recognized in unrestricted net assets consist of:		
Net actuarial gain occurred during the year	(1,890)	(262)
Net actuarial gain amortized during the year	216	-
Prior service credit	51	51
Net transition obligation	(653)	(653)
	(2,276)	(864)
Total benefit cost and other charges recognized in unrestricted net assets	$ (1,565)	$ 187
Amounts expected to be recognized in net periodic benefit costs in the following year:		
Unrecognized actuarial loss	653	653
Unrecognized prior service cost	(51)	(51)
	$ 602	$ 602

(dollars in thousands)

The measurement dates were as of September 30 for both fiscal 2016 and fiscal 2015. The weighted average discount rates used to determine benefit obligations and net cost were 3.50% for September 30, 2016 and 4.15% for September 30, 2015. Participants included in the valuation were 178 and 244 for September 30, 2016 and 2015, respectively.

Information associated with health care cost trend rate assumptions follows as of and for the years ended September 30:

	2016	2015
Health care cost trend rate assumptions:		
Current health care cost trend rate	7.50%	8.00%
Ultimate health care cost trend rate	5.00%	5.00%
Ultimate trend rate is reached in year	2021	2021

	1% Decrease		1% Increase	
	2016	2015	2016	2015
Sensitivity to the assumed health care cost trend rates:				
Effect on total of service and interest cost components	$ (29)	$ (42)	$ 34	$ 50
Effect on postretirement benefit obligation	(807)	(1,086)	949	1,263

The benefits expected to be paid, net of Medicare Part D Subsidy, in each of the years 2017 to 2021 are $708, $699, $680, $653 and $622, respectively. The aggregate benefits expected to be paid in the five years from 2022 to 2026 are $2,690. The expected benefits are based on the same assumptions used to measure Palmetto Health's benefit obligation at September 30, 2016.

In addition, as part of the Tuomey transaction (see Note 20), Palmetto Health assumed the unfunded post-retirement benefit obligations associated with Tuomey's defined benefit plan which provided postretirement medical and dental benefits to eligible employees and/or dependents. Benefits available under the plan were frozen in March 2014.

The changes in the associated benefit obligation follow as of and for the period from January 1 to September 30:

	2016
Benefit obligation at beginning of year	$ 519
Interest cost	5
Plan participants' contributions	173
Actuarial loss	1
Benefits paid	(282)
Total benefit obligation, end of year	$ 416

The measurement date was September 30, 2016. The weighted average discount rate used to determine benefit obligations and net cost was 1.26% for September 30, 2016. The valuation included 50 participants.

(dollars in thousands)

Information associated with health care cost trend rate assumptions follows as of and for the period from January 1 to September 30:

	2016
Health care cost trend rate assumptions:	
Current health care cost trend rate	6.50%
Ultimate health care cost trend rate	5.00%
Ultimate trend rate is reached in year	2022

	2016	
	1% Decrease	1% Increase
Sensitivity to the assumed health care cost trend rates:		
Effect on total of service and interest cost components	$ (100)	$ 100
Effect on postretirement benefit obligation	(7,400)	7,500

The benefits expected to be paid, net of Medicare Part D Subsidy, in each of the years 2017 to 2019 are $154, $133, and $135, respectively. The expected benefits are based on the same assumptions used to measure Palmetto Health's benefit obligation at September 30, 2016.

Note 17 – Palmetto Health Tuomey Pension Plan

As part of the Tuomey transaction (see Note 20), Palmetto Health assumed the post-retirement benefit obligations associated with the previously-existing Tuomey pension plan.

Benefits under the plan were frozen effective December 31, 2009. The changes associated with the benefit obligation and plan assets follow as of and for the period from January 1 to September 30:

	2016
Change in benefit obligation:	
Benefit obligation at beginning of year	$ 85,194
Interest cost	2,615
Actuarial loss	8,929
Benefits paid	(2,228)
Total benefit obligation, end of year	94,510
Change in plan assets:	
Fair value of plan assets at beginning of year	57,520
Actual return on plan assets	3,593
Benefits paid	(2,228)
Employer contributions	650
Fair value of plan assets at end of year	59,535
Funded status of plan	$ (34,975)

(dollars in thousands)

The components of net periodic benefit cost and other pension accounting follow as of and for the period from January 1 to September 30:

	2016
Interest cost	$ 2,615
Expected return on plan assets	(2,829)
Net periodic pension income	(214)
Total benefit cost and other charges recognized in unrestricted net assets	$ (214)
Expected contributions in the following year	$ 1,132

The measurement date is September 30, 2016. The weighted average discount rate used to determine benefit obligations at September 30, 2016 was 4.17%. The rate of compensation increase used to determine benefit obligations at September 30, 2016 was 6.75%. The valuation included 1,784 participants.

