KPMG

Geisinger

Consolidated Financial Statements

June 30, 2017 and 2016

Geisinger
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KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

The Board of Directors
Geisinger Health:

We have audited the accompanying consolidated financial statements of Geisinger Health and its subsidiaries (collectively referred to as "Geisinger"), which comprise the consolidated balance sheets as of June 30, 2017 and 2016, 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 consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Geisinger as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Philadelphia, Pennsylvania
September 11, 2017

Geisinger
Consolidated Balance Sheets
June 30, 2017 and 2016

(dollars in thousands)	2017	2016
Assets		
Current assets		
Cash and cash equivalents	$ 282,931	$ 215,622
Investments	854,354	964,542
Assets limited as to use	13,355	14,998
Accounts receivable, net of estimated uncollectibles of $72,222 in 2017 and $71,404 in 2016	622,955	612,280
Inventories and other	172,537	142,934
Total current assets	1,946,132	1,950,376
Long-term investments	2,599,264	2,350,157
Assets limited as to use, noncurrent		
Internally by Board	276,117	24,206
Externally restricted by donors	108,623	100,975
Externally other	66,920	25,872
Total assets limited as to use, noncurrent	451,660	151,053
Property and equipment, net	2,074,974	1,895,368
Other assets, net	322,452	272,107
Assets held in trust	33,753	30,880
Total assets	$ 7,428,235	$ 6,649,941
Liabilities and Net Assets		
Current liabilities		
Current installments of long-term debt	$ 22,071	$ 18,249
Estimated third-party payor settlements	122,875	198,931
Accounts payable	145,651	177,220
Medical claims payable	168,890	148,547
Accrued expenses and other	681,343	633,073
Total current liabilities	1,140,830	1,176,020
Long-term debt, net of current installments	1,807,390	1,498,434
Other liabilities and contingencies	608,178	656,622
Total liabilities	3,556,398	3,331,076
Net assets		
Unrestricted	3,702,723	3,162,711
Unrestricted-noncontrolling interest	12,425	14,736
Temporarily restricted	64,333	54,777
Permanently restricted	92,356	86,641
Total net assets	3,871,837	3,318,865
Total liabilities and net assets	$ 7,428,235	$ 6,649,941

See accompanying notes to the consolidated financial statements.

Geisinger
Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2017 and 2016

(dollars in thousands)	**2017**	**2016**
Unrestricted net assets		
Revenues		
Patient service revenue (net of contractual adjustments and discounts)	$ 3,446,571	$ 3,022,451
Provision for bad debts	(58,868)	(49,413)
Net patient service revenue less provision for bad debts	3,387,703	2,973,038
Premium revenue	2,709,967	2,357,091
Other revenue	239,689	212,811
	6,337,359	5,542,940
Expenses		
Salaries and benefits	2,703,786	2,347,583
Medical claims	1,509,535	1,313,582
Supplies and other	1,786,669	1,514,315
Depreciation and amortization	227,779	199,954
	6,227,769	5,375,434
Operating income (carried forward)	$ 109,590	$ 167,506

See accompanying notes to the consolidated financial statements.

(Continued)

Geisinger
Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2017 and 2016

(dollars in thousands)	2017	2016
Operating income (brought forward)	$ 109,590	$ 167,506
Investing and financing activities		
Net realized investment earnings	12,335	190,923
Net unrealized investment gains (losses)	330,951	(194,264)
Interest expense	(44,350)	(39,638)
Unrealized gain (loss) on derivatives	8,456	(5,716)
Contribution from acquisitions	47,617	555,021
Loss on extinguishment of debt	(20,085)	(6,285)
Gain from investing and financing activities	334,924	500,041
Nonoperating losses, net	(45)	(210)
Excess of revenue and gains over expenses and losses	444,469	667,337
Other changes in unrestricted net assets		
Unrealized gain (loss) on derivatives	9,447	(10,009)
Net assets released from restriction, capital purchases	4,851	3,035
Pension liability adjustments	82,762	(72,706)
Net asset transfers for underwater endowments	47	(48)
Net (distribution to) contribution from noncontrolling interest	(4,383)	(478)
Changes in equity based compensation	508	637
Increase in unrestricted net assets	537,701	587,768
Changes in temporarily restricted net assets		
Donor contributions, net of uncollectibles	10,677	8,431
Contribution from acquisition	9,674	11,787
Net investment gains (losses)	8,018	(1,137)
Net asset transfers for underwater endowments	(47)	48
Net assets released from restriction, fund operations	(13,915)	(11,434)
Net assets released from restriction, capital purchases	(4,851)	(3,035)
Increase in temporarily restricted net assets	9,556	4,660
Changes in permanently restricted net assets		
Donor contributions	1,295	1,503
Contribution from acquisition	2,348	1,564
Net investment gain (loss)	2,072	(1,413)
Increase in permanently restricted net assets	5,715	1,654
Increase in net assets	552,972	594,082
Net assets		
Beginning of year	3,318,865	2,724,783
End of year	$ 3,871,837	$ 3,318,865

See accompanying notes to the consolidated financial statements.

Geisinger
Consolidated Statements of Cash Flows
Years Ended June 30, 2017 and 2016

(dollars in thousands)	2017	2016
Cash flows from operating activities		
Increase in net assets	$ 552,972	$ 594,082
Change in net assets attributable to noncontrolling interest	2,311	(866)
Increase in net assets attributable to GHS	555,283	593,216
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	227,779	199,954
Provision for bad debts	59,365	49,571
Unrealized (gain) loss on derivatives	(17,903)	15,725
Net realized gain on investments	(12,239)	(119,237)
Net unrealized gain on investments	(339,093)	200,702
Contribution from acquisitions, net of cash received	(45,259)	(520,114)
Restricted contributions	(11,972)	(9,934)
Noncontrolling interest	2,072	1,344
Pension liability adjustments	(82,762)	72,706
Gain on step acquisition	(4,490)	-
Net change in operating assets and liabilities:		
Accounts receivable	(65,323)	(22,447)
Inventories and other	(28,519)	(40,829)
Estimated third-party payor settlements	(75,268)	(16,401)
Accounts payable	(31,986)	32,263
Medical claims payable	20,343	(27,965)
Accrued expenses and other	51,181	1,967
Other assets and liabilities	6,685	3,446
Net cash provided by operating activities	207,894	413,967
Cash flows from investing activities		
Additions to property and equipment, net	(329,747)	(284,319)
Purchases of investments	(1,297,586)	(970,306)
Purchases of assets limited as to use	(458,155)	(43,977)
Sales of investments	1,493,299	945,687
Sales of assets limited as to use	201,066	47,374
Cash paid in connection with acquisitions	(35,500)	-
Net cash used in investing activities	(426,623)	(305,541)
Cash flows from financing activities		
Proceeds from issuance of debt	670,990	352,783
Repayment of debt	(388,450)	(371,574)
Deferred bond issue costs	(4,091)	-
Net distribution to noncontrolling interest	(4,383)	(478)
Proceeds from restricted contributions	11,972	9,934
Net cash provided by (used in) financing activities	286,038	(9,335)
Increase in cash and cash equivalents	67,309	99,091
Cash and cash equivalents		
Beginning of year	215,622	116,531
End of year	$ 282,931	$ 215,622
Non-cash investing activities		
In-kind transfers of investments	$ 1,393,576	-

See accompanying notes to the consolidated financial statements.

1. Organization

Geisinger Health and its subsidiaries (collectively referred to as "Geisinger") is a physician-led, integrated health services organization that has as its main components: (i) an array of health services providers, including seven acute-care hospitals with multiple campuses and a drug and alcohol treatment facility; (ii) multispecialty physician group practices; (iii) insurance operations, including a licensed health maintenance organization and a non-licensed risk assuming Preferred Provider Organization; and (iv) a community-based medical college and degree-granting institution. Geisinger operates in 45 of Pennsylvania's 67 counties, with a significant presence in central, south-central and northeastern Pennsylvania and in seven counties in southern New Jersey.

