Providence St. Joseph Health

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

Year ended December 31, 2017

About Providence St. Joseph Health

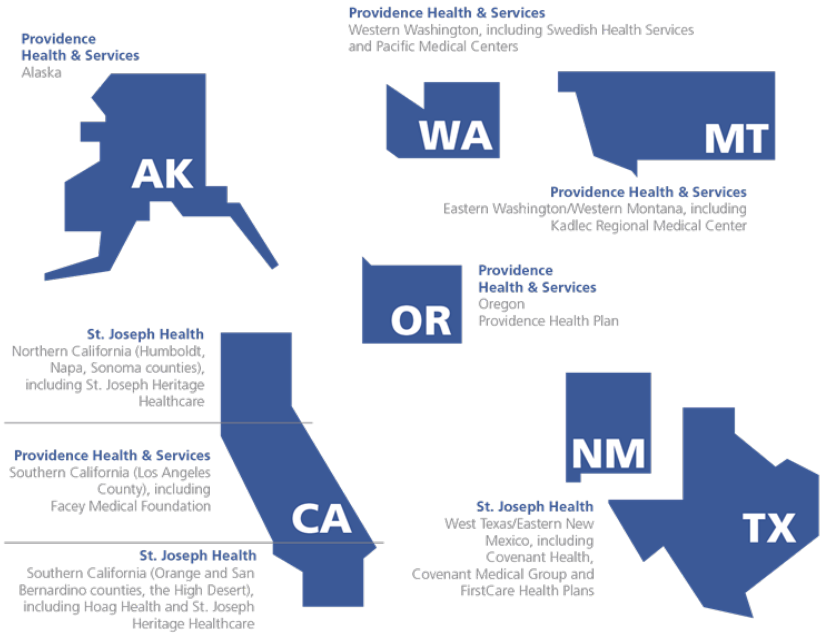
Our Organization

Providence St. Joseph Health (the System) has been a strong and stable force in health care for more than 160 years. In 2016, Providence Health & Services and St. Joseph Health came together as one national health system with the goal of improving the health of the communities we serve, especially the poor and vulnerable. During 2017, the System generated revenues of $23 billion, an increase of 5 percent over the prior year. In addition, we have invested $1.6 billion in community benefit in support of our Mission.

> *"Together, we can invest more in the needs of everyone we serve, especially the most vulnerable,"*
> ***-Rod Hochman, M.D., President and CEO***

While we have sustained our performance, we strive to increase access to health care and bring quality, compassionate care to those we serve, regardless of coverage or ability to pay. We are privileged to serve in fast growing markets in the western United States with growing populations, which has led to consistent increases in our services in these markets. We believe that health care is a basic human right and experience has shown us that when individuals and families have access to care, quality of life improves. We offer a comprehensive range of industry-leading services, including an integrated care delivery system for inpatient and outpatient services, directly employed and affiliated physicians, health plans, senior care and housing programs, financial assistance programs for those unable to pay their medical bills and educational ministries. With a shared commitment to transform health care, we are pioneering new care settings, population health, and solutions in clinical research and investing in digital technologies. Together, we are bringing quality care to all, with a focus on those most in need, and we are consistent advocates on behalf of the vulnerable and marginalized.

We employ more than 114,000 caregivers (employees) who serve in 50 hospitals, over 800 clinics and hundreds of programs and services across seven states.



Industry Trends

Providers are adapting to a rapidly changing industry and finding innovative ways to provide better, more affordable care and consumer-centric services. More hospitals and health systems are making innovative digital offerings that better engage customers, improve continuum of care and reduce clinical and operational variations and costs. With the advent of cloud computing and regulatory changes improving access for patients and sharing medical information, there will be more demand for applications that reduce friction in the system. These advancements will also improve collaboration between caregivers and patients using real-time data that improves managed and preventive care and enables more effective, customized health regimens. Advances in technology are improving the quality of care, such as direct-to-consumer tests, integrating genomic data and other personal health information with clinical labs. We anticipate the following developments ahead:

- **Technology -** Digital transformation will be increasingly important to empower patients to become more involved in their care as providers leverage cloud computing, artificial intelligence and machine learning, and consumer engagement platforms in health care
- **Personalized Medicine -** Using medicine, big data/analytics, and social networks
- **Population Health –** A stronger focus on the social determinants of health is ahead through ongoing improvements in analytics and care management to help prevent illness and care for those with chronic conditions
- **Workforce –** Sourcing a wide base of healthcare talent to meet the challenges of providing cost-effective, high-quality care will demand new and inventive workforce strategies
- **Ambulatory and Home Health –** Providers will offer convenient at-home services that utilize video, email, online chat or text to provide patients with more opportunities to manage their health and wellness
- **Partnerships –** Successful traditional and non-traditional partnerships will expand access, improve efficiencies, and help reduce or stabilize costs for medical supplies and pharmaceuticals

Policy and Advocacy

Our advocacy agenda for 2018 maintains a vigorous focus on protecting and advancing gains in health insurance coverage with a special emphasis on Medicaid and Medicare. Responding to the needs of our communities, advocacy will endorse initiatives to help pioneer new paths in health care, advance population health strategies and respond to provider shortages. The System will continue to be a voice for the vulnerable in our communities and nation promoting legislative solutions that improve quality and access to care.

Throughout 2017, our family of organizations served as strong advocates in Congress and state legislatures for the preservation of coverage gains and access to care, and the stability of health insurance markets. As a mission-driven health system, we maintain a special focus on serving those who are poor and vulnerable and advocating for safety net programs that they depend on, particularly Medicaid. Uncertainty about the scope of government-sponsored insurance and levels of reimbursement was significant in 2017, and we expect these trends to continue into 2019, as governments face budgetary restraints. At least two of the states we serve are now reducing Medicaid payments or taxing providers and insurers for budget relief. Even with passage of a bill to fund the federal Children's Health Insurance Program for 10 years, we do not expect government reimbursement to keep up with industry costs and have developed operational and financial management strategies to respond accordingly.

The tax overhaul passed in late 2017 maintains not-for-profit hospital access to tax-exempt debt, which is an important tool in helping us to manage our infrastructure costs and allowing for continued investments in

our communities. Another provision repeals the Affordable Care Act's individual mandate in 2019 that requires most Americans to have a minimum level of health insurance. As a result, the uninsured rate is expected to rise by several million, leading to poorer health and more need for free or subsidized care.

Strategy

As health care evolves, we are responding with a vision and core strategy to transform and innovate at scale. Across the western United States, we share one strategic plan designed to improve the health of entire populations by supporting the well-being of each person served. That integrated strategic and financial plan is supported by three key principles:

Strengthen the Core. We will deliver outstanding, affordable health care, housing, education and other essential services to our patients and communities by:

- Delivering safe, compassionate, high-value health care
- Stewarding our resources with a rigor and discipline that enables improved operational earnings into the future
- Fostering community commitment to our Mission via philanthropy
- Creating a work experience where caregivers are developed, fulfilled and inspired to carry on the Mission

Be Our Communities' Health Partner. We will be our communities' health partner, aiming for physical, spiritual and emotional well-being. We seek to ease the way of our neighbors by:

- Transforming care and improving population health outcomes, especially for the poor and vulnerable
- Leading the way in improving our nation's mental and emotional well-being
- Extending our commitment to whole person care for people at every age and stage of life
- Engaging with partners in addressing the social determinants of health, with a focus on education, housing and the environment
- Being the preferred health partner for those we serve

Transform Our Future. We will respond to the evolving health care landscape, pursuing new opportunities that transform our services, in a strategic and effective manner. We seek to expand our share of lives and health spend and further sustain our Mission by:

- Continuing the shift toward a consumer-centric health organization with multiple, convenient access points
- Digitally enabling, simplifying, and personalizing the health experience
- Engaging and initiating strategic partnerships along the care continuum
- Creating an integrated scientific wellness, clinical research and genomics program that is nationally recognized for breakthrough advances
- Utilizing insights and value from data to drive strategic transformation
- Activating the voice and presence of the System nationally to improve health policies

In support of our Strategic Plan, we will manage and deploy our resources to their highest and best use to sustain our Mission by:

- Allocating capital in support of our Strategic Plan
- Introducing more rigor and financial discipline in our Capital allocation process with an emphasis on our Return-on-Invested Capital (ROIC)
- Diversifying our care delivery and payment models to capture more value and align with community and industry trends
- Developing premium assets and services where we have unique advantages and/or leverage disruptive technologies

- Unlocking the value in our non-core assets through divestitures or pursing structures and partnerships
- Continuing to safeguard our financial assets through attainment of further efficiencies, increased transparency and ensure full integration with our balance sheet

Consumerization

Extending our Ambulatory network

We are expanding our ambulatory care network through organic and inorganic growth strategies, new outpatient centers, corporate development activities, and strategic partnerships. Our ambulatory network is comprised of 32 ambulatory care centers, 39 imaging centers, 55 urgent care centers, 34 retail clinics, and over 700 primary and specialty clinics. We believe ambulatory networks offer advantages to patients and physicians, including greater affordability, predictability, flexibility, and convenience. Due to advancements in medical technology, the lower cost structure and greater efficiencies that are attainable in a specialized outpatient facility. We believe the volume and complexity of surgical cases performed in an outpatient setting will continue to steadily increase. We are evolving our care model for the future by providing patients with consumer-oriented, lower cost options for virtual and at-home care that provide greater ease of access.

Population Health

Transforming care and improving population outcomes

Population Health models and initiatives form a vital pillar in achieving our strategic plan of creating healthier communities, together. Our goal is to maximize the health outcomes of the people in our defined populations and communities through the design, delivery, and coordination of affordable quality health care. In 2017, our health plan served over one million patients and was one of only 23 plans nationally to achieve 5-Star Medicare Health Plan Quality Status which represents our commitment to value-based care delivery. We are focused on the social determinants of health, including access to care and services, reliable transportation, housing, education, and nutrition, and by building partnerships that involve care management, housing, community services, and increased access.

