Interim Unaudited Consolidated Financial Statements and Other Information

For The Period Ended December 31, 2016

The Cleveland Clinic Foundation
d.b.a. Cleveland Clinic Health System

Contents

Cleveland Clinic

March 21, 2017

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Cleveland Clinic Foundation (together with its subsidiaries and affiliates that comprise the health system, the "Cleveland Clinic") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Cleveland Clinic's consolidated financial statements for external purposes in accordance with generally accepted accounting principles. This process contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Cleveland Clinic; (ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of the consolidated financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Cleveland Clinic are being made only in accordance with appropriate authorizations of management and directors of the Cleveland Clinic; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Cleveland Clinic's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an assessment of the Cleveland Clinic's internal control over financial reporting as of December 31, 2016 using the framework specified in *Internal Control – Integrated Framework (2013 framework)*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, Cleveland Clinic maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

Delos M. Cosgrove, MD
Chief Executive Officer

Steven C. Glass
Chief Financial Officer

Michael P. Harrington
Chief Accounting Officer

The Cleveland Clinic Foundation

9500 Euclid Avenue
Cleveland, Ohio 44195

Unaudited Consolidated Balance Sheets

($ in thousands)

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

Unaudited Consolidated Balance Sheets (continued)

($ in thousands)

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

See notes to unaudited consolidated financial statements.

Unaudited Consolidated Statements of Operations and Changes in Net Assets

($ in thousands)

Operations

	Three Months Ended December 31	
	2016	**2015**
Unrestricted revenues		
Net patient service revenue	**$ 1,954,809**	$ 1,856,740
Provision for uncollectible accounts	**(60,703)**	(35,180)
Net patient service revenue less provision for uncollectible accounts	**1,894,106**	1,821,560
Other	**208,374**	202,536
Total unrestricted revenues	**2,102,480**	2,024,096
Expenses		
Salaries, wages, and benefits	**1,201,415**	1,023,793
Supplies	**193,666**	181,982
Pharmaceuticals	**225,992**	204,089
Purchased services and other fees	**130,769**	115,411
Administrative services	**56,492**	59,482
Facilities	**87,700**	84,898
Insurance	**10,801**	12,529
	1,906,835	1,682,184
Operating income before interest, depreciation, and amortization expenses	**195,645**	341,912
Interest	**36,288**	31,473
Depreciation and amortization	**123,377**	105,737
Operating income before special charges	**35,980**	204,702
Special charges	**2,734**	40,927
Operating income	**33,246**	163,775
Nonoperating gains and losses		
Investment return	**38,545**	61,981
Derivative gains	**44,858**	3,956
Gain on remeasurement of Akron General equity investment	**–**	38,777
Akron General member substitution contribution	**–**	242,822
Goodwill impairment loss	**–**	(63,060)
Other, net	**(583)**	1,407
Net nonoperating gains	**82,820**	285,883
Excess of revenues over expenses	**116,066**	449,658

Unaudited Consolidated Statements of Operations and Changes in Net Assets (continued)

($ in thousands)

Changes in Net Assets

	Net Assets			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balances at October 1, 2015	$ 6,162,949	$ 546,087	$ 301,296	$ 7,010,332
Excess of revenues over expenses	449,658	–	–	449,658
Donated capital and assets released from restrictions for capital purposes	2,464	(2,439)	–	25
Gifts and bequests	–	42,116	7,891	50,007
Net investment income	–	4,775	–	4,775
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(15,080)	–	(15,080)
Retirement benefits adjustment	24,018	–	–	24,018
Change in interests in foundations	–	(16,106)	(17,543)	(33,649)
Change in value of perpetual trusts	–	–	(449)	(449)
Net change in unrealized losses on nontrading investments	(5)	–	–	(5)
Akron General member substitution contribution	–	27,553	4,121	31,674
Other	(11,678)	(630)	–	(12,308)
Increase (decrease) in net assets	464,457	40,189	(5,980)	498,666
Balances at December 31, 2015	6,627,406	586,276	295,316	7,508,998
Balances at October 1, 2016	**$ 6,987,798**	**$ 607,592**	**$ 302,702**	**$ 7,898,092**
Excess of revenues over expenses	**116,066**	**–**	**–**	**116,066**
Donated capital and assets released from restrictions for capital purposes	**15,742**	**(15,981)**	**–**	**(239)**
Gifts and bequests	**–**	**48,609**	**4,555**	**53,164**
Net investment income	**–**	**3,350**	**–**	**3,350**
Net assets released from restrictions used for operations included in other unrestricted revenues	**–**	**(15,836)**	**–**	**(15,836)**
Retirement benefits adjustment	**(16,125)**	**–**	**–**	**(16,125)**
Change in interests in foundations	**–**	**97**	**–**	**97**
Change in value of perpetual trusts	**–**	**–**	**2,907**	**2,907**
Foreign currency translation loss	**(15,961)**	**–**	**–**	**(15,961)**
Net change in unrealized gains on nontrading investments	**499**	**–**	**–**	**499**
Other	**190**	**(405)**	**–**	**(215)**
Increase in net assets	**100,411**	**19,834**	**7,462**	**127,707**
Balances at December 31, 2016	**$ 7,088,209**	**$ 627,426**	**$ 310,164**	**$ 8,025,799**

See notes to unaudited consolidated financial statements.

Unaudited Consolidated Statements of Operations and Changes in Net Assets (continued)

($ in thousands)

Operations

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

Unaudited Consolidated Statements of Operations and Changes in Net Assets (continued)

($ in thousands)

Changes in Net Assets

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

See notes to unaudited consolidated financial statements.

Unaudited Consolidated Statements of Cash Flows

($ in thousands)

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

See notes to unaudited consolidated financial statements.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. For further information, refer to the audited financial statements and notes thereto for the year ended December 31, 2016.

1. Organization and Consolidation

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

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

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

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

2. Business Combinations

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

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

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

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

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

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

2. Business Combinations (continued)

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

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

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

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

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

2. Business Combinations (continued)

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

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

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

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

3. Accounting Policies

Recent Accounting Pronouncements

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

3. Accounting Policies (continued)

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

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

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

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

3. Accounting Policies (continued)

In March 2017, the FASB issued ASU 2017-07, *Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. ASU 2017-07 is effective for the System for annual reporting periods beginning after December 15, 2018 and interim periods within annual reporting periods beginning after December 15, 2019 with early adoption permitted in the first quarter of 2017. Upon adoption, the System is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements, except for the guidance limiting the capitalization of net periodic benefit costs in assets which is required to be applied prospectively The System will adopt the provisions of ASU 2017-07 in the first quarter of 2017. The impact of adopting ASU 2017-07 for the System when applied retrospectively to the year ended December 31, 2016 will decrease salaries, wages and benefits on the consolidated statement of operations as presented herein by $103.9 million, with a corresponding increase to operating income and decrease to net nonoperating gains. As a result, for the year ended December 31, 2016 operating income will be $243.2 million and net nonoperating gains will be $270.3 million upon retrospective adoption of ASU 2017-07. The adoption of ASU 2017-07 will have no impact on excess of revenues over expenses or net assets.

Use of Estimates

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

Net Patient Service Revenue and Patient Receivables

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

3. Accounting Policies (continued)

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

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

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

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

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

3. Accounting Policies (continued)

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

Electronic Health Record Incentive Program

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

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

3. Accounting Policies (continued)

Charity Care

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

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

Management Service Agreements

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

Cash and Cash Equivalents

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

Inventories

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

3. Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment purchased by the System are recorded at cost. Donated property, plant, and equipment are recorded at fair value at the date of donation. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation, including amortization of capital leased assets, is computed by the straight-line method using the estimated useful lives of individual assets. Buildings and building components are assigned useful lives ranging from five years to forty years. Equipment is assigned a useful life ranging from three to twenty years. Interest cost incurred on borrowed funds during the period of construction of capital assets and interest income on unexpended project funds are capitalized as a component of the cost of acquiring those assets. The System records costs and legal obligations associated with long-lived asset retirements. Assets acquired though capital lease arrangements are excluded from the consolidated statements of cash flows.

Impairment of Long-Lived Assets

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

Investments and Investment Income

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

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

3. Accounting Policies (continued)

Investments in alternative investments, which include hedge funds, private equity/venture funds and real estate funds, are primarily limited partnerships that invest in marketable securities, privately held securities, real estate, and derivative products and are reported using the equity method of accounting based on net asset value information provided by the respective partnership or third-party fund administrators. Investments held by the partnerships consist of marketable securities as well as securities that do not have readily determinable values. The values of the securities held by the limited partnerships that do not have readily determinable values are determined by the general partner and are based on historical cost, appraisals, or other valuation estimates that require varying degrees of judgment. There is inherent uncertainty in such valuations, and the estimated fair values may differ from the values that would have been used had a ready market for the securities existed. Generally, the equity method investment balance of the System's holdings in alternative investments reflects net contributions to the partnerships and the System's share of realized and unrealized investment income and expenses. The investments may individually expose the System to securities lending, short sales, and trading in futures and forward contract options and other derivative products. The System's risk is limited to its carrying value. The financial statements of the limited partnerships are audited annually.