Geisinger Health, formerly Geisinger Health System Foundation, serves as the corporate parent and exercises control over all of Geisinger's affiliated entities subject to corporate, legal, and/or regulatory limitations. Geisinger Health and all subsidiary corporate entities comprising Geisinger are tax-exempt pursuant to Sections 501(c) (2), 501(c) (3) and 501(c) (4) of the Internal Revenue Code, except for Geisinger Health's for-profit subsidiaries.

All significant intercompany transactions have been eliminated.

2. Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

Cash and Cash Equivalents
Cash and cash equivalents include investments in highly liquid debt instruments purchased with an initial maturity of three months or less, exclusive of long-term investments and assets limited as to use. The carrying amount reported approximates fair value.

Investments, Assets Limited as to Use, and Investment Income
Investments and assets limited as to use are measured at fair value. All of Geisinger's investments in debt and equity securities are classified as trading. This classification requires Geisinger to recognize unrealized gains and losses on its investments in debt and equity securities as net unrealized investment gains (losses) in the Consolidated Statements of Operations and Changes in Net Assets. Interest income, dividends, and realized and unrealized gains and losses on unrestricted investments are recorded as investment income within other revenue or within investing and financing activities in the Consolidated Statements of Operations and Changes in Net Assets (net of investment-related expenses). Restricted interest income, dividends, and realized and unrealized gains and losses on trusts held as temporarily restricted and permanently restricted endowment funds are recorded as net investment gains (losses) in changes in temporarily restricted net assets in the Consolidated Statements of Operations and Changes in Net Assets. Restricted interest income, dividends, and realized and unrealized gains and losses on trusts held as permanently restricted are recorded as net investment gains (losses) in changes in permanently restricted net assets in the Consolidated Statements of Operations and Changes in Net Assets.

Geisinger's alternative investments, which include private equity and hedge funds, are reported at fair value, as estimated and reported by general partners, based upon the underlying net asset value (NAV) of the fund or partnership as a practical expedient. Adjustment from NAV is required when Geisinger expects to sell the investment at a value other than NAV. Interest income, dividends and realized and unrealized gains and losses from these investments are recorded as investment income within other revenues or within investing and financing activities in the Consolidated Statements of Operations and Changes in Net Assets.

Market risk exists to the extent that the values of Geisinger's monetary assets fluctuate as a result of changes in market prices. Changes in market prices can arise from factors specific to individual securities or their respective issuers or factors affecting all securities traded in a particular market. Relevant factors for Geisinger are both volatility and liquidity of specific securities and markets in which Geisinger holds investments. Geisinger employs the services of professional investment managers and has established investment guidelines to ensure that the portfolio is diversified and exposure to market risk is managed. Due to the level of risk associated with investments and the level of uncertainty related to changes in their value, it is at least reasonably possible that changes in market valuations in the near term could materially affect account balances and the amounts reported in the consolidated financial statements.

Amounts available to meet current liabilities have been reclassified to current investments in the Consolidated Balance Sheets. In-kind transfers of investments disclosed in the Consolidated Statements of Cash Flows represents the value of investments transferred to a new investment manager in fiscal 2017.

Accounts Receivable and Allowances

Geisinger's health services providers have agreements with third-party payors that provide for payments at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, which vary according to a patient classification system that is based on clinical, diagnostic, and other factors; reimbursed costs; discounted charges; and per diem payments. Management regularly reviews accounts and contracts and provides appropriate contractual allowances and discounts that are netted against patient accounts receivable in the Consolidated Balance Sheets. Patient accounts receivable are further reduced by an allowance for uncollectible accounts.

Geisinger estimates an allowance for uncollectible accounts and provision for bad debts based upon past collection history and payment trends for its major payor sources of patient service revenue. For patient accounts receivable associated with patients without insurance coverage and patients with deductibles and coinsurance balances for which third-party coverage exists for a portion of the bill, Geisinger records a provision for bad debts. Account balances are charged off against the allowance for uncollectible accounts after all means of collection have been exhausted.

Insurance premiums that are past due greater than 60 days are written off as uncollectible and are subject to subsequent contract cancellation under terms of the insurance contract.

Geisinger's insurance operations are subject to the Affordable Care Act ("ACA"), which transforms the U.S. healthcare system and increases regulations within the U.S. health insurance industry. The ACA creates state health insurance exchanges, which help to provide individuals and small businesses with access to affordable and quality health insurance. Geisinger Health Plan ("GHP") and Geisinger Quality Options ("GQO") participate in the Pennsylvania market. To address restrictions on premium setting and unpredictability of medical expenses, among other items, the ACA established three transitional risk sharing programs for insurers: reinsurance, risk adjustment, and risk corridor programs ("3R's"). The reinsurance and risk corridor programs were temporary and expired at the conclusion of calendar year 2016. The risk adjustment is a permanent program under the ACA. These programs are complex and involve significant judgment and uncertainties with respect to both recorded amounts and timing of collections and therefore, the degree of estimation involved in recording amounts related to the programs is significant. Accounts receivable in the Consolidated Balance Sheets includes 3R's net receivables totaling $10.0 million and $31.6 million at June 30, 2017 and 2016, respectively.

Inventories
Inventories are stated at the lower of cost or market. Cost is determined primarily on a first-in, first-out basis.

Property and Equipment and Long-Lived Assets
Property and equipment and construction in progress are recorded at the lower of cost or fair value, if impaired. Depreciation is recorded using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of their useful life or the term of the lease and renewal periods that are deemed to be reasonably assured at the date the leasehold improvements are purchased using the straight-line method. Repairs and maintenance are expensed as incurred. Capital leases and software licenses are amortized over the shorter of their useful life or the term of the lease using the straight-line method. The cost of assets and the related accumulated depreciation are removed from the Balance Sheet, upon retirement or disposition and any gain or loss is reported in supplies and other expenses in the Consolidated Statements of Operations and Changes in Net Assets.

Geisinger recognizes an impairment loss if the carrying amount of a long-lived asset is not recoverable from its future undiscounted cash flows and measures any impairment loss as the difference between the carrying amount and the fair value of the asset.

Pledges Receivable and Contributions
Unconditional donor promises to give cash, marketable securities, and other assets are reported at fair value and discounted to present value at the date the promise is received to the extent estimated to be collectible. 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 either as temporarily or permanently restricted donor contributions in the Consolidated Statements of Operations and Changes in Net Assets. 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 net assets released from restriction and within unrestricted other revenue. Pledges receivable are reported in other assets in the Consolidated Balance Sheets.

Goodwill
Goodwill represents the excess of the purchase price over the estimated fair value of the net assets of acquired entities.

Geisinger evaluates goodwill for impairment annually and as events or changes in circumstances indicate that the value of the asset may be impaired. Impairment testing consists of internal qualitative assessments and considers other publicly available market information. If the carrying amount of the goodwill exceeds the estimated fair value, an impairment charge to current operations is recorded to reduce the carrying amount to estimated fair value. As of June 30, 2017 and 2016, there was no indication of impairment of goodwill. Total goodwill recognized on acquisitions is included in other assets in the Consolidated Balance Sheets and was $66.4 million and $55.3 million as of June 30, 2017 and 2016, respectively.

Accrued Medical Claims
GHP, GIIC (Geisinger Indemnity Insurance Corporation), and GQO are at risk for certain medical costs of their members up to reinsurance limits. Accrued medical claims and related expenses (hospitalization and other outside medical services) are recorded in medical claims payable in the Consolidated Balance Sheets. This liability includes amounts billed from other medical providers and not yet paid and estimates of costs incurred for obligations to provide services under contracts as of the balance sheet dates.

GHP, GIIC, and GQO record a liability based on management's estimate for claims, which are expected to be paid after the end of the period for services provided to members during the policy period. The estimate of costs incurred for obligations to provide services is based on historical data, current membership, health service utilization statistics, and other related information. These accruals are continually monitored and reviewed and, as settlements are made or accruals adjusted, differences are reflected in current operations. Changes in assumptions for medical costs as well as changes in actual experience could cause these estimates to change in the near term.