Scientific Wellness

Aligning biomedical innovation with real world clinical practice

We are pioneering predictive modeling through our research affiliate, the Institute for Systems Biology, a biomedical research organization comprised of a cross-disciplinary team of scientists with expertise in biology, technology, computer science, engineering, and bioinformatics. The ISB consists of 185 full-time staff from 30 countries, produced over 1,300 research publications since 2000, ranked 4th in the world for research impact, and has generated over $364 million in grants and contracts revenue. Through ISB, we have formed partnerships, most recently with Seattle startup Arivale to explore how data-driven lifestyle coaching can prevent the advancement of Alzheimer's or reverse early symptoms of the disease. We seek to take a systems-driven approach to optimize health and predict and prevent disease, and enable a sustainable environment in the communities we serve and nationally.

Data and Digital Innovation

Rapid proliferation of data, advanced analytics and digital technology

We are investing in a fully integrated patient system to leverage technology that allows us to operate more effectively across regions and ministries, surfaces and socializes best practices, and identifies trends and opportunities across the system. We expect cost savings as standardizations continue across all ministries and anticipate these improvements will also allow our caregivers to serve our patients more efficiently. The

renewal and expansion of our core platform represents our dedication to enhancing the patient experience across the continuum of care.

Bringing together technology and digital innovation with health care delivery

We work to bring health care into the digital and consumer age with the goal of better serving patients and consumers by delivering care on their terms. We believe digital engagement increases the patient's access to care by creating a continuous relationship with patients between episodes of care and expanding beyond our existing markets. We offer the following direct-to-customer products to engage patients:

- Express Care is a digital platform that enables on-demand patient access to Express Care retail clinics, telehealth, or at-home visits through the web or mobile apps
- The Circle™ is a mobile women's health platform that delivers relevant content, products and services on pregnancy and pediatrics
- Xealth™ allows physicians to prescribe digital content, apps and services to patients through electronic medical records
- Optimal Aging™ provides seniors with affordable access to non-clinical services such as transportation, meals, home care and other lifestyle necessities

"Growth through access, convenience, and personalization is a great first step in digitally enabling our health system to deliver modernized, frictionless care to our patients."
-Aaron Martin, Executive Vice President and Chief Digital Officer

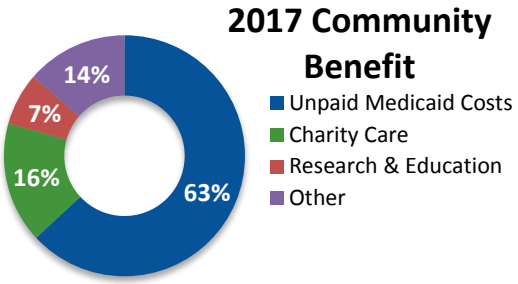
SWEDISH EXPRESS CARE | VIRTUAL · PROVIDENCE Express Care at Walgreens · PROVIDENCE Express Care | at Home · circle · xealth

Community Benefit

Sustaining our Mission by investing in our communities

We have a deep rooted history of reaching out to those in need, working to bring hope, health and healing to those we serve. As a faith-based, not-for-profit health and social services system, our commitment to community is realized, in part, through community programs and services that:

- Promote health and well-being
- Extend care to those poor and vulnerable who lack coverage from the U.S. healthcare finance system
- Support health professions education aimed at increasing the health care workforce
- Provide free and discounted medical care through our Financial Assistance Program



In each of the past two years, we have invested over $1.6 billion per year in community benefit demonstrating our commitment to the communities we serve. In an environment of decreased reimbursement for government sponsored medical care, Medicaid shortfall, after accounting for government reimbursement, was $1.0 billion, the total community benefit in both 2017 and 2016. We recognize that health begins in our homes, schools, workplaces, neighborhood, and communities.

Introduction to Management's Discussion and Analysis

Management's discussion and analysis provides additional narrative explanation of the financial condition, operational results and cash flow of the System to assist in understanding the combined financial statements. The following information should be read in conjunction with the audited combined financial statements of the System, including the notes thereto, and the report of KPMG LLP, independent auditors.

Leadership in the Health Care Industry

We announced the selection of **Venkat Bhamidipati**, formerly of Microsoft, as Executive Vice President and Chief Financial Officer in 2017 overseeing finance, as well as real estate, treasury, supply chain, and revenue cycle.

Principles of Consolidation

The audited combined financial information as of and for the twelve-month period ended December 31, 2017, presented below, has been derived by the System's management from the audited financial information. The unaudited pro forma combined financial information presented below of the System for the twelve-month period ended December 31, 2016 have been derived by combining the consolidated year-to-date results of Providence Health & Services and St. Joseph Health assuming that operations of the two organizations were combined as of January 1, 2016. Acquisition-related adjustments are included in the results as of the date of acquisition of July 1, 2016.

Results of Operations

Consolidated Statements of Operations

DATA PRESENTED YEAR TO DATE; PRESENTED IN MILLIONS	12-31-17	*Pro Forma* 12-31-16	VARIANCE	VARIANCE %
Net Patient Service Revenue	17,867	17,296	571	3%
Premium and Capitation Revenue	4,079	3,773	306	8%
Other Revenue	1,217	1,088	129	12%
Total Operating Revenue	**23,163**	**22,157**	**1,006**	**5%**
Salaries, Wages and Other	21,853	21,111	742	4%
Depreciation	1,038	1,036	2	0%
Interest and Amortization	269	265	4	2%
Total Operating Expenses	**23,160**	**22,412**	**748**	**3%**
Excess (Deficit) of Revenues Over Expenses from Operations	3	(255)	258	(101%)
Net Non-operating (Losses) Gains	777	378	399	106%
Contributions from Affiliations and loss on extinguishment of debt	0	5,108	(5,108)	(100%)
Excess of Revenues Over Expenses	**780**	**5,231**	**(4,451)**	**(85%)**
Operating EBIDA	**1,310**	**1,046**	**264**	**25%**

Consolidated Balance Sheets

PRESENTED IN MILLIONS	12-31-17	12-31-16	VARIANCE	VARIANCE %
ASSETS				
Current Assets:				
Cash and Cash Equivalents	1,371	1,000	371	37%
Short-term Investments	414	657	(243)	(37%)
Accounts Receivable, Net	2,222	2,206	16	1%
Supplies Inventory at Cost	277	279	(2)	(1%)
Other Current Assets	1,157	1,169	(12)	(1%)
Current Portion of Funds Held by Trustee	66	109	(43)	(39%)
Total Current Assets	**5,507**	**5,420**	**87**	**2%**
Assets Whose Use Is Limited:				
Long-term Investments	9,526	8,341	1,185	14%
Gift, Annuity, Trust and Other	181	131	50	38%
Funds Held by Trustee	279	259	20	8%
Total Assets Whose Use Is Limited	**9,986**	**8,731**	**1,255**	**14%**
Property, Plant & Equipment, Net	10,955	11,022	(67)	(1%)
Total Other Assets	1,197	1,118	79	7%
Total Assets	**27,645**	**26,291**	**1,354**	**5%**
LIABILITIES AND NET ASSETS				
Current Liabilities:				
Master Trust Debt classified as Short-term	57	153	(96)	(63%)
Accounts Payable	684	632	52	8%
Accrued Compensation	1,111	1,104	7	1%
Payable to Contractual Agencies	122	197	(75)	(38%)
Other Current Liabilities	2,169	1,666	503	30%
Current Portion of Long-term Debt	78	200	(122)	(61%)
Total Current Liabilities	**4,221**	**3,952**	**269**	**7%**
Long-term Debt, Net of Current Portion	6,485	6,396	89	1%
Other Long-term Liabilities	2,193	2,147	46	2%
Total Liabilities	**12,899**	**12,495**	**404**	**3%**
Net Assets:				
Unrestricted	13,545	12,760	785	6%
Temporarily Restricted	958	816	142	17%
Permanently Restricted	243	220	23	10%
Total Net Assets	**14,746**	**13,796**	**950**	**7%**
Total Liabilities and Net Assets	**27,645**	**26,291**	**1,354**	**5%**

Operating income was $3 million for the year ended December 31, 2017, compared with an operating loss of $255 million in the prior year. Operating earnings before interest, depreciation and amortization ("EBIDA") increased to $1.3 billion for the year ended December 31, 2017, compared with $1 billion over the prior year. Operating EBIDA includes a $133 million gain related to the sale of Pathology Associates Medical Laboratories, LLC in 2017 which balanced a $90 million decline related to approval delays for the managed care portion of the California provider tax program. Excluding these items, operating EBIDA increased to $1.2 billion, or 21 percent for the year ended December 2017, compared with $956 million over the prior year, primarily driven by expense reduction efforts and higher volumes.