The plan's long-term rate of return assumption of 6.75% is based on expectations regarding each asset category and average long-term rate of returns for a portfolio allocated across those categories.

Pension assets are invested to provide growth of capital with a moderate level of volatility by investing in a balanced portfolio. The actual asset allocation of the overall plan assets, as well as the performance of the individual managers, is reviewed by management on a quarterly basis.

	Percentage of Plan Assets as	
	Target Allocation	September 30, 2016
Cash and cash equivalents	3%	2%
Fixed income securities	35%	30%
Equity securities	62%	68%
	100%	100%

(dollars in thousands)

The following table presents the fair value of the plan's investments, along with the level within the fair value hierarchy (see Note 19) for the investments as of September 30, 2016:

	Fair Value Measurements at September 30, 2016 using:			
	Fair value at September 30, 2016	Quoted prices in active markets for identical assets (Level 1 inputs)	Quoted prices for similar assets (Level 2 inputs)	Significant Unobservable (Level 3 inputs)
Money market funds	$ 1,201	$ 1,201	$ -	$ -
Fixed income securities				
U.S. treasury bonds	3,393	-	3,393	-
U.S. corporate bonds	14,381	-	14,381	-
Equities				
Exchange traded	5,826	5,826	-	-
Indexed equity	11,754	11,754	-	-
U.S. large cap	17,563	17,563	-	-
U.S. small cap	1,863	1,863	-	-
International	3,554	3,554	-	-
Total assets at fair value	$ 59,535	$ 41,761	$ 17,774	$ -

Note 18 - Related Parties

Related-party Obligations with Richland County, Richland and Baptist

The total payments by Palmetto Health to Richland under the employee lease agreement described in Note 15 above totaled $5,624 and $6,038 for the years ended September 30, 2016 and 2015, respectively. Palmetto Health deposits with Richland an amount equal to two payrolls for leased employees, which totals $462 and $553 for the years ended September 30, 2016 and 2015, respectively. The deposit is included in other current assets in the accompanying consolidated financial statements.

Concurrent with the transfer of substantially all net assets to Palmetto Health, the operating rights of associated real property and improvements thereon were conveyed to Palmetto Health through the leases described above in Note 13. In exchange for an annual lease payment (including a fixed portion and other expenses assumed by Palmetto Health from Richland County), Richland County and Richland leased to Palmetto Health all of the real property recorded on the Richland property records as of the date Palmetto Health was formed. Real property includes all land, buildings and the building systems.

In addition, Palmetto Health reimburses Richland County an amount from operations equal to the County's annual responsibility for the MIAP as determined by the State of South Carolina.

Palmetto Health is also committed to provide an annual payment from operations to cover certain governance costs of Richland and Baptist. The payment is calculated using a base of $250, subject to adjustment based upon the Consumer Price Index and other expenses, as defined, for an original term of 35 years with three five-year renewal options, of which two have been exercised. Expense of $728 and $733 for the years ended September 30, 2016 and 2015, respectively, was recorded associated with these payments and is included in supplies and other expense in the accompanying consolidated statements of operations.

Palmetto Health provides certain services to BEH for a contractually-defined fee. Approximately $7,618 and $7,659 in other revenue was recognized for the years ended September 30, 2016 and 2015, respectively, with respect to the related service contract and a sublease (see Note 5 for related receivable).

(dollars in thousands)

Related-party Obligations with Affiliated Foundations

Palmetto Health is affiliated with the Palmetto Health Foundation and the Tuomey Foundation (collectively, the Affiliated Foundations). During the years ended September 30, 2016 and 2015, Palmetto Health received $5,382 and $5,637, respectively, in contributions from the Affiliated Foundations and Palmetto Health recorded $1,598 and $1,350 in operating expenses of the Affiliated Foundations, respectively.