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

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

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

Fair Value Measurements

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

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

3. Accounting Policies (continued)

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

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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

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

Goodwill and Other Intangibles

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

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

Derivatives and Hedging Activities

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

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

3. Accounting Policies (continued)

Foreign Currency Translation

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

Debt Issuance Costs

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

Contributions

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

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

Grants

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

3. Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

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

Excess of Revenues Over Expenses

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

4. Net Patient Service Revenue and Patient Receivables

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

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

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

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

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

5. Cash, Cash Equivalents, and Investments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7. Goodwill and Other Intangible Assets

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

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

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

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

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

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

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

8. Fair Value Measurements

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

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

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

8. Fair Value Measurements (continued)

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

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

8. Fair Value Measurements (continued)

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

8. Fair Value Measurements (continued)

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

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

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

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

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

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

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

8. Fair Value Measurements (continued)

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

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

9. Property, Plant, and Equipment

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

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

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

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

10. Pledges Receivable

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

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

11. Notes Payable and Capital Leases

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

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

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

11. Notes Payable and Capital Leases (continued)

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

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

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

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

12. Bonds

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

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

12. Bonds (continued)

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

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

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

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

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

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

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

12. Bonds (continued)

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

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

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

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

13. Derivative Instruments

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

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

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

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

13. Derivative Instruments (continued)

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

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

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

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

13. Derivative Instruments (continued)

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

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

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

14. Professional and General Liability Insurance

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

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

14. Professional and General Liability Insurance (continued)

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

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

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

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

15. Pensions and Other Postretirement Benefits

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

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

15. Pensions and Other Postretirement Benefits (continued)

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

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

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

16. Income Taxes

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

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

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

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

17. Commitments and Contingent Liabilities

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

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

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

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

17. Commitments and Contingent Liabilities (continued)

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

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

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

18. Endowment

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

Interpretation of Relevant Law

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

18. Endowment (continued)

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

Funds With Deficiencies

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

Return Objectives and Risk Parameters

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

Strategies Employed for Achieving Objectives

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

Spending Policy and How the Investment Objectives Relate to Spending Policy

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

18. Endowment (continued)

Changes in Endowment Net Assets (in thousands)

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

19. Functional Expenses

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

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

20. Special Charges

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

21. Subsequent Events

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

Unaudited Consolidating Balance Sheets

($ in thousands)

	December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	$ 511,102	$ 9,526	$ –	$ 520,628
Patient receivables, net	976,060	109,412	(26,301)	1,059,171
Due from affiliates	4,091	28	(4,119)	–
Investments for current use	–	52,126	–	52,126
Other current assets	313,911	85,292	(2,311)	396,892
Total current assets	1,805,164	256,384	(32,731)	2,028,817
Investments:				
Long-term investments	6,090,613	385,646	–	6,476,259
Funds held by trustees	75,892	–	–	75,892
Assets held for self-insurance	–	128,128	–	128,128
Donor-restricted assets	572,982	39,239	–	612,221
	6,739,487	553,013	–	7,292,500
Property, plant, and equipment, net	3,478,405	1,033,673	–	4,512,078
Other assets:				
Pledges receivable, net	149,889	820	–	150,709
Trusts and interests in foundations	59,069	8,150	–	67,219
Other noncurrent assets	514,693	51,138	(155,824)	410,007
	723,651	60,108	(155,824)	627,935
Total assets	$ 12,746,707	$ 1,903,178	$ (188,555)	$ 14,461,330

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Balance Sheets (continued)

($ in thousands)

	December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Liabilities and net assets				
Current liabilities:				
Accounts payable	$ 398,704	$ 86,033	$ (2,310)	$ 482,427
Compensation and amounts withheld from payroll	289,650	32,843	–	322,493
Current portion of long-term debt	75,918	5,893	(72)	81,739
Variable rate debt classified as current	466,203	60,912	–	527,115
Due to affiliates	28	4,091	(4,119)	–
Other current liabilities	388,183	100,680	(26,302)	462,561
Total current liabilities	1,618,686	290,452	(32,803)	1,876,335
Long-term debt:				
Hospital revenue bonds	2,926,949	–	–	2,926,949
Notes payable and capital leases	121,896	547,127	(152,304)	516,719
	3,048,845	547,127	(152,304)	3,443,668
Other liabilities:				
Professional and general liability insurance reserves	57,290	88,819	–	146,109
Accrued retirement benefits	429,965	48,909	–	478,874
Other noncurrent liabilities	434,093	56,452	–	490,545
	921,348	194,180	–	1,115,528
Total liabilities	5,588,879	1,031,759	(185,107)	6,435,531
Net assets:				
Unrestricted	6,267,797	823,860	(3,448)	7,088,209
Temporarily restricted	597,449	29,977	–	627,426
Permanently restricted	292,582	17,582	–	310,164
Total net assets	7,157,828	871,419	(3,448)	8,025,799
Total liabilities and net assets	$ 12,746,707	$ 1,903,178	$ (188,555)	$ 14,461,330

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Balance Sheets (continued)

($ in thousands)

	December 31, 2015			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	$ 176,869	$ 72,711	$ –	$ 249,580
Patient receivables, net	879,420	94,544	(23,660)	950,304
Due from affiliates	916	40	(956)	–
Investments for current use	–	53,852	–	53,852
Other current assets	343,901	66,682	(2,444)	408,139
Total current assets	1,401,106	287,829	(27,060)	1,661,875
Investments:				
Long-term investments	5,813,363	371,015	–	6,184,378
Funds held by trustees	116,046	9,677	–	125,723
Assets held for self-insurance	–	93,662	–	93,662
Donor-restricted assets	520,474	44,687	–	565,161
	6,449,883	519,041	–	6,968,924
Property, plant, and equipment, net	3,384,312	1,004,355	–	4,388,667
Other assets:				
Pledges receivable, net	140,137	1,331	–	141,468
Trusts and interests in foundations	77,416	9,325	–	86,741
Other noncurrent assets	325,545	81,257	(53,051)	353,751
	543,098	91,913	(53,051)	581,960
Total assets	$ 11,778,399	$ 1,903,138	$ (80,111)	$ 13,601,426

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Balance Sheets (continued)

($ in thousands)

	December 31, 2015			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Liabilities and net assets				
Current liabilities:				
Accounts payable	$ 345,228	$ 69,508	$ (2,177)	$ 412,559
Compensation and amounts withheld from payroll	253,615	42,053	–	295,668
Current portion of long-term debt	84,392	11,302	–	95,694
Variable rate debt classified as current	370,375	148,877	–	519,252
Due to affiliates	27	929	(956)	–
Other current liabilities	379,854	111,115	(23,927)	467,042
Total current liabilities	1,433,491	383,784	(27,060)	1,790,215
Long-term debt:				
Hospital revenue bonds	2,669,251	58,220	–	2,727,471
Notes payable and capital leases	95,327	420,296	(49,603)	466,020
	2,764,578	478,516	(49,603)	3,193,491
Other liabilities:				
Professional and general liability insurance reserves	52,587	87,030	–	139,617
Accrued retirement benefits	426,180	64,573	–	490,753
Other noncurrent liabilities	425,155	53,197	–	478,352
	903,922	204,800	–	1,108,722
Total liabilities	5,101,991	1,067,100	(76,663)	6,092,428
Net assets:				
Unrestricted	5,851,045	779,809	(3,448)	6,627,406
Temporarily restricted	548,408	37,868	–	586,276
Permanently restricted	276,955	18,361	–	295,316
Total net assets	6,676,408	836,038	(3,448)	7,508,998
Total liabilities and net assets	$ 11,778,399	$ 1,903,138	$ (80,111)	$ 13,601,426

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Statements of Operations and Changes in Net Assets

($ in thousands)

Operations

	Three Months Ended December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	$ 1,771,527	$ 256,425	$ (73,143)	$ 1,954,809
Provision for uncollectible accounts	(51,261)	(9,442)	–	(60,703)
Net patient service revenue less provision for uncollectible accounts	1,720,266	246,983	(73,143)	1,894,106
Other	168,900	82,121	(42,647)	208,374
Total unrestricted revenues	1,889,166	329,104	(115,790)	2,102,480
Expenses				
Salaries, wages, and benefits	1,119,879	149,973	(68,437)	1,201,415
Supplies	165,115	28,840	(289)	193,666
Pharmaceuticals	205,534	20,458	–	225,992
Purchased services and other fees	108,195	43,565	(20,991)	130,769
Administrative services	37,716	26,655	(7,879)	56,492
Facilities	70,104	19,522	(1,926)	87,700
Insurance	17,440	9,629	(16,268)	10,801
	1,723,983	298,642	(115,790)	1,906,835
Operating income before interest, depreciation, and amortization expenses	165,183	30,462	–	195,645
Interest	33,733	2,555	–	36,288
Depreciation and amortization	103,078	20,299	–	123,377
Operating income before special charges	28,372	7,608	–	35,980
Special charges	(1)	2,735	–	2,734
Operating income	28,373	4,873	–	33,246
Nonoperating gains and losses				
Investment return	37,706	839	–	38,545
Derivative gains (losses)	45,482	(624)	–	44,858
Other, net	(146)	(437)	–	(583)
Net nonoperating gains (losses)	83,042	(222)	–	82,820
Excess of revenues over expenses	111,415	4,651	–	116,066

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

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

($ in thousands)

Operations

	Three Months Ended December 31, 2015			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	$ 1,724,836	$ 177,942	$ (46,038)	$ 1,856,740
Provision for uncollectible accounts	(27,139)	(8,041)	–	(35,180)
Net patient service revenue less provision for uncollectible accounts	1,697,697	169,901	(46,038)	1,821,560
Other	168,396	70,372	(36,232)	202,536
Total unrestricted revenues	1,866,093	240,273	(82,270)	2,024,096
Expenses				
Salaries, wages, and benefits	959,686	119,914	(55,807)	1,023,793
Supplies	159,354	22,955	(327)	181,982
Pharmaceuticals	191,602	12,487	–	204,089
Purchased services and other fees	102,096	16,241	(2,926)	115,411
Administrative services	45,176	22,546	(8,240)	59,482
Facilities	71,090	15,188	(1,380)	84,898
Insurance	15,204	10,915	(13,590)	12,529
	1,544,208	220,246	(82,270)	1,682,184
Operating income before interest, depreciation, and amortization expenses	321,885	20,027	–	341,912
Interest	29,413	2,060	–	31,473
Depreciation and amortization	92,181	13,556	–	105,737
Operating income before special charges	200,291	4,411	–	204,702
Special charges	8,701	32,226	–	40,927
Operating income (loss)	191,590	(27,815)	–	163,775
Nonoperating gains and losses				
Investment return	60,418	1,563	–	61,981
Derivative gains (losses)	4,367	(411)	–	3,956
Gain on remeasurement of Akron General equity investment	38,777	–	–	38,777
Akron General member substitution	–	242,822	–	242,822
Goodwill impairment loss	–	(63,060)	–	(63,060)
Other, net	1,038	369	–	1,407
Net nonoperating gains	104,600	181,283	–	285,883
Excess of revenues over expenses	296,190	153,468	–	449,658