The table below provides key financial indicators for the periods indicated:

DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	12-31-17	*Pro Forma* 12-31-16	VARIANCE	VARIANCE %
Operating Margin %	0.0	(1.2)	1.2	100%
Operating EBIDA Margin %	5.7	4.7	1.0	21%
Total Community Benefit	1,601	1,632	(31)	(2%)
Net Service Revenue/Case Mix Adjusted Admits	11,652	11,817	(165)	(1%)
Expense/Case Mix Adjusted Admits	11,650	11,976	(326)	(3%)
Full-time Equivalents (thousands)	103	102	1	1%

Volume Trends

The System's core strategy of delivering outstanding, affordable health care led to higher volumes in 2017 compared with the prior year. This growth was largely driven by outpatient activity and higher acuity within the acute setting as measured by case mix index which increased four percent for the year ended December 31, 2017, compared with the prior year. Outpatient visits grew five percent, primarily driven by an eight percent increase in surgeries including 13 percent growth in the outpatient setting for the year ended December 31, 2017. The table below provides key volume indicators for the periods indicated:

DATA PRESENTED YEAR TO DATE; IN THOUSANDS UNLESS NOTED	12-31-17	*Pro Forma* 12-31-16	VARIANCE	VARIANCE %
Inpatient Admissions	522	526	(4)	(1%)
Acute Adjusted Admissions	1,002	989	13	1%
Acute Patient Days	2,420	2,387	33	1%
Long-term Patient Days	399	400	(1)	0%
Outpatient Visits (incl. Physicians)	25,648	24,352	1,296	5%
Emergency Room Visits	2,119	2,124	(5)	0%
Total Surgeries	613	567	46	8%
Acute Average Daily Census	6,631	6,522	109	2%
Providence Health Plan Members	648	639	9	1%

The Providence Health Plan enrollment grew one percent compared with the prior year. Connected lives member months, a measure of coverage for insured members, were 8 million for the Providence Health Plan, an increase of 2 percent for the year ended December 31, 2017, compared with the prior year.

Operating Revenue

Operating revenue for the year ended December 31, 2017 was $23 billion, an increase of five percent compared with the prior year due primarily to volumes growth. Capitation and premium revenue, representing 18 percent of total operating revenue, grew eight percent during the year ended December 31, 2017, compared with the prior year. The System's operating revenue share by geographic region for the year ended December 31, 2017 is shown in the table below for the periods indicated:

REGIONAL OPERATING REVENUE SHARE	12-31-17	*Pro Forma* 12-31-16	VARIANCE
Alaska	4%	4%	0%
Swedish	11%	12%	(1%)
Washington and Montana	20%	20%	0%
Oregon	21%	20%	1%
Northern California	6%	6%	0%
Southern California	29%	29%	0%
Texas	6%	7%	(1%)
Other	3%	2%	1%

The System's operating revenue share by line of business for the year ended December 31, 2017 is shown in the table below for the periods indicated:

SEGMENT OPERATING REVENUE SHARE	12-31-17	*Pro Forma* 12-31-16	VARIANCE
Hospitals	71%	72%	(1%)
Health Plans and Accountable Care	12%	11%	1%
Physician and Outpatient Activities	12%	12%	0%
Continuum Services	5%	5%	0%

Net patient revenue per case mix adjusted admissions declined one percent for the year ended December 31, 2017, on a reported basis; however, grew 2 percent when adjusting for the timing of the provider fee in California despite lower commercial mix. The System's net patient revenue by payor mix is shown in the table below for the periods indicated:

PAYOR NET PATIENT REVENUE SHARE	12-31-17	*Pro Forma* 12-31-16	VARIANCE
Commercial	50%	51%	(1%)
Medicare	33%	32%	1%
Medicaid	14%	15%	(1%)
Self-pay and Other	3%	2%	1%

Operating Expenses

Operating expenses for the year ended December 31, 2017 were $23 billion, an increase of three percent compared with the prior year, driven mainly by costs to serve higher volumes. The increase was nearly two points lower than revenue growth due to productivity improvements and the realization of synergies from the System's affiliation in 2016. Salaries and wages expense increased four percent for the year ended December 31, 2017, compared with the prior year, driven by full-time equivalent growth, and higher wage rates and benefit costs, while supplies expense increased four percent from higher volumes, pharmaceutical spend, and a shift into procedures leveraging new technologies.

Non-Operating Income

Non-operating income is primarily comprised of investment gains and losses, pension settlement costs and innovation projects and expense. Non-operating income included a combined net gain of $5 billion in 2016, from affiliation and subsequent debt restructuring. Excluding the impact of gains related to the affiliation and debt refinancing, non-operating income increased to $777 million for the year ended December 31, 2017, compared with $378 million in the prior year, driven by strong investment performance.

Liquidity and Capital Resources

Financial Ratios

The table below includes the System's financial ratios for the periods indicated:

DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	12-31-17	*Pro Forma* 12-31-16	VARIANCE
Debt to Capitalization %	32.6	33.9	(1.3)
Debt Service Coverage	3.3	2.7	0.6
Cash to Debt Ratio %	163.9	148.8	15.1
Operating Cash Flow Margin %	5.7	4.7	1.0
Cash to Comprehensive Debt %	109.1	99.8	9.3
Debt to Cash Flow	3.1	4.6	(1.5)
Cushion Ratio	28	25	3
Maximum Annual Debt Service	384	389	(5)
Comprehensive Debt to Capitalization %	42.2	43.7	(1.5)
Cash to Total Net Asset Ratio	0.79	0.76	0.03

Unrestricted Cash and Investments

Unrestricted cash reserves totaled $10.7 billion as of December 31, 2017 compared to $9.7 billion in the prior year driven primarily by investment gains, partially offset by payments related to pension obligations, debt service costs, and capital expenditures. Days of cash on hand, a measure of cash in relation to monthly operating expenses, was 182 days at December 31, 2017, an improvement of 14 days compared with the prior year, primarily driven by increases in investment income.

Credit Agency Ratings

The System received affirmation on the following ratings from the three national credit rating agencies conducted during their annual review in 2017 and issued the following credit ratings:

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

Subsequent Events

Plan of Finance

In February 2018, the System closed on its 2018 plan of finance which included $350 million of taxable debt and $142 million in fixed rate tax-exempt debt for the System and its affiliates. The proceeds will be used primarily to refinance existing bonds and draws on existing lines of credit. The bonds also finance a small portion of new debt and prior series of debt.

Financial Performance Crosswalk

As noted previously, certain results discussed in this document are presented on a pro forma basis for the System. The tables below represent a comparison of the combined pro forma data for the year ended December 31, 2016 versus the audited results of the System, which includes St. Joseph Health financial results from the effective date of the affiliation of July 1, 2016. The difference represents activity from January 1, 2016 to June 30, 2016, which was prior to the effective date of the affiliation.

Statements of Operations	12-31-2016	
DATA PRESENTED YEAR TO DATE; $ FIGURES PRESENTED IN MILLIONS	Pro Forma	Audited
Net Patient Revenue	17,296	14,769
Premium and Capitation Revenue	3,773	3,105
Other Revenue	1,088	1,005
Total Revenue	**22,157**	**18,879**
Salaries and Wages	8,926	7,788
Depreciation	1,036	851
Interest and Amortization	265	215
Other Expenses	12,185	10,274
Total Operating Expenses	**22,412**	**19,128**
Excess of Revenues Over Expenses from Operations	(255)	(249)
Net Non-operating (Losses) Gains	5,486	5,480
Excess of Revenues Over Expenses	**5,231**	**5,231**

Obligated Group

During the year ended December 31, 2017, the audited combined net operating revenue and total assets attributable to the Obligated Group Members were approximately 83.0% and 88.2%, respectively, of the System totals. For the year ended December 31, 2016, the unaudited pro forma combined net operating revenues and total assets attributable to the Obligated Group Members were approximately 78.8% and 90.5%, respectively, of the Systems totals. The following exhibits are voluntary supplemental information on the Obligated Group Members.

EXHIBIT A.1 - SUMMARY AUDITED AND UNAUDITED PRO FORMA COMBINED STATEMENTS OF OPERATION

	Ended December 31, 2017 (in 000's of dollars)		*Pro Forma* Ended December 31, 2016 (in 000's of dollars)	
	Consolidated	Obligated	Consolidated	Obligated
Operating Revenue:				
Net Service Revenue	$ 17,866,609	$ 17,387,036	$ 17,296,033	$ 15,634,509
Premium and Capitation Revenue	4,079,290	772,317	3,773,289	920,446
Other Operating Revenue	1,217,346	1,071,744	1,087,711	906,984
Net Operating Revenues	23,163,245	19,231,097	22,157,033	17,461,939
Operating Expenses:				
Salaries, Wages and Benefits	11,464,879	10,391,082	11,028,633	9,411,158
Supplies	3,389,917	3,194,180	3,260,563	2,811,508
Depreciation Expense	1,037,984	974,623	1,036,273	873,016
Interest and Amortization	269,042	257,793	265,036	225,025
Other Expenses	6,998,330	3,826,726	6,821,429	3,964,044
Total Operating Expenses	23,160,152	18,644,404	22,411,934	17,284,751
Excess (Deficit) of Rev Over Exp from Operations	3,093	586,693	(254,901)	177,188
Net Non-operating (Losses) Gains	776,859	769,305	5,484,963	81,254
Excess of Revenue Over Expenses	$ 779,952	$ 1,355,998	$ 5,230,062	$ 258,442

EXHIBIT A.2 - SUMMARY AUDITED AND UNAUDITED PRO FORMA COMBINED STATEMENTS OF CASH FLOW

	Ended December 31, 2017 (in 000's of dollars)		*Pro Forma* Ended December 31, 2016 (in 000's of dollars)	
	Consolidated	Obligated	Consolidated	Obligated
Net cash provided by (used in) operating activities	$ 1,268,066	$ 2,314,246	$ 1,006,944	$ 1,169,294
Net cash provided by (used in) investing activities	(1,027,427)	(814,554)	(1,195,392)	(929,188)
Net cash provided by (used in) financing activities	130,363	(1,263,649)	303,187	(134,743)
Increase in cash and cash equivalents	371,002	236,043	114,739	105,363
Cash and cash equivalents, beginning of period	1,000,187	550,883	885,448	445,520
Cash and cash equivalents, end of period	$ 1,371,189	$ 786,926	$ 1,000,187	$ 550,883