The Palmetto Health Foundation was established through the merger of the Baptist Medical Center Columbia Foundation into the Richland Memorial Hospital Foundation for the sole purpose of supporting the mission, purposes and activities of Palmetto Health and its related organizations. The directors of Palmetto Health Foundation include certain officers and board members of Palmetto Health, as well as other community leaders. The Palmetto Health Foundation is constituted so as to attract support and contributions directly or indirectly from persons in the community in which it operates and was not formed for pecuniary profit or financial gain.

The Tuomey Foundation's sole purpose is to support the mission, purposes and activities of Palmetto Health Tuomey activities. The directors of the Tuomey Foundation include certain officers and board members of Palmetto Health Tuomey, as well as other community leaders. The Tuomey Foundation is constituted so as to attract support and contributions directly or indirectly from persons in the community in which it operates and was not formed for pecuniary profit or financial gain. As part of the Tuomey transaction (see Note 20), Palmetto Health agreed to contribute $320 annually to the Tuomey Foundation to be used solely in furtherance of the Tuomey Foundation's charitable purpose as described above.

The following table sets forth selected unaudited financial information of the Affiliated Foundations at September 30, 2016 and 2015:

	2016	2015
Assets	$ 49,112	$ 31,490
Liabilities	3,622	2,464
Unrestricted net assets	11,113	2,237
Temporary and permanently restricted net assets	34,377	26,789

Note 19 - Fair Value Measurements

ASC 820, "Fair Value Measurements and Disclosures," establishes a framework for measuring fair value. That framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. That hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that Palmetto Health has the ability to access.

Level 2 – Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs that are derived principally from, or corroborated by, observable market data by correlation other means.

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

(dollars in thousands)

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Changes in economic conditions or valuation techniques may require the transfer of financial instruments from one fair value to another. In such instances, the transfer is reported at the beginning of the reporting period. For the fiscal years ended September 30, 2016 and 2015, there were no transfers in or out of Levels 1, 2, or 3.

The following tables set forth the level, within the fair value hierarchy, of Palmetto Health's financial instruments at fair value as of September 30, 2016 and September 30, 2015:

At September 30, 2016

	Level 1	Level 2	Level 3	Total
U.S. Treasury and government agencies	$ 82,493	$ -	$ -	$ 82,493
Cash and short-term investments	48,328	-	-	48,328
Mutual funds	377,479	-	-	377,479
Common stocks and options	56,099	-	-	56,099
Corporate bonds, mortgage and asset backed securities, and other	-	172,101	-	172,101
Alternative investments	-	-	91,642	91,642
Assets at fair value	$ 564,399	$ 172,101	$ 91,642	$ 828,142
Derivative financial instruments	$ -	$ (90,523)	$ -	$ (90,523)
Liabilities at fair value	$ -	$ (90,523)	$ -	$ (90,523)

At September 30, 2015

	Level 1	Level 2	Level 3	Total
U.S. Treasury and government agencies	$ 62,965	$ -	$ -	$ 62,965
Cash and short-term investments	30,506	-	-	30,506
Mutual funds	347,058	-	-	347,058
Common stocks and options	76,909	-	-	76,909
Corporate bonds, mortgage and asset backed securities, and other	-	175,409	-	175,409
Alternative investments	-	-	84,060	84,060
Assets at fair value	$ 517,438	$ 175,409	$ 84,060	$ 776,907
Derivative financial instruments	$ -	$ (62,541)	$ -	$ (62,541)
Liabilities at fair value	$ -	$ (62,541)	$ -	$ (62,541)

(dollars in thousands)

The table below sets forth a summary of changes in the fair value of Palmetto Health's Level 3 financial instruments for the years ended September 30, 2016 and September 30, 2015:

	2016	2015
Balance, beginning of year	$ 84,060	$ 88,518
Purchases	8,325	-
Unrealized (loss) gain	(391)	1,155
Settlements, net	(352)	(5,613)
Balance, end of year	$ 91,642	$ 84,060

Palmetto Health estimates the fair value of debt securities based on fair values determined by independent vendors. The vendors compile prices from various sources and may apply matrix pricing for similar bonds where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued.