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

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

($ in thousands)

Change in Net Assets

	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Total net assets at October 1, 2015	$ 6,518,410	$ 495,369	$ (3,447)	$ 7,010,332
Excess of revenues over expenses	296,190	153,468	–	449,658
Donated capital, excluding assets released from restrictions for capital purposes	25	–	–	25
Restricted gifts and bequests	51,985	(1,978)	–	50,007
Restricted net investment income (loss)	4,796	(21)	–	4,775
Net assets released from restrictions used for operations included in other unrestricted revenues	(13,959)	(1,121)	–	(15,080)
Retirement benefits adjustment	27,817	(3,799)	–	24,018
Transfers (to) from affiliates	(208,202)	208,202	–	–
Change in restricted net assets related to interest in foundations	(112)	(33,537)	–	(33,649)
Change in restricted net assets related to value of perpetual trusts	(325)	(124)	–	(449)
Net change in unrealized losses on nontrading investments	(5)	–	–	(5)
Akron General member substitution contribution of restricted net assets	–	31,674	–	31,674
Other	(212)	(12,095)	(1)	(12,308)
Increase in total net assets	157,998	340,669	(1)	498,666
Total net assets at December 31, 2015	$ 6,676,408	$ 836,038	$ (3,448)	$ 7,508,998
Total net assets at October 1, 2016	**$ 7,051,990**	**$ 849,550**	**$ (3,448)**	**$ 7,898,092**
Excess of revenues over expenses	**111,415**	**4,651**	**–**	**116,066**
Donated capital, excluding assets released from restrictions for capital purposes	**(239)**	**–**	**–**	**(239)**
Restricted gifts and bequests	**51,577**	**1,587**		**53,164**
Restricted net investment income	**3,324**	**26**	**–**	**3,350**
Net assets released from restrictions used for operations included in other unrestricted revenues	**(14,107)**	**(1,729)**	**–**	**(15,836)**
Retirement benefits adjustment	**(5,171)**	**(10,954)**	**–**	**(16,125)**
Transfers (to) from affiliates	**(44,364)**	**44,364**	**–**	**–**
Change in restricted net assets related to interest in foundations	**97**	**–**	**–**	**97**
Change in restricted net assets related to value of perpetual trusts	**2,732**	**175**	**–**	**2,907**
Foreign currency translation gain (loss)	**105**	**(16,066)**	**–**	**(15,961)**
Net change in unrealized gains on nontrading investments	**499**	**–**	**–**	**499**
Other	**(30)**	**(185)**	**–**	**(215)**
Increase in total net assets	**105,838**	**21,869**	**–**	**127,707**
Total net assets at December 31, 2016	**$ 7,157,828**	**$ 871,419**	**$ (3,448)**	**$ 8,025,799**

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

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

($ in thousands)

Operations

	Year Ended December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	$ 6,882,932	$ 928,179	$ (260,045)	$ 7,551,066
Provision for uncollectible accounts	(263,790)	(37,904)	–	(301,694)
Net patient service revenue less provision for uncollectible accounts	6,619,142	890,275	(260,045)	7,249,372
Other	641,752	308,593	(162,510)	787,835
Total unrestricted revenues	7,260,894	1,198,868	(422,555)	8,037,207
Expenses				
Salaries, wages, and benefits	4,218,025	589,056	(272,212)	4,534,869
Supplies	644,499	105,605	(1,031)	749,073
Pharmaceuticals	791,670	71,027	–	862,697
Purchased services and other fees	408,293	140,622	(42,808)	506,107
Administrative services	154,624	68,946	(26,612)	196,958
Facilities	276,150	72,148	(4,921)	343,377
Insurance	67,624	74,093	(74,971)	66,746
	6,560,885	1,121,497	(422,555)	7,259,827
Operating income before interest, depreciation, and amortization expenses	700,009	77,371	–	777,380
Interest	126,401	9,704	–	136,105
Depreciation and amortization	402,420	73,885	–	476,305
Operating income (loss) before special charges	171,188	(6,218)	–	164,970
Special charges	968	24,650	–	25,618
Operating income (loss)	170,220	(30,868)	–	139,352
Nonoperating gains and losses				
Investment return	375,676	28,515	–	404,191
Derivative losses	(20,130)	(2,694)	–	(22,824)
Other, net	94	(7,306)	–	(7,212)
Net nonoperating gains	355,640	18,515	–	374,155
Excess (deficiency) of revenues over expenses	525,860	(12,353)	–	513,507

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

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

($ in thousands)

Operations

	Year Ended December 31, 2015			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Unrestricted revenues				
Net patient service revenue	$ 6,557,092	$ 350,239	$ (194,848)	$ 6,712,483
Provision for uncollectible accounts	(216,960)	(14,344)	–	(231,304)
Net patient service revenue less provision for uncollectible accounts	6,340,132	335,895	(194,848)	6,481,179
Other	572,069	238,172	(134,448)	675,793
Total unrestricted revenues	6,912,201	574,067	(329,296)	7,156,972
Expenses				
Salaries, wages, and benefits	3,753,065	276,086	(229,937)	3,799,214
Supplies	611,439	54,397	(990)	664,846
Pharmaceuticals	677,496	23,740	–	701,236
Purchased services and other fees	370,608	40,078	(12,308)	398,378
Administrative services	127,155	74,694	(26,015)	175,834
Facilities	271,167	35,174	(5,689)	300,652
Insurance	59,798	56,626	(54,357)	62,067
	5,870,728	560,795	(329,296)	6,102,227
Operating income before interest, depreciation, and amortization expenses	1,041,473	13,272	–	1,054,745
Interest	120,318	3,823	–	124,141
Depreciation and amortization	380,440	29,013	–	409,453
Operating income (loss) before special charges	540,715	(19,564)	–	521,151
Special charges	8,701	32,226	–	40,927
Operating income (loss)	532,014	(51,790)	–	480,224
Nonoperating gains and losses				
Investment return	(48,924)	(7,404)	–	(56,328)
Derivative losses	(22,325)	(2,685)	–	(25,010)
Gain on remeasurement of Akron General equity investment	38,777	–	–	38,777
Akron General member substitution	–	242,822	–	242,822
Goodwill impairment loss	–	(63,060)	–	(63,060)
Other, net	477	316	–	793
Net nonoperating (losses) gains	(31,995)	169,989	–	137,994
Excess of revenues over expenses	500,019	118,199	–	618,218

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

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

Changes in Net Assets

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

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Statements of Cash Flows

($ in thousands)

	Year Ended December 31, 2016			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Operating activities and net nonoperating gains and losses				
Increase in total net assets	$ 481,420	$ 35,381	$	$ 516,801
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	–	3,925	–	3,925
Retirement benefits adjustment	6,835	10,954	–	17,789
Net realized and unrealized gains on investments	(356,893)	(25,253)	–	(382,146)
Depreciation and amortization	402,420	88,872	–	491,292
Provision for uncollectible accounts	263,790	37,904	–	301,694
Foreign currency translation loss	73	59,108	–	59,181
Donated capital	(724)	(41)	–	(765)
Restricted gifts, bequests, investment income, and other	(119,076)	(4,911)	–	(123,987)
Transfers to (from) affiliates	116,453	(116,453)	–	–
Amortization of bond premiums and debt issuance costs	(1,670)	13	–	(1,657)
Net gain in value of derivatives	(1,954)	(6,881)	–	(8,835)
Changes in operating assets and liabilities:				
Patient receivables	(360,430)	(52,772)	2,641	(410,561)
Other current assets	46,920	(18,837)	3,030	31,113
Other noncurrent assets	(191,171)	29,839	102,773	(58,559)
Accounts payable and other current liabilities	94,448	3,147	(5,671)	91,924
Other liabilities	23,621	(14,693)	–	8,928
Net cash provided by operating activities and net nonoperating gains and losses	404,062	29,302	102,773	536,137
Financing activities				
Proceeds from long-term borrowings	502,370	145,711	(145,633)	502,448
Payments for advance refunding and redemption of long-term debt	–	(148,260)	–	(148,260)
Principal payments on long-term debt	(143,228)	(26,643)	42,860	(127,011)
Debt issuance costs	(949)	–	–	(949)
Change in pledges receivables, trusts and interests in foundations	(11,510)	1,307	–	(10,203)
Restricted gifts, bequests, investment income, and other	119,076	4,911	–	123,987
Net cash provided by (used in) financing activities	465,759	(22,974)	(102,773)	340,012
Investing activities				
Expenditures for property and equipment	(487,936)	(176,767)	–	(664,703)
Proceeds from sale of property and equipment	1,585	–	–	1,585
Net change in cash equivalents reported in long-term investments	91,241	54,823	–	146,064
Purchases of investments	(2,375,754)	(381,917)	–	(2,757,671)
Sales of investments	2,351,802	320,101	–	2,671,903
Transfers (to) from affiliates	(116,453)	116,453		–
Net cash used in investing activities	(535,515)	(67,307)	–	(602,822)
Effect of exchange rate changes on cash	(73)	(2,206)	–	(2,279)
Increase (decrease) in cash and cash equivalents	334,233	(63,185)	–	271,048
Cash and cash equivalents at beginning of year	176,869	72,711	–	249,580
Cash and cash equivalents at end of year	$ 511,102	$ 9,526	$ –	$ 520,628

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Unaudited Consolidating Statements of Cash Flows (continued)

($ in thousands)