EXHIBIT A.3 - SUMMARY AUDITED AND UNAUDITED PRO FORMA NET PATIENT REVENUE PAYOR MIX

	Ended December 31, 2017 (in 000's of dollars)		*Pro Forma* Ended December 31, 2016 (in 000's of dollars)	
	Consolidated	Obligated	Consolidated	Obligated
Commercial	50%	50%	51%	48%
Medicare	33%	33%	32%	33%
Medicaid	14%	15%	15%	16%
Self-pay and Other	3%	2%	2%	3%

Providence St. Joseph Health

EXHIBIT A.4 - SUMMARY AUDITED AND UNAUDITED COMBINED BALANCE SHEETS

	As of December 31, 2017 (in 000's of dollars)		As of December 31, 2016 (in 000's of dollars)	
	Consolidated	Obligated	Consolidated	Obligated
Current Assets:				
Cash and Cash Equivalents	$ 1,371,189	$ 786,926	$ 1,000,187	$ 550,883
Short-term Management Designated Investments	413,700	254,383	657,392	487,902
Accounts Receivable, Net	2,221,520	2,147,724	2,206,313	2,122,934
Other Current Assets	1,434,329	1,373,457	1,447,967	1,644,012
CP of Assets-Use is Limited	66,242	1,532	108,839	3,476
Total Current Assets	5,506,980	4,564,022	5,420,698	4,809,207
Assets Whose Use is Limited:				
Management Designated Cash and Investments	9,525,490	7,168,794	8,190,080	6,525,727
Funds Held by Trustee, Gift Annuity, and Other	460,361	411,613	541,030	294,214
Assets Whose Use is Limited	9,985,851	7,580,407	8,731,110	6,819,941
Property Plant Equipment Net	10,955,120	10,495,562	11,022,371	10,561,025
Total Other Long-term Assets	1,196,723	1,732,368	1,117,521	1,594,830
Total Assets	$ 27,644,674	$ 24,372,359	$ 26,291,700	$ 23,785,003
Current Liabilities:				
Short-term Debt	$ 56,676	$ 56,675	$ 153,350	$ 153,350
Accounts Payable	684,382	623,661	632,240	506,281
Accrued Compensation	1,110,682	1,033,090	1,104,376	1,025,646
Other Current Liabilities	2,369,876	1,699,368	2,062,386	1,483,963
Total Current Liabilities	4,221,616	3,412,794	3,952,352	3,169,240
Long Term Debt	6,484,528	6,457,366	6,396,089	6,376,495
Total Other Long-term Liabilities	2,193,453	1,562,861	2,148,641	1,653,888
Total Liabilities	12,899,597	11,433,021	12,497,082	11,199,623
Net Assets:				
Unrestricted	13,544,700	12,177,980	12,759,330	11,921,608
Restricted Net Assets	1,200,377	761,358	1,035,288	663,772
Total Net Assets	14,745,077	12,939,338	13,794,618	12,585,380
Total Liabilities and Net Assets	$ 27,644,674	$ 24,372,359	$ 26,291,700	$ 23,785,003

Providence St. Joseph Health

EXHIBIT A.5 - KEY PERFORMANCE METRICS

	Ended December 31, 2017		*Pro Forma* Ended December 31, 2016	
	Consolidated	Obligated	Consolidated	Obligated
Total Acute Admissions	522,153	516,227	526,342	520,368
Total Acute Patient Days	2,420,196	2,391,407	2,387,172	2,358,776
Acute Outpatient Visits	12,353,677	11,759,499	12,184,611	11,598,565
Primary Care Visits	12,127,920	8,345,993	11,193,978	7,703,288
Inpatient Surgeries	226,149	221,487	224,287	219,663
Outpatient Surgeries	386,881	336,140	342,323	297,426
Long-Term Care Patient Days	398,917	387,459	400,031	388,541
Home Health Visits	1,166,858	793,982	972,973	662,054
Hospice Days	869,064	611,544	835,183	587,703
Housing and Assisted Living Days	612,698	248,169	579,503	234,724
Health Plan Members	818,640	n/a	825,331	n/a
Total Average Daily Census	6,631	6,552	6,522	6,445
Total Acute Licensed Beds	11,817	11,747	11,915	11,844
FTEs	103,058	93,326	101,846	92,229

Providence St. Joseph Health

EXHIBIT B.1 - SUMMARY AUDITED COMBINING STATEMENTS OF OPERATIONS BY REGION

	Ended December 31, 2017 (in 000's of dollars)								
	Alaska	Swedish	Washington/ Montana	Oregon	Northern California	Southern California	Texas	Other/ Eliminations	Consolidated
Operating Revenue:									
Net Service Revenue	$ 817,706	$ 2,515,900	$ 4,160,401	$ 2,436,046	$ 1,303,771	$ 5,427,279	$ 840,490	$ 365,016	$ 17,866,609
Premium and Capitation Revenue	0	0	147,187	2,130,582	57,321	1,129,600	565,894	48,706	4,079,290
Other Operating Revenue	58,597	133,740	221,781	255,367	45,747	215,769	67,679	218,666	1,217,346
Net Operating Revenues	876,303	2,649,640	4,529,369	4,821,995	1,406,839	6,772,648	1,474,063	632,388	23,163,245
Operating Expenses:									
Salaries, Wages and Benefits	331,122	1,255,344	2,047,093	1,556,464	663,314	2,806,823	516,049	2,288,670	11,464,879
Supplies	110,938	440,805	744,140	470,519	194,994	983,151	192,158	253,212	3,389,917
Depreciation Expense	49,105	113,130	134,587	111,250	56,136	280,948	45,273	247,555	1,037,984
Interest and Amortization	11,848	46,551	52,021	8,001	14,695	92,482	5,730	37,714	269,042
Other Expenses	285,807	816,605	1,527,013	2,590,732	450,292	2,786,618	663,692	(2,122,429)	6,998,330
Total Operating Expenses	788,820	2,672,435	4,504,854	4,736,966	1,379,431	6,950,022	1,422,902	704,722	23,160,152
Excess (Deficit) of Revenue Over Expenses from Operations	87,483	(22,795)	24,515	85,029	27,408	(177,374)	51,161	(72,334)	3,093
Net Non-operating (Losses) Gains	52,897	62,000	71,779	125,553	45,142	307,334	10,220	101,934	776,859
Excess of Revenue Over Expenses	$ 140,380	$ 39,205	$ 96,294	$ 210,582	$ 72,550	$ 129,960	$ 61,381	$ 29,600	$ 779,952

Providence St. Joseph Health

EXHIBIT B.2 - SUMMARY AUDITED COMBINING BALANCE SHEETS BY REGION

	As of December 31, 2017 (in 000's of dollars)								
	Alaska	Swedish	Washington/ Montana	Oregon	Northern California	Southern California	Texas	Other/ Eliminations	Consolidated
Current Assets:									
Cash and Cash Equivalents	$ 172,414	$ 85,792	$ 192,357	$ 98,938	$ 34,153	$ 426,649	$ 127,832	$ 233,054	$ 1,371,189
Short-term Management Designated Investments	0	0	0	0	3,886	17,072	1,751	390,991	413,700
Accounts Receivable, Net	129,985	332,753	504,673	262,072	157,389	684,480	137,388	12,780	2,221,520
Other Current Assets	367,048	167,459	522,578	494,068	90,966	(215,097)	74,202	(66,895)	1,434,329
Current Portion of Assets-Use is Limited	0	0	0	0	0	0	0	66,242	66,242
Total Current Assets	669,447	586,004	1,219,608	855,078	286,394	913,104	341,173	636,172	5,506,980
Assets Whose Use is Limited:									
Management Designated Cash and Investments	570,509	565,955	754,354	1,914,016	429,130	2,812,208	129,126	2,350,192	9,525,490
Funds Held by Trustee, Gift Annuity, and Other	282	14,453	4,890	136,679	14,317	43,419	3,939	242,382	460,361
Assets Whose Use is Limited	570,791	580,408	759,244	2,050,695	443,447	2,855,627	133,065	2,592,574	9,985,851
Property Plant Equipment Net	491,645	1,343,130	1,719,598	1,082,050	648,258	3,734,530	409,364	1,526,545	10,955,120
Total Other Long-term Assets	24,009	112,668	198,605	29,446	13,725	480,184	55,184	282,902	1,196,723
Total Assets	$ 1,755,892	$ 2,622,210	$ 3,897,055	$ 4,017,269	$ 1,391,824	$ 7,983,445	$ 938,786	$ 5,038,193	$ 27,644,674
Current Liabilities:									
Short-term Debt	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 56,676	$ 56,676
Accounts Payable	14,640	53,475	96,666	79,169	37,153	211,828	22,123	169,328	684,382
Accrued Compensation	29,882	85,817	170,726	127,426	47,975	286,559	40,628	321,669	1,110,682
Other Current Liabilities	7,341	142,561	352,550	409,666	147,357	674,285	78,489	557,627	2,369,876
Total Current Liabilities	51,863	281,853	619,942	616,261	232,485	1,172,672	141,240	1,105,300	4,221,616
Long Term Debt	259,066	1,034,008	1,185,976	210,619	360,810	2,133,335	150,191	1,150,523	6,484,528
Total Other Long-term Liabilities	22,889	436,712	38,671	40,279	7,444	188,987	36,664	1,421,807	2,193,453
Total Liabilities	333,818	1,752,573	1,844,589	867,159	600,739	3,494,994	328,095	3,677,630	12,899,597
Net Assets:									
Unrestricted	1,407,926	791,576	1,988,958	2,984,100	733,280	3,836,659	574,543	1,227,658	13,544,700
Restricted Net Assets	14,148	78,061	63,508	166,010	57,805	651,792	36,148	132,905	1,200,377
Total Net Assets	1,422,074	869,637	2,052,466	3,150,110	791,085	4,488,451	610,691	1,360,563	14,745,077
Total Liabilities and Net Assets	$ 1,755,892	$ 2,622,210	$ 3,897,055	$ 4,017,269	$ 1,391,824	$ 7,983,445	$ 938,786	$ 5,038,193	$ 27,644,674

