Consolidated Financial Statements and Supplementary Information

The Cleveland Clinic Foundation
d.b.a. Cleveland Clinic Health System
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Cleveland Clinic Health System

Consolidated Financial Statements
and Supplementary Information

Years Ended December 31, 2016 and 2015

Contents

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Report of Independent Auditors

The Board of Directors
The Cleveland Clinic Foundation

We have audited the accompanying consolidated financial statements of The Cleveland Clinic Foundation and controlled affiliates, d.b.a. Cleveland Clinic Health System, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Cleveland Clinic Foundation and controlled affiliates, d.b.a. Cleveland Clinic Health System, at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 21, 2017

1612-2136592

Cleveland Clinic Health System

Consolidated Balance Sheets
(In Thousands)

	December 31	
	2016	**2015**
Assets		
Current assets:		
Cash and cash equivalents	**$ 520,628**	$ 249,580
Patient receivables, net of allowances for uncollectible accounts of $186,241 in 2016 and $213,516 in 2015	**1,059,171**	950,304
Investments for current use	**52,126**	53,852
Other current assets	**396,892**	408,139
Total current assets	**2,028,817**	1,661,875
Investments:		
Long-term investments	**6,476,259**	6,184,378
Funds held by trustees	**75,892**	125,723
Assets held for self-insurance	**128,128**	93,662
Donor-restricted assets	**612,221**	565,161
	7,292,500	6,968,924
Property, plant, and equipment, net	**4,512,078**	4,388,667
Other assets:		
Pledges receivable, net	**150,709**	141,468
Trusts and interests in foundations	**67,219**	86,741
Other noncurrent assets	**410,007**	353,751
	627,935	581,960
Total assets	**$ 14,461,330**	$ 13,601,426

	December 31	
	2016	**2015**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 482,427**	$ 412,559
Compensation and amounts withheld from payroll	**322,493**	295,668
Current portion of long-term debt	**81,739**	95,694
Variable rate debt classified as current	**527,115**	519,252
Other current liabilities	**462,561**	467,042
Total current liabilities	**1,876,335**	1,790,215
Long-term debt:		
Hospital revenue bonds	**2,926,949**	2,727,471
Notes payable and capital leases	**516,719**	466,020
	3,443,668	3,193,491
Other liabilities:		
Professional and general liability insurance reserves	**146,109**	139,617
Accrued retirement benefits	**478,874**	490,753
Other noncurrent liabilities	**490,545**	478,352
	1,115,528	1,108,722
Total liabilities	**6,435,531**	6,092,428
Net assets:		
Unrestricted	**7,088,209**	6,627,406
Temporarily restricted	**627,426**	586,276
Permanently restricted	**310,164**	295,316
Total net assets	**8,025,799**	7,508,998
Total liabilities and net assets	**$ 14,461,330**	$ 13,601,426

See accompanying notes.

Cleveland Clinic Health System

Consolidated Statements of Operations
and Changes in Net Assets
(In Thousands)

Operations

	Year Ended December 31	
	2016	**2015**
Unrestricted revenues		
Net patient service revenue	**$ 7,551,066**	$ 6,712,483
Provision for uncollectible accounts	**(301,694)**	(231,304)
Net patient service revenue less provision for uncollectible accounts	**7,249,372**	6,481,179
Other	**787,835**	675,793
Total unrestricted revenues	**8,037,207**	7,156,972
Expenses		
Salaries, wages, and benefits	**4,534,869**	3,799,214
Supplies	**749,073**	664,846
Pharmaceuticals	**862,697**	701,236
Purchased services and other fees	**506,107**	398,378
Administrative services	**196,958**	175,834
Facilities	**343,377**	300,652
Insurance	**66,746**	62,067
	7,259,827	6,102,227
Operating income before interest, depreciation, and amortization expenses	**777,380**	1,054,745
Interest	**136,105**	124,141
Depreciation and amortization	**476,305**	409,453
Operating income before special charges	**164,970**	521,151
Special charges – *Note 20*	**25,618**	40,927
Operating income	**139,352**	480,224
Nonoperating gains and losses		
Investment return	**404,191**	(56,328)
Derivative losses	**(22,824)**	(25,010)
Gain on remeasurement of Akron General equity investment	**–**	38,777
Akron General member substitution contribution	**–**	242,822
Goodwill impairment loss	**–**	(63,060)
Other, net	**(7,212)**	793
Net nonoperating gains	**374,155**	137,994
Excess of revenues over expenses	**513,507**	618,218

(continued on next page)

Changes in Net Assets

	Net Assets			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balances at January 1, 2015	$ 5,998,053	$ 519,730	$ 284,712	$ 6,802,495
Excess of revenues over expenses	618,218	–	–	618,218
Donated capital and assets released from restrictions for capital purposes	5,806	(5,760)	–	46
Gifts and bequests	–	107,982	24,639	132,621
Net investment loss	–	(732)	–	(732)
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(44,493)	–	(44,493)
Retirement benefits adjustment	21,747	–	–	21,747
Change in interests in foundations	–	(17,351)	(17,480)	(34,831)
Change in value of perpetual trusts	–	–	(676)	(676)
Net change in unrealized losses on nontrading investments	(4,947)	–	–	(4,947)
Akron General member substitution contribution	–	27,553	4,121	31,674
Other	(11,471)	(653)	–	(12,124)
Increase in net assets	629,353	66,546	10,604	706,503
Balances at December 31, 2015	6,627,406	586,276	295,316	7,508,998
Excess of revenues over expenses	**513,507**	**–**	**–**	**513,507**
Donated capital and assets released from restrictions for capital purposes	**23,448**	**(22,683)**	**–**	**765**
Gifts and bequests	**–**	**84,256**	**16,939**	**101,195**
Net investment income	**–**	**24,451**	**–**	**24,451**
Net assets released from restrictions used for operations included in other unrestricted revenues	**–**	**(45,292)**	**–**	**(45,292)**
Retirement benefits adjustment	**(17,789)**	**–**	**–**	**(17,789)**
Change in interests in foundations	**–**	**432**	**–**	**432**
Change in value of perpetual trusts	**–**	**–**	**(2,091)**	**(2,091)**
Foreign currency translation loss	**(59,181)**	**–**	**–**	**(59,181)**
Net change in unrealized gains on nontrading investments	**320**	**–**	**–**	**320**
Other	**498**	**(14)**	**–**	**484**
Increase in net assets	**460,803**	**41,150**	**14,848**	**516,801**
Balances at December 31, 2016	**$ 7,088,209**	**$ 627,426**	**$ 310,164**	**$ 8,025,799**

See accompanying notes.

Cleveland Clinic Health System

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended December 31 2016	2015
Operating activities and net nonoperating gains and losses		
Increase in net assets	**$ 516,801**	$ 706,503
Adjustments to reconcile increase in net assets to net cash provided by operating activities and net nonoperating gains and losses:		
Loss on extinguishment of debt	**3,925**	209
Retirement benefits adjustment	**17,789**	(21,747)
Net realized and unrealized (gains) losses on investments	**(382,146)**	97,816
Depreciation and amortization	**491,292**	418,890
Provision for uncollectible accounts	**301,694**	231,304
Foreign currency translation loss	**59,181**	–
Gain on change in terms of long-term lease	**–**	(6,856)
Donated capital	**(765)**	(46)
Restricted gifts, bequests, investment income, and other	**(123,987)**	(96,382)
Amortization of bond premiums and debt issuance costs	**(1,657)**	(2,552)
Net gain in value of derivatives	**(8,835)**	(558)
Goodwill impairment loss	**–**	63,060
Gain on remeasurement of Akron General equity investment	**–**	(38,777)
Akron General member substitution contribution	**–**	(274,496)
Changes in operating assets and liabilities:		
Patient receivables	**(410,561)**	(299,939)
Other current assets	**31,113**	(48,770)
Other noncurrent assets	**(58,559)**	(77,581)
Accounts payable and other current liabilities	**91,924**	35,818
Other liabilities	**8,928**	(3,495)
Net cash provided by operating activities and net nonoperating gains and losses	**536,137**	682,401
Financing activities		
Proceeds from long-term borrowings	**502,448**	375,000
Payments for advance refunding and redemption of long-term debt	**(148,260)**	–
Principal payments on long-term debt	**(127,011)**	(71,073)
Debt issuance costs	**(949)**	(89)
Change in pledges receivable, trusts, and interests in foundations	**(10,203)**	63,560
Restricted gifts, bequests, investment income, and other	**123,987**	96,382
Net cash provided by financing activities	**340,012**	463,780
Investing activities		
Expenditures for property and equipment	**(664,703)**	(453,536)
Proceeds from sale of property and equipment	**1,585**	1,170
Cash acquired through member substitution	**–**	15,367
Acquisition of business, net of cash acquired	**–**	(420,144)
Net change in cash equivalents reported in long-term investments	**146,064**	305,575
Purchases of investments	**(2,757,671)**	(2,828,674)
Sales of investments	**2,671,903**	2,413,319
Net cash used in investing activities	**(602,822)**	(966,923)
Effect of exchange rate changes on cash	**(2,279)**	–
Increase in cash and cash equivalents	**271,048**	179,258
Cash and cash equivalents at beginning of year	**249,580**	70,322
Cash and cash equivalents at end of year	**$ 520,628**	$ 249,580
Supplemental disclosure of noncash activity		
Assets acquired through capital leases	**$ 15,479**	$ 17,333

See accompanying notes.

1. Organization and Consolidation

The Cleveland Clinic Foundation (Foundation) is a nonprofit, tax-exempt, Ohio corporation organized and operated to provide medical and hospital care, medical research, and education. The accompanying consolidated financial statements include the accounts of the Foundation and its controlled affiliates, d.b.a. Cleveland Clinic Health System (System).

The System is the leading provider of healthcare services in northeast Ohio. The System operates 14 hospitals with approximately 3,900 staffed beds. Thirteen of the hospitals are operated in the Northeast Ohio area, anchored by the Foundation. The System operates 21 outpatient Family Health Centers, 10 ambulatory surgery centers, as well as numerous physician offices located throughout a seven-county area of northeast Ohio, and specialized cancer centers in Sandusky and Mansfield, Ohio. In addition, the System operates a hospital and a clinic in Weston, Florida, health and wellness centers in West Palm Beach, Florida and Toronto, Canada, and a specialized neurological clinical center in Las Vegas, Nevada. Pursuant to agreements, the System also provides management services for Ashtabula County Medical Center, located in Ashtabula, Ohio, with approximately 180 staffed beds, Cleveland Clinic Abu Dhabi, a multispecialty hospital offering critical and acute care services that is part of Mubadala Development Company’s network of healthcare facilities located in Abu Dhabi, United Arab Emirates with approximately 250 staffed beds, and in cooperation with Abu Dhabi Health Services Company, the Sheikh Khalifa Medical City, a network of healthcare facilities in Abu Dhabi, United Arab Emirates with approximately 711 staffed beds.

In November 2015, the Foundation became the sole member of Akron General Health System (Akron General), an integrated healthcare delivery system with a 532-registered bed flagship medical center located in Akron, Ohio. In addition to the flagship medical center, Akron General also includes Lodi Community Hospital, Edwin Shaw Rehabilitation Institute, three health and wellness centers, Visiting Nurse Services and affiliates, a physician group practice and other outpatient locations. The System previously had a 35% special membership interest in Akron General pursuant to an affiliation agreement as further described in Note 2.

All significant intercompany balances and transactions have been eliminated in consolidation.

2. Business Combinations

Effective November 1, 2015, the Foundation became the sole member of Akron General through a non-cash business combination transaction. The business combination was recorded under the acquisition method of accounting. Prior to November 1, 2015, the Foundation was a minority member in Akron General with limited reserve powers pursuant to an affiliation agreement that was effective in September 2014. The affiliation agreement provided for a $100 million capital investment, comprised of $10 million cash and $90 million note payable, in Akron General in exchange for a 35% special membership interest.

The Foundation's investment in Akron General was $147.8 million at October 31, 2015, which was recorded under the equity method of accounting. The Foundation recorded $5.5 million in equity earnings in 2015 prior to the business combination transaction. Equity earnings on the Foundation's investment in Akron General are recorded in other unrestricted revenues in the consolidated statements of operations and changes in net assets.

On October 31, 2015, immediately prior to the business combination transaction, the investment in Akron General was remeasured to fair value using a combination of techniques consistent with the income and market approaches. As a result of this remeasurement, the System recorded a $38.8 million gain on remeasurement of the 35% equity investment, which is reported in nonoperating gains and losses in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015. The Foundation's investment in Akron General of $147.8 million was derecognized on November 1, 2015 in conjunction with the accounting for the business combination transaction.

The fair value of Akron General's net assets as of November 1, 2015 by major type is as follows (in thousands):

Net working capital	$ 29,869
Intangible assets	32,280
Property and equipment	330,176
Investments	215,966
Other assets	92,106
Noncurrent liabilities assumed	(278,096)
Subtotal	422,301
Less October 31, 2015 investment in Akron General	(147,805)
Fair value of net assets	$ 274,496

2. Business Combinations (continued)

The fair value of net assets of $274.5 million in the preceding table was recognized in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015 as a nonoperating member substitution contribution of $242.8 million, contributions of temporarily restricted net assets of $27.6 million and contributions of permanently restricted net assets of $4.1 million.