	Year Ended December 31, 2015			
	Obligated Group	Non-Obligated Group	Consolidating Adjustments and Eliminations	Consolidated
Operating activities and net nonoperating gains and losses				
Increase in total net assets	$ 402,798	$ 303,705	$	$ 706,503
Adjustments to reconcile increase in total net assets to net cash provided by operating activities and net nonoperating gains and losses:				
Loss on extinguishment of debt	209	–	–	209
Retirement benefits adjustment	(25,546)	3,799	–	(21,747)
Net realized and unrealized losses on investments	87,709	10,107	–	97,816
Depreciation and amortization	380,440	38,450	–	418,890
Provision for uncollectible accounts	216,960	14,344	–	231,304
Gain on change in terms of long-term lease	–	(6,856)	–	(6,856)
Donated capital	(46)	–	–	(46)
Restricted gifts, bequests, investment income, and other	(129,323)	32,941	–	(96,382)
Transfers to (from) affiliates	207,971	(207,971)	–	–
Amortization of bond premiums and debt issuance costs	(2,533)	(19)	–	(2,552)
Net loss (gain) in value of derivatives	57	(615)	–	(558)
Goodwill impairment loss	–	63,060	–	63,060
Gain on remeasurement of Akron General equity investment	(38,777)	–	–	(38,777)
Akron General member substitution contribution	–	(274,496)	–	(274,496)
Changes in operating assets and liabilities:				
Patient receivables	(289,295)	(10,036)	(608)	(299,939)
Other current assets	(37,760)	5,091	(16,101)	(48,770)
Other noncurrent assets	(81,420)	27,953	(24,114)	(77,581)
Accounts payable and other current liabilities	15,025	20,902	(109)	35,818
Other liabilities	(14,922)	11,427	–	(3,495)
Net cash provided by operating activities and net nonoperating gains and losses	691,547	31,786	(40,932)	682,401
Financing activities				
Proceeds from long-term borrowings	–	378,777	(3,777)	375,000
Principal payments on long-term debt	(109,280)	(6,502)	44,709	(71,073)
Debt issuance costs	–	(89)	–	(89)
Change in pledges receivables, trusts and interests in foundations	23,980	39,580	–	63,560
Restricted gifts, bequests, investment income, and other	129,323	(32,941)	–	96,382
Net cash provided by financing activities	44,023	378,825	40,932	463,780
Investing activities				
Expenditures for property and equipment	(380,380)	(73,156)	–	(453,536)
Proceeds from sale of property and equipment	183	987	–	1,170
Cash acquired through member substitution	–	15,367	–	15,367
Acquisition of business, net of cash acquired	–	(420,144)	–	(420,144)
Net change in cash equivalents reported in long-term investments	327,466	(21,891)	–	305,575
Purchases of investments	(2,534,242)	(294,432)	–	(2,828,674)
Sales of investments	2,085,486	327,833	–	2,413,319
Transfers (to) from affiliates	(60,166)	60,166	–	–
Net cash used in investing activities	(561,653)	(405,270)	–	(966,923)
Increase in cash and cash equivalents	173,917	5,341	–	179,258
Cash and cash equivalents at beginning of year	2,952	67,370	–	70,322
Cash and cash equivalents at end of year	$ 176,869	$ 72,711	$ –	$ 249,580

See notes to unaudited consolidated financial statements.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Utilization

The following table provides selected utilization statistics for The Cleveland Clinic Health System:

CLEVELAND CLINIC HEALTH SYSTEM

	Year Ended December 31				
	Actual			Pro Forma[3]	
	2014	2015[4]	2016	2015	2016
Total Staffed Beds[1]	3,565	4,034	3,906	4,034	3,906
Percent Occupancy[1]	67.0%	67.9%	69.2%	67.6%	69.2%
Inpatient Admissions[1]					
Acute	140,596	146,990	161,674	164,254	161,674
Post-acute	11,908	11,779	12,487	13,976	12,487
Total	152,504	158,769	174,161	178,230	174,161
Patient Days[1]					
Acute	746,293	782,316	842,403	856,583	842,403
Post-acute	99,701	98,268	105,554	116,802	105,554
Total	845,994	880,584	947,957	973,385	947,957
Average Length of Stay					
Acute	5.28	5.30	5.21	5.20	5.21
Post-acute	8.38	8.30	8.48	8.32	8.48
Surgical Facility Cases					
Inpatient	55,515	56,311	59,760	60,605	59,760
Outpatient	130,706	137,139	147,850	147,030	147,850
Total	186,221	193,450	207,610	207,635	207,610
Emergency Room Visits	497,631	542,768	652,196	638,123	652,196
Outpatient Observations	49,724	49,237	58,385	55,451	58,385
Outpatient Evaluation and Management Visits[2]	3,508,030	3,742,901	4,194,593	3,742,901	4,194,593
Acute Medicare Case Mix Index - Health System	1.90	1.91	1.93	1.87	1.93
Acute Medicare Case Mix Index - Cleveland Clinic	2.47	2.47	2.53	2.47	2.53
Total Acute Patient Case Mix Index - Health System	1.81	1.81	1.84	1.77	1.84
Total Acute Patient Case Mix Index - Cleveland Clinic	2.37	2.36	2.44	2.36	2.44

(1) Acute and post-acute, including rehabilitative and psychiatric services within post-acute, but excluding newborns and bassinets.
(2) Statistic is calculated based on Cleveland Clinic and Florida.
(3) Pro Forma utilization statistics include Akron General.
(4) Includes Akron General statistics for November and December 2015. The Clinic became the sole member of Akron General on November 1, 2015.

Utilization (continued)

The following table provides selected utilization statistics for the obligated group:

TOTAL OBLIGATED GROUP

	Year Ended December 31		
	2014	**2015**	**2016**
Total Staffed Beds[1]	3,297	3,352	3,283
Percent Occupancy[1]	68.2%	69.6%	69.9%
Inpatient Admissions[1]			
Acute	134,704	138,287	138,741
Post-acute	9,827	9,740	9,487
Total	144,531	148,027	148,228
Patient Days[1]			
Acute	722,977	747,231	742,387
Post-acute	71,989	73,473	76,330
Total	794,966	820,704	818,717
Average Length of Stay			
Acute	5.34	5.38	5.35
Post-acute	7.31	7.50	8.04
Surgical Facility Cases			
Inpatient	53,764	53,839	53,922
Outpatient	127,903	132,800	135,849
Total	181,667	186,639	189,771
Emergency Room Visits	464,981	493,930	535,599
Outpatient Observations	46,409	45,687	50,416
Outpatient Evaluation and Management Visits[2]	3,508,030	3,742,901	4,194,593
Acute Medicare Case Mix Index	1.85	1.89	1.96
Total Acute Patient Case Mix Index	1.76	1.80	1.87

(1) Acute and post-acute, including rehabilitative and psychiatric services within post-acute, but excluding newborns and bassinets.
(2) Statistic is calculated based on Cleveland Clinic and Florida.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Payor Mix

The following table shows payor mix as a percentage of gross patient service revenue for the health system and obligated group as a whole:

CLEVELAND CLINIC HEALTH SYSTEM
Based on Gross Patient Service Revenue

	Year Ended December 31				
	Actual			Pro Forma[1]	
	2014	2015[2]	2016	2015	2016
Payor					
Managed Care and Commercial	43%	42%	39%	41%	39%
Medicare	43%	43%	44%	43%	44%
Medicaid	10%	12%	14%	13%	14%
Self-Pay & Other	4%	3%	3%	3%	3%
Total	100%	100%	100%	100%	100%

OBLIGATED GROUP
Based on Gross Patient Service Revenue

	Year Ended December 31		
	2014	2015	2016
Payor			
Managed Care and Commercial	44%	42%	39%
Medicare	42%	43%	45%
Medicaid	10%	12%	13%
Self-Pay & Other	4%	3%	3%
Total	100%	100%	100%

(1) Pro Forma payor mix includes Akron General.
(2) Includes Akron General payor mix for November and December 2015. The Clinic became the sole member of Akron General on November 1, 2015.

Please refer to Management's Discussion and Analysis for a listing of the hospitals in the Obligated Group.

Research Support

($ in thousands)

The Clinic funds the annual cost of research from external sources, such as federal grants and contracts and contributions restricted for research, and internal sources, such as contributions, endowment earnings and revenue from operations. The following table summarizes the sources of research support for the Clinic:

	Year Ended December 31		
	2014	**2015**	**2016**
External Grants Earned			
Federal Sources	$97,327	$103,022	$108,253
Non-Federal Sources	88,284	81,796	87,883
Total	185,611	184,818	196,136
Internal Support	66,758	63,240	59,326
Total Sources of Support	$252,369	$248,058	$255,462

Key Ratios

The following table provides selected key ratios for the System as a whole:

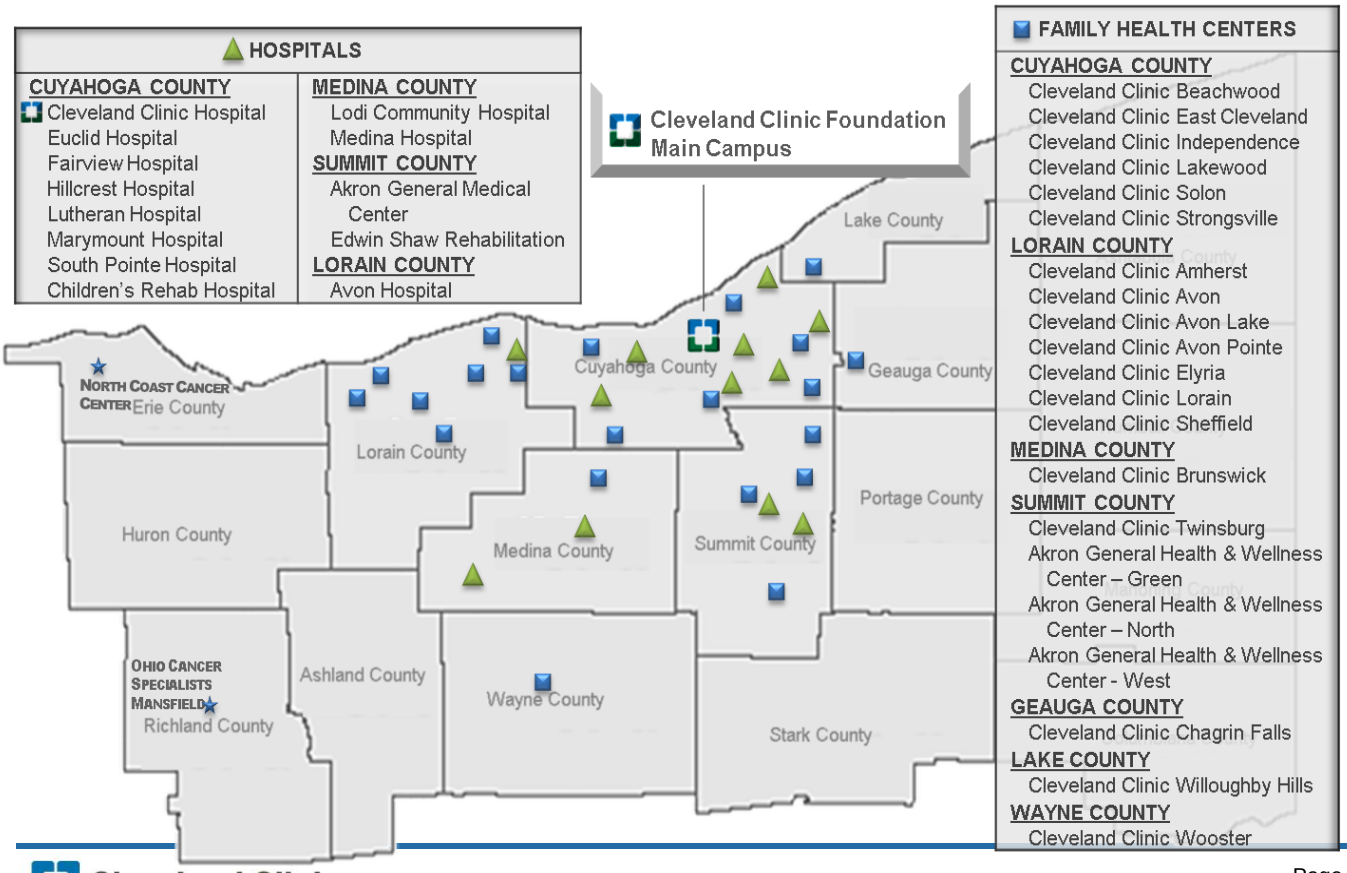
	Year Ended December 31		
	2014	**2015**	**2016**
Liquidity ratios			
Days of cash on hand	377	347	349
Days of revenue in accounts receivable	47	47	51
Coverage ratios			
Cash to debt (%)	177.5	168.9	172.7
Maximum annual debt service coverage (x)	5.6	5.7	3.8
Interest expense coverage (x)	11.2	10.1	7.5
Debt to cash flow (x)	3.0	3.4	4.6
Leverage ratio			
Debt to capitalization (%)	36.1	36.5	36.4
Profitability ratios			
Operating margin (%)	7.0	6.7	1.7
Operating cash flow margin (%)	14.4	14.7	9.7
Excess margin (%)	10.2	8.5	6.1
Return on assets (%)	5.7	4.5	3.6

NOTE:
Certain prior period ratios have been restated to conform to the current presentation.

OVERVIEW

The Cleveland Clinic Health System (System) is a world-renowned provider of healthcare services and attracted patients from across the United States and from 185 other countries in 2016. The System operates 14 hospitals with approximately 3,900 staffed beds and is the leading provider of healthcare services in northeast Ohio. Thirteen of the hospitals are operated in the Northeast Ohio area, anchored by The Cleveland Clinic Foundation (Clinic). The System operates 21 outpatient Family Health Centers, 10 ambulatory surgery centers, as well as numerous physician offices located throughout a seven-county area of northeast Ohio, and specialized cancer centers in Sandusky and Mansfield, Ohio. In addition, the System operates a hospital and a clinic in Weston, Florida, health and wellness centers in West Palm Beach, Florida and Toronto, Canada and a specialized neurological clinical center in Las Vegas, Nevada. Pursuant to agreements, the System also provides management services for Ashtabula County Medical Center, located in Ashtabula, Ohio, with approximately 180 staffed beds, Cleveland Clinic Abu Dhabi, a multispecialty hospital offering critical and acute care services that is part of Mubadala Development Company's network of healthcare facilities located in Abu Dhabi, United Arab Emirates with approximately 250 staffed beds, and, in cooperation with Abu Dhabi Health Services Company, the Sheikh Khalifa Medical City, a network of healthcare facilities in Abu Dhabi, United Arab Emirates with approximately 711 staffed beds.

CLEVELAND CLINIC HEALTH SYSTEM – NORTHEAST OHIO SERVICE AREA AND FACILITIES



The following table sets forth the number of staffed beds for the hospitals operated by the obligated group as well as the other entities in the System as of December 31, 2016:

	Staffed Beds
OBLIGATED	
Cleveland Clinic	1,274
Euclid Hospital	221
Fairview Hospital	451
Hillcrest Hospital	453
Lutheran Hospital	194
Marymount Hospital	226
Medina Hospital	136
South Pointe Hospital	173
Weston Hospital	155
	3,283
NON-OBLIGATED	
Akron General Medical Center	439
Avon Hospital	104
Children's Rehab Hospital	25
Edwin Shaw Rehabilitation Institute	35
Lodi Hospital	20
	623
HEALTH SYSTEM	3,906

AWARDS & RECOGNITION

The Clinic was ranked as the second best hospital in the United States by *U.S. News and World Report* in its 2016-2017 edition of "America's Best Hospitals." This is the eighteenth consecutive year the Clinic was ranked among the top five hospitals in the United States. The Clinic's Heart and Vascular Institute, located on the Clinic's main campus, was recognized as the best cardiology and heart surgery program in the United States, an honor the Clinic has received annually for twenty-two consecutive years. The Clinic was nationally ranked in fourteen specialties, including nine in the top three nationwide, and is one of just twenty hospitals to earn a place on the *U.S. News'* 2016-2017 Honor Roll. The following table summarizes the Clinic's national rankings by medical specialty:

Cleveland Clinic Children's Hospital located on the Clinic's main campus ranked as one of the top pediatric hospitals in the country. The Children's Hospital earned national recognition in nine out of ten medical specialties ranked by *U.S. News and World Report* in its 2016-2017 edition of "Best Children's Hospitals." The following table summarizes the Clinic's national rankings by pediatric specialty:

The publication also evaluated hospitals by state and metropolitan area with a methodology similar to that used to determine the national rankings. The Clinic was ranked as the best hospital in both the state of Ohio and the Cleveland metropolitan area, which includes the City of Cleveland and its surrounding suburbs. The report also ranked two of the System's regional hospitals in the top hospitals in the Cleveland metropolitan area and Ohio: Fairview Hospital ranked third in Cleveland and fourth in Ohio and Hillcrest Hospital ranked fifth in Cleveland and twelfth in Ohio. Akron General Medical Center, located in Summit County, was ranked ninth in the state of Ohio. Weston Hospital was ranked first in the Miami-Fort Lauderdale metro area and fifth out of more than 250 hospitals in the state of Florida.

U.S. News and World Report created a list of the "Most Connected Hospitals" to recognize hospitals whose excellence in patient safety, patient engagement, and clinical connectedness improves patient care. The Clinic, Euclid, Fairview, Hillcrest, Lutheran, South Pointe and Weston hospitals were all included on the 2015-2016 list, which consisted of 159 hospitals nationwide. Selection for the list was based on hospitals' national ranking or high performing recognition on various *U.S News and World Report* lists as well as responses to certain questions from the 2013 and 2014 American Hospital Association Annual Survey Information Technology Supplements.

In 2016, the Clinic was named one of the World's Most Ethical Companies by the Ethisphere Institute for the sixth time in eight years. The award recognizes organizations that promote ethical business standards and practices internally, enable managers and employees to make good choices and shape future industry standards by introducing best practices.

Companies were evaluated in five categories: ethics and compliance programs; corporate citizenship and responsibility; culture of ethics; governance; and leadership, innovation and reputation.

The Clinic and Fairview Hospital received Healthgrades' 2016 Outstanding Patient Experience Award. Recipients of this award were chosen for providing outstanding performance in the delivery of positive experiences for patients based on achievement of clinical quality standards and the highest patient ratings from Hospital Consumer Assessment of Healthcare Providers and Systems (HCAHPS) patient survey scores. Hospitals that received the award were in the top fifteen percent of HCAHPS scores nationally.

Medina Hospital earned the Joint Commission's Gold Seal of Approval for Hospital Accreditation. The hospital underwent an onsite survey during which Joint Commission surveyors evaluated compliance with hospital standards related to several areas, including emergency management, environment of care, infection prevention and control, leadership and medication management. The award represents a symbol of quality that reflects Medina Hospital's commitment to providing safe and effective patient care.

Lutheran Hospital and Medina Hospital both received the Vizient Bernard A. Birnbaum, MD, Quality Leadership Award for excellence in delivering safe, patient-centered care that is timely, effective, efficient, and equitable. In a list of 14 community hospitals recognized with this award, Lutheran placed first, and Medina placed ninth. More than 100 academic medical centers and 124 community hospitals were included in the study, which reviewed performance data from a variety of sources, including Vizient's clinical database, core measures data, the HCAHPS survey and the Center for Disease Control and Prevention's National Healthcare Safety Network.

The Clinic's Center for Continuing Education earned the highest level of accreditation, "Accreditation with Commendation," from the Accreditation Council for Continuing Medical Education, the governing body for continuing medical education providers. This accreditation is reserved for providers that comply with all criteria and accreditation policies. The Center is now accredited through 2021.

The Clinic has been named one of eight participants in a new four-year program of the Accreditation Council for Graduate Medical Education. The "Pursuing Excellence in Clinic Learning Environments" program aims to support and encourage innovation, promote transformative improvement in clinical learning environments and ultimately enhance patient care. The eight participants were chosen from a total of 47 applicants. Organizations were selected for their capacity to engage in transformational change and willingness to fully integrate a culture of learning into the clinical environment.

The Clinic was named an American Medical Group Association's 2016 Acclaim Award honoree. This award recognizes quality improvement efforts that measurably improve health outcomes and quality of life for patients. The Clinic was recognized for continued progress in methods to standardize care and improve patient experience.

The Clinic has been awarded a nearly $5 million grant from the National Institutes of Health that will go towards an in-human clinical trial to assess deep brain stimulation as a therapy for stroke recovery patients. The grant expands the National Institutes of Health's efforts to develop new tools and technologies to understand how

the brain functions and capture a dynamic view of the brain in action.