Providence St. Joseph Health

EXHIBIT B.3 - KEY PERFORMANCE METRICS BY REGION

As of December 31, 2017

	Alaska	Swedish	Washington/ Montana	Oregon	Northern California	Southern California	Texas	Consolidated
Total Acute Admissions	16,926	67,237	129,574	64,646	29,489	188,961	25,320	522,153
Total Acute Patient Days	111,385	300,041	638,338	301,536	157,123	781,465	130,307	2,420,196
Acute Outpatient Visits	457,418	756,935	2,816,944	3,480,608	728,962	3,573,255	539,556	12,353,677
Primary Care Visits	129,306	1,889,629	3,724,101	2,292,127	446,427	3,255,716	390,614	12,127,920
Inpatient Surgeries	8,842	32,047	59,729	31,125	8,361	77,716	8,329	226,149
Outpatient Surgeries	11,774	51,890	108,433	60,872	18,359	117,719	17,834	386,881
Long-Term Care Patient Days	58,571	n/a	14,214	44,542	n/a	82,496	11,458	398,917
Home Health Visits	13,740	n/a	27,091	303,835	53,188	396,247	n/a	1,166,858
Hospice Days	19,151	n/a	n/a	185,458	62,769	116,252	51,629	869,064
Housing and Assisted Living Days	28,936	n/a	28,137	144,528	n/a	n/a	n/a	612,698
Health Plan Members	n/a	n/a	n/a	647,781	n/a	n/a	170,859	818,640
Total Average Daily Census	305	822	1,749	826	430	2,141	357	6,631
Total Acute Licensed Beds	426	1,576	2,771	1,484	(1)	3,909	891	11,817
FTEs	3,647	10,777	20,676	15,856	4,827	27,151	5,405	103,058

PROVIDENCE ST. JOSEPH HEALTH

Combined Financial Statements

December 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Directors
Providence St. Joseph Health:

Report on the Financial Statements

We have audited the accompanying combined financial statements of Providence St. Joseph Health, which comprise the combined balance sheets as of December 31, 2017 and 2016, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of St. Joseph Health as of December 31, 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.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The Obligated Group Combining Balance Sheets and Statements of Operations Information included on pages 33 and 34 is presented for purposes of additional analysis and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

KPMG LLP

Seattle, Washington
March 7, 2018

PROVIDENCE ST. JOSEPH HEALTH

Combined Balance Sheets

December 31, 2017 and 2016

(In millions of dollars)

Assets		2017	2016
Current assets:			
Cash and cash equivalents	$	1,371	1,000
Accounts receivable, less allowance for bad debts of $227 in 2017 and $271 in 2016		2,222	2,206
Supplies inventory		277	279
Other current assets		1,157	1,169
Current portion of assets whose use is limited		480	766
Total current assets		5,507	5,420
Assets whose use is limited		9,986	8,731
Property, plant, and equipment, net		10,955	11,022
Other assets		1,197	1,118
Total assets	$	27,645	26,291
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	78	200
Master trust debt classified as short-term		57	153
Accounts payable		684	632
Accrued compensation		1,111	1,104
Other current liabilities		2,291	1,863
Total current liabilities		4,221	3,952
Long-term debt, net of current portion		6,485	6,396
Pension benefit obligation		1,054	1,120
Other liabilities		1,139	1,027
Total liabilities		12,899	12,495
Net assets:			
Unrestricted:			
Controlling interest		13,366	12,560
Noncontrolling interest		179	200
Temporarily restricted		958	816
Permanently restricted		243	220
Total net assets		14,746	13,796
Total liabilities and net assets	$	27,645	26,291

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Operations

Years ended December 31, 2017 and 2016

(In millions of dollars)

	2017	2016
Operating revenues:		
Net patient service revenues	$ 18,136	14,972
Provision for bad debts	(269)	(203)
Net patient service revenues less provision for bad debts	17,867	14,769
Premium revenues	2,745	2,240
Capitation revenues	1,334	865
Other revenues	1,217	1,005
Total operating revenues	23,163	18,879
Operating expenses:		
Salaries and benefits	11,464	9,599
Supplies	3,390	2,788
Purchased healthcare services	2,539	1,917
Interest, depreciation, and amortization	1,307	1,066
Purchased services, professional fees, and other	4,460	3,758
Total operating expenses	23,160	19,128
Excess (deficit) of revenues over expenses from operations	3	(249)
Net nonoperating gains (losses):		
Contributions from affiliations	—	5,167
Loss on extinguishment of debt	—	(60)
Investment income, net	882	403
Other	(105)	(30)
Total net nonoperating gains	777	5,480
Excess of revenues over expenses	$ 780	5,231

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Changes in Net Assets

Years ended December 31, 2017 and 2016

(In millions of dollars)

	Unrestricted				
	controlling interest	noncontrolling interest	Temporarily restricted	Permanently restricted	Total net assets
Balance, December 31, 2015	$ 7,542	45	325	124	8,036
Excess of revenues over expenses	5,093	138	—	—	5,231
Restricted contributions from affiliations	—	—	405	91	496
Contributions, grants, and other	(13)	17	145	5	154
Net assets released from restriction	19	—	(59)	—	(40)
Pension related changes	(81)	—	—	—	(81)
Increase in net assets	5,018	155	491	96	5,760
Balance, December 31, 2016	12,560	200	816	220	13,796
Excess of revenues over expenses	747	33	—	—	780
Contributions, grants, and other	(43)	(54)	222	23	148
Net assets released from restriction	44	—	(80)	—	(36)
Pension related changes	58	—	—	—	58
Increase (decrease) in net assets	806	(21)	142	23	950
Balance, December 31, 2017	$ 13,366	179	958	243	14,746

See accompanying notes to combined financial statements.

PROVIDENCE ST. JOSEPH HEALTH

Combined Statements of Cash Flows

Years ended December 31, 2017 and 2016

(In millions of dollars)

		2017	2016
Cash flows from operating activities:			
Increase in net assets	$	950	5,760
Adjustments to reconcile increase in net assets to net cash provided by operating activities:			
Contributions from affiliations		—	(5,663)
Gain on divestiture		(133)	—
Depreciation and amortization		1,057	860
Provision for bad debt		269	203
Loss on extinguishment of debt		—	60
Restricted contributions and investment income received		(245)	(150)
Net realized and unrealized gains on investments		(761)	(316)
Changes in certain current assets and current liabilities		166	13
Change in certain long-term assets and liabilities		(35)	26
Net cash provided by operating activities		1,268	793
Cash flows from investing activities:			
Property, plant, and equipment additions		(1,009)	(967)
Sales of trading securities, net		18	68
Purchases of alternative investments and commingled funds		(551)	(466)
Proceeds from sales of alternative investments and commingled funds		367	153
Cash acquired through affiliation and divestiture activities, net of cash paid		114	367
Other investing activities		34	49
Net cash used in investing activities		(1,027)	(796)
Cash flows from financing activities:			
Proceeds from restricted contributions and restricted income		245	150
Debt borrowings		376	3,606
Debt payments		(483)	(3,474)
Other financing activities		(8)	(8)
Net cash provided by financing activities		130	274
Increase in cash and cash equivalents		371	271
Cash and cash equivalents, beginning of year		1,000	729
Cash and cash equivalents, end of year	$	1,371	1,000
Supplemental disclosure of cash flow information:			
Cash paid for interest (net of amounts capitalized)	$	245	191

See accompanying notes to combined financial statements.

(1) Basis of Presentation and Significant Accounting Policies

(a) Reporting Entity

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

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

The Health System has been recognized as exempt from federal income taxes, except on unrelated business income, under Section 501(a) of the Internal Revenue Code (IRC) as an organization described in Section 501(c)(3) and further described as a public charitable organization under Section 509(a)(3). PHS, SJHS, and substantially all of the various corporations within the Health System have been granted exemptions from federal income tax under Section 501(a) of the Internal Revenue Code as charitable organizations described in Section 501(c)(3). During 2017 and 2016, the Health System did not record any liability for unrecognized tax benefits.

The accompanying combined balance sheets and related combined statements of operations, changes in nets assets, and cash flows reflect the Health System financial position and results of operations as of and for the year ended December 31, 2017. The Health System results of operations for the year ended December 31, 2016 include twelve months of results of operations for PHS and six months of results of operations for SJHS subsequent to acquisition.

(b) Basis of Presentation

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

Intercompany balances and transactions have been eliminated in combination.

(c) Performance Indicator

The performance indicator is the excess of revenues over expenses. Changes in unrestricted net assets that are excluded from the performance indicator include net assets released from restriction for the purchase of property plant and equipment, certain changes in funded status of pension and other

postretirement benefit plans, restricted contributions from affiliations, net changes in noncontrolling interests in combined joint ventures, and certain other activities.

(d) Operating and Nonoperating Activities

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

(e) Use of Estimates and Assumptions

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

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

(f) Cash and Cash Equivalents

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

(g) Supplies Inventory

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

(h) Property, Plant, and Equipment

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

(Continued)

(In millions of dollars)

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

Property, plant, and equipment and the total accumulated depreciation are as follows as of December 31:

	Approximate useful life (years)	2017	2016
Land	—	$ 1,465	1,451
Buildings and improvements	5–60	9,714	9,434
Equipment:			
Fixed	5–25	1,278	1,254
Major movable and minor	3–20	5,833	5,470
Construction in progress	—	1,030	870
		19,320	18,479
Less accumulated depreciation		(8,365)	(7,457)
Property, plant, and equipment, net		$ 10,955	11,022

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

(i) Other Assets

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

Other assets are as follows as of December 31:

	2017	2016
Investment in nonconsolidated joint ventures	$ 315	285
Intangible assets	248	260
Goodwill	190	158
Beneficial interest in noncontrolled foundations	160	146
Other	284	269
Total other assets	$ 1,197	1,118

(Continued)

(In millions of dollars)

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

The Health System recorded goodwill impairment of $14 and $36 during the years ended December 31, 2017 and 2016, respectively attributable to medical group acquisitions made in previous years.