The results of operations for Akron General are included in the consolidated statements of operations and changes in net assets beginning on November 1, 2015. For the two months ended December 31, 2015, Akron General had total unrestricted revenues of $121.8 million, operating income of $5.9 million and an excess of revenues over expenses of $4.1 million. Additionally, for the two months ended December 31, 2015, Akron General recognized an increase in unrestricted net assets of $1.1 million, including excess of revenues over expenses of $4.1 million, and a decrease in temporarily and permanently restricted net assets of $1.0 million.

On October 13, 2015, the Foundation through its subsidiary purchased all of the share capital of 33 Grosvenor Place Limited (Grosvenor Place) for approximately $424.8 million, including net working capital. Grosvenor Place is a limited liability company existing under Luxembourg law and a private company incorporated under Jersey law that has a long-term leasehold interest in a six-story 198,000 square-foot building in London, England. Upon acquisition, Grosvenor Place currently leased office space to various tenants. The Foundation has established a plan to convert the building to a healthcare facility. The business combination was recorded under the acquisition method of accounting. Purchase price amounts have been assigned to assets acquired and liabilities assumed based on their respective fair values. The excess of the purchase price over the fair value of acquired net assets has been recorded as goodwill.

The fair value of Grosvenor Place's net assets as of October 13, 2015 by major type is as follows (in thousands):

Net working capital	$ 2,833
Goodwill	63,060
Property	358,875
Fair value of net assets	$ 424,768

2. Business Combinations (continued)

The results of operations for Grosvenor Place are included in the consolidated statements of operations and changes in net assets beginning on October 13, 2015. From October 13, 2015 through December 31, 2015, Grosvenor Place had total unrestricted revenues of $3.9 million, operating income of $0.1 million and a deficiency of revenues over expenses of $63.0 million. The operations of Grosvenor Place had no impact on temporarily and permanently restricted net assets.

The following unaudited pro forma financial information presents the combined results of operations and changes in net assets of the System, Akron General and Grosvenor Place for the year ended December 31, 2015, as though the business combination transactions had occurred on January 1, 2015 (in thousands):

Total unrestricted revenues	$ 7,734,115
Total unrestricted expenses	7,242,571
Operating income	491,544
Nonoperating gains and losses	(80,814)
Excess of revenues over expenses	410,730
Increase in unrestricted net assets	426,459
Increase in temporarily restricted net assets	38,922
Increase in permanently restricted net assets	6,547

This pro forma financial information is not necessarily indicative of the results of operations and changes in net assets that would have occurred had the System, Akron General and Grosvenor Place constituted a single entity during this period, nor is it necessarily indicative of future operating results and changes in net assets.

2. Business Combinations (continued)

The pro forma financial information in the table above includes certain adjustments attributable to the Akron General and Grosvenor Place business combination transactions. The nonoperating gains and losses, excess of revenues over expenses and the increase in unrestricted net assets for the year ended December 31, 2015 in the table above excludes the gain on remeasurement, unrestricted member substitution contribution and impairment loss of $38.8 million, $242.8 million and $63.1 million, respectively, that were reflected in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015. In addition, the increases in temporarily restricted net assets and permanently restricted net assets for the year ended December 31, 2015 in the table above exclude the member substitution contributions of $27.6 million and $4.1 million, respectively, that were reflected in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015.

3. Accounting Policies

Recent Accounting Pronouncements

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

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

3. Accounting Policies (continued)

In April 2015, the FASB issued ASU 2015-03, *Imputation of Interest, Simplifying the Presentation of Debt Issuance Costs*. This ASU requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability, consistent with the presentation of a debt discount. This amends current guidance that requires debt issuance costs to be presented as assets on the balance sheet. ASU 2015-03 is effective for the System for reporting periods beginning after December 15, 2015. The System adopted ASU 2015-03 in 2016 and applied the new guidance retrospectively to all periods presented in the consolidated financial statements. The System has $23.2 million of debt issuance costs at both December 31, 2016 and 2015, respectively, that have been reclassified under the new guidance.

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

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. This standard intends to make certain improvements to the current reporting requirements for not-for-profit entities. This standard sets forth changes to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. ASU 2016-14 is effective for the System for reporting periods beginning after December 15, 2017. The System is currently evaluating the impact that ASU 2016-14 will have on its financial statements and will adopt the provisions upon the effective date.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. ASU 2017-07 is effective

3. Accounting Policies (continued)

for the System for annual reporting periods beginning after December 15, 2018 and interim periods within annual reporting periods beginning after December 15, 2019 with early adoption permitted in the first quarter of 2017. Upon adoption, the System is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements, except for the guidance limiting the capitalization of net periodic benefit costs in assets which is required to be applied prospectively. The System will adopt the provisions of ASU 2017-07 in the first quarter of 2017. The impact of adopting ASU 2017-07 for the System when applied retrospectively to the year ended December 31, 2016 will decrease salaries, wages and benefits on the consolidated statement of operations as presented herein by $103.9 million, with a corresponding increase to operating income and decrease to net nonoperating gains. As a result, for the year ended December 31, 2016 operating income will be $243.2 million and net nonoperating gains will be $270.3 million upon retrospective adoption of ASU 2017-07. The adoption of ASU 2017-07 will have no impact on excess of revenues over expenses or net assets.

Use of Estimates

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

Net Patient Service Revenue and Patient Receivables

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others, including retroactive adjustments under payment agreements with third-party payors. The System has agreements with third-party payors that generally provide for payments to the System at amounts different from its established rates. For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts as determined by the System. An estimated provision for uncollectible accounts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The System has determined, based on an assessment at the consolidated entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts related to patient service revenue is recorded as a deduction from patient service revenue.

3. Accounting Policies (continued)

The System is paid a prospectively determined rate for the majority of inpatient acute care and outpatient, skilled nursing, and rehabilitation services provided (principally Medicare, Medicaid, and certain insurers). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for capital are received on a prospective basis for Medicare and on a cost reimbursement methodology for Medicaid. Payments are received on a prospective basis for the System's medical education costs, subject to certain limits. The System is paid for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare Administrative Contractor. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided. The System recorded an increase in net patient service revenue of $12.0 million and $24.0 million in 2016 and 2015, respectively, related to changes in estimates.

In 2014, the Provider Reimbursement Review Board provided a favorable decision to the System regarding the graduate medical education program for Weston Hospital. The decision requires the Centers for Medicare and Medicaid Services (CMS) to reimburse Weston Hospital on its annual cost reports for graduate medical education under new program regulations, which includes all years since the hospital opened in 2001. The System recorded an increase in net patient service revenue of $7.5 million and $3.2 million in 2016 and 2015, respectively, related to changes in estimates.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation as well as significant regulatory action, and, in the normal course of business, the System is subject to contractual reviews and audits, including audits initiated by the Medicare Recovery Audit Contractor program. As a result, there is at least a reasonable possibility that recorded estimates will change in the near term. The System believes it is in compliance with applicable laws and regulations governing the Medicare and Medicaid programs and that adequate provisions have been made for any adjustments that may result from final settlements.

As part of integration efforts involving Akron General and through review of contractual relationships between Akron General and some of its independent physician practice groups, the System identified possible violations to the Federal Anti-Kickback Statute and Limitations on Certain Physician Referrals regulation (commonly referred to as the "Stark Law"), which may have resulted in false claims to federal and/or state health care programs and may result in liability under the False Claims Act. Akron General is cooperating with the appropriate government authorities on such possible violations.

3. Accounting Policies (continued)

There is a probable liability associated with the matters described above, which may put at risk federal reimbursements related to services provided to patients at Akron General by the practice groups, and potential fines and penalties that could be assessed. It is not possible to estimate the amount of the liability at this time and therefore no amount has been recognized in the consolidated financial statements.

Patient receivables are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in healthcare coverage, major payor sources and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the System.

Electronic Health Record Incentive Program

CMS implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide annual incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The objectives and clinical quality measures are implemented in stages with increasing requirements for participation. The Medicare EHR incentive program provides annual incentive payments to eligible professionals and eligible hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology in the first year of participation and successfully demonstrating meaningful use of certified EHR technology in subsequent participation years. Incentive payments are subject to retrospective adjustments after the submission of the annual cost reports by the System and audits thereof by the Medicare administrative contractor.

3. Accounting Policies (continued)

The System utilizes a grant accounting model to recognize EHR incentive revenues. The System records EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. Beginning in 2015, CMS updated the EHR incentive reporting period for all hospitals to be based on the calendar year. The System believes that the professionals and hospitals that met meaningful use objectives for 2015, and that are eligible for EHR incentive payments in the 2016 program year, will continue to meet these objectives for the 2016 program year. Therefore, for the year ended December 31, 2016, the System has accrued EHR revenues related to the EHR reporting period in 2016. In 2016, the System recorded EHR incentive revenues of $4.3 million, comprised of $3.0 million of Medicare revenues and $1.3 million of Medicaid revenues. In 2015, the System recorded EHR incentive revenues of $7.0 million, comprised of $5.7 million of Medicare revenues and $1.3 million of Medicaid revenues. EHR incentive revenues are included in other unrestricted revenues in the consolidated statements of operations and changes in net assets.

Charity Care

The System provides care to patients who do not have the ability to pay and who qualify for charity care pursuant to established policies of the System. Charity care is defined as services for which patients have the obligation and willingness to pay but do not have the ability to do so. The System does not report charity care as net patient service revenue. The cost of charity care provided in 2016 and 2015 approximated $87 million and $65 million, respectively. The System estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients.

The System participates in the Hospital Care Assurance Program (HCAP). Ohio created HCAP to financially support those hospitals that service a disproportionate share of low-income patients unable to pay for care. HCAP funds basic, medically necessary hospital services for patients whose family income is at or below the federal poverty level, which includes Medicaid patients and patients without health insurance. The System recorded HCAP revenues of $3.1 million and $9.3 million for the years ended December 31, 2016 and 2015, respectively, which are included in net patient service revenue.

3. Accounting Policies (continued)

Management Service Agreements

The System has management service agreements with regional, national and international organizations to provide advisory services for various healthcare ventures. The scope of these services range from managing current healthcare operations that are designed to improve clinical quality, innovation, patient care, medical education and research at other healthcare organizations and educational institutions to managing the construction, training, organizational infrastructure, and operational management of healthcare entities. The System recognizes revenues related to management service agreements on a pro rata basis over the term of the agreements as services are provided. Payments received in advance are recorded as deferred revenue until the services have been provided. The System has recorded deferred revenue related to management service agreements, included in other current liabilities, of $13.6 million and $15.0 million at December 31, 2016 and 2015, respectively. Revenue related to management service agreements for 2016 and 2015 was $99.5 million and $58.3 million, respectively, and is included in other unrestricted revenues.

Cash and Cash Equivalents

The System considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents. Cash equivalents are recorded at fair value in the consolidated balance sheets and exclude amounts included in long-term investments and investments for current use.

Inventories

Inventories (primarily supplies and pharmaceuticals) are stated at an average cost or the lower of cost (first-in, first-out method) or market and are recorded in other current assets.

Property, Plant, and Equipment

Property, plant, and equipment purchased by the System are recorded at cost. Donated property, plant, and equipment are recorded at fair value at the date of donation. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation, including amortization of capital leased assets, is computed by the straight-line method using the estimated useful lives of individual assets. Buildings and building components are assigned useful lives ranging from five years to forty years.

3. Accounting Policies (continued)

Equipment is assigned a useful life ranging from three to twenty years. Interest cost incurred on borrowed funds during the period of construction of capital assets and interest income on unexpended project funds are capitalized as a component of the cost of acquiring those assets. The System records costs and legal obligations associated with long-lived asset retirements. Assets acquired though capital lease arrangements are excluded from the consolidated statements of cash flows.

Impairment of Long-Lived Assets

The System evaluates the recoverability of long-lived assets and the related estimated remaining lives when indicators of impairment are present. For purposes of impairment analysis, assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The System records an impairment charge or changes the useful life if events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the consolidated balance sheets. Investments, excluding alternative investments, are primarily classified as trading. Investment transactions are recorded on a settlement date basis. Realized gains and losses are determined using the average cost method.

Commingled investment funds are valued using, as a practical expedient, the net asset value as provided by the respective investment companies and partnerships. There are no significant redemption restrictions on the commingled investment funds.

Investments in alternative investments, which include hedge funds, private equity/venture funds and real estate funds, are primarily limited partnerships that invest in marketable securities, privately held securities, real estate, and derivative products and are reported using the equity method of accounting based on net asset value information provided by the respective partnership or third-party fund administrators. Investments held by the partnerships consist of marketable securities as well as securities that do not have readily determinable values. The values of the securities held by the limited partnerships that do not have readily determinable values are determined by the general partner and are based on historical cost, appraisals, or other valuation estimates that require varying degrees of judgment. There is inherent uncertainty in such

3. Accounting Policies (continued)

valuations, and the estimated fair values may differ from the values that would have been used had a ready market for the securities existed. Generally, the equity method investment balance of the System's holdings in alternative investments reflects net contributions to the partnerships and the System's share of realized and unrealized investment income and expenses. The investments may individually expose the System to securities lending, short sales, and trading in futures and forward contract options and other derivative products. The System's risk is limited to its carrying value. The financial statements of the limited partnerships are audited annually.

Alternative investments can be divested only at specified times in accordance with terms of the partnership agreements. Hedge fund redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution while the underlying investments are liquidated. These redemptions are subject to lock-up provisions that are generally imposed upon initial investment in the fund. Private equity/venture funds and real estate funds are generally closed-end funds and have significant redemption restrictions that prohibit redemptions during the fund's life.