Palmetto Health estimates the fair value of alternative investments using the reported net asset value as a practical expedient for fair value. The use of net asset value as a practical expedient for fair value is permitted under GAAP for investments in entities that meet the description of an investment company and whose underlying investments are measured at fair value. The table below is a summary of the alternative investments held by Palmetto Health as of September 30, 2016 and 2015:

	2016	2015	Unfunded Commitments	Redemption Notice Period
Equity long/short hedge fund of funds	$ 18,378	$ 10,457	None	Written notification by 9/15 for redemption at 12/31 of each year
U.S. macro hedge fund of funds	-	147	None	N/A - currently liquidating
Diversified multi-strategy fund of funds	73,264	73,456	None	5-90 days
Balance, end of year	$ 91,642	$ 84,060		

The Equity long/short hedge fund of funds oversees various managers which seek to earn attractive returns by generally focusing on investments in global equities, both long and short, but may also use other securities and instruments deemed appropriate by the investment manager to carry out the overall objective of the fund. The investment manager has broad and flexible investment authority and may trade in any type of security, issuer, or group of related issuers, country, region, etc., believed to help the fund achieve its investment objectives.

The U.S. macro hedge fund of funds oversees various managers whose investment objective is to seek risk-adjusted returns while preserving capital during difficult market periods, through exposure to the financial, metal, energy, agricultural, currency and other markets, in addition to diversify its portfolio through investment in a range of funds or managed accounts seeking to implement trading strategies in numerous U.S. and international currency, futures, options, forward and other derivative markets.

The Diversified multistrategy fund of funds oversees various managers which seek diversification by investment strategy. Strategy sectors include, among others, Commodity Trading Advisor's (CTA)/Managed Futures, Distressed, Equity Long/Short High Hedge, Equity Long/Short Opportunistic, Event Driven, Macro, Mergers/Risk Arbitrage, Mortgage Arbitrage, Multi Strategy, Other Directional, Relative Value, and Statistical Arbitrage.

The fair values of interest rate swaps are obtained from third party advisors, overseen by management, and are based primarily on Level 2 inputs. Management also considers the creditworthiness of Palmetto Health and its counterparties in estimating the fair value of interest rate swaps, and the effect of any potential credit valuation adjustments was not significant to the fair value measurements as of September 30, 2016 or 2015.Note 20 – Acquisition of Subsidiary

Note 20 Acquisition of Subsidiary

On January 1, 2016, Palmetto Health acquired substantially all of the assets and assumed certain liabilities of Tuomey. Tuomey was a not-for-profit integrated healthcare delivery system serving Sumter, Lee, and Clarendon Counties in South Carolina, with a 301-bed medical center located in Sumter, South Carolina (approximately 45 miles from Palmetto Health's primary service locations in Columbia, South Carolina) and historically generating approximately $200,000 in annual operating revenues.

As part of the transaction, substantially all of the assets and liabilities of Tuomey were transferred to a new wholly owned subsidiary of Palmetto Health (Palmetto Health Tuomey). Palmetto Health provided the acquisition funding to Palmetto Health Tuomey through a $90,000 taxable bridge loan from a bank, which was subsequently refinanced with tax-exempt bonds (see Note 11).

In connection with a legal settlement with the Department of Justice (DOJ), Tuomey entered into a five-year Corporate Integrity Agreement (CIA) effective October 16, 2015. While Palmetto Health is not a party to the CIA, Palmetto Health did commit to the OIG, through the execution of a Side Letter, to assume certain responsibilities under the CIA as such responsibilities pertain solely to the Palmetto Health Tuomey entity. Specifically, Palmetto Health, through Palmetto Health Tuomey, agreed to extend Palmetto Health's compliance program to Palmetto Health Tuomey; provide education and training programs for staff, vendors and providers; and provide management and oversight of certain other monitoring and tracking activities as set forth in the CIA. These responsibilities and activities only affect Palmetto Health Tuomey and do not extend to Palmetto Health and its other affiliated entities.