In December 2016, the Clinic performed its first deep brain stimulation surgery on a patient as part of a stroke recovery clinical trial. During the procedure, electrodes were implanted into the patient's cerebellum. The electrodes provide small electric pulses as a way to help patients recover control of their movements. The electrodes are connected to a pacemaker that allows the patient to be monitored and evaluated to determine how deep brain stimulation can enhance the effects of physical therapy.

The Clinic was recognized by Becker's Healthcare in its 2016 edition of "150 Great Places to Work in Healthcare." Organizations were selected based on factors such as benefit offerings, wellness initiatives, professional development, diversity and inclusion, work-life balance and a sense of community among employees. Becker's Healthcare cited yoga sessions, farmer's markets, on-site health clinics and professional development opportunities as contributors to the Clinic earning this recognition.

The Plain Dealer newspaper recognized the Clinic as one of Northeast Ohio's 100 top workplaces, ranking it fourteenth in the category for large local employers. This list was based on the opinions of employees who responded to a survey about leadership, values, training, work/life balance, compensation and benefits.

The Clinic was recognized for having a positive impact on its employees and the region with a NorthCoast 99 award, an annual recognition program that honors ninety-nine great workplaces in Northeast Ohio based on results from employee surveys. The Clinic has received this recognition eleven times.

The Clinic's CEO and President, Delos M. Cosgrove, M.D., was named the fifth most influential physician executive in the nation by Modern Healthcare in its 2016 list of the fifty most influential physician executives and leaders. The list honors physicians working in the healthcare industry who are recognized by their peers and an expert panel as being influential in terms of demonstrated leadership and impact. Dr. Cosgrove was recognized for his focus on the System's growth.

Dr. Cosgrove ranked 14th in Fortune's annual rankings of the top 50 business leaders of 2016. Fortune weighs several metrics to come up with the list, gauging organizational financial strength as well as nonfinancial elements like business influence, leadership style and strategic initiatives.

Hillcrest Hospital

Mayfield Heights, Ohio

CORPORATE GOVERNANCE

The Board of Directors of the Clinic is responsible for all of its operations and affairs and controls its property. The Board of Directors is also responsible for ensuring that the Clinic is organized, and at all times operated, consistent with its charitable mission and its status as an Ohio nonprofit corporation and tax-exempt charitable organization. The Board of Directors generally meets eight times per year, including an annual meeting during which the Clinic's officers are elected and standing committees are appointed. The size of the Board of Directors can range between 15 to 25 Directors (currently there are 22 Directors). The Board of Trustees serves as an advisor to the Board of Directors. The Trustees actively serve on the committees of the Board of Directors. At present, there are 69 active Trustees and 12 Emeritus Trustees (not including Directors). Directors and Trustees each serve four-year terms and are selected on the basis of their expertise and experience in a variety of areas beneficial to the Clinic. Directors and Trustees are not compensated for their service.

The Board of Directors annually appoints certain committees to perform duties that it delegates to them from time to time, subject to ratification of such action by the Board of Directors. The current committees are as follows:

Members of the Committees are chosen based on the interests and skills of individual Board members and the needs of the particular Committee. Most Committees meet three or four times per year, though a few (such as the Audit Committee) meet five or six times per year.

The Clinic and its regional hospitals maintain a governance model for the regional hospitals that provides for regional hospital representation on the Clinic's Board of Directors while also maintaining separate boards of trustees for each hospital. The regional hospital boards meet quarterly and, among other topics, provide local input on quality and patient safety and community health needs.

APPOINTMENTS

Linda McHugh was appointed Chief Human Resources Officer, succeeding Joe Cabral, who resigned in February 2016. Ms. McHugh previously served as the Executive Administrator for the Office of the CEO and Assistant Secretary for the Clinic since 2005. She served as part of the strategy team and played a role in advancing initiatives and programs that have resulted in operational efficiencies across the System.

Brian J. Harte, MD was appointed President of Cleveland Clinic Akron General and the Southern Region. Dr. Harte most recently served as President of Hillcrest Hospital and previously served as president of South Pointe Hospital. He also currently serves as the President of the Society of Hospital Medicine and is an associate professor of medicine in the Cleveland Clinic Lerner College of Medicine of Case Western Reserve University.

Richard D. Parker, MD has been appointed President of Hillcrest Hospital effective April 2017. Dr. Parker will also take on the additional role of President of the Eastern Region. Dr. Parker most recently served as President of Marymount Hospital and previously served as Chairman of Orthopedic Surgery. With a practice dedicated to sports medicine and arthroscopic knee surgery, Dr. Parker is a national and international expert in orthopedic surgery. He has more than 150 publications in peer-reviewed journals and is a professor of surgery in the Cleveland Clinic Lerner College of Medicine of Case Western Reserve University.

Medina General Hospital
Medina, Ohio

LAKEWOOD HOSPITAL ASSOCIATION

The Lakewood Hospital Association (LHA) is a non-obligated affiliate of the System. The Clinic, LHA and the City of Lakewood entered into an agreement in December 2015 that outlines the transition of healthcare services in the City of Lakewood and how the Clinic can be a leader in meeting those healthcare needs. Participation in the agreement by the City of Lakewood was authorized by an ordinance adopted by Lakewood City Council. Under the terms of the agreement, the Clinic and LHA will make contributions over the next 17 years for the creation of a new health and wellness community foundation to be used to address community health and wellness needs in the City of Lakewood. In addition, the Clinic will construct, own and operate an approximately 65,000-square-foot family health center expected to open in 2018 that will be located adjacent to the current site of the hospital. LHA ceased inpatient operations at the hospital in February 2016, while the emergency department and several outpatient services at the hospital will continue until the opening of the new family health center and emergency department. The Lakewood Hospital site is currently leased by LHA from the City of Lakewood, and clinical services at that location are operated by the Clinic since the cessation of inpatient operations. The lease has been amended and is expected to terminate approximately thirty days after the opening of the family health center and emergency department. The Clinic has provided every Lakewood Hospital employee who wants a job with an employment opportunity within the System or at one of its partner organizations.

Prior to the signing of the agreement, a lawsuit was filed against the Clinic, LHA, the City of Lakewood and others (Defendants) by a few Lakewood residents (Plaintiffs) seeking to stop the closure of the hospital and money damages. To date, the court has denied the Plaintiffs' Motion for a Temporary Restraining Order. The Plaintiffs' Motion for a Preliminary Injunction is still pending. The Defendants jointly filed Motions to Dismiss the lawsuit. In November 2015, Lakewood voters defeated a proposed charter amendment that would have required voter approval on any Lakewood City Council ordinance that would have caused the hospital to no longer be a full time and full service hospital. As a result of duly signed petitions, a referendum vote to repeal the ordinance occurred in November 2016. The results upheld the ordinance adopted by Lakewood City Council.

EXPANSION AND IMPROVEMENT PROJECTS

Due to the anticipated long-term growth in the demand for services and the desire to continually upgrade medical facilities, the System is investing in buildings, equipment and technology to better serve its patients.

In November 2016, the System opened Avon Hospital (named "The Roseann Park Family Tower"), a new hospital located adjacent to the existing Family Health Center in Avon. Avon Hospital is an approximately 221,500 square foot five-story facility with capacity for 126 beds. The facility includes an intensive care unit, a cardiac catheterization lab, and expanded surgical and emergency services. The facility has been designed to leverage the latest in wireless capabilities and serve as a test site for evaluating future advancements in patient care. The cost of the new facility was approximately $160 million,

and construction took over two years to complete.

In March 2017, the System opened a new cancer outpatient building on the Clinic's main campus that unites multidisciplinary surgical, medical, and support services of the Cleveland Clinic Taussig Cancer Institute in one facility. The new building is adjacent to the Crile Outpatient Building and across from the Tomsich Pathology Laboratories Building. The 377,000 square foot, seven-story building houses 126 exam rooms, 98 infusion bays, 6 linear accelerators, 7 procedure rooms, a Gamma Knife suite and other cancer support functions. The building was designed to improve the patient experience by allowing natural light in the infusion bays and other treatment areas and helping patients receive treatment more quickly, efficiently and effectively. The cost of the new building was approximately $276 million, and construction took over two years to complete.

With the anticipated increase in patient services provided by the new cancer outpatient building, the System opened a 3,000 space structured parking garage in November 2016 located on the southeast corner of the main campus. The garage is exclusively for employees, allowing current employee parking to be designated for patients and visitors. A pedestrian bridge will connect the garage to the Clinic's facilities. The garage and connecting bridge are expected to cost approximately $49 million. The pedestrian bridge is expected to be completed in the second quarter of 2017.

The System also has the following expansion and improvement projects currently in progress:

Radiology Master Plan - This multi-year, five-phase renovation and construction plan is aimed at fulfilling the growth needs of the Department of Radiology within the Imaging Institute. The project will consolidate and centralize magnetic resonance (MR) services for the Clinic in the Glickman Tower located on the Clinic's main campus. The project also includes the renovation of vacated molecular functional imaging space into a new Computed Tomography (CT) department including sub-waiting, prep, changing, and hydration. Additionally, the plan allows for a new outpatient entrance to the Department of Radiology and enhanced patient waiting and changing areas. Phase 1A of the project, the Interventional MR Surgical Suite, began in 2009 and was completed in 2010. The Suite combines high-field MR imaging with a surgical suite, which allows surgeons to take advantage of MR imaging in real time during surgical procedures. Phase 1B, the consolidation of MR services in the Glickman Tower, began in the fourth quarter 2010 and was completed in July 2011. Phase 2, the consolidation of CT services, was completed in the third quarter of 2013. Phase 3, the relocation and upgrade of the Interventional Radiology Department, began in the third quarter of 2013 and was completed in the first quarter of 2015. Phase 4 began in the fourth quarter of 2015, and phase 5 began in the fourth quarter of 2016. These phases include thirty hard-walled and ten curtained holding rooms, a preparation and recovery area with 20 bed spaces that opened in July, a newly renovated ultrasound department that includes adult and pediatric scanning that opened in October, a state of the art myelogram room, gastrointestinal department and general diagnostic departments with sub-waiting and changing areas. The entire project is expected to be completed in 2018 with a total estimated cost of approximately $86 million.