Investment return, including equity method income on alternative investments, is reported as nonoperating gains and losses, except for earnings on funds held by bond trustees and interest and dividends earned on assets held for self-insurance, which are included in other unrestricted revenues. Donor-restricted investment return on temporarily and permanently restricted investments is included in temporarily restricted net assets.

Certain of the System's assets and liabilities are exposed to various risks, such as interest rate, market, and credit risks.

Fair Value Measurements

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

Authoritative guidance provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The System did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

3. Accounting Policies (continued)

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

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

Goodwill and Other Intangibles

Goodwill has resulted from business combinations, primarily international business and physician practice acquisitions, and is based on the purchase price in excess of the fair values of assets acquired and liabilities assumed at the acquisition date. Annually, or when indicators of impairment exist, the System evaluates goodwill for impairment to determine whether there are events or circumstances that indicate it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The System considers assets to be impaired and writes them down to fair value if the expected undiscounted cash flows are less than the carrying amounts.

Intangible assets other than goodwill are recorded at fair value in the period of acquisition. Intangible assets with finite lives, which consist primarily of patient medical records, non-compete agreements and leasehold interests, are amortized over their estimated useful lives, ranging from two to five years, with a weighted-average amortization period of approximately three years.

3. Accounting Policies (continued)

Derivatives and Hedging Activities

The System's derivative financial instruments consist of interest rate swaps and foreign currency forward contracts (Note 13), which are recognized as assets or liabilities in the consolidated balance sheets at fair value.

The System accounts for changes in the fair value of derivative instruments depending on whether they are designated and qualified as part of a hedging relationship and further, on the type of hedging relationship. The System has not designated any derivative instruments as hedges. Accordingly, the changes in fair value of derivative instruments and the related cash payments are recorded in derivative losses in the consolidated statements of operations and changes in net assets.

Foreign Currency Translation

The statements of operations of foreign subsidiaries whose functional currencies are other than the U.S. dollar are translated into U.S. dollars using average exchange rates for the period. The assets and liabilities of foreign subsidiaries whose functional currencies are other than the U.S. dollar are translated into U.S. dollars using exchange rates as of the balance sheet date. The U.S. dollar effects that arise from translating the net assets of these subsidiaries at changing rates are recorded as foreign currency translation gains and losses in the consolidated statements of operations and changes in net assets. Cumulative foreign currency translation losses included in unrestricted net assets were $71.4 million and $12.2 million at December 31, 2016 and 2015, respectively.

Debt Issuance Costs

Debt issuance costs are amortized over the period the obligation is outstanding using the straight-line method, which approximates the interest method.

3. Accounting Policies (continued)

Contributions

Unconditional donor pledges to give cash, marketable securities, and other assets are reported at fair value at the date the pledge is made to the extent estimated to be collectible by the System. Conditional donor promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are transferred to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as other unrestricted revenues if the purpose relates to operations or reported as a change in unrestricted net assets if the purpose relates to capital.

No amounts have been reflected in the consolidated financial statements for donated services. The System pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the System with various programs.

Grants

Grant revenue is recognized in the period it is earned based on when the applicable project expenses are incurred and project milestones are achieved. Grant payments received in advance of related project expenses are deferred until the expenditure has been incurred and recorded as deferred revenue and included in other current liabilities. The System recorded research grant revenue, included in other unrestricted revenues, of $189.2 million and $176.5 million in 2016 and 2015, respectively.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the System. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Permanently restricted net assets consist of amounts held in perpetuity or for terms designated by donors, including the fair value of several perpetual trusts for which the System is an income beneficiary, or the beneficial interest in the fair value of underlying trust assets. Earnings on permanently restricted net assets are recorded as investment income in temporarily restricted net assets and subsequently used in accordance with the donor's designation. Temporarily and permanently restricted net assets are primarily restricted for research, education, and strategic capital projects.

3. Accounting Policies (continued)

Excess of Revenues Over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments classified as nontrading, retirement benefits adjustments, foreign currency translation gains and losses, contributions of long-lived assets (including assets acquired using grants or contributions that by donor restriction were to be used for the purpose of acquiring such assets), and transfers of net assets to maintain donor-restricted endowment funds at the level required by donor stipulations or law.

4. Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for uncollectible accounts by major payor source for the years ended December 31, 2016 and 2015, are as follows (in thousands):

	2016		**2015**	
Medicare	**$ 2,521,242**	**33%**	$ 2,012,743	30%
Medicaid	**572,130**	**8**	420,960	6
Managed care and commercial	**4,288,570**	**57**	3,983,065	60
Self-pay	**169,124**	**2**	295,715	4
	$ 7,551,066	**100%**	$ 6,712,483	100%

The System has experienced an increase in Medicare and Medicaid revenue primarily as a result of the Affordable Care Act and other industry trends. The State of Ohio expanded Medicaid eligibility in 2014, which has increased enrollment in the Medicaid program and allowed former uninsured patients to shift into the expanded Medicaid program. The System records an estimated provision for uncollectible accounts in the year of service for self-pay accounts receivable, which includes patient receivables associated with self-pay patients and deductible and copayment balances for which third-party coverage provides for a portion of the services provided. The System's allowance for doubtful accounts was 15% and 18% of accounts receivable at December 31, 2016 and 2015, respectively. Write-offs on self-pay accounts receivable increased $81.1 million in 2016 compared to 2015. The System does not maintain a material allowance for uncollectible accounts for third-party payors.

4. Net Patient Service Revenue and Patient Receivables (continued)

The System's concentration of credit risk relating to patient receivables is limited due to the diversity of patients and payors. Patient receivables consist of amounts due from government programs, commercial insurance companies, other group insurance programs, and private pay patients. Patient receivables due from Medicare, Medicaid, and one commercial payor account for approximately 29%, 8%, and 23% at December 31, 2016, and 25%, 6%, and 24% at December 31, 2015, respectively, of the System's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor account for approximately 33%, 8%, and 17% for 2016, and 30%, 6%, and 17% for 2015, respectively, of the System's net patient service revenue. Excluding these payors, no one payor represents more than 10% of the System's patient receivables or net patient service revenue.

5. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2016 and 2015, is as follows (in thousands):

	2016	2015
Cash and cash equivalents	**$ 687,410**	$ 562,406
Fixed income securities:		
U.S. treasuries	**963,715**	810,036
U.S. government agencies	**20,270**	22,158
U.S. corporate	**167,025**	147,703
U.S. government agencies asset-backed securities	**25,102**	18,519
Corporate asset-backed securities	**2,829**	7,295
Foreign	**44,759**	40,774
Fixed income mutual funds	**222,670**	172,996
Commingled fixed income funds	**663,154**	690,372
Common and preferred stocks:		
U.S.	**422,947**	418,135
Foreign	**267,061**	252,376
Equity mutual funds	**381,686**	262,774
Commingled equity funds	**1,591,389**	1,453,528
Commingled commodity funds	**122,297**	117,100
Alternative investments:		
Hedge funds	**1,134,136**	1,350,427
Private equity/venture funds	**696,786**	541,009
Real estate	**452,018**	404,748
Total cash, cash equivalents, and investments	**$ 7,865,254**	$ 7,272,356

5. Cash, Cash Equivalents, and Investments (continued)

Investments are primarily maintained in a master trust fund administered using a bank as trustee. The management of the majority of the System's investments is conducted by numerous external investment management organizations that are monitored by management and an external third-party advisor. Of these investment managers, 20 managers focus on equity investments, 11 managers focus on fixed income investments, and 107 managers focus on alternative investments. The alternative investments have separate administrators and custodian arrangements. Alternative investments also include three holdings in which the System invests directly.

Total investment return (loss) is comprised of the following for the years ended December 31, 2016 and 2015 (in thousands):

	2016	2015
Other unrestricted revenues:		
Interest income and dividends	**$ 2,750**	$ 2,123
Nonoperating gains (losses), net:		
Interest income and dividends	**61,430**	49,851
Net realized gains on sales of investments	**157,358**	156,710
Net change in unrealized gains (losses) on investments	**100,079**	(314,771)
Equity method income on alternative investments	**104,184**	69,600
Investment management fees	**(18,860)**	(17,718)
	404,191	(56,328)
Other changes in net assets:		
Net change in unrealized gains (losses) on nontrading investments	**320**	(4,947)
Investment income (loss) on restricted investments	**24,451**	(732)
Total investment return (loss)	**$ 431,712**	$ (59,884)

6. Other Current Assets and Liabilities and Other Noncurrent Assets and Liabilities

Other current and noncurrent assets at December 31, 2016 and 2015, consist of the following (in thousands):

	2016	2015
Current:		
Inventories	**$ 133,074**	$ 125,536
Pledges receivable current *(see Note 10)*	**58,188**	37,703
Prepaid expenses	**52,989**	54,211
Estimated amounts due from third-party payors	**41,162**	90,045
Research receivables	**36,390**	35,099
Other	**75,089**	65,545
Total other current assets	**$ 396,892**	$ 408,139

	2016	2015
Noncurrent:		
Deferred compensation plan assets	**$ 162,820**	$ 136,012
Goodwill and other intangible assets	**92,574**	90,407
Note receivable	**37,455**	13,535
Investments in affiliates	**37,244**	33,868
Other	**79,914**	79,929
Total other noncurrent assets	**$ 410,007**	$ 353,751

6. Other Current Assets and Liabilities and Other Noncurrent Assets and Liabilities (continued)

Other current and noncurrent liabilities at December 31, 2016 and 2015 consist of the following (in thousands):

	2016	**2015**
Current:		
Research deferred revenue	**$ 71,885**	$ 73,639
Interest payable	**64,141**	61,314
Current portion of professional and general liability insurance reserves *(see Note 14)*	**52,125**	52,223
Estimated amounts due to third-party payors	**45,000**	48,639
Management contracts and other deferred revenue	**38,602**	40,432
Employee benefit related liabilities	**34,384**	38,452
Foreign currency forward contracts *(see Note 13)*	**11,076**	–
State assessment liabilities	**5,185**	40,869
Other	**140,163**	111,474
Total other current liabilities	**$ 462,561**	$ 467,042

	2016	**2015**
Noncurrent:		
Employee benefit related liabilities	**$ 216,666**	$ 190,962
Interest rate swap liabilities *(see Note 13)*	**139,422**	159,333
Pledge liabilities	**34,134**	33,518
Estimated amounts due to third-party payors	**24,523**	16,284
Gift annuity liabilities	**11,114**	10,480
Accrued income tax liabilities *(see Note 16)*	**2,258**	4,062
Other	**62,428**	63,713
Total other noncurrent liabilities	**$ 490,545**	$ 478,352

7. Goodwill and Other Intangible Assets

In 2016, the System recorded goodwill of $4.1 million related to the acquisitions of various physician practices. In 2015, the System recorded goodwill of $79.2 million related to the acquisitions of Grosvenor Place and various physician practices. Subsequent to the acquisition of Grosvenor Place, the System established a plan to change the use of the facility. As a result of the expected changes in the business, the System determined that the fair value of the reporting unit was below the carrying amount. The fair value of the reporting unit was determined using techniques consistent with the market approach. The System recorded a goodwill impairment loss of $63.1 million in the consolidated statement of operations and changes in net assets for the year ended December 31, 2015. Goodwill is recorded in other noncurrent assets in the consolidated balance sheets.

The changes in the carrying amount of goodwill for the years ended December 31, 2016 and 2015 are as follows (in thousands):

	Year Ended December 31	
	2016	**2015**
Balance, beginning of year	**$ 54,411**	$ 38,319
Goodwill acquired	**4,086**	79,152
Goodwill impairment loss	**–**	(63,060)
Balance, end of year	**$ 58,497**	$ 54,411

In 2016, the System acquired other intangible assets of $0.4 million related to physician practice acquisitions. In 2015, the System acquired other intangible assets of $34.7 million, comprised of $32.3 million related to the member substitution of Akron General and $2.4 million related to physician practice acquisitions. Other intangible assets are recorded in other noncurrent assets in the consolidated balance sheets.

7. Goodwill and Other Intangible Assets (continued)

Other intangible assets at December 31, 2016 and 2015 consist of the following (in thousands):

	2016		2015	
	Historical Cost	**Accumulated Amortization**	**Historical Cost**	**Accumulated Amortization**
Trade name	**$ 31,700**	**$ –**	$ 31,700	$ –
Finite-lived intangible assets	**6,643**	**4,266**	6,261	1,965
Total	**$ 38,343**	**$ 4,266**	$ 37,961	$ 1,965

Amortization related to finite-lived intangible assets was $2.3 million and $1.3 million in 2016 and 2015, respectively, and is included in depreciation and amortization in the consolidated statements of operations and changes in net assets. Future amortization is as follows (in thousands): 2017 – $1,576; 2018 – $623; 2019 – $152; and 2020 – $26.

8. Fair Value Measurements

The carrying values of accounts receivable and accounts payable are reasonable estimates of fair value due to the short-term nature of these financial instruments. Investments, other than alternative investments, are recorded at their fair value. Other current and noncurrent assets and liabilities have carrying values that approximate fair value.

The fair value of the System's pledges receivable is based on discounted cash flow analysis using treasury yield curve interest rates consistent with the maturities of the pledges receivable and adjusted for consideration of the donor's credit. The fair value of pledges receivable was $211.7 million and $185.4 million (see carrying value at Note 10) at December 31, 2016 and 2015, respectively. Pledges receivable would be classified as Level 3 in the fair value hierarchy.