Derivative Instruments
Interest rate swap agreements are used by Geisinger to manage interest rate exposures and to hedge the changes in cash flows on variable rate debt. Derivative financial instruments involve, to a varying degree, elements of market and credit risk. The market risk associated with these instruments resulting from interest rate movements is expected to offset the market risk of the liabilities being hedged. The counterparties to the agreements relating to the interest rate swaps, collar and option are major financial institutions with high credit ratings. Geisinger continually monitors the credit ratings of the counterparties and does not believe that there is significant risk of nonperformance by these counterparties.

All derivatives are reported in the Consolidated Balance Sheets at fair value, including those that are designated and qualify as cash flow hedging instruments. The gain or loss on the effective portion of the derivative is reported as an unrealized gain or loss on derivative in other changes in unrestricted net assets in the Consolidated Statements of Operations and Changes in Net Assets. The gain or loss on the ineffective portion of the derivative and changes in value of derivatives not designated as hedging instruments are recognized as an unrealized gain or loss on derivatives under investing and financing activities in the Consolidated Statements of Operations and Changes in Net Assets.

Net Asset Classification
Unrestricted net assets are not restricted by donors, or the donor-imposed restrictions have been satisfied.

Temporarily restricted net assets are those whose use by Geisinger has been limited by donors to a specific time period or purpose, primarily to support operations or for capital purchases.

Permanently restricted net assets have been restricted by donors to be maintained by Geisinger, or a designated trustee, in perpetuity.

Permanently restricted net assets represent the original fair value of gifts donated to Geisinger through endowments. Geisinger's permanently restricted net assets consist of approximately 200 endowments and trusts. Unless otherwise directed by the donor, gifts received for endowments are invested in accordance with Geisinger's investment policy. From time to time, the fair value of investments associated with individual donor-restricted endowments may fall below the original gift amount. Deficiencies of this nature, which are referred to as underwater funding, are reported as changes in unrestricted and temporarily restricted net assets in the Consolidated Statements of Operations and Changes in Net Assets.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Geisinger annually appropriates up to 4.5% of each endowment for spending in accordance with the donor's intent. In order to preserve the real value of a donor's gift and to sustain funding consistent with donor intent, the annual appropriation rate is set to strike a reasonable balance between long-term objectives of preserving and growing each endowment for the future and providing stable, annual appropriations. The difference between the endowment original value and the market value of the endowment is recorded as accumulated earnings within temporarily restricted net assets.

The composition of and changes in endowment net assets, excluding trusts, by type of fund, is as follows:

	Temporarily Restricted	Permanently Restricted (Excluding Trusts)	Total
Endowment net assets at June 30, 2015	$ 12,298	$ 69,069	$ 81,367
Investment return			
Realized investment gains	3,982	254	4,236
Unrealized investment losses	(5,303)	(430)	(5,733)
Total investment return	(1,321)	(176)	(1,497)
Contributions received from acquisition	-	1,564	1,564
Contributions received	-	1,463	1,463
Underwater funding	48	-	48
Annual appropriations	(2,835)	-	(2,835)
Endowment net assets at June 30, 2016	8,190	71,920	80,110
Investment return			
Realized investment (losses) gains	(681)	65	(616)
Unrealized investment gains	7,832	386	8,218
Total investment return	7,151	451	7,602
Contributions received from acquisition	-	2,348	2,348
Contributions received	-	1,372	1,372
Underwater funding	(47)	-	(47)
Annual appropriations	(2,890)	-	(2,890)
Endowment net assets at June 30, 2017	$ 12,404	$ 76,091	$ 88,495

Noncontrolling Interest

Noncontrolling interest represents the proportionate share of xG Health Solutions, Inc. ("xG"), Geisinger SCA Holdings, LLC ("GSCA"), AtlantiCare Surgery Center, LLC ("ASC") and Keystone Accountable Care Organization ("KACO") that are owned by third parties. xG is a for-profit, collaboration with Oak Investment Partners that provides consulting, healthcare analytics, and care management services and is 45.6% owned by Geisinger at June 30, 2017. GSCA is a Delaware limited liability company and joint venture with SCA Pennsylvania Holdings, LLC that operates an ambulatory surgery center in Dickson City, Pennsylvania and is 51.0% owned by Geisinger at June 30, 2017. ASC is a same-day surgical center with three locations in southern New Jersey and is 40.0% owned by Geisinger at June 30, 2017. KACO is a group of health care providers who collaborate to improve health services and care and is 75.0% owned by Geisinger at June 30, 2017. The net income or loss of these ventures is allocated to the noncontrolling interest holders based on their percentage of ownership.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

For the years ended June 30, 2017 and 2016, components of the changes in consolidated net assets impacting the controlling financial interest and noncontrolling interest are as follows:

	Total	Controlling Interest	Non-Controlling Interest
Balance July 1, 2015	$ 2,589,679	$ 2,575,809	$ 13,870
Excess of revenue and gains over expenses and losses	667,337	666,615	722
Other changes in unrestricted net assets			
Unrealized (loss) on derivatives	(10,009)	(10,009)	-
Net assets released from restriction, capital purchases	3,035	3,035	-
Pension liability adjustment	(72,706)	(72,706)	-
Net asset transfers for underwater endowments	(48)	(48)	-
Contributions from noncontrolling interest	(478)	2,789	(3,267)
Changes in equity based compensation	637	-	637
Acquisition of AtlantiCare Surgery Center	-	(2,774)	2,774
Balance June 30, 2016	$ 3,177,447	$ 3,162,711	$ 14,736
Excess of revenue and gains over expenses and losses	444,469	441,822	2,647
Other changes in unrestricted net assets			
Unrealized gain on derivatives	9,447	9,447	-
Net assets released from restriction, capital purchases	4,851	4,851	-
Pension liability adjustment	82,762	82,762	-
Net asset transfers for underwater endowments	47	47	-
Contributions from noncontrolling interest	(4,383)	1,083	(5,466)
Changes in equity based compensation	508	-	508
Balance June 30, 2017	$ 3,715,148	$ 3,702,723	$ 12,425

Net Patient Service Revenue
Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Premium Revenue
GHP, GIIC, and GQO recognize premiums from members as revenue in the period to which healthcare coverage relates. Premiums billed and collected in advance are recorded as unearned premiums and are included in accrued expenses on the accompanying Consolidated Balance Sheets.

Charity Care
Geisinger provides services to all patients regardless of ability to pay. In accordance with Geisinger’s policy, a patient is classified as a charity patient based on income eligibility criteria. Geisinger also provides free care to patients that either do not pursue charity care eligibility or are

otherwise determined to be in need. Because Geisinger does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Additionally, Geisinger sponsors other charitable programs that provide substantial benefit to the broader community. Such programs include services to the needy and elderly population requiring special support, various clinical outreach programs, and health education and promotion.

Bad Debt
In evaluating the collectibility of accounts receivable, Geisinger analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with self-pay patients, which include both patients without insurance and patients with deductible and copayment balances due after third-party coverage, Geisinger records a provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates charged to these patients and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

Nonoperating Losses
For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue and expenses. Other transactions are reported as nonoperating losses, net.

Excess of Revenue and Gains Over Expenses and Losses
The excess of revenue and gains over expenses and losses, consistent with industry practice, includes all unrestricted revenue, expenses, and net gains and losses for the reporting period, except for net assets released from restriction to fund purchases of capital, pension liability adjustments, net asset transfers for underwater endowments, unrealized gains (losses) on the effective portion of derivatives, contribution from noncontrolling interest, net of distributions, and changes in equity-based compensation.