Enterprise Administrative Patient Management - The System is currently in the midst of a multi-year project to align revenue cycle support services and processes to support patients as they progress through their continuum of care. The Enterprise Administrative Patient Management (EAPM) project will consolidate thirteen different technology systems used for scheduling appointments, admissions, electronic medical records, billing and collections into one technology platform with the goal of improving patient experiences. Reducing the number of systems will improve patient service and employee efficiency. Implementation of EAPM began in the first quarter of 2012 at the System facilities in Weston, Florida. The Clinic's main campus and family health centers implemented EAPM in the first quarter of 2016. Implementation will continue in phases for the other System hospitals over the next several years and is expected to cost approximately $191 million over the entire implementation period.

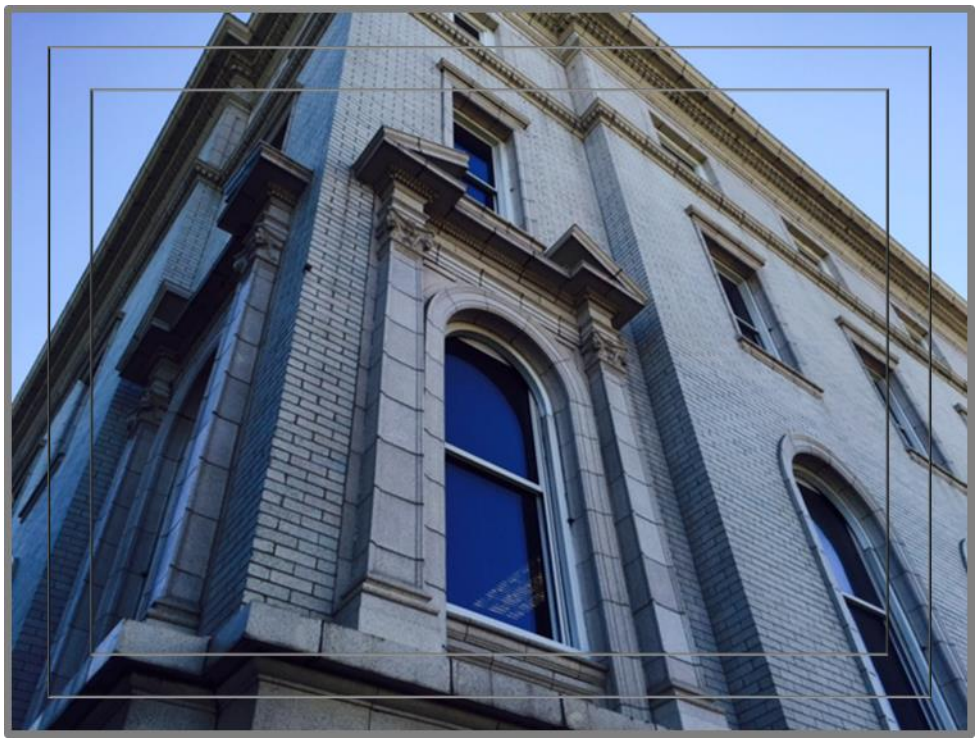
Weston Hospital Expansion – In 2015, the System started design on expansion of Weston Hospital. The expansion will include a new tower hosting a 40-bed emergency department, a 24-bed observation unit, 26 acute care beds and 48 intensive care beds, including 23 relocated from the existing hospital. The new tower will also include a shelled floor for future expansion. To support this growth, significant renovation and backfill is planned to increase the size of existing imaging, laboratory, pharmacy, sterile processing and food services. A new endoscopy suite and three new operating rooms are also included in the renovation and backfill. The project includes a new central utility plant and new surface parking to support the campus expansion. The project is expected to cost approximately $230 million and be completed in late 2018.

Coral Springs Family Health Center and Surgery Center - Cleveland Clinic Florida is expecting to expand its services in a new Family Health Center and Surgery Center that will be built on land previously purchased in Coral Springs, Florida. Coral Springs is approximately twenty miles northeast of the Weston campus. This new 74,000 square foot facility will accommodate approximately forty exam rooms, four operating rooms with shell space for two additional operating rooms in the future, two endoscopy rooms and imaging services. The full scope and cost for the facility have not been finalized. Design began in the second quarter of 2016, and construction is projected to be completed in the second quarter of 2018.

Akron General Emergency Department – In 2015, Akron General Medical Center began site preparations for a two-story, 73,000 square foot emergency department that will triple the size of the current space. The first floor will house the emergency department, and the second floor will contain administrative offices and potential space for expansion. The facility will have eight triage rooms and 39 treatment rooms for patients, including six high-acuity trauma rooms, an area designated for patients seeking treatment for sexual assault, an expanded behavioral health unit, an imaging department, a separate urgent care area, and an area for quarantining and treating highly contagious patients. The facility is expected to cost approximately $49 million. Construction of the building began in the first quarter of 2017 and is expected to be completed in third quarter of 2018.

Lakewood Family Health Center – In January 2016, the Clinic started design of a new approximately 65,000 square foot, three story family health center in Lakewood on a site adjacent to the recently closed Lakewood Hospital. The facility will have an emergency department located on the first floor with 16 treatment rooms. On the second and third floors, the facility will have 60 exam rooms. There will also be lab and imaging services to support operations at the facility. The facility is projected to cost approximately $36 million and is scheduled to open in the third quarter of 2018.

Health Education Campus - In the second quarter of 2013, the Clinic and Case Western Reserve University (CWRU) School of Medicine reached an agreement to build a health education campus that will contain CWRU's medical school program and the Cleveland Clinic Lerner College of Medicine. The campus includes a facility that will be located on the Clinic's main campus and will serve as home for the seminar, lecture, and laboratory curriculum taught during the first two years of medical school. Students' clinical training will continue to take place at area hospitals. This initiative is aligned with the future plans of the Clinic's main campus and supports the Clinic's mission and strategic direction. The facility will also house the CWRU Nursing School and School of Dental Medicine. The facility is designed to encourage extensive interaction and collaboration among the professions. Construction of the facility broke ground on October 1, 2015 and is expected to take approximately four years to complete. CWRU and the Clinic will share in the construction costs of approximately $453 million and the ongoing operational costs of the facility, with a portion of the construction costs expected to be raised through fundraising efforts and donations. Plans also include a separate dental clinic that will be adjacent to the medical school facility. The dental clinic is expected to open at the same time as the medical school.



Cleveland Clinic's original building, built in 1921

PHILANTHROPY CAMPAIGN

The Clinic publicly launched "The Power of Every One" philanthropic campaign in June 2014 with a goal of raising $2 billion by the Clinic's 100th anniversary in 2021. The campaign will enable the Clinic to transform patient care, promote health, advance research and innovation, train caregivers and revitalize facilities through new construction and renovation of existing buildings. As of December 31, 2016, the Clinic has raised almost $1.1 billion toward the goal.

The $2 billion campaign is divided into four categories: promoting health ($800 million), advancing discovery ($700 million), training caregivers ($400 million) and transforming care ($100 million). Promoting health will focus on improving patient experience and supporting construction and renovation projects, including the new Avon Hospital, new cancer and neurology buildings at the Clinic, renovation of the Taussig Cancer Institute building, new facilities in Florida and other building projects at regional hospitals and family health centers. Training caregivers will support scholarships, training programs and the construction of the new health education campus, a collaboration with CWRU. Advancing discovery will support translational, basic science and clinical research as well as endowed chairs. Transforming care will support the development of new care delivery models, personalized therapies and information technology.

INNOVATIONS

Cleveland Clinic Innovations promotes scientific, clinical and administrative creativity throughout the System and seeks commercial application of the products of that creativity. Specifically, it helps to grow the Clinic's innovative capacity, mentors inventors, licenses technology, secures resources, and establishes spin-off companies and strategic collaborations with corporate partners. Since 2000, Cleveland Clinic Innovations has launched 77 companies, transacted more than 500 technology licenses, filed over 3,600 patent applications with over 1,200 issued patents, and acted on approximately 3,800 new inventions.

Cleveland Clinic Innovations operates a 50,000-square-foot Global Cardiovascular Innovation Center (GCIC) on the Clinic's main campus, which is home to its operations, as well as an incubator facility for approximately 30 companies.

Cleveland Clinic Innovations manages the "Healthcare Innovations Alliance", a collaborative network of healthcare systems, academic institutions and industry partners from around the nation. Alliance partners utilize the Clinic's comprehensive technology and commercialization experience to turn medical ideas into marketable inventions and commercial ventures. The integration of capabilities between organizations is focused on discovery, development and rapid deployment of new technologies with the goal of improving patient care.

In January 2016, through the efforts of Cleveland Clinic Innovations, spin-off Tatara Vascular LLC received 510(k) approval from the Food and Drug Administration (FDA) to market a coronary guidewire invented by Patrick Whitlow, MD from the Heart & Vascular Institute. The approval marks the first time Cleveland Clinic Innovations

has facilitated FDA approval to market a technology in its portfolio.

In June 2016, Cleveland Clinic Innovations executed a license with a national patient experience services company to distribute and implement the Clinic's Communicate with H.E.A.R.T.® program to hospitals looking to improve their patient experience. The program, created and launched at the Clinic in 2010, has played a significant role in transforming the Clinic's culture to utilize patient centric approaches in care and service interactions.

Funded by the State of Ohio, and managed by Cleveland Clinic Innovations, the GCIC concluded its 16th Commercialization Funding Program selection process in August 2016 making project development awards to three Ohio-based companies totaling $1.2 million. Since inception in 2007, the program has funded a total of 51 projects totaling $21 million to companies that have created over 1,060 jobs in Ohio and secured over $1 billion in follow-on funding.

In October 2016, the Ohio Third Frontier Commission awarded $500,000 to the Clinic to create a Technology Validation and Start-up Fund, which will help the Clinic Innovations demonstrate the commercial viability of technologies through activities such as testing and prototyping.