The fair value of the System's long-term debt is estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for the System's credit. Inputs, which include reported/comparable trades, broker/dealer quotes, bids and offerings, are obtained from various sources, including market participants, dealers, brokers and various news media/market information. The fair value of long-term debt was $3.6 billion and $3.5 billion (see carrying value at Note 12) at December 31, 2016 and 2015, respectively. Long-term debt would be classified as Level 2 in the fair value hierarchy.

8. Fair Value Measurements (continued)

The following tables present the financial instruments measured at fair value on a recurring basis as of December 31, 2016 and 2015, based on the valuation hierarchy (in thousands):

December 31, 2016	Level 1	Level 2	Level 3	Total
Assets				
Cash and investments:				
Cash and cash equivalents	$ 687,410	$ –	$ –	$ 687,410
Fixed income securities:				
U.S. treasuries	963,715	–	–	963,715
U.S. government agencies	–	20,270	–	20,270
U.S. corporate	–	167,025	–	167,025
U.S. government agencies asset-backed securities	–	25,102	–	25,102
Corporate asset-backed securities	–	2,829	–	2,829
Foreign	–	44,759	–	44,759
Fixed income mutual funds	222,670	–	–	222,670
Common and preferred stocks:				
U.S.	420,744	2,203	–	422,947
Foreign	265,689	1,372	–	267,061
Equity mutual funds	381,686	–	–	381,686
Total cash and investments	2,941,914	263,560	–	3,205,474
Perpetual and charitable trusts	–	45,350	–	45,350
Total assets at fair value	$ 2,941,914	$ 308,910	$ –	$ 3,250,824
Liabilities				
Interest rate swaps	$ –	$ 139,422	$ –	$ 139,422
Foreign currency forward contracts	–	11,076	–	11,076
Total liabilities at fair value	$ –	$ 150,498	$ –	$ 150,498

8. Fair Value Measurements (continued)

December 31, 2015	Level 1	Level 2	Level 3	Total
Assets				
Cash and investments:				
Cash and cash equivalents	$ 562,350	$ 56	$ –	$ 562,406
Fixed income securities:				
U.S. treasuries	810,036	–	–	810,036
U.S. government agencies	–	22,158	–	22,158
U.S. corporate	–	147,703	–	147,703
U.S. government agencies asset-backed securities	–	18,519	–	18,519
Corporate asset-backed securities	–	7,295	–	7,295
Foreign	–	40,774	–	40,774
Fixed income mutual funds	172,996	–	–	172,996
Common and preferred stocks:				
U.S.	416,316	1,819	–	418,135
Foreign	251,046	1,330	–	252,376
Equity mutual funds	262,774	–	–	262,774
Total cash and investments	2,475,518	239,654	–	2,715,172
Perpetual and charitable trusts	–	65,305	–	65,305
Total assets at fair value	$ 2,475,518	$ 304,959	$ –	$ 2,780,477
Liabilities				
Interest rate swaps	$ –	$ 159,333	$ –	$ 159,333
Total liabilities at fair value	$ –	$ 159,333	$ –	$ 159,333

8. Fair Value Measurements (continued)

Financial instruments at December 31, 2016 and 2015 are reflected in the consolidated balance sheets as follows (in thousands):

	2016	2015
Cash, cash equivalents, and investments measured at fair value	**$ 3,205,474**	$ 2,715,172
Commingled funds measured at net asset value	**2,376,840**	2,261,000
Alternative investments accounted for under the equity method	**2,282,940**	2,296,184
Total cash, cash equivalents, and investments	**$ 7,865,254**	$ 7,272,356
Perpetual and charitable trusts measured at fair value	**$ 45,350**	$ 65,305
Interests in foundations	**21,869**	21,436
Trusts and interests in foundations	**$ 67,219**	$ 86,741

Interest rate swaps and forward currency forward contracts (Note 13) are reported in other noncurrent liabilities in the consolidated balance sheets.

The following is a description of the System's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is determined as follows:

Investments classified as Level 2 are primarily determined using techniques that are consistent with the market approach. Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs, which include broker/dealer quotes, reported/comparable trades, and benchmark yields, are obtained from various sources, including market participants, dealers, and brokers.

8. Fair Value Measurements (continued)

The fair value of perpetual and charitable trusts in which the System receives periodic payments from the trust is determined based on the present value of expected cash flows to be received from the trust using discount rates ranging from 1.9% to 5.0%, which are based on Treasury yield curve interest rates or the assumed yield of the trust assets. The fair value of charitable trusts in which the System is a remainder beneficiary is based on the System's beneficial interest in the investments held in the trust, which are measured at fair value.

The fair value of interest rate swaps is determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The valuations include a credit spread adjustment to market interest rate curves to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market. The System manages credit risk based on the net portfolio exposure with each counterparty.

The fair value of foreign currency forward contracts is based on the difference between the contracted forward rate and current market foreign currency exchange rates. A credit spread adjustment is included in the valuations to appropriately reflect nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds recently priced in the market.

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

9. Property, Plant, and Equipment

Property, plant, and equipment at December 31, 2016 and 2015 consist of the following (in thousands):

	2016	2015
Land and improvements	**$ 390,669**	$ 382,832
Buildings	**5,350,756**	5,075,427
Leasehold improvements	**30,609**	30,254
Equipment	**1,599,562**	1,541,883
Computer hardware and software	**797,300**	760,757
Construction-in-progress	**611,587**	468,380
Leased facilities and equipment	**150,561**	144,794
	8,931,044	8,404,327
Accumulated depreciation and amortization	**(4,418,966)**	(4,015,660)
	$ 4,512,078	$ 4,388,667

Included in the preceding table is unamortized computer software of $188.3 million and $81.1 million at December 31, 2016 and 2015, respectively. Amortization of computer software totaled $48.9 million and $32.1 million in 2016 and 2015, respectively. Amortization of computer software for the five years subsequent to December 31, 2016, is as follows (in millions): 2017 – $43.9; 2018 – $33.5; 2019 – $23.5; 2020 – $17.4; and 2021 – $15.9.

Accumulated amortization of leased facilities and equipment was $58.8 million and $40.2 million at December 31, 2016 and 2015, respectively.

10. Pledges Receivable

Outstanding pledges receivable from various corporations, foundations, and individuals at December 31, 2016 and 2015, are as follows (in thousands):

	2016	2015
Pledges due:		
In less than one year	**$ 72,117**	$ 58,082
In one to five years	**108,075**	83,460
In more than five years	**88,540**	99,958
	268,732	241,500
Allowance for uncollectible pledges and discounting	**(59,835)**	(62,329)
Current portion (net of allowance for uncollectible pledges of $13.9 million in 2016 and $20.4 million in 2015)	**(58,188)**	(37,703)
	$ 150,709	$ 141,468

11. Notes Payable and Capital Leases

Notes payable and capital leases at December 31, 2016 and 2015 consist of the following (in thousands):

	2016	2015
Notes payable with interest rates up to 6.0%	**$ 381,308**	$ 390,099
Revolving credit facility	**60,000**	–
Capital leases for facilities and equipment	**96,435**	108,085
City of Lakewood lease	**1,565**	2,715
	539,308	500,899
Unamortized debt issuance costs	**(620)**	–
Less current portion	**(21,969)**	(34,879)
Total notes payable and capital leases	**$ 516,719**	$ 466,020

In 2015, the System executed a $375.0 million term loan agreement with a financial institution. The proceeds of the term loan were used to finance the System's international business strategy. The term loan matures in 2018 and bears interest at a variable rate based on the London Interbank Offered Rate (LIBOR) plus an applicable spread. The interest rate on the term loan ranged from 0.73% to 1.11% in 2016 (average rate 0.99%) and from 0.69% to 0.73% in 2015 (average rate 0.72%).

11. Notes Payable and Capital Leases (continued)

In 2016, the System entered into a $300.0 million revolving credit facility with multiple financial institutions. The revolving credit facility expires in 2019 with provisions allowing the Foundation to extend the term for one-year periods. The facility allows the System to enter into short-term loans that automatically renew throughout the term of the facility. At December 31, 2016, the System has the intent and the ability to refinance the short-term loans beyond one year. The revolving credit facility bears interest at a variable rate based on the London Interbank Offered Rate (LIBOR) plus an applicable spread. Amounts outstanding on the revolving credit facility as of December 31, 2016 totaled $60.0 million. The proceeds were used to pay the full outstanding amount on a line of credit executed in January 2016 that was used to defease the Series 2012 Akron Bonds and redeem the Series 2012 taxable Akron Bonds (Note 12). The line of credit was terminated in 2016. The interest rate on the revolving credit facility ranged from 1.38% to 1.53% in 2016 (average rate 1.40%).

Maturities of the notes payable and revolving credit facility for the five years subsequent to December 31, 2016, are as follows (in thousands): 2017 – $4,866; 2018 – $376,416; 2019 – $60,026; 2020 – $0; and 2021 – $0.

Future minimum capital lease payments, including total interest of $22.7 million, are as follows (in thousands): 2017 – $20,712; 2018 – $18,744; 2019 – $18,437; 2020 – $12,181; and 2021 – $10,809; and thereafter – $38,264. Assets acquired through capital lease arrangements are included in property, plant, and equipment.

The City of Lakewood, Ohio (the City) leases real and personal property to Lakewood Hospital Association (LHA) for the purpose of enabling the operation of certain healthcare services at Lakewood Hospital. In connection with executing an Amended Lease with the City, LHA had agreed to make additional payments to the City. In 2015, the Amended Lease was further amended to shorten the lease term and to reduce the total payments due under the lease. The payments under the current lease as amended range in annual amounts up to $1.2 million through 2018, or until certain provisions in the lease are satisfied. The net present value of the additional payments discounted at an interest rate of 6% is $1.6 million and $2.7 million at December 31, 2016 and 2015, respectively. The System recorded a $6.9 million gain in special charges (Note 20) related to the change in lease terms for the year ended December 31, 2015. LHA has approximately $27 million of net assets, included in the System's unrestricted net assets at December 31, 2016, available for use under the terms of the current lease but unavailable to other members of the System.

12. Bonds

Bonds at December 31, 2016 and 2015 consist of the following (in thousands):

	Interest Rate(s)	Final Maturity	Amount Outstanding at December 31 2016	2015
Series 2016, Private Placement	3.35%	2046	**$ 325,000**	$ –
Series 2016, Term Loan	Variable rate	2026	**17,370**	–
Series 2014	4.86%	2114	**400,000**	400,000
Series 2014A CP Notes	Variable rate	2044	**70,955**	–
Series 2014A, Akron	Variable rate	2031	–	70,925
Series 2014B, Akron	Variable rate	2031	–	20,000
Series 2013A	3.62% to 4.04%	2042	**73,150**	81,225
Series 2013B	Variable rate	2039	**201,160**	201,160
Series 2013, Keep Memory Alive	Variable rate	2037	**63,135**	65,030
Series 2012A	1.23% to 4.07%	2039	**460,080**	469,485
Series 2012, Akron	3.80% to 5.00%	2031	–	39,835
Series 2012 taxable, Akron	Variable rate	2019	–	17,370
Series 2011A	2.45% to 4.83%	2032	**172,030**	181,180
Series 2011B	2.94%	2031	**29,120**	31,250
Series 2011C	2.73% to 4.72%	2032	**170,995**	170,995
Series 2009A	5.58%	2039	**305,400**	305,400
Series 2009B	3.74% to 5.58%	2039	**366,215**	380,455
Series 2008A	4.24% to 5.55%	2043	**409,740**	419,690
Series 2008B	Variable rate	2043	**369,250**	369,250
Series 2003C	Variable rate	2035	**41,905**	41,905
Series 2002	Variable rate	2032	**9,635**	9,940
			3,485,140	3,275,095
Net unamortized premium			**51,287**	55,630
Unamortized debt issuance costs			**(22,593)**	(23,187)
Current portion			**(59,770)**	(60,815)
Long-term variable rate debt classified as current			**(527,115)**	(519,252)
			$ 2,926,949	$ 2,727,471

12. Bonds (continued)

The majority of the System's outstanding revenue bonds are limited obligations of various issuing authorities payable solely by the System pursuant to loan agreements between the borrowing entities and the issuing authorities. Under various financing agreements, the System must meet certain operating and financial performance covenants. The Series 2016 private placement, the Series 2016 term loan and the Series 2014 bonds are issued directly by the Foundation. The Series 2013 Keep Memory Alive bonds are issued directly by Keep Memory Alive, a non-obligated affiliate of the System.

In January 2016, the System entered into a line of credit with a financial institution totaling $60.0 million. The System drew the full amount on the line of credit and also issued $100.0 million of Taxable Hospital Revenue Commercial Paper Notes (Series 2014A CP Notes). The proceeds from the draw on the line of credit and a portion of the proceeds from the issuance of the Series 2014A CP Notes were used to defease the Series 2012 Akron Bonds and redeem the Series 2012 taxable Akron Bonds, the Series 2014A Akron Bonds and the Series 2014B Akron Bonds. The System recorded a loss on extinguishment of debt of $3.9 million in 2016 related to this transaction, which is recorded in other nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

In August 2016, the Foundation issued private placement debt totaling $325.0 million that was purchased by a financial institution. The private placement debt matures in 2046 and bears interest at a fixed rate of 3.35%. The proceeds of the private placement debt were used for the general corporate purposes of the Foundation.