Use of Estimates
The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include contractual allowances, estimated amounts due to third-party payors, bad debt reserves, depreciation, accrued medical claims, medical legal liabilities, workers' compensation liabilities, derivative valuations, alternative investment valuations, valuation of 3R's, and expected rate of return on investments used to value defined-benefit pension liabilities.

Adopted Accounting Standard
In April 2015, the FASB issued Accounting Standards Update (ASU) 2015-03, Simplifying the Presentation of Debt Issuance Costs (Subtopic 835-30). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. The ASU did not change the measurement or recognition guidance for the debt issuance costs. Geisinger adopted this ASU on July 1, 2016. The adoption of this standard was applied retroactively to all periods presented, and had no impact on Geisinger's consolidated results of operations or cash flows. The

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

unamortized balance of debt issue costs was $7.5M and $6.2M at June 30, 2017 and 2016, respectively. As a result of this adoption, $6.2M of deferred debt issuance costs were reclassified from noncurrent other assets to a direct reduction of long-term debt at June 30, 2016.

3. Acquisitions

Effective January 1, 2017, Geisinger Health acquired The Commonwealth Medical College and subsequently changed its name to Geisinger Commonwealth School of Medicine. Assets acquired and liabilities assumed in the acquisition were recorded in the accompanying Consolidated Balance Sheet as of the acquisition date based upon their estimated fair values. The results of operations have been included in the accompanying Consolidated Statements of Operations and Changes in Net Assets since the acquisition date and are not material to Geisinger's consolidated revenue or operating income.

In connection with this transaction, Geisinger Health paid $29.0M to a charitable organization. This amount reduced the contribution from acquisition recognized in the accompanying Consolidated Statements of Operations and Changes in Net Assets.

Geisinger Health recorded a contribution totaling $43.6 million representing the excess of the fair value of assets acquired over the fair value of liabilities assumed. Fair value of the acquired assets and liabilities at January 1, 2017 were as follows:

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Cash and cash equivalents	$ 6,584	$ 3,766	$ -	$ 10,350
Investments	23,177	-	1,814	24,991
Property and equipment	80,062	-	-	80,062
Other assets	1,958	5,908	534	8,400
Debt	(31,921)	-	-	(31,921)
Other liabilities and contingencies	(7,239)	-	-	(7,239)
	72,622	9,674	2,348	84,644
Other acquisitions	3,995	-	-	3,995
	$ 76,617	$ 9,674	$ 2,348	$ 88,639

No goodwill or other intangible assets were recognized as a result of this acquisition. The unrestricted net asset was recognized as a contribution from acquisitions in deriving the excess of revenue and gains over expenses and losses in the accompanying Consolidated Statements of Operations and Changes in Net Assets.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Effective October 1, 2015, Geisinger acquired AtlantiCare Health System and its affiliates (collectively "AHS"). As a result of this transaction, Geisinger recorded contribution income representing the excess of the fair value of assets acquired over the fair value of liabilities assumed. Fair value of the acquired assets and liabilities assumed at October 1, 2015 were as follows:

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Cash and cash equivalents	$ 47,938	$ -	$ -	$ 47,938
Investments	601,910	11,782	1,563	615,255
Property and equipment	453,022	-	-	453,022
Other assets	136,091	-	-	136,091
Debt	(281,576)	-	-	(281,576)
Other liabilities and contingencies	(402,640)	-	-	(402,640)
	554,745	11,782	1,563	568,090
Other acquisitions	276	5	1	282
	$ 555,021	$ 11,787	$ 1,564	$ 568,372

The following summarizes the amounts attributable to AHS in the accompanying fiscal year 2016 Consolidated Statement of Operations and Changes in Net Assets:

	Period from October 1, 2015 to June 30, 2016
Revenues	$ 763,007
Expenses	692,181
Operating income	70,826
Realized and unrealized investment gains, net	23,580
Interest Expense	(4,181)
Loss on extinguishment of debt	(6,285)
Nonoperating gains, net	3,704
Excess of revenue over expenses	$ 87,644

4. Cash, Investments, Assets Limited as to Use, and Assets Held in Trust

Geisinger values certain financial and nonfinancial assets and liabilities by applying fair value measurements. Fair value is 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 (an exit price).

Assets limited as to use - internally by the Board are resources that have been designated by a governing board of Geisinger Health or its affiliates for specific purposes. The designating board retains control over designated assets and may, at their discretion, subsequently use the assets for other purposes. Assets limited as to use – externally other are primarily investments held by a Trustee under debt agreements for tax-exempt bond proceeds. Assets limited as to use – externally restricted by donors are held to meet donor restrictions.

The fair value hierarchy is broken down into three levels based on inputs that market participants would use in valuing the asset based on market data obtained from sources independent of Geisinger as follows:

Level 1: Unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2: Unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable.

Level 3: Unobservable inputs for the asset or liability.

Inputs broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. Geisinger's investment strategy is to maximize the use of observable inputs (Levels 1 and 2) and minimize the use of unobservable inputs (Level 3). Geisinger considers observable data to be that market data, which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to Geisinger's perceived risk of that instrument.

Assets are disclosed within the hierarchy based on the lowest (or least observable) input that is significant to the measurement. Geisinger's assessment of the significance of an input requires judgment, which may affect the valuation and categorization within the fair value hierarchy. The fair value of assets and liabilities using Level 3 inputs are generally determined by using pricing models or discounted cash flow methods, which all require significant management judgment or estimation.

The basis for fair value hierarchy are established below:

Cash and Cash Equivalents
Cash and cash equivalents include short-term investments and fixed income investments with initial maturities of less than three months. Cash and cash equivalents are valued using observable market data and are categorized as Level 1 based on quoted market prices in active markets. The majority of these investments are held in money market accounts. Other cash and cash equivalents are short term corporate obligations valued based on quoted market prices or dealer or broker quotations and are categorized as Level 2.

Equity Funds
Equity funds consist of commingled trust funds and mutual funds that are valued on quoted market prices in active markets obtained from exchange or dealer markets for identical assets and are categorized as Level 1 with no valuation adjustments applied. Other equity funds are measured using net asset value or its equivalent.

Marketable Equity Securities
Marketable equity securities consist of individual securities that are generally valued based on quoted market prices in active markets obtained from exchange or dealer markets and are accordingly categorized as Level 1 with no valuation adjustments applied. Other marketable equity securities are measured using NAV or its equivalent and are not categorized in the fair value hierarchy.

Corporate Obligations
Corporate obligations consist of individual securities that are valued based on quoted market prices or dealer or broker quotations and are categorized as Level 2.

Fixed Income Funds
Fixed income funds consist of commingled trust funds and mutual funds, which are valued on quoted market prices in active markets obtained from exchange or dealer markets for identical assets and categorized as Level 1. Other fixed income funds are measured using net asset value or its equivalent and are not categorized in the fair value hierarchy.

U.S. Government and Agency Obligations
U.S. Government and agency obligations consist of individual securities and are valued based on quoted market prices or dealer/broker quotations. Direct obligations of the U.S. Government are categorized as Level 1 and agency obligations are categorized as Level 2.

Absolute and Total Return Funds
Absolute and total return funds include equity and fixed income managed funds consisting of limited partnership interests in hedge funds. The fund managers invest in a variety of securities based on the strategy of the fund, which may or may not be quoted in an active market. The hedge funds are valued at NAV. These investments are not categorized in the fair value hierarchy.

Private Equity
Private equity investments are in the form of limited partnership interests. The fund managers primarily invest in private investments for which there is no readily determinable market value. The fund manager may value the underlying private investments based on an appraised value, discounted cash flow, industry comparables, or some other method. These limited partnership investments are valued at NAV and are not categorized in the fair value hierarchy.