(j) Investments Including Assets Whose Use Is Limited

The Health System has classified all of its investments as trading securities. These investments are reported on the combined balance sheets at fair value on a trade-date basis.

Investment sales and purchases initiated prior to and settled subsequent to the combined balance sheet date result in amounts due from and to brokers. As of December 31, 2017, the Health System recorded a receivable of $174 for investments sold but not settled and a payable of $428 for investments purchased but not settled in other current assets and other current liabilities, respectively, in the accompanying combined balance sheets. As of December 31, 2016, the Health System recorded a receivable of $136 for investments sold but not settled and a payable of $375 for investments purchased but not settled in other current assets and other current liabilities, respectively, in the accompanying combined balance sheets.

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

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

		2017	2016
Interest and dividend income	$	121	87
Net realized gains (losses) on sale of trading securities		166	(9)
Change in net unrealized gains on trading securities		595	325
Investment income, net	$	882	403

(k) Derivative Instruments

The Health System uses derivative financial instruments (interest rate swaps) to manage its interest rate exposure and overall cost of borrowing. As of December 31, 2017 and 2016, the Health System had interest rate swap contracts with a total current notional amount totaling $467 and $480, respectively, with varying expiration dates.

(In millions of dollars)

Derivative financial instruments are recorded at fair value taking into consideration the Health System's and the counterparties' nonperformance risk. As of December 31, 2017 and 2016, the fair value of outstanding interest rate swaps was in a net liability position of $101 and $104, respectively, and is included in other liabilities in the accompanying combined balance sheets. As of December 31, 2017 and 2016, collateral posted in connection with the outstanding swap agreements was $6 and $5, respectively, and is included in other assets in the accompanying combined balance sheets.

The interest rate swap agreements do not meet the criteria for hedge accounting and all changes in the valuation are recognized as a component of net nonoperating gains (losses) in the accompanying combined statements of operations. Settlements related to these agreements are recognized as a component of interest, depreciation, and amortization expense in the accompanying combined statements of operations. For the years ended December 31, 2017 and 2016, the change in valuation was a gain of $4 and $52, respectively, and settlements recognized as a component of interest expense were $12 and $7, respectively.

The Health System also allows certain investment managers to use derivative financial instruments (futures and forward currency contracts) to manage interest rate risk related to the Health System's fixed-income holdings. The investment managers have executed master netting arrangements with the counterparties of the futures and forward currency purchase and sale contracts whereby the financial instruments held by the same counterparty are legally offset as the instruments are settled. The following table presents gross investment derivative assets and liabilities reported on a net basis at fair value included in assets whose use is limited in the combined balance sheets as of December 31:

		2017	2016
Derivative assets:			
Futures contracts	$	275	394
Foreign currency forwards and other contracts		86	80
Total derivative assets	$	361	474
Derivative liabilities:			
Futures contracts	$	(275)	(394)
Foreign currency forwards and other contracts		(84)	(76)
Total derivative liabilities	$	(359)	(470)

(l) Self-Insurance Liabilities

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

(In millions of dollars)

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

At December 31, 2017 and 2016, the estimated liability for future costs of professional and general liability claims was $357 and $302, respectively. At December 31, 2017 and 2016, the estimated workers' compensation obligation was $309 and $306, respectively, both are recorded in other current liabilities and other liabilities in the accompanying combined balance sheets.

(m) Net Assets

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

Temporarily restricted net assets are available for the following purposes as of December 31:

		2017	2016
Program support	$	657	570
Capital acquisition		168	144
Low-income housing and other		133	102
Total temporarily restricted net assets	$	958	816

(n) Donor-Restricted Gifts

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

(In millions of dollars)

(o) Net Patient Service Revenues

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

Net patient service revenues are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with governmental payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as appropriate. Adjustments from finalization of prior years' cost reports and other third-party settlement estimates resulted in an increase in net patient service revenues of $27 for the year ended December 31, 2017 and a decrease in net patient service revenues of $1 for the year ended December 31, 2016, respectively.

The composition of payors as a percentage of net patient service revenues are as follows for the years ended December 31:

	2017	2016
Commercial	50 %	49 %
Medicare	33	32
Medicaid	14	16
Self-pay and other	3	3
	100 %	100 %

Various states in which the Health System operates have instituted a provider tax on certain patient service revenues at qualifying hospitals to increase funding from other sources and obtain additional Federal funds to support increased payments to providers for Medicaid services. The taxes are included in purchased services, professional fees, and other expenses in the accompanying combined statements of operations and were $434 and $495 for the years ended December 31, 2017 and 2016, respectively. These programs resulted in enhanced payments from these states in the way of lump-sum payments and per claim increases. These enhanced payments are included in net patient service revenues in the accompanying combined statements of operations and were $471 and $616 for the years ended December 31, 2017 and 2016, respectively.

(p) Allowance for Bad Debts

The Health System provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Health System estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business

(In millions of dollars)

practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Health System. The Health System records a provision for bad debts in the period of services on the basis of past experience, which has historically indicated that many patients are unresponsive or are otherwise unwilling to pay the portion of their bill for which they are financially responsible.

The estimates made and changes affecting those estimates are summarized as follows for the years ended December 31:

		2017	2016
Changes in allowance for bad debts:			
Allowance for doubtful accounts at beginning of year	$	271	344
Write-off of uncollectible accounts, net of recoveries		(313)	(276)
Provision for bad debts		269	203
Allowance for bad debts at end of year	$	227	271

(q) Charity Care and Community Benefit

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

Charity care is reported at cost and is determined by multiplying the charges incurred at established rates for services rendered by the Health System's cost-to-charge ratio. The cost of charity care provided by the Health System for the years ended December 31, 2017 and 2016 was $259 and $174, respectively.

(r) Premium and Capitation Revenues

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

(s) Functional Expenses

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

		2017	2016
Healthcare expenses	$	16,983	14,300
Purchased healthcare expenses		2,539	1,917
General and administrative expenses		3,638	2,911
Total operating expenses	$	23,160	19,128

(Continued)

(t) Subsequent Events

In February 2018, the Health System issued $350 of Series 2018A taxable bonds and $142 of Series 2018B Washington Health Care Facilities Authority revenue bonds.

The Health System has performed an evaluation of subsequent events through March 7, 2018, the date the accompanying combined financial statements were issued.

(u) New Accounting Pronouncements

In March 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The Health System adopted the ASU for the period beginning January 1, 2017, and $38 in net periodic benefit costs were recorded in net nonoperating gains (losses) on the statements of operations for the period ended December 31, 2017.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Health System has evaluated the impact and will be implementing ASU 2016-01 for the fiscal year beginning January 1, 2018.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendments in the ASU can be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the update recognized at the date of the initial application along with additional disclosures. The Health System evaluated the impact of ASU 2014-09 and is implementing this ASU beginning January 1, 2018. Management will include new disclosures in 2018, in accordance with Topic 606. The adoption of Topic 606 will not have a significant impact on the Health System's results of operations.

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

(Continued)

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

(v) Reclassifications

Certain reclassifications, which have no impact on net assets or changes in net assets, have been made to prior year amounts to conform to the current year presentation.

(2) Affiliated Activities and Divestitures

Effective February 23, 2017 the Health System and Catholic Health Initiatives entered into an agreement with Laboratory Corporation of America to sell all of its ownership interest in Pathology Associates Medical Laboratories (PAML) and its affiliated joint ventures. PAML was a PHS consolidated joint venture. A gain in the amount of $133 was recorded in other operating revenues on the combined statements of operations during the year ended December 31, 2017.

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

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

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

(In millions of dollars)

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

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

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

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

The following unaudited pro forma combined financial information presents the Health System's results as if the affiliation had been reported as of the beginning of the Health System's fiscal year of January 1, 2016:

	2016		
	Actual	**Pro forma** (Unaudited)	
Total operating revenues	$ 18,879	22,157	(1)
Deficit of revenues over expenses from operations	(249)	(265)	(1)(2)
Excess of revenues over expenses	5,231	57	(1)

(1) Includes the historical results of SJHS for the six-month period ended June 30, 2016 prior to the affiliation, including the impact of purchase accounting adjustments.

(2) Includes additional depreciation related to the fair value adjustments and useful life adjustments recorded related to the affiliation.