In November 2016, the System entered into a loan agreement with a financial institution totaling $17.4 million. The loan matures in 2026 and bears interest at a variable rate based on the LIBOR index rate plus an applicable spread. The proceeds of the loan were used to pay a portion of the outstanding Series 2014A CP Notes.

Certain of the System's current outstanding bonds bear interest at a variable rate. During 2016 and 2015, the rates for the System's variable rate bonds ranged from 0.01% to 1.78% (average rate 0.45%) and 0.01% to 1.59% (average rate 0.11%), respectively.

12. Bonds (continued)

Certain variable rate revenue bonds are secured by irrevocable direct pay letters of credit and standby bond purchase agreements totaling $377.5 million at December 31, 2016. Bonds are classified as current in the consolidated balance sheets if they are supported by lines of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year or contain a subjective clause that, if declared by the lender, could cause immediate repayment of the bonds.

The System provides self-liquidity on the Series 2003C Bonds, certain sub-series of the Series 2008B Bonds and the Series 2014A CP Notes. These bonds are classified as current liabilities in the consolidated balance sheets.

During the term of agreements with the issuing authorities, the System is required to make specified deposits with trustees to fund principal and interest payments when due. Also, unexpended bond proceeds are held by the trustee and released to the System for approved requisition requests for capital projects. Unexpended bond proceeds representing a reserve fund related to the Series 2012 Akron Bonds was $4.0 million at December 31, 2015. There was no unexpended bond proceeds at December 31, 2016. The current portion of the funds held by trustees, which consists of deposits with the trustees to fund current principal and interest payments, was $1.6 million at December 31, 2015 and is included in investments for current use. There was no current portion of funds held by trustees at December 31, 2016.

The System is subject to certain restrictive covenants, including provisions relating to certain debt ratios, days cash on hand, and other matters. The System was in compliance with these covenants at December 31, 2016 and 2015.

Combined current aggregate scheduled maturities, assuming the remarketing of the variable rate demand bonds, for the five years subsequent to December 31, 2016, are as follows (in thousands): 2017 – $59,770; 2018 – $62,020; 2019 – $64,040; 2020 – $66,235; and 2021 – $69,210.

Total interest paid approximated $134.4 million and $122.1 million in 2016 and 2015, respectively. Capitalized interest cost approximated $1.1 million and $2.8 million in 2016 and 2015, respectively.

13. Derivative Instruments

The System has entered into various derivative financial instruments to manage interest rate risk and foreign currency exposures.

The System's objective with respect to interest rate risk is to manage the risk of rising interest rates on the System's variable rate debt and certain variable rate operating lease payments. Consistent with its interest rate risk management objective, the System entered into various interest rate swap agreements with a total outstanding notional amount of $633.1 million and $653.1 million at December 31, 2016 and 2015, respectively. During the term of these transactions, the System pays interest at a fixed rate and receives interest at a variable rate based on the London Interbank Offered Rate (LIBOR) or the Securities Industry and Financial Markets Association Index (SIFMA). The swap agreements are not designated as hedging instruments. Net interest paid or received under the swap agreements is included in derivative losses in the consolidated statements of operations and changes in net assets.

The following table summarizes the System's interest rate swap agreements (in thousands):

Swap Type	Expiration Date	System Pays	System Receives	Notional Amount at December 31 2016	2015
Fixed	2016	5.28%	100% of SIFMA	**$ –**	$ 4,150
Fixed	2021	3.21%	68% of LIBOR	**33,265**	34,770
Fixed	2024	3.42%	68% of LIBOR	**27,800**	28,300
Fixed	2027	3.56%	68% of LIBOR	**128,333**	132,212
Fixed	2028	5.12%	100% of LIBOR	**38,800**	39,815
Fixed	2028	3.51%	68% of LIBOR	**29,965**	30,755
Fixed	2030	5.07%	100% of LIBOR	**60,825**	62,500
Fixed	2030	5.06%	100% of LIBOR	**60,800**	62,500
Fixed	2031	3.04%	68% of LIBOR	**52,625**	53,900
Fixed	2032	4.32%	79% of LIBOR	**2,361**	2,438
Fixed	2032	4.33%	70% of LIBOR	**4,723**	4,874
Fixed	2032	3.78%	70% of LIBOR	**2,361**	2,438
Fixed	2036	4.90%	100% of LIBOR	**49,725**	50,000
Fixed	2036	4.90%	100% of LIBOR	**78,350**	79,375
Fixed	2037	4.62%	100% of SIFMA	**63,135**	65,030
				$ 633,068	$ 653,057

13. Derivative Instruments (continued)

The System is exposed to fluctuations in various foreign currencies against its functional currency, the U.S. dollar (USD). The System uses foreign currency derivatives including currency forward contracts and currency options to manage its exposure to fluctuations in the USD – British Pound (GBP) exchange rate. Currency forward contracts involve fixing the USD – GBP exchange rate for delivery of a specified amount of foreign currency on a specified date. The currency forward contracts are typically cash settled in USD for their fair value at or close to their settlement date. The System has also used currency option contracts to manage its foreign currency exchange risk.

In June 2016, the System entered into five foreign currency contracts, expiring between September 2016 and September 2017, with a total outstanding notional amount of $150 million. At December 31, 2016, the System has three outstanding foreign currency forward contracts with a total notional amount of $75 million. The foreign currency contracts are not designated as hedging instruments.

The following table summarizes the location and fair value for the System's derivative instruments (in thousands):

	Derivatives Liability			
	December 31, 2016		**December 31, 2015**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives not designated as hedging instruments				
Interest rate swap agreements	Other noncurrent liabilities	**$ 139,422**	Other noncurrent liabilities	$ 159,333
Foreign currency contracts	Other current liabilities	**$ 11,076**		$ –

13. Derivative Instruments (continued)

The following table summarizes the location and amounts of derivative losses on the System's interest rate swap agreements (in thousands):

	Location of Loss Recognized	Year Ended December 31 2016	2015
Derivatives not designated as hedging instruments			
Interest rate swap agreements	Derivative losses	**$ (4,539)**	$ (25,010)
Foreign currency contracts	Derivative losses	**$ (18,285)**	$ –

The System has used various derivative contracts in connection with certain prior obligations and investments. Although minimum credit ratings are required for counterparties, this does not eliminate the risk that a counterparty may fail to honor its obligations. Derivative contracts are subject to periodic "mark-to-market" valuations. A derivative contract may, at any time, have a positive or negative value to the System. In the event that the negative value reaches certain thresholds established in the derivative contracts, the System is required to post collateral, which could adversely affect its liquidity. At December 31, 2016 and 2015, the System posted $75.6 million and $94.1 million, respectively, of collateral with counterparties that is included in funds held by trustees in the consolidated balance sheets. In addition, if the System were to choose to terminate a derivative contract or if a derivative contract were terminated pursuant to an event of default or a termination event as described in the derivative contract, the System could be required to pay a termination payment to the counterparty.

14. Professional and General Liability Insurance

The System manages its professional and general liability insurance program through a captive insurance arrangement, except for Akron General in 2015, which was self-insured for professional and general liability claims. In 2016, professional and general liability insurance coverage for Akron General was provided by the System's captive insurance subsidiary.

In the ordinary course of business, professional and general liability claims have been asserted against the System by various claimants. These claims are in various stages of processing or, in certain instances, are in litigation. In addition, there are known incidents, and there also may be unknown incidents, which may result in the assertion of additional claims. The System has accrued its best estimate of both asserted and unasserted claims based on actuarially determined amounts. These estimates are subject to the effects of trends in loss severity and frequency, and ultimate settlement of professional and general liability claims may vary significantly from the estimated amounts.

The System's professional and general liability insurance reserves of $198.2 million and $191.8 million at December 31, 2016 and 2015, respectively, are recorded as current and noncurrent liabilities and include discounted estimates of the ultimate costs for both asserted claims and unasserted claims. Asserted claims for the System's reserves were discounted at 1.75% and 1.50% at December 31, 2016 and 2015, respectively, except for Akron General, which discounted asserted claims at 1.75% at December 31, 2015. Unasserted claims were discounted at 2.25% and 2.00% at December 31, 2016 and 2015, respectively. Through the captive insurance subsidiary and a trust at Akron General, the System has set aside investments of $180.3 million ($52.1 million included in investments for current use) and $145.9 million ($52.2 million included in investments for current use) at December 31, 2016 and 2015, respectively, of which $37.0 million and $36.6 million at December 31, 2016 and 2015, respectively, are restricted in accordance with reinsurance trust agreements related to coverage of the Florida operations and other reinsurance programs provided by the captive insurance subsidiary, and $7.6 million at December 31, 2015 is restricted in a separate trust established for the payment of self-insured professional liability claims of Akron General. The assets in the trust were transferred to the System's captive insurance subsidiary in 2016.

14. Professional and General Liability Insurance (continued)

Activity in the professional and general liability insurance reserves is summarized as follows (in thousands):

	2016	2015
Balance at beginning of year	**$ 191,840**	$ 190,068
Incurred related to:		
Current period	**65,512**	56,965
Prior period	**(13,985)**	(4,145)
Total incurred	**51,527**	52,820
Paid related to:		
Current period	**6,862**	2,167
Prior period	**37,710**	64,502
Total paid	**44,572**	66,669
	6,955	(13,849)
Increase (decrease) in unasserted claims	**1,671**	(2,174)
Decrease in reinsurance recoverable	**(2,232)**	(105)
Akron General member substitution	**–**	17,900
Balance at end of year	**$ 198,234**	$ 191,840

The foregoing reconciliation shows $14.0 million and $4.1 million of favorable development in 2016 and 2015, respectively, due to changes in actuarial estimates as a result of lower claim activity, closed claims, and expedited settlement of claims, which has reduced claim expenses and resulted in more favorable settlements. The System utilizes a combination of actual and industry statistics to estimate loss and loss adjustment expense reserves.

15. Pensions and Other Postretirement Benefits

The System has four defined benefit pension plans, including two plans assumed by the System from the Akron General member substitution. The CCHS Retirement Plan covers substantially all employees of the System, except those employed by Akron General. The CCHS Retirement Plan ceased benefit accruals as of December 31, 2009 for substantially all employees, with benefit accruals for remaining employees ceasing at various intervals through December 31, 2012. Akron General has a defined benefit plan covering substantially all of its employees that were hired before 2004 who meet certain eligibility requirements. In 2009, Akron General ceased benefit accruals for substantially all nonunion employees. Benefits for union employees ceased at various intervals through 2013 except in certain circumstances. The benefits for the System's defined benefit pension plans are provided based on age, years of service, and compensation. The System's policy for its defined benefit pension plans is to fund at least the minimum amounts required by the Employee Retirement Income Security Act. The System also maintains two nonqualified defined benefit supplemental retirement plans, which cover certain of its employees.

The System sponsors two noncontributory, defined contribution plans, and three contributory, defined contribution plans, including two contributory defined contribution plans assumed by the System from the Akron General member substitution. The Cleveland Clinic Investment Pension Plan (IPP) is a noncontributory, defined contribution plan, which covers substantially all of the System's employees, except those employed by Akron General. The System's contribution for the IPP is based upon a percentage of employee compensation and years of service. The System sponsors an additional noncontributory, defined contribution plan, which covers certain of its employees. The System's contribution to the plan is based upon a percentage of employee compensation, as defined, determined according to age. The System also sponsors three contributory, defined contribution plans, including two plans at Akron General, which cover substantially all employees. Any System contribution to the applicable contributory plan is determined based on employee contributions.

The System provides healthcare benefits upon retirement for substantially all of its employees who meet certain minimum age and years of service provisions at retirement. The System's healthcare plans generally provide for cost sharing, in the form of retiree contributions, deductibles, and coinsurance. The System's policy is to fund the annual cost of healthcare benefits from the general assets of the System. The estimated cost of these postretirement benefits is actuarially determined and accrued over the employees' service periods.

15. Pensions and Other Postretirement Benefits (continued)

In 2015, the System updated the generational mortality projections scale from Scale MP-2014 to Scale MP-2015. In 2016, the System updated the generational mortality projections scale from Scale MP-2015 to Scale MP-2016. The System believes that the updated mortality rates are the best estimate of future experience.

The System expects to make contributions of $9.3 million to the defined benefit pension plans in 2017. Pension benefit payments over the next ten years are estimated as follows: 2017 – $102.8 million; 2018 – $108.8 million; 2019 – $112.3 million; 2020 – $114.2 million; 2021 – $116.6 million; and in the aggregate for the five years thereafter – $563.3 million.

The System expects to make contributions of $4.5 million to other postretirement benefit plans in 2017. Other postretirement benefit payments over the next ten years, net of the average annual Medicare Part D subsidy of approximately $2.3 million, are estimated as follows: 2017 – $4.5 million; 2018 – $4.6 million; 2019 – $4.6 million; 2020 – $4.6 million; 2021 – $4.4 million; and in the aggregate for the five years thereafter – $18.3 million.

No plan assets are expected to be returned to the employer during 2017.

The System is required to recognize the funded status, which is the difference between the fair value of plan assets and the projected benefit obligations, of its pension and other postretirement benefit plans in the consolidated balance sheets, with a corresponding adjustment to unrestricted net assets. Amounts recorded in unrestricted net assets consist of actuarial gains and losses and prior service credits and costs. Actuarial gains and losses recorded in unrestricted net assets outside of the corridor, which is 10% of the greater of the projected benefit obligation or the fair value of the plan assets, will be recognized as a component of net periodic benefit cost immediately in the current period. Prior service credits and costs will be amortized over future periods, pursuant to the System's accounting policy.

