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.