Assets Held in Trust
Assets held in trust represent Geisinger's beneficial interest in perpetual and other trusts that are maintained and administered by independent trustees and are valued based on the fair value of the assets held in trust. Trusts that are perpetual, whereby the original corpus cannot be expended, are reported as permanently restricted net assets. Other trusts are reported as temporarily restricted net assets until they are liquidated. Distributions from trusts are recorded as investment earnings in unrestricted net assets or as net investment gains (losses) in temporarily restricted net assets if their use is restricted by the donor. These assets are categorized as Level 3.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Details on remaining estimated life, current redemption terms, and restrictions by asset class and type of investment are provided below:

Investment Types	Remaining Life	Redemption Terms	Redemption Restrictions
Cash and cash equivalents	N/A	Daily	None
Equity funds	N/A	Daily	None
Marketable equity securities	N/A	Daily	None
Corporate obligations	N/A	Daily	None
Fixed income funds	N/A	Daily	None
U.S. Government and agency obligations	N/A	Daily	None
Absolute and total return funds	N/A	90% of NAV quarterly with 60 day notice	1 year restriction on new investment
Private equity	1 to 15 years	Redemptions not permitted. Distributions received as underlying investments are liquidated.	N/A

The following tables set forth Geisinger's cash, investments, assets limited as to use, and assets held in trust at June 30, 2017 and 2016 by level within the fair value hierarchy and NAV.

	2017				
	Level 1	Level 2	Level 3	NAV	Total
Cash and cash equivalents	$ 396,077	$ 1,099	$ -	$ -	$ 397,176
Equity funds	2,463,763	-	-	-	2,463,763
Marketable equity securities	163,280	-	-	-	163,280
Corporate obligations	-	207,537	-	-	207,537
Fixed income funds	754,954	-	-	-	754,954
U.S. Government and agency obligations	63,157	67,751	-	-	130,908
Total return fund	-	-	-	71	71
Absolute return fund	-	-	-	2,316	2,316
Private equity	-	-	-	81,559	81,559
Assets held in trust	-	-	33,753	-	33,753
	$ 3,841,231	$ 276,387	$ 33,753	$ 83,946	$ 4,235,317

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

	2016				
	Level 1	**Level 2**	**Level 3**	**NAV**	**Total**
Cash and cash equivalents	$ 467,279	$ -	$ -	$ -	$ 467,279
Equity funds	1,728,382	-	-	10,208	1,738,590
Marketable equity securities	104,168	-	-	-	104,168
Corporate obligations	-	405,906	-	-	405,906
Fixed income funds	437,496	-	-	10,232	447,728
U.S. Government and agency obligations	147,142	66,779	-	-	213,921
Total return fund	-	-	-	155,696	155,696
Absolute return fund	-	-	-	70,160	70,160
Private equity	-	-	-	92,924	92,924
Assets held in trust	-	-	30,880	-	30,880
	$ 2,884,467	$ 472,685	$ 30,880	$ 339,220	$ 3,727,252

The following table shows the changes in Level 3:

	Assets Held in Trust
Level 3 balances at June 30, 2015	$ 32,255
Net unrealized losses	(880)
Distributions, net of contributions	(495)
Level 3 balances at June 30, 2016	30,880
Net unrealized gains	2,127
Contributions, net of distributions	746
Level 3 balances at June 30, 2017	$ 33,753

During the years ended June 30, 2017 and 2016, there were no transfers among levels. Geisinger has committed to fund certain partnership investments, which were not yet drawn at June 30, 2017. These unfunded commitments totaled $54.6 million at June 30, 2017. Such commitments have terms from one to fifteen years.

Unrealized investment earnings represent the change in fair value of investments calculated where a security is still held at the end of the period. Realized gains or losses on the sale of investments are the difference between sale proceeds (net of any transaction costs) and original cost. Interest and dividend income is recorded on the accrual basis.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

5. Property and Equipment

Property, equipment and accumulated depreciation and amortization consist of the following:

	Estimated Useful Lives	June 30, 2017	June 30, 2016
Land		$ 91,361	$ 81,628
Land improvements	(5–25 years)	80,988	74,708
Buildings and building improvements	(5–40 years)	1,215,252	1,089,652
Equipment	(3–20 years)	1,657,219	1,465,313
Computer software	(5 years)	270,137	198,217
		3,314,957	2,909,518
Less: Accumulated depreciation		(1,342,647)	(1,152,502)
		1,972,310	1,757,016
Construction in progress		102,664	138,352
		$ 2,074,974	$ 1,895,368

Depreciation expense related to property and equipment for the years ended June 30, 2017 and 2016 was $225.3 million and $197.6 million, respectively. At June 30, 2017 and 2016, respectively, $18.9 million and $26.8 million of construction-related purchases had not been paid and accordingly, were included in accrued expenses and other liabilities on the Consolidated Balance Sheets.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

6. Long-Term Debt

Long-term debt consists of the following:

	June 30, 2017	June 30, 2016
Series A-1 of 2017 Bonds	$ 350,370	$ -
Series A-2 of 2017 Bonds	236,540	-
Series A of 2015 Bonds	99,525	102,500
Series B of 2015 Bonds	29,415	31,495
Series C of 2015 Bonds	27,600	30,305
Series D of 2015 Bonds	60,000	60,000
Series E of 2015 Bonds	50,000	50,000
Series F of 2015 Bonds	65,000	65,000
Series A of 2014 Bonds	48,040	48,040
Series B of 2014 Bonds	62,700	62,700
Series A of 2013 Bonds	65,000	65,000
Series B of 2013 Bonds	-	50,000
Series C of 2013 Bonds	84,700	84,700
Series D of 2013 Bonds	84,700	84,700
Series 2011 Bonds Holy Spirit Hospital	21,560	45,010
Series B of 2011 Bonds Holy Spirit Hospital	25,820	33,640
Series A-1 of 2011 Bonds	100,000	100,000
Series A-2 of 2011 Bonds	23,580	23,580
Series B of 2011 Bonds	50,000	50,000
Series A of 2009 Bonds	-	157,000
Series 2007 Lewistown	-	17,705
Series 2007 Bonds	68,850	68,850
Series A of 2005 Bonds	65,000	65,000
Series B of 2005 Bonds	62,300	62,300
Series 2002 Bonds	-	50,000
Series A of 1998 Bonds	27,700	27,700
Total tax-exempt revenue bonds	1,708,400	1,435,225
Other long-term debt		
Bank loans	29,314	30,821
Notes payable	12,164	13,222
Capital leases	28,032	30,133
Total debt	1,777,910	1,509,401
Less: current installments	(22,071)	(18,249)
Net unamortized premium	52,072	2,617
Deferred debt issue costs and fair market value adjustments	(521)	4,665
	$ 1,807,390	$ 1,498,434

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Maturities of long-term debt for the next five years and thereafter for the years ending June 30 are as follows:

2018	$	22,071
2019		29,154
2020		36,665
2021		37,606
2022		36,617
Thereafter		1,615,797
	$	1,777,910

Montour County, Pennsylvania, established the Geisinger Authority (the "Authority") for the purpose of financing through tax-exempt bonds certain capital projects of Geisinger and other nonprofit organizations within the Commonwealth of Pennsylvania and, under certain circumstances, contiguous states. All but the Series 2007 Lewistown Bonds, Series 2011 Bonds Holy Spirit Hospital and Series B of 2011 Bonds Holy Spirit Hospital were issued through the Authority. Geisinger Health has entered into a Master Trust Indenture ("MTI") with the bond trustee that governs all debt issued thereunder. All of the bonds listed below have now been issued master notes under the MTI. Under the terms of the MTI, substantially all indebtedness is a joint and several obligation of the Obligated Group, whose sole present member is Geisinger Health. Supplemental indentures governed by the existing MTI were issued with each new bond issuance. The proceeds from the bond issuances were used for the purpose of financing capital projects or to refinance other bonds.

During fiscal year 2017, the Authority issued Series 2017 Bonds on behalf of Geisinger Health with total proceeds of $636.2 million. Proceeds totaling $351.2 million were used to refund existing debt. The remaining proceeds of $285.0 million were used to fund loan pools to reimburse qualified capital expenditures of Geisinger affiliates. As a result of this transaction Geisinger recognized a loss on extinguishment of debt totaling $17.3 million. Total loss on extinguishment of debt was $20.1 million and $6.3 million for the years ended June 30, 2017 and 2016, respectively.