Unrecognized prior service credits and costs are amortized on a straight-line basis over the estimated life of the plan participants. In 2017, the System is expected to amortize $2.6 million of unrecognized prior service credits in net periodic benefit costs.

15. Pensions and Other Postretirement Benefits (continued)

Included in unrestricted net assets at December 31, 2016 and 2015 are the following amounts that have not yet been recognized in net periodic benefit cost (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2016	**2015**	**2016**	**2015**
Unrecognized actuarial losses (gains)	**$ 168,337**	$ 146,336	**$ (9,890)**	$ (7,815)
Unrecognized prior service credit	**(12,763)**	(14,444)	**(8,946)**	(5,128)
Total	**$ 155,574**	$ 131,892	**$ (18,836)**	$ (12,943)

Unrecognized actuarial losses (gains) included in unrestricted net assets represent amounts within the corridor that do not require recognition in net periodic benefit cost for each respective year.

Changes in plan assets and benefit obligations recognized in unrestricted net assets for the years ended December 31, 2016 and 2015 are as follows (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2016	**2015**	**2016**	**2015**
Current year actuarial (loss) gain	**$ (130,527)**	$ (16,382)	**$ 6,482**	$ 15,545
Recognition of actuarial loss in excess of corridor	**108,526**	25,612	**(4,407)**	–
Current year prior service credit	–	–	**4,355**	–
Amortization of prior service credit	**(1,681)**	(1,681)	**(537)**	(1,347)
Total	**$ (23,682)**	$ 7,549	**$ 5,893**	$ 14,198

15. Pensions and Other Postretirement Benefits (continued)

The following table sets forth the funded status of the System's pensions and other postretirement benefit plans and the amounts recognized in the System's December 31, 2016 and 2015 consolidated balance sheets (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2016	**2015**	**2016**	**2015**
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	**$ 1,649,131**	$ 1,556,304	**$ 111,309**	$ 126,091
Service cost	**2,178**	2,463	**1,681**	261
Interest cost	**76,074**	65,703	**5,368**	5,430
Actuarial loss (gain)	**98,362**	(76,458)	**(6,482)**	(15,546)
Participant contributions	**–**	–	**12,186**	9,162
Plan amendments and benefit changes	**–**	–	**(4,357)**	–
Benefits paid	**(89,064)**	(86,934)	**(21,928)**	(20,322)
Federal subsidy		–	**1,123**	1,212
Member substitution	**–**	188,053	**–**	5,021
Projected benefit obligation at end of year	**1,736,681**	1,649,131	**98,900**	111,309
Change in plan assets:				
Fair value of plan assets at beginning of year	**1,255,431**	1,213,402	**–**	–
Actual return on plan assets	**47,291**	(8,861)	**–**	–
Participant contributions	**–**	–	**12,186**	9,162
System contributions	**129,312**	6,019	**9,742**	11,160
Benefits paid	**(89,064)**	(86,934)	**(21,928)**	(20,322)
Member substitution	**–**	131,805	**–**	–
Fair value of plan assets at end of year	**1,342,970**	1,255,431	**–**	–
Accrued retirement benefits	**$ (393,711)**	$ (393,700)	**$ (98,900)**	$ (111,309)
Current liabilities	**$ (9,263)**	$ (9,382)	**$ (4,474)**	$ (4,874)
Noncurrent liabilities	**(384,448)**	(384,318)	**(94,426)**	(106,435)
Net liability recognized in consolidated balance sheets	**$ (393,711)**	$ (393,700)	**$ (98,900)**	$ (111,309)

The accumulated benefit obligation for all defined benefit pension plans was $1.7 billion and $1.6 billion at December 31, 2016 and 2015, respectively.

15. Pensions and Other Postretirement Benefits (continued)

The components of net periodic benefit cost are as follows (in thousands):

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2016	**2015**	**2016**	**2015**
Components of net periodic benefit cost:				
Service cost	**$ 2,178**	$ 2,463	**$ 1,681**	$ 261
Interest cost	**76,074**	65,703	**5,368**	5,430
Expected return on plan assets	**(79,456)**	(83,979)	**–**	–
Recognition of actuarial loss (gain) in excess of corridor	**108,526**	25,612	**(4,407)**	–
Amortization of unrecognized prior service credit	**(1,681)**	(1,681)	**(537)**	(1,347)
Net periodic benefit cost	**105,641**	8,118	**2,105**	4,344
Defined contribution plans	**217,941**	188,247	**–**	–
Total included in operations	**$ 323,582**	$ 196,365	**$ 2,105**	$ 4,344

Weighted-average assumptions used to determine pension and postretirement benefit obligations and net periodic benefit cost are as follows:

	Defined Benefit Pension Plans		Other Postretirement Benefits	
	2016	**2015**	**2016**	**2015**
Weighted-average assumptions:				
Discount rates:				
Used for benefit obligations	**4.24%**	4.74%	**4.36%**	4.85%
Used for net periodic benefit cost	**4.74%**	4.30%	**4.86%**	4.43%
Expected rate of return on plan assets	**6.56%**	7.06%	–	–
Rate of compensation increase:				
Used for benefit obligations	**2.25%**	2.25%	–	–
Used for net periodic benefit cost	**2.25%**	2.37%	–	–

15. Pensions and Other Postretirement Benefits (continued)

The System uses a direct cost approach to estimate its postretirement benefit obligation for healthcare services provided by the System (internally provided services). Healthcare services provided by non-System entities (externally provided services) are based on the System's historical cost experience.

The annual assumed healthcare cost trend rates for the next year and the assumed trend thereafter is as follows:

	2016	**2015**
Internally provided services:		
Initial rate	**5.50%**	5.75%
Ultimate rate	**4.50%**	4.50%
Year ultimate reached	**2021**	2021
Externally provided services:		
Initial rate	**6.50%**	6.75%
Ultimate rate	**5.50%**	5.50%
Year ultimate reached	**2021**	2021

A one-percentage-point increase or decrease in the healthcare cost trend rate would have increased or decreased the December 31, 2016 service and interest costs in total by $2.5 million and $1.7 million, respectively, and the December 31, 2015 service and interest costs in total by $2.9 million and $1.8 million, respectively.

The System's weighted-average asset allocation of pension plan assets at December 31, 2016 and 2015, by asset category, are as follows:

	Percentage of Plan Assets		
	December 31 2016	**December 31 2015**	**Target Allocation**
Asset category			
Interest-bearing cash	**7.0%**	4.4%	0%–10%
Fixed income securities	**47.0**	48.4	40%–80%
Common and preferred stocks	**31.1**	27.6	17%–37%
Alternative investments	**14.9**	19.6	3%–23%
Total	**100.0%**	100.0%	

15. Pensions and Other Postretirement Benefits (continued)

The System's investment strategy for its pension assets balances the liquidity needs of the pension plans with the long-term return goals necessary to satisfy future pension obligations. The target allocation ranges of the investment pool to various asset classes are designed to diversify the portfolio in a way that achieves an efficient trade-off between long-term return and risk while providing adequate liquidity to meet near-term expenses and obligations.

The System's weighted-average pension portfolio return assumption of 6.56% and 7.06% in 2016 and 2015, respectively, is based on the targeted assumed rate of return through its asset mix at the beginning of each year, which is designed to mitigate short-term return volatility and achieve an efficient trade-off between return and risk. Expected returns and risk for each asset class are formed using a global capital asset pricing model framework in which the expected return is the compensation earned from taking risk. Forward-looking adjustments are made to expected return, volatility, and correlation estimates as well. Additionally, constraints such as permissible asset classes, portfolio guidelines, and liquidity considerations are included in the model.

In 2015, the System updated its investment strategy and modified the target allocations of pension plan assets in the CCHS Retirement Plan based on the current funded status of the plan. Coincident with this update, the System reduced the asset allocation for common and preferred stocks with a corresponding increase in fixed income securities. The updated investment strategy was implemented because of the funded status of the pension plan and the anticipation that such changes in investment strategy will result in lower volatility of future changes in funded status. Once the new investment strategy is fully implemented, it is anticipated that the duration of the investment assets will match the liabilities of the pension plan over time. Additional revisions in asset allocations and expected rate of return on plan assets may occur based on future changes in the funded status of the pension plans.

15. Pensions and Other Postretirement Benefits (continued)

The following tables present the financial instruments in the System's defined benefit pension plans measured at fair value on a recurring basis as of December 31, 2016 and 2015, based on the valuation hierarchy (in thousands):

December 31, 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Cash and investments:				
Cash and cash equivalents	**$ 94,013**	**$ 2**	**$ –**	**$ 94,015**
Fixed income securities:				
U.S. treasuries	**303,857**	–	**–**	**303,857**
U.S. government agencies	–	**4,431**	**–**	**4,431**
U.S. corporate	–	**83,201**	**–**	**83,201**
Foreign	–	**12,280**	**–**	**12,280**
Fixed income mutual funds	**77,615**	–	**–**	**77,615**
Common and preferred stocks:				
U.S.	**70,524**	**421**	**–**	**70,945**
Foreign	**27,406**	**719**	**–**	**28,125**
Equity mutual funds	**78,630**	–	**–**	**78,630**
Total assets at fair value	**$ 652,045**	**$ 101,054**	**$ –**	**$ 753,099**

15. Pensions and Other Postretirement Benefits (continued)

December 31, 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Cash and investments:				
Cash and cash equivalents	$ 56,113	$ 9	$ –	$ 56,122
Fixed income securities:				
U.S. treasuries	308,329	–	–	308,329
U.S. government agencies	–	5,230	–	5,230
U.S. corporate	–	74,798	–	74,798
Foreign	–	10,909	–	10,909
Fixed income mutual funds	64,599	–	–	64,599
Common and preferred stocks:				
U.S.	61,930	382	–	62,312
Foreign	24,915	640	–	25,555
Equity mutual funds	36,133	–	–	36,133
Total assets at fair value	$ 552,019	$ 91,968	$ –	$ 643,987

Total plan assets in the System's defined benefit pension plans at December 31, 2016 and 2015 are comprised of the following (in thousands):

	2016	**2015**
Plan assets measured at fair value	**$ 753,099**	$ 643,987
Commingled fixed-income funds measured at net asset value	**149,065**	143,018
Commingled equity funds measured at net asset value	**240,453**	222,351
Alternative investments measured at net asset value	**200,353**	246,075
Total fair value of plan assets at end of year	**$ 1,342,970**	$ 1,255,431

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 8.

15. Pensions and Other Postretirement Benefits (continued)

Fixed income securities include debt obligations of the U.S. government and various agencies, U.S. corporations, and other fixed income instruments such as mortgage-backed and asset-backed securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined fixed income indexes such as the Barclays Capital U.S. Aggregate Index. Additionally, investments include mutual funds and commingled fixed-income funds that may also invest in opportunistic as well as non-U.S. and high-yield debt instruments. Commingled fixed-income funds are valued using net asset value as a practical expedient.

Common and preferred stocks include investments of publicly traded common stocks of both U.S. and international corporations, the majority of which represent actively traded and liquid securities that are traded on many of the world's major exchanges and include large-, mid-, and small-capitalization securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined equity indexes such as the Russell 3000 Index and the Morgan Stanley Capital International (MSCI) All Country World ex-U.S. Index. Investments also include equity mutual funds and commingled equity funds whose underlying assets may include publicly traded equity securities. Commingled equity funds are valued using net asset value as a practical expedient.

Alternative investments include hedge funds and private equity funds that are valued using net asset value as a practical expedient. Hedge funds are meant to provide returns between those expected from stocks and fixed income investments with commensurate levels of risk and lower correlation relative to traditional investments. Included in this category are investments that are well diversified across various strategies and may consist of absolute return funds, long/short funds, and other opportunistic/multi-strategy funds. The underlying investments in such funds may include publicly traded and privately held equity and debt instruments issued by U.S. and international corporations as well as various derivatives based on these securities. Hedge fund redemptions typically contain restrictions that allow for a portion of the withdrawal proceeds to be held back from distribution while the underlying investments are liquidated. Private equity investments make up a smaller portion of the alternative investments and generally consist of limited partnerships formed to invest in equity and debt investments in operating companies that are not publicly traded. Investment strategies in this category may include buyouts, distressed debt, and venture capital. Private equity funds are closed-end funds and have significant redemption restrictions that prohibit redemptions during the fund's life.

16. Income Taxes

The Foundation and most of its controlled affiliates are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code. These organizations are subject to income tax on any income from unrelated business activities. The System also owns or controls certain taxable affiliates.

The System files income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. With few exceptions, the System is no longer subject to U.S. federal, state, and local or non-U.S. income tax examinations by tax authorities for years before 2013.

At December 31, 2016 and 2015, the liability for uncertainty in income taxes was $2.3 million and $4.1 million, respectively. The System does not expect a significant increase or decrease in unrecognized tax benefits within the next 12 months. The System recognizes interest and penalties accrued related to the liability for unrecognized tax benefits in the consolidated statements of operations and changes in net assets.

The System has net operating losses available for federal income tax purposes of $121.5 million at both December 31, 2016 and 2015. These losses expire in varying amounts from 2018 through 2036. A valuation allowance has been recorded for the full amount of the deferred tax asset related to the net operating loss carryforwards due to the uncertainty regarding their use.