The Tuomey transaction was accounted for as an acquisition with an effective date of January 1, 2016, and therefore the financial position and results of operations of Palmetto Health Tuomey are included in the Palmetto Health consolidated financial statements as of the effective date. The acquisition price was allocated to acquired assets and assumed liabilities based on their respective fair values, and resulted in recognition of an excess of net assets acquired over consideration transferred (a net "contribution") of $17,094 in the consolidated statement of changes in net assets for the year ended September 30, 2016. It is not atypical for not-for-profit community hospitals to be acquired where the purchase consideration is lower than the business enterprise value of the entity. With respect to the Tuomey transaction, and as generally disclosed in the notes to these consolidated financial statements, there were a number of legal and operational issues which drove Tuomey to identify a potential acquirer of its operations on an accelerated basis. The excess of net assets acquired over consideration received arises from the impact of these factors on the negotiated purchase price in the Tuomey transaction.

Palmetto Health also recognized $4,000 in other revenue for funds received from the SCDHHS Hospital Transformation Plan. The program includes encouraging new long-term partnerships between rural hospitals and community, tertiary and teaching facilities to ensure seamless, timely and high quality clinical care for patients in rural areas of the state. This aided to offset Palmetto Health's estimated acquisition costs incurred of $4,485.

(dollars in thousands)

The following table summarizes the consideration transferred and estimated fair value of assets acquired and liabilities and net assets assumed at January 1, 2016 (the acquisition date):

Consideration paid:		
Cash	$	89,068
Acquired assets:		
Cash and cash equivalents	$	932
Assets limited as to use		14,671
Patient accounts receivable, net		29,536
Other receivables		4,525
Inventories		4,037
Property and equipment, net		83,449
Other assets		19,209
Total assets	$	156,359
Liabilities assumed:		
Accounts payable	$	7,609
Accrued salaries and benefits		13,002
Other current liabilities		1,216
Other noncurrent liabilities		28,370
Total liabilities		50,197
Net assets assumed:		
Temporarily restricted		2,774
Permanently restricted		5,337
Total net assets		8,111
Total liabilities and net assets	$	58,308

The following table summarizes Palmetto Health's pro forma consolidated results from operations for the years ended September 30, 2016 and 2015 as though the acquisition occurred October 1, 2015 and October 1, 2014, respectively:

		2016		2015
Total operating revenues	$	1,626,923	$	1,461,596
Operating income		14,198		15,318
Other income, net		25,083		(55,363)
Revenue and gains over expense and losses		38,033		(86,393)
Changes in net assets:				
Unrestricted	$	839,443	$	792,415
Temporarily restricted		30,112		30,126
Permanently restricted		16,014		18,409
Total changes in net assets	$	885,569	$	840,950

(dollars in thousands)

The following table summarizes Palmetto Health Tuomey's results for the nine months ended September 30, 2016:

	9 months ended 2016
Total operating revenues	$ 142,850
Operating income	6,962
Other income, net	38
Revenue and gains less expenses and losses	7,000
Changes in net assets:	
Unrestricted	$ 8,463
Temporarily restricted	647
Permanently restricted	146
Total changes in net assets	$ 9,256

Note 21 - Subsequent Events

Palmetto Health evaluated subsequent events through December 16, 2016, the date at which the consolidated financial statements were issued. No subsequent events requiring recognition in the consolidated financial statements as of December 16, 2016 were identified by Palmetto Health.

Note 22 – Other Matters

During October 2015, a historic flood event impacted Palmetto Health's primary service area. While Palmetto Health's primary operating facilities were not materially damaged, provision of certain services was interrupted due to damage to community infrastructure. Palmetto Health resumed normal operations within ten days of this event. Palmetto Health carries substantial business interruption and physical damage insurance for such events. Palmetto Health recorded $9,800 in insurance recoveries within other revenue for the year ended September 30, 2016, of which $7,000 was received during fiscal 2016. The remaining $2,800 is recorded in other receivables as of September 30, 2016 (Note 5).

Palmetto Health and the University of South Carolina School of Medicine Educational Trust have formed a new 501(c)(3) entity in order offer improved care and expanded research collaboration opportunities. Several key members of management, including the Executive Dean/CEO have been hired and numerous clinical integration committees are being formed. The integration was launched in April, 2016 and it is expected operations will commence sometime in fiscal year 2017. The financial position and results of operations associated with this venture are immaterial to the consolidated financial statements as of and for the year ended September 30, 2016.