Fixed rate bonds have various installments of principal due prior to maturity. Variable rate demand bonds ("VRDB"), bank held rate, and index floating rate bonds have balloon payments due upon maturity. The following table provides information on each bond issue. Average interest rates include the impact of a discount or premium and remarketing and liquidity fees.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Bond Issue	Interest Rate Mode	Par	Final Maturity	Average Interest Rate 2017	2016
Series A-1 of 2017 Bonds	Fixed Rate	$ 350,370	02/15/47	4.1 %	N/A
Series A-2 of 2017 Bonds	Fixed Rate	236,540	02/15/39	3.5 %	N/A
Series A of 2015 Bonds	Bank Held Rate	99,525	07/01/37	1.0 %	0.8 %
Series B of 2015 Bonds	Fixed Rate	29,415	12/01/30	1.2 %	1.2 %
Series C of 2015 Bonds	Fixed Rate	27,600	07/01/25	1.8 %	1.8 %
Series D of 2015 Bonds	Fixed Rate	60,000	04/01/42	2.4 %	2.4 %
Series E of 2015 Bonds	Bank Held Rate	50,000	06/01/39	0.9 %	0.7 %
Series F of 2015 Bonds	Bank Held Rate	65,000	06/01/39	0.9 %	0.7 %
Series A of 2014 Bonds	Fixed Rate	48,040	06/01/41	4.2 %	4.2 %
Series B of 2014 Bonds	Bank Held Rate	62,700	06/01/28	1.6 %	1.3 %
Series A of 2013 Bonds	VRDB	65,000	10/01/43	0.6 %	0.5 %
Series C of 2013 Bonds	Bank Held Rate	84,700	10/01/43	1.2 %	0.9 %
Series D of 2013 Bonds	Bank Held Rate	84,700	10/01/43	1.2 %	1.0 %
Series 2011 Bonds Holy Spirit Hospital	Fixed Rate	21,560	01/01/41	5.8 %	5.7 %
Series B of 2011 Bonds Holy Spirit Hospital	Fixed Rate	25,820	01/01/41	5.6 %	5.6 %
Series A-1 of 2011 Bonds	Fixed Rate	100,000	06/01/41	4.8 %	4.8 %
Series A-2 of 2011 Bonds	Fixed Rate	23,580	06/01/28	4.5 %	4.3 %
Series B of 2011 Bonds	VRDB	50,000	06/01/41	0.6 %	0.4 %
Series 2007 Bonds	Index Floating Rate	68,850	05/01/37	1.4 %	1.1 %
Series A of 2005 Bonds	VRDB	65,000	05/15/35	0.6 %	0.6 %
Series B of 2005 Bonds	VRDB	62,300	08/01/22	0.6 %	0.4 %
Series A of 1998 Bonds	Fixed Rate	27,700	08/15/23	5.2 %	5.2 %

All VRDB are supported by standby bond purchase agreements. The standby bond purchase agreements provide loans to Geisinger in the amounts necessary to purchase variable rate bonds that are not remarketed.

The MTI and various bank obligations require Geisinger to maintain, as of June 30, an annual debt service coverage ratio of 1.0 to 1.1. Geisinger is in compliance with the covenant as of June 30, 2017.

Net interest paid including swap agreements was $43.3 million and $39.4 million in 2017 and 2016, respectively.

7. Derivative Instruments

During 2007, Geisinger Health entered into two interest rate swap agreements with a total outstanding notional amount of $68.9 million at both June 30, 2017 and 2016 remaining in effect until May 1, 2037. Under the swaps, Geisinger Health pays a fixed rate of 4.40% times the notional amount and receives a floating rate equal to 67% of the London Inter-Bank Offer Rate (“LIBOR”) plus 0.77%. This transaction qualifies as an effective cash flow hedge.

In September 2005, Geisinger Health entered into an interest rate swap agreement with a total outstanding notional amount of $24.5 million at June 30, 2017 and $27.4 million at June 30, 2016 decreasing incrementally to $0 by August 1, 2028. Under the swap, Geisinger Health pays a fixed rate of 3.40% times the notional amount and receives a floating rate equal to 68% of the LIBOR. Payments under the swap were exchanged beginning September 2008. This transaction does not qualify as an effective cash flow hedge.

During 2001, Geisinger Health entered into an interest rate swap agreement with a total outstanding notional amount of $80.0 million at June 30, 2017 and 2016. The swap has a notional amount of $80.0 million from inception until August 1, 2022 and $40.0 million from August 1, 2022 to August 1, 2028. Under the swap, Geisinger Health pays a fixed rate of 4.86% times the notional amount and receives a rate equal to the Securities Industry and Financial Markets Association ("SIFMA") rate, an index of high-grade tax-exempt variable rate demand obligations. This transaction does not qualify as an effective cash flow hedge. During 2001, Geisinger Health also entered into an option that provides Geisinger Health with 0.85% times the same notional amount of the swap. In exchange for the premium, Geisinger Health granted the counterparty the right to create a derivative transaction with the same remaining terms as the swap, but with the counterparty as the fixed-rate payor and Geisinger Health as the floating-rate payor. This derivative would have cash flows exactly opposite to the swap. The counterparty may only exercise this option if SIFMA has averaged more than 7% for six consecutive months. As of June 30, 2017, this option has not been triggered.

Geisinger Commonwealth School of Medicine (GCSOM) is a party to two interest rate swap agreements with a total outstanding notional amount of $29.5 million at June 30, 2017 remaining in effect until September 1, 2034.

Under the first swap, GCSOM pays a fixed rate of 3.54% times the notional amount and receives a floating rate equal to the SIFMA rate. Under the second swap, GCSOM pays a fixed rate of 2.95% times the notional amount and receives a floating rate equal to 68% of the one-month LIBOR rate. Neither transaction qualifies as an effective cash flow hedge.

AtlantiCare Health Services, Inc. is a party to an interest rate collar agreement with a commercial bank. The collar has a notional amount of $13.0 million at June 30, 2017. The cap and floor are set at 7.30% and 5.15%, respectively. This transaction qualifies as an effective cash flow hedge.

During the term of the swaps, the swaps effectively converts variable rate debt to a fixed rate. Net interest paid or received under the swap agreements is included in interest expense in the Consolidated Statements of Operations and Changes in Net Assets. The changes in fair value of an effective cash flow hedge are reported as unrealized gain or loss on derivative within other changes in unrestricted net assets in the Consolidated Statements of Operations and Changes in Net Assets. The changes in fair value of a derivative instrument that does not qualify as a cash flow hedge are recognized as an unrealized gain or loss on derivatives within the investing and financing activities in the Consolidated Statements of Operations and Changes in Net Assets.

The fair value of the derivative instruments, which are categorized as level 2 in the fair value hierarchy and recorded in other liabilities and contingencies in the Consolidated Balance Sheets, is as follows at June 30:

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

	2017	2016
Derivatives designated as hedging instruments		
Swap (2007)	$ 20,630	$ 29,358
Collar	630	1,364
Total derivatives designated as hedging instruments	21,260	30,722
Derivatives not designated as hedging instruments		
Swap (2001)	18,315	25,794
Swap (2005)	3,899	5,853
Swap GCSOM 1	1,264	-
Swap GCSOM 2	2,584	-
Option	(4,477)	(5,475)
Total derivatives not designated as hedging instruments	21,585	26,172
Derivative liability balance	$ 42,845	$ 56,894

Management intends to hold the derivative contracts to maturity and records noncash entries to account for fluctuations in their market values. The following table shows the change in derivative liability values at June 30:

	2017	2016
Derivative liability value at beginning of year	$ 56,894	$ 39,519
AtlantiCare acquisition	-	1,650
GCSOM acquisition	3,854	-
Unrealized (gain) loss recorded in investing and financing activities	(8,456)	5,716
Unrealized (gain) loss recorded as a component of changes in net assets	(9,447)	10,009
Derivative liability value at end of year	$ 42,845	$ 56,894

Based on provisions contained in the swap agreements regarding the aggregate position of derivative instruments, no collateral was posted as of June 30, 2017.