17. Commitments and Contingent Liabilities

The System leases various equipment and facilities under operating lease arrangements. Total rental expense in 2016 and 2015 was $73.6 million and $63.0 million, respectively. Minimum operating lease payments over the next five years are as follows (in thousands): 2017 – $46,069; 2018 – $39,463; 2019 –$23,346; 2020 – $18,443; and 2021 – $15,811.

Included in the System’s operating lease payments are the following off-balance-sheet financing agreements:

> In 2003, the System entered into an operating lease agreement for the purpose of leasing a genetics and stem cell research building (Stem Cell Building Lease). Under the terms of the Stem Cell Building Lease, the System began to lease the facility upon the issuance of the certificate of occupancy in December 2004 and is required to lease the facility for 29 years. At December 31, 2016, total remaining minimum operating lease payments were $27.8 million.

17. Commitments and Contingent Liabilities (continued)

In 2006, the System entered into an operating lease agreement for the purpose of leasing a parking garage and service center building (Service Center Lease). Under the terms of the Service Center Lease, the System began to lease the facility upon issuance of a certificate of occupancy in October 2008 and is required to lease the facility for 21 years with an option (by the System) to extend the lease an additional five years. At December 31, 2016, total remaining minimum operating lease payments were $75.5 million.

In 2007, the System entered into two operating lease agreements to lease an office complex comprised of five buildings primarily used for administrative services, totaling approximately 707,000 square feet. The System is required to lease the facilities for 22 years with an option (by the System) to extend the leases an additional five years. At December 31, 2016, total remaining minimum operating lease payments were $39.3 million.

At December 31, 2016, the System has commitments for construction and other related capital contracts of $422 million and letters of credit of $0.5 million. Guarantees of mortgage loans made by banks to certain staff members are $16.6 million at December 31, 2016. In addition, the System has remaining commitments to invest approximately $614 million in alternative investments at December 31, 2016. The largest commitment at December 31, 2016, to any one alternative strategy manager is $29.1 million. These investments are expected to occur over the next three to five years. No amounts have been recorded in the consolidated balance sheets for these commitments and guarantees.

Pledge liabilities to various foundations and other entities at December 31, 2016 are as follows (in thousands): 2017 – $306; 2018 – $14,892; 2019 –$500; 2020 – $4,800; 2021 – $500; and thereafter – $18,300. The unamortized discount on pledge liabilities at December 31, 2016 was $4.9 million. Pledge liabilities are recorded in other current liabilities and other noncurrent liabilities in the consolidated balance sheets.

18. Endowment

The System's endowment consists of approximately 313 individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on donor-imposed restrictions.

Interpretation of Relevant Law

In 2009, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) was enacted to update and replace Ohio's previous law, the Uniform Management of Institutional Funds Act. The System has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the System classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard for expenditure prescribed by UPMIFA. In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund.
2. The purposes of the System and the donor-restricted endowment fund.
3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the System.
7. The investment policies of the System.

18. Endowment (continued)

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the System to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were $0.6 million and $0.7 million as of December 31, 2016 and 2015, respectively.

Return Objectives and Risk Parameters

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the endowment assets are invested in a highly diversified portfolio of U.S. and non-U.S. publicly traded equities, alternative investments, and fixed income securities structured to achieve an optimal balance between return and risk. The System expects its endowment funds, over time, to provide an average rate of return of approximately 7.5% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation to achieve its long-term return objective within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The System has a policy of appropriating for distribution each year up to 5% of its endowment fund's average fair value over the prior three years through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the System considered the long-term expected return on its endowment. Accordingly, over the long term, the System expects the current spending policy to allow its endowment to grow at an average of 2.5% annually. This is consistent with the System's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

18. Endowment (continued)

Changes in Endowment Net Assets (in thousands)

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, January 1, 2015	$ 47,566	$ 232,043	$ 279,609
Investment return	1,287	–	1,287
Net depreciation	(2,281)	–	(2,281)
Contributions	–	25,049	25,049
Appropriation of endowment assets for expenditure	(7,785)	–	(7,785)
Akron General member substitution	–	3,218	3,218
Endowment net assets, December 31, 2015	38,787	260,310	299,097
Investment return	**1,245**	–	**1,245**
Net appreciation	**14,521**	–	**14,521**
Contributions	–	**16,979**	**16,979**
Appropriation of endowment assets for expenditure	**(7,290)**	–	**(7,290)**
Endowment net assets, December 31, 2016	**$ 47,263**	**$ 277,289**	**$ 324,552**

19. Functional Expenses

The System provides healthcare services and education and performs research. Expenses related to these functions were as follows (in thousands):

	2016	2015
Healthcare services	**$ 6,344,767**	$ 5,337,903
Research	**220,137**	210,779
Medical education	**333,354**	290,506
General and administrative	**894,707**	755,065
Non-healthcare services	**104,890**	82,495
	$ 7,897,855	$ 6,676,748

20. Special Charges

The System incurred and recorded special charges of $25.6 million and $40.9 million in 2016 and 2015, respectively. Special charges in 2016 include $7.8 million of statutory compensation costs related to the termination of tenant leases at the System's London building that is being converted from office space to a healthcare facility and $17.8 million of accelerated depreciation expense and other costs related to LHA. The Foundation, LHA and the City of Lakewood entered into an agreement in December 2015 that outlines the transition of healthcare services in the City of Lakewood. Participation in the agreement by the City of Lakewood was authorized by an ordinance adopted by Lakewood City Council. Under the terms of the agreement, the Foundation and LHA will make contributions over the next 17 years for the creation of a new health and wellness community foundation to be used to address community health and wellness needs in the City of Lakewood. In addition, the Foundation will construct, own and operate an approximately 62,000-square-foot family health center expected to open in 2018 that will be located adjacent to the current site of the hospital. LHA ceased inpatient operations at the hospital in February 2016, while the current emergency department and several outpatient services at the hospital will continue until the opening of the new family health center and emergency department. The cessation of inpatient services at the hospital is not considered a discontinued operation since the System provides inpatient hospital services at the Foundation and its subsidiary hospitals in the Northeast Ohio area. Special charges in 2015 include $33.7 million of pledge liabilities in connection with the agreement, $13.3 million of accelerated depreciation and other property, plant and equipment costs, $0.8 million in employee retention costs, offset by a $6.9 million gain related to changes in the terms of the lease between the City of Lakewood and LHA.

21. Subsequent Events

The System evaluated events and transactions occurring subsequent to December 31, 2016 through March 21, 2017, the date the consolidated financial statements were issued. During this period, there were no subsequent events requiring recognition in the consolidated financial statements, and there were no nonrecognized subsequent events requiring disclosure.

Supplementary Information

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Report of Independent Auditors on Supplementary Information

The Board of Directors
The Cleveland Clinic Foundation

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

Ernst & Young LLP

March 21, 2017

Cleveland Clinic Health System

Consolidating Balance Sheet

December 31, 2016
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	**$ 511,102**	**$ 9,526**	**$ –**	**$ 520,628**
Patient receivables, net	**976,060**	**109,412**	**(26,301)**	**1,059,171**
Due from affiliates	**4,091**	**28**	**(4,119)**	**–**
Investments for current use	**–**	**52,126**	**–**	**52,126**
Other current assets	**313,911**	**85,292**	**(2,311)**	**396,892**
Total current assets	**1,805,164**	**256,384**	**(32,731)**	**2,028,817**
Investments:				
Long-term investments	**6,090,613**	**385,646**	**–**	**6,476,259**
Funds held by trustees	**75,892**	**–**	**–**	**75,892**
Assets held for self-insurance	**–**	**128,128**	**–**	**128,128**
Donor-restricted assets	**572,982**	**39,239**	**–**	**612,221**
	6,739,487	**553,013**	**–**	**7,292,500**
Property, plant, and equipment, net	**3,478,405**	**1,033,673**	**–**	**4,512,078**
Other assets:				
Pledges receivable, net	**149,889**	**820**	**–**	**150,709**
Trusts and interests in foundations	**59,069**	**8,150**	**–**	**67,219**
Other noncurrent assets	**514,693**	**51,138**	**(155,824)**	**410,007**
	723,651	**60,108**	**(155,824)**	**627,935**
Total assets	**$ 12,746,707**	**$ 1,903,178**	**$ (188,555)**	**$ 14,461,330**

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Liabilities and net assets				
Current liabilities:				
Accounts payable	**$ 398,704**	**$ 86,033**	**$ (2,310)**	**$ 482,427**
Compensation and amounts withheld from payroll	**289,650**	**32,843**	**–**	**322,493**
Current portion of long-term debt	**75,918**	**5,893**	**(72)**	**81,739**
Variable rate debt classified as current	**466,203**	**60,912**	**–**	**527,115**
Due to affiliates	**28**	**4,091**	**(4,119)**	**–**
Other current liabilities	**388,183**	**100,680**	**(26,302)**	**462,561**
Total current liabilities	**1,618,686**	**290,452**	**(32,803)**	**1,876,335**
Long-term debt:				
Hospital revenue bonds	**2,926,949**	**–**	**–**	**2,926,949**
Notes payable and capital leases	**121,896**	**547,127**	**(152,304)**	**516,719**
	3,048,845	**547,127**	**(152,304)**	**3,443,668**
Other liabilities:				
Professional and general liability insurance reserves	**57,290**	**88,819**	**–**	**146,109**
Accrued retirement benefits	**429,965**	**48,909**	**–**	**478,874**
Other noncurrent liabilities	**434,093**	**56,452**	**–**	**490,545**
	921,348	**194,180**	**–**	**1,115,528**
Total liabilities	**5,588,879**	**1,031,759**	**(185,107)**	**6,435,531**
Net assets:				
Unrestricted	**6,267,797**	**823,860**	**(3,448)**	**7,088,209**
Temporarily restricted	**597,449**	**29,977**	**–**	**627,426**
Permanently restricted	**292,582**	**17,582**	**–**	**310,164**
Total net assets	**7,157,828**	**871,419**	**(3,448)**	**8,025,799**
Total liabilities and net assets	**$ 12,746,707**	**$ 1,903,178**	**$ (188,555)**	**$ 14,461,330**

See accompanying note.

Cleveland Clinic Health System

Consolidating Balance Sheet

December 31, 2015
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	$ 176,869	$ 72,711	$ –	$ 249,580
Patient receivables, net	879,420	94,544	(23,660)	950,304
Due from affiliates	916	40	(956)	–
Investments for current use	–	53,852	–	53,852
Other current assets	343,901	66,682	(2,444)	408,139
Total current assets	1,401,106	287,829	(27,060)	1,661,875
Investments:				
Long-term investments	5,813,363	371,015	–	6,184,378
Funds held by trustees	116,046	9,677	–	125,723
Assets held for self-insurance	–	93,662	–	93,662
Donor-restricted assets	520,474	44,687	–	565,161
	6,449,883	519,041	–	6,968,924
Property, plant, and equipment, net	3,384,312	1,004,355	–	4,388,667
Other assets:				
Pledges receivable, net	140,137	1,331	–	141,468
Trusts and interests in foundations	77,416	9,325	–	86,741
Other noncurrent assets	325,545	81,257	(53,051)	353,751
	543,098	91,913	(53,051)	581,960
Total assets	$ 11,778,399	$ 1,903,138	$ (80,111)	$ 13,601,426

	Obligated Group		Non-Obligated Group		Consolidating Adjustments and Eliminations		Consolidated
Liabilities and net assets							
Current liabilities:							
Accounts payable	$	345,228	$	69,508	$	(2,177)	$ 412,559
Compensation and amounts withheld from payroll		253,615		42,053		–	295,668
Current portion of long-term debt		84,392		11,302		–	95,694
Variable rate debt classified as current		370,375		148,877		–	519,252
Due to affiliates		27		929		(956)	–
Other current liabilities		379,854		111,115		(23,927)	467,042
Total current liabilities		1,433,491		383,784		(27,060)	1,790,215
Long-term debt:							
Hospital revenue bonds		2,669,251		58,220		–	2,727,471
Notes payable and capital leases		95,327		420,296		(49,603)	466,020
		2,764,578		478,516		(49,603)	3,193,491
Other liabilities:							
Professional and general liability insurance reserves		52,587		87,030		–	139,617
Accrued retirement benefits		426,180		64,573		–	490,753
Other noncurrent liabilities		425,155		53,197		–	478,352
		903,922		204,800		–	1,108,722
Total liabilities		5,101,991		1,067,100		(76,663)	6,092,428
Net assets:							
Unrestricted		5,851,045		779,809		(3,448)	6,627,406
Temporarily restricted		548,408		37,868		–	586,276
Permanently restricted		276,955		18,361		–	295,316
Total net assets		6,676,408		836,038		(3,448)	7,508,998
Total liabilities and net assets	$	11,778,399	$	1,903,138	$	(80,111)	$ 13,601,426

See accompanying note.