(Continued)

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

(3) Fair Value Measurements

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

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

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

(a) Assets Whose Use Is Limited

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

(In millions of dollars)

The composition of assets whose use is limited is set forth in the following tables:

	December 31, 2017	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Management-designated cash and investments:				
Cash and cash equivalents	$ 547	547	—	—
Equity securities:				
Domestic	1,058	1,058	—	—
Foreign	372	372	—	—
Mutual funds	1,313	1,313	—	—
Domestic debt securities:				
State and federal government	1,441	961	480	—
Corporate	717	—	717	—
Other	460	—	460	—
Foreign debt securities	155	—	155	—
Commingled funds	545	545	—	—
Other	20	—	20	—
Investments measured using NAV	3,312			
Total management-designated cash and investments	9,940			
Gift annuities, trusts, and other	181	41	35	105
Funds held by trustee:				
Cash and cash equivalents	105	105	—	—
Domestic debt securities	216	113	103	—
Foreign debt securities	24	—	24	—
Total funds held by trustee	345			
Total assets whose use is limited	$ 10,466			

(Continued)

(In millions of dollars)

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

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

(Continued)

(In millions of dollars)

The following table presents information, including unfunded commitments as of December 31, 2017, for investments where the NAV was used to estimate the value of the investments as of December 31:

	Fair value		Unfunded commitments	Redemption frequency	Redemption notice period
	2017	2016			
Hedge funds:					
Long/short equity	$ 579	501	—	Monthly, quarterly, semi-annually, or annually	30–120 days
Credit	300	166	—	Quarterly or annually	45–150 days
Relative value	206	194	—	Quarterly	60–90 days
Global macros	278	226	—	Monthly or quarterly	2–90 days
Fund of hedge funds	82	80	—	Quarterly	90 days
Private equity	258	214	350	Not applicable	Not applicable
Private real estate	75	33	159	Not applicable	Not applicable
Risk parity	110	173	—	Monthly or annually	5–60 days
Real assets	315	327	60	Monthly or quarterly	10–60 days
Commingled	1,109	838	—	Monthly, quarterly, or semi-annually	6–90 days
Total	$ 3,312	2,752	569		

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

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

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

Risk parity is an approach to investment portfolio management which focuses on allocation of risk, usually defined as volatility, rather than allocation of capital. The risk parity approach asserts that when asset allocations are adjusted to the same risk level, the risk parity portfolio can achieve a higher Sharpe ratio and can be more resistant to market downturns than the traditional portfolio. The key to risk parity is to diversify across asset classes that behave differently across economic environments.

Real asset strategies invest in securities backed by tangible real assets, with the objective of achieving attractive diversified total returns over the long term, while maximizing the potential for real returns in

(In millions of dollars)

periods of rising inflation. Real asset investments should provide a return in excess of inflation, and their performance should be sensitive to changes in inflation or expectations for future levels of inflation. The real asset category is made up of many different underlying sectors inclusive of agriculture, commodities, gold, infrastructure, private energy, MLPs (Master Limited Partnerships), real estate, REITs (Real Estate Investment Trusts), timberland, and TIPS (Treasury Inflation Protected Securities). Each of these sectors tends to have a high degree of sensitivity to inflation and be less correlated with traditional equities and fixed income.

Commingled describes a type of fund structure. Commingled funds consist of assets from several accounts that are blended together. Investors in commingled fund investments benefit from economies of scale, which allow for lower trading costs per dollar of investment.

(b) Derivative Instruments

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

The following tables present the fair value of swaps and related collateral:

	December 31, 2017	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Cash collateral held by swap counterparty	$ 6	6	—	—
Liabilities under interest rate swaps	101	—	101	—

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

(c) Debt

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. The carrying value and fair value of long-term debt was $6,620 and $6,963, respectively, as of December 31, 2017, and $6,749 and $6,980, respectively, as of December 31, 2016.

(In millions of dollars)

(d) Assets Measured Using Significant Unobservable Inputs

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

Balance at December 31, 2015	$	62
Level 3 assets acquired through affiliation		8
Total realized and unrealized gains, net		1
Total purchases		16
Total sales		(3)
Transfers into Level 3		4
Balance at December 31, 2016		88
Total realized and unrealized losses, net		(2)
Total purchases		21
Total sales		(2)
Balance at December 31, 2017	$	105

There were no significant transfers between assets classified as Level 1 and Level 2 during the years ended December 31, 2017 and 2016.

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

(4) Debt

(a) Short-Term and Long-Term Debt

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

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

(Continued)

(In millions of dollars)

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

	Maturing through	Coupon rates	Unpaid principal 2017	Unpaid principal 2016
Master trust debt:				
Fixed rate:				
Series 1997, Direct Obligation Notes	2017	7.70%	$ —	1
Series 2005, Direct Obligation Notes	2030	4.31–5.39%	40	42
Series 2006C, WHCFA Revenue Bonds	2033	5.25%	69	69
Series 2006D, WHCFA Revenue Bonds	2033	5.25%	69	69
Series 2006E, WHCFA Revenue Bonds	2033	5.25%	26	26
Series 2008B, LHFDC Revenue Bonds	2023	4.00–5.00%	33	46
Series 2008C, CHFFA Revenue Bonds	2038	3.00–6.50%	6	12
Series 2009A, Direct Obligation Notes	2019	5.05–6.25%	100	100
Series 2009A, CHFFA Revenue Bonds	2039	5.50–5.75%	185	185
Series 2009B, CHFFA Revenue Bonds	2039	5.50%	150	150
Series 2009B, CHFFA Revenue Bonds	2021	3.00–5.25%	37	42
Series 2009C, CHFFA Revenue Bonds	2034	5.00%	91	91
Series 2009D, CHFFA Revenue Bonds	2034	1.70%	40	40
Series 2010A, WHCFA Revenue Bonds	2039	4.88–5.25%	174	174
Series 2011A, AIDEA Revenue Bonds	2041	5.00–5.50%	123	123
Series 2011B, WHCFA Revenue Bonds	2021	2.00–5.00%	42	51
Series 2011C, OFA Revenue Bonds	2026	3.50–5.00%	15	17
Series 2012A, WHCFA Revenue Bonds	2042	2.00–5.00%	480	489
Series 2012B, WHCFA Revenue Bonds	2042	4.00–5.00%	100	100
Series 2013A, OFA Revenue Bonds	2024	2.00–5.00%	54	61
Series 2013A, CHFFA Revenue Bonds	2037	4.00–5.00%	325	325
Series 2013B, CHFFA Revenue Bonds	2043	4.15–4.26%	—	110
Series 2013C, CHFFA Revenue Bonds	2043	4.15–4.26%	110	110
Series 2013D, Direct Obligation Notes	2023	4.38%	252	252
Series 2013D, CHFFA Revenue Bonds	2043	4.15–4.26%	110	110
Series 2014A, CHFFA Revenue Bonds	2038	2.00–5.00%	270	273
Series 2014B, CHFFA Revenue Bonds	2044	4.25–5.00%	119	119
Series 2014C, WHCFA Revenue Bonds	2044	4.00–5.00%	92	92
Series 2014D, WHCFA Revenue Bonds	2041	5.00%	179	179
Series 2015A, WHCFA Revenue Bonds	2045	4.00%	78	78
Series 2015C, OFA Revenue Bonds	2045	4.00–5.00%	71	71
Series 2016A, CHFFA Revenue Bonds	2047	2.50–5.00%	448	448
Series 2016B, CHFFA Revenue Bonds	2036	1.25–4.00%	286	286
Series 2016H, Direct Obligation Bonds	2036	2.75%	300	300
Series 2016I, Direct Obligation Bonds	2047	3.74%	400	400
Total fixed rate			4,874	5,041

(Continued)

(In millions of dollars)

	Maturing through	Effective interest rate (1) 2017	Effective interest rate (1) 2016	Unpaid principal 2017	Unpaid principal 2016
Variable rate:					
Series 2012C, WHCFA Revenue Bonds	2042	0.86 %	0.43 %	80	80
Series 2012D, WHCFA Revenue Bonds	2042	0.86	0.43	80	80
Series 2012E, Direct Obligation Notes	2042	1.08	0.57	229	231
Series 2013C, OFA Revenue Bonds	2022	1.79	1.41	57	117
Series 2013E, Direct Obligation Notes	2017	6.28	4.79	—	100
Series 2016C, LHFDC Revenue Bonds	2030	0.86	0.24	37	39
Series 2016D, WHCFA Revenue Bonds	2036	1.34	1.04	106	106
Series 2016E, WHCFA Revenue Bonds	2036	1.26	0.96	106	106
Series 2016F, MFFA Revenue Bonds	2026	1.23	0.93	46	50
Series 2016G, Direct Obligation Notes	2047	1.08	0.76	100	100
Total variable rate				841	1,009
Wells Fargo Credit Facility	2019	1.73	—	110	—
Wells Fargo Credit Facility	2021	1.63	1.22	369	252
Unpaid principal, master trust debt				6,194	6,302
Premiums, discounts, and unamortized financing costs, net				148	167
Master trust debt, including premiums and discounts, net				6,342	6,469
Other long-term debt				278	280
Total debt				$ 6,620	6,749

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

In November 2017, the Health System received a Well Fargo Bridge Loan for $110 and repaid the CHFFA Series 2013B revenue bonds.

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

In connection with the Series 2016A-I issuance, the Health System recorded losses due to extinguishment of debt of $60 in the year ended December 31, 2016, which was recorded in net nonoperating gains (losses) in the accompanying combined statement of operations.

(Continued)

(In millions of dollars)

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

		2017	2016
Current portion of long-term debt	$	78	200
Short-term master trust debt		57	153
Long-term debt, classified as a long-term liability		6,485	6,396
Total debt	$	6,620	6,749

Short-term master trust debt represents debt issues with remarketing provisions unsupported by credit facilities with mandatory redemption within one year of the December 31, 2017 and 2016.