8. Operating Leases

Geisinger leases equipment and real property under operating leases, some of which require increasing monthly payments expiring over the next several years. Expenses under such operating leases during the years ended June 30, 2017 and 2016 were $50.8 million and $46.2 million, respectively.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

The following is a schedule by year of future minimum lease payments under noncancelable operating leases as of June 30, 2017:

Year Ending June 30,	
2018	$ 31,472
2019	25,479
2020	12,280
2021	9,762
2022	7,523
2023 and after	19,007
	$ 105,523

9. Retirement and Deferred Compensation Plans

Defined Contribution Plans:

Substantially all employees participate in defined-contribution plans. Employer contributions to the plans were $88.0 million and $79.0 million for the years ended June 30, 2017 and 2016, respectively.

Various 457(b) and 457(f) nonqualified deferred compensation plans are offered to physicians and other highly compensated employees. The investments held in these deferred compensation plans are recorded in other assets with a corresponding liability in other liabilities and contingencies in the Consolidated Balance Sheets.

Defined-Benefit Plans:

Geisinger affiliates sponsor several defined-benefit plans covering various employee groups.

Effective June 30, 2017, the Geisinger Community Medical Center (GCMC) and Geisinger Lewistown Hospital (GLH) sponsored defined-benefit plans were merged and created the Geisinger Consolidated Pension Plan (“GCPP”).

GCPP and the Geisinger Bloomsburg Hospital (GBH) sponsored defined-benefit plan are frozen to new participants and further accumulation of service benefits. AHS sponsors a defined-benefit plan and a postretirement welfare plan that are both frozen to new participants. The projected benefit obligation, the fair value of plan assets, and the accrued pension costs recognized in the Consolidated Balance Sheets as other liabilities and contingencies for all Geisinger defined-benefit plans at June 30, 2017 were $669.1 million, $533.4 million, and $135.8 million, respectively. The same amounts for 2016 were $713.0 million, $493.6 million, and $219.4 million, respectively.

The hospitals intend to contribute approximately $17.0 million to the plans in 2018.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

The assumptions used in computing the total net periodic pension cost and total benefit obligation for the sponsors of the retirement plans at June 30, 2017 and 2016 are as follows:

	2017			2016			
	GCPP	GBH	AHS	GCMC	GLH	GBH	AHS
Discount rate, net periodic pension cost	3.40%	3.40%	3.20%	4.27%	4.27%	4.27%	3.85%
Discount rate, total benefit obligation	3.67%	3.67%	3.55%	3.40%	3.40%	3.40%	3.20%
Expected long-term return on plan assets	6.50%	6.50%	6.40%	6.50%	6.50%	6.50%	7.75%

The following tables set forth the composition of plan assets, inputs used to measure those assets, actual and target asset allocations at June 30:

	2017					
	Level 1	Level 2	Level 3	NAV	Total	Actual Allocation
Equity funds	$ 370,479	$ -	$ -	$ -	$ 370,479	69%
Fixed income funds	150,914	-	-	-	150,914	28%
Hedge Fund Equity	-	-	-	26	26	0%
Hedge Fund Fixed	-	-	-	2,081	2,081	0%
Private Equity	-	-	-	7,819	7,819	1%
Cash and cash equivalents	2,046	-	-	-	2,046	0%
	$ 523,439	$ -	$ -	$ 9,926	$ 533,365	100%

	2016					
	Level 1	Level 2	Level 3	NAV	Total	Actual Allocation
Equity funds	$ 287,958	$ -	$ -	$ -	$ 287,958	58%
Fixed income funds	152,225	-	-	-	152,225	31%
Hedge Fund Equity	-	-	-	37,093	37,093	8%
Hedge Fund Fixed	-	-	-	2,592	2,592	1%
Private Equity	-	-	-	7,847	7,847	2%
Cash and cash equivalents	5,843	-	-	-	5,843	1%
	$ 446,026	$ -	$ -	$ 47,532	$ 493,558	100%

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Target investment allocations for each plan are as follows:

	GCPP	GBH	AHS
Equity funds	54-78%	54-78%	40-60%
Fixed income funds	22-46%	22-46%	20-40%
Hedge Fund Equity	NA	NA	0-20%
Hedge Fund Fixed	NA	NA	0-20%
Private Equity	NA	NA	0-20%
Cash and cash equivalents	0-20%	0-20%	0-10%

The following is a schedule by year of estimated future benefit payments as of June 30, 2017:

Year Ending June 30,	
2018	$ 34,743
2019	38,085
2020	41,817
2021	49,042
2022	48,083
2023-2027	242,690
Total	$ 454,460

10. Hospital and Provider Professional Liability Claims Coverage

In the ordinary course of business, various claimants have asserted professional and general liability claims against Geisinger. 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, that may result in the assertion of additional claims. Geisinger has accrued its best estimate of both asserted and unasserted claims based on actuarially determined amounts.

Certain entities insure hospital and provider professional liability claims coverage through a captive insurance program with Geisinger Insurance Corporation, Risk Retention Group ("RRG"), which is reinsured through Geisinger Assurance Company, Ltd. ("GAC"). The limits of the professional liability coverage relating to the years ended June 30, 2017 and 2016 are subject to the following sublimits:

Institutional professional liability	$0.5 million per claim; $2.5 million annual aggregate
Physician professional liability	$0.5 million per claim; $1.5 million annual aggregate
Non-MCARE Entities' professional liability	$1.0 million per claim; $1.0 million annual aggregate
Employed Allied Healthcare and Dentists	$1.0 million per claim; $3.0 million annual aggregate
Long-Term Care Facility	$1.0 million per claim; $3.0 million annual aggregate

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Certain entities insure hospital and provider professional liability and general liability claims coverage through a captive insurance program with English Creek Assurance, Ltd. ("ECA"). The limits of the professional liability coverage relating to the year ended June 30, 2017 were subject to the following sublimits:

Institutional professional (4/14/16-10/31/16)	$1.0 million per claim; $5.5 million annual aggregate
Institutional professional (11/1/2016-6/30/17)	$1.0 million per claim; $5.5 million captive policy aggregate*
General liability (4/14/2016-10/31/2017)	$1.0 million per claim; $1.0 million annual aggregate
Physician professional (4/14/2015-10/31/2016)	$3.0 million per claim; $7.0 million annual aggregate
Physician profession liability (11/1/2016-6/30/2017)	$3.0 million per claim; $7.0 million captive policy aggregate*

* Effective 10/1/2016 per claim limits are shared by hospital and physicians and captive policy aggregate limits are not recognized by excess coverage.

The limits of the professional liability coverage relating to the year ended June 30, 2016 were subject to the following sublimits:

Institutional professional (6/30/14-4/14/15)	$1.0 million per claim; $3.0 million annual aggregate
Institutional professional (4/14/15-6/30/16)	$1.0 million per claim; $5.5 million annual aggregate
General liability	$1.0 million per claim; $1.0 million annual aggregate
Physician professional liability	$1.0 million per claim; $3.0 million annual aggregate*

* overall policy aggregate of $7.0M

The loss accruals, which were discounted at a rate of 3% for 2017 and 2016, include estimates of known and incurred but not reported losses based on annual actuarial studies and are reported in other liabilities and contingencies in the Consolidated Balance Sheets. Amounts expected to be paid out in the next twelve months are reported as a current liability in accrued expenses and other in the Consolidated Balance Sheets. The total net loss accruals were $223.1 million and $188.4 million at June 30, 2017 and 2016, respectively.