Cleveland Clinic Health System

Consolidating Statements of Operations and Changes in Net Assets

Year Ended December 31, 2016
(In Thousands)

Operations

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	**$ 6,882,932**	**$ 928,179**	**$ (260,045)**	**$ 7,551,066**
Provision for uncollectible accounts	**(263,790)**	**(37,904)**	**–**	**(301,694)**
Net patient service revenue less provision for uncollectible accounts	**6,619,142**	**890,275**	**(260,045)**	**7,249,372**
Other	**641,752**	**308,593**	**(162,510)**	**787,835**
Total unrestricted revenues	**7,260,894**	**1,198,868**	**(422,555)**	**8,037,207**
Expenses				
Salaries, wages, and benefits	**4,218,025**	**589,056**	**(272,212)**	**4,534,869**
Supplies	**644,499**	**105,605**	**(1,031)**	**749,073**
Pharmaceuticals	**791,670**	**71,027**	**–**	**862,697**
Purchased services and other fees	**408,293**	**140,622**	**(42,808)**	**506,107**
Administrative services	**154,624**	**68,946**	**(26,612)**	**196,958**
Facilities	**276,150**	**72,148**	**(4,921)**	**343,377**
Insurance	**67,624**	**74,093**	**(74,971)**	**66,746**
	6,560,885	**1,121,497**	**(422,555)**	**7,259,827**
Operating income before interest, depreciation, and amortization expenses	**700,009**	**77,371**	**–**	**777,380**
Interest	**126,401**	**9,704**	**–**	**136,105**
Depreciation and amortization	**402,420**	**73,885**	**–**	**476,305**
Operating income (loss) before special charges	**171,188**	**(6,218)**	**–**	**164,970**
Special charges	**968**	**24,650**	**–**	**25,618**
Operating income (loss)	**170,220**	**(30,868)**	**–**	**139,352**
Nonoperating gains and losses				
Investment return	**375,676**	**28,515**	**–**	**404,191**
Derivative losses	**(20,130)**	**(2,694)**	**–**	**(22,824)**
Other, net	**94**	**(7,306)**	**–**	**(7,212)**
Net nonoperating gains	**355,640**	**18,515**	**–**	**374,155**
Excess (deficiency) of revenues over expenses	**525,860**	**(12,353)**	**–**	**513,507**

Cleveland Clinic Health System

Consolidating Statements of Operations and Changes in Net Assets

Year Ended December 31, 2015
(In Thousands)

Operations

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	$ 6,557,092	$ 350,239	$ (194,848)	$ 6,712,483
Provision for uncollectible accounts	(216,960)	(14,344)	–	(231,304)
Net patient service revenue less provision for uncollectible accounts	6,340,132	335,895	(194,848)	6,481,179
Other	572,069	238,172	(134,448)	675,793
Total unrestricted revenues	6,912,201	574,067	(329,296)	7,156,972
Expenses				
Salaries, wages, and benefits	3,753,065	276,086	(229,937)	3,799,214
Supplies	611,439	54,397	(990)	664,846
Pharmaceuticals	677,496	23,740	–	701,236
Purchased services and other fees	370,608	40,078	(12,308)	398,378
Administrative services	127,155	74,694	(26,015)	175,834
Facilities	271,167	35,174	(5,689)	300,652
Insurance	59,798	56,626	(54,357)	62,067
	5,870,728	560,795	(329,296)	6,102,227
Operating income before interest, depreciation, and amortization expenses	1,041,473	13,272	–	1,054,745
Interest	120,318	3,823	–	124,141
Depreciation and amortization	380,440	29,013	–	409,453
Operating income (loss) before special charges	540,715	(19,564)	–	521,151
Special charges	8,701	32,226	–	40,927
Operating income (loss)	532,014	(51,790)	–	480,224
Nonoperating gains and losses				
Investment return	(48,924)	(7,404)	–	(56,328)
Derivative losses	(22,325)	(2,685)	–	(25,010)
Gain on remeasurement of Akron General equity investment	38,777	–	–	38,777
Akron General member substitution	–	242,822	–	242,822
Goodwill impairment loss	–	(63,060)	–	(63,060)
Other, net	477	316	–	793
Net nonoperating (losses) gains	(31,995)	169,989	–	137,994
Excess of revenues over expenses	500,019	118,199	–	618,218

Cleveland Clinic Health System

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

(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Total net assets at January 1, 2015	$ 6,273,610	$ 532,333	$ (3,448)	$ 6,802,495
Excess of revenues over expenses	500,019	118,199	–	618,218
Donated capital, excluding assets released from restrictions for capital purposes of $5,760	46	–	–	46
Restricted gifts and bequests	132,253	368	–	132,621
Restricted net investment (loss) income	(972)	240	–	(732)
Net assets released from restrictions used for operations included in other unrestricted revenues	(38,438)	(6,055)	–	(44,493)
Retirement benefits adjustment	25,546	(3,799)	–	21,747
Transfers (to) from affiliates	(207,971)	207,971	–	–
Change in restricted net assets related to interest in foundations	(1,478)	(33,353)	–	(34,831)
Change in restricted net assets related to value of perpetual trusts	(480)	(196)	–	(676)
Net change in unrealized losses on nontrading investments	(4,947)	–	–	(4,947)
Akron General member substitution contribution of restricted net assets	–	31,674	–	31,674
Other	(780)	(11,344)	–	(12,124)
Increase in total net assets	402,798	303,705	–	706,503
Total net assets at December 31, 2015	6,676,408	836,038	(3,448)	7,508,998
Excess (deficiency) of revenues over expenses	**525,860**	**(12,353)**	**–**	**513,507**
Donated capital, excluding assets released from restrictions for capital purposes of $22,683	**724**	**41**	**–**	**765**
Restricted gifts and bequests	**97,207**	**3,988**	**–**	**101,195**
Restricted net investment income	**22,755**	**1,696**	**–**	**24,451**
Net assets released from restrictions used for operations included in other unrestricted revenues	**(40,895)**	**(4,397)**	**–**	**(45,292)**
Retirement benefits adjustment	**(6,835)**	**(10,954)**	**–**	**(17,789)**
Transfers (to) from affiliates	**(116,453)**	**116,453**	**–**	**–**
Change in restricted net assets related to interest in foundations	**432**	**–**	**–**	**432**
Change in restricted net assets related to value of perpetual trusts	**(1,318)**	**(773)**	**–**	**(2,091)**
Foreign currency translation loss	**(73)**	**(59,108)**	**–**	**(59,181)**
Net change in unrealized gains on nontrading investments	**320**	**–**	**–**	**320**
Other	**(304)**	**788**	**–**	**484**
Increase in total net assets	**481,420**	**35,381**	**–**	**516,801**
Total net assets at December 31, 2016	**$ 7,157,828**	**$ 871,419**	**$ (3,448)**	**$ 8,025,799**

See accompanying note.

Cleveland Clinic Health System

Consolidating Statement of Cash Flows

Year Ended December 31, 2016
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Operating activities and net nonoperating gains and losses				
Increase in total net assets	$ 481,420	$ 35,381	$ –	$ 516,801
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	–	3,925	–	3,925
Retirement benefits adjustment	6,835	10,954	–	17,789
Net realized and unrealized gains on investments	(356,893)	(25,253)	–	(382,146)
Depreciation and amortization	402,420	88,872	–	491,292
Provision for uncollectible accounts	263,790	37,904	–	301,694
Foreign currency translation loss	73	59,108	–	59,181
Donated capital	(724)	(41)	–	(765)
Restricted gifts, bequests, investment income, and other	(119,076)	(4,911)	–	(123,987)
Transfers to (from) affiliates	116,453	(116,453)	–	–
Amortization of bond premiums and debt issuance costs	(1,670)	13	–	(1,657)
Net gain in value of derivatives	(1,954)	(6,881)	–	(8,835)
Changes in operating assets and liabilities:				
Patient receivables	(360,430)	(52,772)	2,641	(410,561)
Other current assets	46,920	(18,837)	3,030	31,113
Other noncurrent assets	(191,171)	29,839	102,773	(58,559)
Accounts payable and other current liabilities	94,448	3,147	(5,671)	91,924
Other liabilities	23,621	(14,693)	–	8,928
Net cash provided by operating activities and net nonoperating gains and losses	404,062	29,302	102,773	536,137
Financing activities				
Proceeds from long-term borrowings	502,370	145,711	(145,633)	502,448
Payments for advance refunding and redemption of long-term debt	–	(148,260)	–	(148,260)
Principal payments on long-term debt	(143,228)	(26,643)	42,860	(127,011)
Debt issuance costs	(949)	–	–	(949)
Change in pledges receivables, trusts and interests in foundations	(11,510)	1,307	–	(10,203)
Restricted gifts, bequests, investment income, and other	119,076	4,911	–	123,987
Net cash provided by (used in) financing activities	465,759	(22,974)	(102,773)	340,012
Investing activities				
Expenditures for property and equipment	(487,936)	(176,767)	–	(664,703)
Proceeds from sale of property and equipment	1,585	–	–	1,585
Net change in cash equivalents reported in long-term investments	91,241	54,823	–	146,064
Purchases of investments	(2,375,754)	(381,917)	–	(2,757,671)
Sales of investments	2,351,802	320,101	–	2,671,903
Transfers (to) from affiliates	(116,453)	116,453	–	–
Net cash used in investing activities	(535,515)	(67,307)	–	(602,822)
Effect of exchange rate changes on cash	(73)	(2,206)	–	(2,279)
Increase (decrease) in cash and cash equivalents	334,233	(63,185)	–	271,048
Cash and cash equivalents at beginning of year	176,869	72,711	–	249,580
Cash and cash equivalents at end of year	$ 511,102	$ 9,526	$ –	$ 520,628

See accompanying note.

Cleveland Clinic Health System

Consolidating Statement of Cash Flows

Year Ended December 31, 2015
(In Thousands)

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Operating activities and net nonoperating gains and losses				
Increase in total net assets	$ 402,798	$ 303,705	$ –	$ 706,503
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	209	–	–	209
Retirement benefits adjustment	(25,546)	3,799	–	(21,747)
Net realized and unrealized losses on investments	87,709	10,107	–	97,816
Depreciation and amortization	380,440	38,450	–	418,890
Provision for uncollectible accounts	216,960	14,344	–	231,304
Gain on change in terms of long-term lease	–	(6,856)	–	(6,856)
Donated capital	(46)	–	–	(46)
Restricted gifts, bequests, investment income, and other	(129,323)	32,941	–	(96,382)
Transfers to (from) affiliates	207,971	(207,971)	–	–
Amortization of bond premiums and debt issuance costs	(2,533)	(19)	–	(2,552)
Net loss (gain) in value of derivatives	57	(615)	–	(558)
Goodwill impairment loss	–	63,060	–	63,060
Gain on remeasurement of Akron General equity investment	(38,777)	–	–	(38,777)
Akron General member substitution contribution	–	(274,496)	–	(274,496)
Changes in operating assets and liabilities:				
Patient receivables	(289,295)	(10,036)	(608)	(299,939)
Other current assets	(37,760)	5,091	(16,101)	(48,770)
Other noncurrent assets	(81,420)	27,953	(24,114)	(77,581)
Accounts payable and other current liabilities	15,025	20,902	(109)	35,818
Other liabilities	(14,922)	11,427	–	(3,495)
Net cash provided by operating activities and net nonoperating gains and losses	691,547	31,786	(40,932)	682,401
Financing activities				
Proceeds from long-term borrowings	–	378,777	(3,777)	375,000
Principal payments on long-term debt	(109,280)	(6,502)	44,709	(71,073)
Debt issuance costs	–	(89)	–	(89)
Change in pledges receivables, trusts and interests in foundations	23,980	39,580	–	63,560
Restricted gifts, bequests, investment income, and other	129,323	(32,941)	–	96,382
Net cash provided by financing activities	44,023	378,825	40,932	463,780
Investing activities				
Expenditures for property and equipment	(380,380)	(73,156)	–	(453,536)
Proceeds from sale of property and equipment	183	987	–	1,170
Cash acquired through member substitution	–	15,367	–	15,367
Acquisition of business, net of cash acquired	–	(420,144)	–	(420,144)
Net change in cash equivalents reported in long-term investments	327,466	(21,891)	–	305,575
Purchases of investments	(2,534,242)	(294,432)	–	(2,828,674)
Sales of investments	2,085,486	327,833	–	2,413,319
Transfers (to) from affiliates	(60,166)	60,166	–	–
Net cash used in investing activities	(561,653)	(405,270)	–	(966,923)
Increase in cash and cash equivalents	173,917	5,341	–	179,258
Cash and cash equivalents at beginning of year	2,952	67,370	–	70,322
Cash and cash equivalents at end of year	$ 176,869	$ 72,711	$ –	$ 249,580

See accompanying note.

1. Presentation of Consolidating Financial Statements

The accompanying financial statement information presents consolidating financial statement information for the Obligated Group (as defined herein) and certain controlled affiliates of The Cleveland Clinic Foundation (collectively referred to as the Non-Obligated Group), which have no liability under the Master Trust Indenture (Indenture), amended and restated as of April 1, 2003 (as supplemented, the Indenture), between The Cleveland Clinic Foundation and The Huntington National Bank, as successor Master Trustee. The Cleveland Clinic Foundation, Cleveland Clinic Health System – East Region, Fairview Hospital, Lutheran Hospital, Marymount Hospital, Inc., Medina Hospital, Cleveland Clinic Florida (a nonprofit corporation) and Cleveland Clinic Florida Health System Nonprofit Corporation are the sole members of the Obligated Group under the Indenture.

With respect to the Obligated Group, certain properties and interests are considered to be Excluded Property under the Indenture. In addition, the provisions of the Indenture provide that additional property may be categorized as Excluded Property upon satisfaction of various financial tests. As such, these properties and interests are not subject to the restrictions contained in the Indenture and, under the Indenture, are not subject to the restriction on liens and other encumbrances that may be placed on property of the Obligated Group. Furthermore, the revenues derived from the Excluded Property are not subject to the restrictions contained in the Indenture until they are received and commingled with other revenues of the Obligated Group. The accompanying financial statement information is presented by legal entity and no adjustment has been made for the Excluded Property.

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