(b) Other Long-Term Debt

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

		2017	2016
Capital leases	$	152	159
Notes payable		105	110
Bonds not under master trust indenture and other		21	11
Total other long-term debt	$	278	280

(c) Debt Service

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

		Master trust	Other	Total
2018	$	69	9	78
2019		283	11	294
2020		93	11	104
2021		472	10	482
2022		107	10	117
Thereafter		5,170	227	5,397
Scheduled principal payments of long-term debt	$	6,194	278	6,472

(Continued)

(In millions of dollars)

(5) Retirement Plans

(a) Defined Benefit Plans

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

		2017	2016
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	2,680	2,600
Service cost		23	22
Interest cost		114	94
Actuarial loss		110	140
Benefits paid and other		(186)	(176)
Projected benefit obligation at end of year		2,741	2,680
Change in fair value of plan assets:			
Fair value of plan assets at beginning of year		1,559	1,535
Actual return on plan assets		218	119
Employer contributions		95	81
Benefits paid and other		(186)	(176)
Fair value of plan assets at end of year		1,686	1,559
Funded status		(1,055)	(1,121)
Unrecognized net actuarial loss		495	552
Unrecognized prior service cost		3	4
Net amount recognized	$	(557)	(565)
Amounts recognized in the combined balance sheets consist of:			
Current liabilities	$	(1)	(1)
Noncurrent liabilities		(1,054)	(1,120)
Unrestricted net assets		498	556
Net amount recognized	$	(557)	(565)
Weighted average assumptions:			
Discount rate		4.00 %	4.40 %
Rate of increase in compensation levels		3.50	3.50
Long-term rate of return on assets		6.50	6.90

(Continued)

(In millions of dollars)

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

		2017	2016
Components of net periodic pension cost:			
Service cost	$	23	22
Interest cost		114	94
Expected return on plan assets		(102)	(107)
Amortization of prior service cost		1	1
Recognized net actuarial loss		25	19
Net periodic pension cost	$	61	29
Special recognition – settlement expense	$	25	28

Certain plans sponsored by the Health System allow participants to receive their benefit through a lump-sum distribution upon election. When lump-sum distributions exceed the combined total of service cost and interest cost during a reporting period settlement expense is recognized. Settlement expense represents the proportional recognition of unrecognized actuarial loss and prior service cost. Settlement expense for the years ended December 31, 2017 and 2016 is included in net nonoperating gains (losses) in the accompanying combined statements of operations.

The accumulated benefit obligation was $2,672 and $2,628 at December 31, 2017 and 2016, respectively.

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

2018	$	178
2019		185
2020		191
2021		195
2022–2027		1,077
	$	1,826

The Health System expects to contribute approximately $96 to the defined benefit plans in 2018.

The expected long-term rate of return on plan assets is the expected average rate of return on the funds invested currently and on funds to be invested in the future in order to provide for the benefits included in the projected benefit obligation. The Health System used 6.5% and 6.9% in calculating the 2017 and 2016 expense amounts, respectively. This assumption is based on capital market assumptions and the plan's target asset allocation.

(Continued)

(In millions of dollars)

The Health System continues to monitor the expected long-term rate of return. If changes in those parameters cause 6.5% to be outside of a reasonable range of expected returns, or if actual plan returns over an extended period of time, suggest that general market assumptions are not representative of expected plan results, the Health System may revise this estimate prospectively.

The target asset allocation and expected long-term rate of return on assets (ELTRA) as of December 31, 2017 and 2016, respectively, were as follows:

	2017 Target	2017 ELTRA	2016 Target	2016 ELTRA
Cash and cash equivalents	2 %	2%–3%	1 %	1%–3%
Equity securities	45	7%–8%	42	5%–9%
Debt securities	33	3%–4%	35	2%–5%
Other securities	20	5%–8%	22	5%–9%
Total	100 %	6.5 %	100 %	6.9 %

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

	December 31, 2017	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	$ 68	68	—	—
Equity securities:				
Domestic	177	177	—	—
Foreign	48	48	—	—
Mutual funds	127	127	—	—
Domestic debt securities:				
State and government	272	210	62	—
Corporate	129	—	129	—
Other	13	—	13	—
Foreign debt securities	30	—	30	—
Commingled funds	170	170	—	—
Investments measured using NAV	720			
Transactions pending settlement, net	(68)			
Total	$ 1,686			

(Continued)

(In millions of dollars)

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

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

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

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

	Fair value 2017	Fair value 2016	Redemption frequency	Redemption notice period
Hedge funds:				
Long/short equity	$ 52	74	Monthly or quarterly	30–65 days
Credit and other	56	52	Monthly or quarterly	90 days
Real assets	92	116	Monthly	30 days
Risk parity	130	111	Monthly	5–15 days
Commingled	390	310	Monthly	6–30 days
Total	$ 720	663		

(Continued)

(In millions of dollars)

The Health System's defined benefit plans also allow certain investment managers to use derivative financial instruments (futures and forward currency contracts) to manage interest rate risk related to the plans' fixed-income holdings. The investment managers have executed master netting arrangements with the counterparties of the futures and forward currency purchase and sale contracts whereby the financial instruments held by the same counterparty are legally offset as the instruments are settled. The following table presents gross investment derivative assets and liabilities reported on a net basis at fair value included in the plans' assets as of December 31:

		2017	2016
Derivative assets:			
Futures contracts	$	926	16
Foreign currency forwards and other contracts		5	7
Total derivative assets	$	931	23
Derivative liabilities:			
Futures contracts	$	(926)	(16)
Foreign currency forwards and other contracts		(4)	(5)
Total derivative liabilities	$	(930)	(21)

(b) Defined Contribution Plans

The Health System sponsors various defined contribution retirement plans that cover substantially all employees. The plans provide for employer matching contributions in an amount equal to a percentage of employee pretax contributions, up to a maximum amount. In addition, the Health System makes contributions to eligible employees based on years of service. Retirement expense related to these plans was $478 and $440 in 2017 and 2016, respectively, and is reflected in salaries and benefit expense in the accompanying combined statements of operations.

(6) Commitments and Contingencies

(a) Commitments

Firm purchase commitments, primarily related to construction and equipment and software acquisition, at December 31, 2017 are approximately $381.

(b) Operating Leases

The Health System leases various medical and office equipment and buildings under operating leases.

(Continued)

(In millions of dollars)

Future minimum lease commitments under noncancelable operating leases for the next five years and thereafter are as follows:

2018	$	221
2019		204
2020		186
2021		165
2022		144
Thereafter		773
	$	1,693

Rental expense, including month-to-month leases and contingent rents, was $382 and $302 for the years ended December 31, 2017 and 2016, respectively, and is included in other expenses in the accompanying combined statements of operations.

(c) Litigation

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Government monitoring and enforcement activity continues with respect to investigations and allegations concerning possible violations by healthcare providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of patient services previously billed. Institutions within the Health System are subject to similar regulatory reviews.

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

PROVIDENCE ST. JOSEPH HEALTH

Supplemental Schedule - Obligated Group Combining Balance Sheets Information

December 31, 2017 and 2016

(In millions of dollars)

	2017			2016		
Assets	**Obligated Group**	**Non Obligated, Eliminations, Other**	**Total Combined**	**Obligated Group**	**Non Obligated, Eliminations, Other**	**Total Combined**
Current assets:						
Cash and cash equivalents	$ 787	584	1,371	551	449	1,000
Accounts receivable, net	2,148	74	2,222	2,123	83	2,206
Supplies inventory	270	7	277	266	13	279
Other current assets	1,103	54	1,157	1,378	(209)	1,169
Current portion of assets whose use is limited	256	224	480	492	274	766
Total current assets	4,564	943	5,507	4,810	610	5,420
Assets whose use is limited	7,580	2,406	9,986	6,820	1,911	8,731
Property, plant, and equipment, net	10,496	459	10,955	10,561	461	11,022
Other assets	1,732	(535)	1,197	1,594	(476)	1,118
Total assets	$ 24,372	3,273	27,645	23,785	2,506	26,291
Liabilities and Net Assets						
Current liabilities:						
Current portion of long-term debt	$ 76	2	78	194	6	200
Master trust debt classified as short-term	57	—	57	153	—	153
Accounts payable	624	60	684	506	126	632
Accrued compensation	1,033	78	1,111	1,026	78	1,104
Other current liabilities	1,623	668	2,291	1,289	574	1,863
Total current liabilities	3,413	808	4,221	3,168	784	3,952
Long-term debt, net of current portion	6,457	28	6,485	6,377	19	6,396
Pension benefit obligation	1,054	—	1,054	1,120	—	1,120
Other liabilities	509	630	1,139	535	492	1,027
Total liabilities	11,433	1,466	12,899	11,200	1,295	12,495
Net assets:						
Unrestricted	12,178	1,367	13,545	11,921	839	12,760
Temporarily restricted	622	336	958	535	281	816
Permanently restricted	139	104	243	129	91	220
Total net assets	12,939	1,807	14,746	12,585	1,211	13,796
Total liabilities and net assets	$ 24,372	3,273	27,645	23,785	2,506	26,291

See accompanying independent auditors' report

PROVIDENCE ST. JOSEPH HEALTH

Supplemental Schedule – Obligated Group Combining Statements of Operations Information

Years ended December 31, 2017 and 2016

(In millions of dollars)

	2017			2016		
	Obligated Group	Non Obligated, Eliminations, Other	Total Combined	Obligated Group	Non Obligated, Eliminations, Other	Total Combined
Operating revenues:						
Net patient service revenues	$ 17,630	506	18,136	13,615	1,357	14,972
Provision for bad debts	(243)	(26)	(269)	(150)	(53)	(203)
Net patient service revenues less provision for bad debts	17,387	480	17,867	13,465	1,304	14,769
Other revenues	1,844	3,452	5,296	1,147	2,963	4,110
Total operating revenues	19,231	3,932	23,163	14,612	4,267	18,879
Operating expenses:						
Salaries and benefits	10,391	1,073	11,464	8,199	1,400	9,599
Supplies	3,194	196	3,390	2,419	369	2,788
Interest, depreciation, and amortization	1,232	75	1,307	897	169	1,066
Purchased services, professional fees, and other	3,827	3,172	6,999	2,957	2,718	5,675
Total operating expenses	18,644	4,516	23,160	14,472	4,656	19,128
Excess (deficit) of revenues over expenses from operations	587	(584)	3	140	(389)	(249)
Net nonoperating gains (losses):						
Contributions from affiliations	—	—	—	—	5,167	5,167
Loss on extinguishment of debt	—	—	—	(60)	—	(60)
Investment income, net	773	109	882	277	126	403
Other	(4)	(101)	(105)	(12)	(18)	(30)
Total net nonoperating gains	769	8	777	205	5,275	5,480
Excess of revenues over expenses	$ 1,356	(576)	780	345	4,886	5,231

See accompanying independent auditors' report.