GAC has also issued a direct policy, on a claims-made basis, for miscellaneous professional liability, which is not covered by the Medical Care Availability and Reduction of Error ("MCARE") Fund. The policy provides limits of $1.0 million per occurrence with no aggregate limit. This policy has a retroactive date of July 1, 1985 and later.

The MCARE Act was enacted by the legislature of the Commonwealth of Pennsylvania ("Commonwealth") in 2002. This act created the MCARE Fund, which replaced The Pennsylvania Medical Professional Liability Catastrophe Loss Fund (the "Medical CAT Fund"), to facilitate the payment of medical malpractice claims exceeding the primary layer of professional liability insurance carried by Geisinger and other healthcare providers practicing in the Commonwealth. The MCARE Fund is funded on a "pay-as-you-go-basis" and assesses healthcare providers, calculated as a percentage of the rates established by the Joint Underwriting Association (also a Commonwealth of Pennsylvania agency), for basic coverage. The MCARE act provides for the gradual phase-out of Medical CAT Fund coverage; however, this has been deferred by the Pennsylvania legislature and will be considered in the future. The MCARE Act does not apply to entities insured by ECA.

The actuarially computed liability for all healthcare providers (hospital, physicians, and others) participating in the MCARE Fund at December 31, 2015 (the latest date that such information is available) was $1.0 billion. Even though the MCARE Fund coverage will eventually be phased out, the Commonwealth has indicated that the unfunded liability will likely be funded through assessments in future years as MCARE Fund-covered claims are eventually settled and paid. The Commonwealth has agreed to devote the proceeds of the Automobile Catastrophe Fund surcharge, estimated at $40 million per year for 10 years (for a total of $400 million), to help offset the MCARE Fund unfunded liability.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Geisinger's annual premiums for participation in the MCARE Fund were $7.1 million and $6.1 million for the years ended June 30, 2017 and 2016. No provision has been made for any future MCARE Fund assessments in the accompanying financial statements as Geisinger's portion of the MCARE Fund unfunded liability cannot be reasonably estimated.

Certain entities are provided reinsurance and/or excess coverage through a captive insurance programs with GAC, ECA and excess commercial policies. The reinsurance and/or excess coverage provides coverage above the primary and MCARE Fund layers where applicable.

11. Revenue, Charity Care, and Accounts Receivable, Net

Major components of revenue consist of the following:

	2017		2016	
	Revenue	**% of Total**	**Revenue**	**% of Total**
Net patient service revenue				
Medicare (MC)	$ 1,038,017	16.4%	$ 904,428	16.3%
Medical Assistance (MA)	265,780	4.2%	258,513	4.7%
Other payors	2,083,906	32.9%	1,810,097	32.7%
	3,387,703	53.5%	2,973,038	53.7%
Premium revenue				
MC Advantage	909,748	14.4%	942,758	17.0%
Commercial	881,897	13.9%	644,557	11.6%
MA and other state programs	918,322	14.5%	769,776	13.9%
	2,709,967	42.8%	2,357,091	42.5%
Other revenue	239,689	3.7%	212,811	3.8%
	$ 6,337,359	100.0%	$ 5,542,940	100.0%

Laws and regulations governing MC and MA are complex and subject to interpretation. Geisinger is aware of these laws and regulations and, to the best of its knowledge and belief, is in compliance with them. Amounts received from MC and MA are subject to review and final determination by program intermediaries or their agents. Tentative settlements of these amounts have been completed through June 30, 2016. Provisions have been made in the accompanying financial statements for anticipated adjustments and are included in estimated third-party payor settlements on the Consolidated Balance Sheets.

The cost of charity service provided was approximately $59.0 million and $62.6 million in 2017 and 2016, respectively. The costs of charity care are derived from both estimated and actual data. The estimated cost of charity includes the direct and indirect cost of providing such services and is estimated utilizing the providers' ratio of cost to gross charges, which is then multiplied by the gross uncompensated charges associated with providing care to charity patients. In addition to charity service, services are provided under the MA program to financially needy patients. The payments received under this program are less than the cost of providing the services. The unpaid cost of this program was approximately $331.4 million and $288.0 million for the years ended June 30, 2017 and 2016, respectively. In addition, bad debt expense associated with net patient service revenue was $58.9 million and $49.4 million for the years ended June 30, 2017 and 2016, respectively.

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

Premium revenue from MC Advantage products is based on a risk-adjustment model according to health severity that pays more for enrollees with predictably higher costs. Under this model, rates paid to MC Advantage plans are based on actuarially determined bids, which include a process whereby prospective payments are based on a comparison of beneficiaries' risk scores, derived from medical diagnoses, to those enrolled in the government's original MC program. Under the risk-adjustment model, all MC Advantage plans must collect and submit the necessary diagnosis code information from hospital inpatient, hospital outpatient, and physician providers to CMS within prescribed deadlines. The Centers for Medicare and Medicaid Services (CMS) risk-adjustment model uses this diagnosis data to calculate the risk adjusted premium payment to MC Advantage plans.

CMS is continuing to perform audits of various companies' selected MC Advantage contracts related to this risk adjustment diagnosis data. These Risk-Adjustment Data Validation Audits review medical record documentation in an attempt to validate provider coding practices and the presence of risk adjustment conditions, which influence the calculation of premium payments to MC Advantage plans. In February 2012, CMS released a final version of the audit methodology, which included guidance on: 1) a fee-for-service adjustment factor that will further reduce any identified payment error rate in the event of a CMS audit, 2) the exposure period, which limits exposure to plan payment years 2011 and beyond, and 3) CMS has selected 30 plans for audit years 2011, 2012 and 2013. MC Advantage premiums and related receivables are subject to estimation based upon the diagnosis data submitted to CMS and ultimately accepted by CMS.

Geisinger grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. There are no significant concentrations, payors comprising 10%, or credit risk in accounts receivable.

Major components of accounts receivable, net of estimated uncollectibles consist of the following:

	2017	2016
Clinical services	$ 357,527	$ 297,169
Insurance operations	182,440	229,899
Other	82,988	85,212
	$ 622,955	$ 612,280

June 30, 2017 and 2016 (dollars in thousands unless otherwise noted)

12. Functional Expenses

Expenses related to providing services described in note 1 (including interest expense) are as follows:

	2017	2016
Health care and program services	$ 4,128,065	$ 3,510,283
HMO and PPO services	1,509,535	1,313,582
Basic and clinical research	60,755	51,732
General and administrative	573,764	539,475
	$ 6,272,119	$ 5,415,072

13. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	June 30,	
	2017	2016
Support operations	$ 39,836	$ 27,735
Purchase of equipment	24,497	27,042
	$ 64,333	$ 54,777

Net assets were released from donor restriction by incurring expenditures satisfying the restricted purpose to support operations and capital purchases in the amount of $18.8 million and $14.5 million for the years ended June 30, 2017 and 2016, respectively.

14. Contingent Liabilities and Commitments

Geisinger is involved in litigation arising in the ordinary course of business. After consultation with legal counsel, management believes that the outcome will not materially affect the financial statements of Geisinger.

Geisinger Health maintains $50.0 million of credit facilities for the issuance of letters of credit. As of June 30, 2017 and 2016, $30.0 million and $28.9 million of standby letters of credit were outstanding, respectively. Geisinger Health also maintains a $50.0 million working capital line of credit under which no balances were outstanding at June 30, 2017.

Geisinger has outstanding commitments on construction projects totaling $39.9 million and $76.6 million at June 30, 2017 and 2016, respectively.

15. Subsequent Events

Management has evaluated subsequent events through September 11, 2017, which represents the date the financial statements were available for issuance, to ensure that the financial statements include appropriate disclosure of events both recognized in the financial statements as of June 30, 2017, and events which occurred subsequent to June 30, 2017, but were not recognized in the financial statements.

Effective July 1, 2017, Geisinger Health acquired Jersey Shore Hospital Foundation and its affiliate. No consideration was tendered as part of this transaction. At June 30, 2017, unaudited net deficit of these entities totaled $9.8 million.