Cleveland Clinic Innovations hosts an annual Medical Innovation Summit for industry leaders, investors, and entrepreneurs looking to expand their understanding of the healthcare market and the future of medical innovation. The 14th Annual Medical Innovation Summit was held in October 2016 with over 2,250 attendees to discuss investable innovations in the context of healthcare's historic transformation. Vice President Joe Biden kicked off the three-day summit with a speech about the Cancer Moonshot and the critical need to give hope and time to cancer patients with new treatments and innovations. Other keynote addresses were delivered by Joe Almeida, Chairman & CEO of Baxter; Omar Ishrak, Chairman & CEO of Medtronic; Ian Read, Chairman & CEO of Pfizer; and Mike Musallem, Chairman & CEO of Edwards Lifesciences.

The Summit also unveiled the Top 10 Medical Innovations of 2017, which highlighted the potential for medical breakthroughs in the coming year. Products that harness the power of the microbiome to prevent and treat disease were ranked as the number one innovation by a distinguished panel of Clinic doctors and researchers.

CLINICAL AFFILIATIONS

The Clinic has entered into various affiliations with national and regional partners that are seeking to improve clinical quality, patient care, medical education and research. The goal of clinical affiliations is to provide value-added, high quality clinical care to patients through the support, expansion and development of Institute-driven integrated care strategies. In addition, the Clinic has partnered with educational institutions with the goal of improving medical education and research.

In April 2016, the Clinic's Sydell and Arnold Miller Family Heart and Vascular Institute entered into an affiliation with Froedtert & the Medical College of Wisconsin Froedtert Hospital in Milwaukee, Wisconsin. The two organizations will remain independent but share best practices in patient care, outcomes measurement, quality reporting

and clinical research. Physician teams from both entities will collaborate to accelerate advances in heart care treatments and protocols.

In August 2016, the Clinic's Endocrinology and Metabolism Institute entered into an affiliation with the National Diabetes and Obesity Research Institute (NDORI) to enhance diabetes and obesity related research and discover better treatment protocols. This is the first affiliation for the Clinic's Endocrinology and Metabolism Institute. NDORI was founded in 2015 by a group of health care, education and business leaders in Mississippi with the hopes of finding a cure for diabetes. NDORI will be part of a 150-acre learning medical city located in Tradition, Mississippi. Once the affiliation is fully implemented, NDORI patients will have greater access to better practices related diabetes and obesity treatments.

In August 2016, the Clinic's Taussig Cancer Institute entered into an affiliation with ProMedica Health System in Toledo, Ohio. The affiliation is expected to expand access to highly-specialized cancer treatments, clinical expertise and research studies for patients in northwest Ohio and southeast Michigan, including a process that allows patients to get second opinion consults with Clinic cancer specialists. The first year of the affiliation will focus on sharing quality metrics, protocols, clinical pathways and best practices between the organizations as well as identifying opportunities to collaborate on clinical research and provide expanded education and training.

STRATEGIC ALLIANCES

In April 2016, the Clinic announced a partnership with CVS, a national drugstore chain that offers MinuteClinics. MinuteClinics treat common family ailments in addition to performing various health screenings, pregnancy tests, suture removal and vaccinations. With the new partnership, a MinuteClinic patient who needs further consultation can access a primary care practitioner from the Clinic within five to ten minutes during working hours via "telemedicine" or "telehealth." Examples of telemedicine include primary care by videoconference, as well as remote monitoring of patients via wearable technology and providing medical education to practitioners. CVS and the Clinic are working with American Well, one of the nation's largest telehealth companies, to provide the technology that will be used in MinuteClinics.

In December 2016, the Clinic entered into a five year agreement with IBM to expand its health information technology capabilities. The goal of the agreement is to establish a model for a health system transition to value-based care and population health and to uncover potential standards that could be replicated by providers nationwide. The agreement will expand the Clinic's use of IBM's secured cloud, social, mobile, and Watson cognitive computing technologies across clinical and administrative operations.

JOINT VENTURE

Under a joint venture agreement with Select Medical, the Cleveland Clinic Rehabilitation Hospital opened in December 2015 in Avon, Ohio. Select Medical is the nation's largest provider of post-acute care services and has partnerships with academic medical centers

around the country. The Clinic is a minority member in the joint venture. The new 68,000 square foot facility has 60 beds and features private rooms and the latest rehabilitation equipment to care for patients with stroke, spinal cord injury, brain injury, and a variety of medical and surgical conditions. The facility expands inpatient rehabilitation services in Northeast Ohio and improves access for patients with complex rehabilitation needs. The hospital will also serve as a primary teaching site for a new residency program for physicians in physical medicine and rehabilitation.

In March 2016, the Clinic and Select Medical announced a proposal to build two new rehabilitation facilities in Northeast Ohio - one in Bath Township and one in the City of Beachwood. Each facility is expected to have 60 beds and open in late 2017.

In July 2016, the Clinic entered into a joint venture agreement with Select Medical to operate four long-term acute care (LTAC) facilities in northeast Ohio with a total of 230 beds. The Clinic is a minority member in the joint venture. The joint venture expands the current existing relationship with Select Medical and is expected to combine the experience of both organizations in the treatment of LTAC patients.

AKRON GENERAL HEALTH SYSTEM

In November 2015, the System became the sole member of Akron General Health System (Akron General), an integrated healthcare delivery system with a 532-registered bed flagship medical center located in Akron, Ohio. In addition to the flagship medical center, Akron General also includes Lodi Community Hospital, Edwin Shaw Rehabilitation Institute, three health and wellness centers, Visiting Nurse Services and affiliates, a physician group practice and other outpatient locations. The System previously had a 35% special membership interest in Akron General pursuant to an affiliation agreement effective in September 2014 that included a $100 million capital investment in Akron General. An option to take full ownership of Akron General was exercised after the one-year anniversary of the affiliation agreement due to the successful collaboration that had occurred between the Clinic and Akron General on a number of initiatives. These initiatives resulted in clinical expansion, cost savings, and best practice sharing. The full member substitution became effective following review of the transaction by the Ohio Attorney General and the Federal Trade Commission. As part of the member substitution agreement, the Clinic and Akron General have committed to additional funding for the capital expenditure needs to support Akron General's capital plan for the next five years. Future initiatives include a new emergency department at Akron General Medical Center, two new outpatient centers in the surrounding Akron area and replacement of Akron General's electronic medical records system to enhance safety, quality, and patient experience and reduce the overall cost of care.

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

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

In addition, as a large community hospital, Akron General in the normal course has received information or identified issues regarding various billing, coding and related compliance matters. However, aside from the matters described in the paragraph above, Akron General is not aware of any current matters that would have a material impact on its business or operations.

INTERNATIONAL GROWTH

In October 2015, the Clinic through a subsidiary acquired all of the share capital of 33 Grosvenor Place Limited (Grosvenor Place). Grosvenor Place is a limited liability company existing under Luxembourg law and a private company incorporated under Jersey law that has a long-term leasehold interest in a six-story 198,000 square-foot building in London, England. The Clinic has established a plan to convert the building from office space to a 205-bed hospital with eight operating theatres. The System received approval from local authorities in January 2017 to begin conversion of the building into an advanced healthcare facility. The facility was fully vacated in the first quarter of 2017.

In addition to the London project, the System internationally operates a health and wellness center in Toronto, Canada and provides management services to two hospitals in Abu Dhabi.

Sheikh Khalifa Medical City (SKMC)
Managed by Cleveland Clinic
Abu Dhabi

STRATEGY

The U.S. healthcare industry is undergoing unprecedented change with the intersection of economic pressure, insurance reform, technological breakthroughs, and demographic shifts. At the center of this change is an accelerating shift in reimbursement models from volume- to value-based and/or risk-based payment. Maximizing attributed lives where patients bring an entirely new level of consumerism is of paramount importance in this emerging environment. The System is well engaged in this shift with nearly 500,000 lives from Northeast Ohio and Florida under some form of risk-based contract in 2017. Naturally, this dynamic landscape has and continues to influence how the System shapes its path forward.

The System has set forth a strategy to embrace these fundamental shifts and position the organization for continued leadership and success in meeting its mission and goals in a vastly changing environment. The strategy focuses on the principle of Patients First and contains the following themes designed to transform value and provide for continued growth:

- Continue to thrive as a global referral center for the most complex care
- Master community-based care in a framework of population management
- Innovate medical education to prepare the next generation who are relevant to the changing environment
- Leverage and extend the unique assets and capabilities of the System to grow and diversify the revenue base and to solidify connectivity with other referral sources

The organization has been pursuing a roadmap of transformation referred to as the Strategic Agenda. The Strategic Agenda calls for fundamental changes in the System's care, operating and business models over several years. The specific roadmap is guided by the strategy and five overarching goals:

Patients First	– continuously improve quality, safety and patient experience
Caregivers	– make the System the best place to work
Affordability	– steward resources
Growth	– responsibly develop to sustain the Clinic's mission
Impact	– make a difference through research, education and innovation

The centerpiece of the Strategic Agenda is a set of key performance indicators and priority initiatives established by leadership and formalized in a strategic agenda management (SAM) system. The purpose of the SAM is to enable leadership to systematically translate the strategy and goals to the priority work of the enterprise. The goal of the SAM is that every clinical and non-clinical area and every individual caregiver will work to align their respective efforts and initiatives to the organization's highest priorities.

In parallel with efforts to transform the care model, the System is redefining its relationships with payors/employers and the payment system to match the broader industry trend toward risk-shifting and redesigned payment. The goal of

Lou Ruvo Center for Brain Health
Las Vegas, Nevada

these efforts is to better deliver to the changing demands of payors/employers, while preserving the financial security of the system during the transition. This involves increased forms of risk-taking in payor contracts (from pay-for-value to bundled payment to shared savings) and narrow network arrangements with payor partners.

As a major element of delivering value, an important thread through all of the priority initiatives of the clinical enterprise is care affordability – reducing the cost structure so that the System can be price competitive and render care more affordable for patients. In 2013, the System commissioned a Care Affordability Task Force to perform an enterprise-wide cost structure analysis and propose recommendations for transformational cost and efficiency opportunities. The organization is mobilized to systematically scrutinize its use of resources in all clinical, operational and administrative areas. This work is expected to be an ongoing effort year over year.

The System's caregivers continue to identify and pursue ways to improve on every dimension of the organization's performance: relentless pursuit of quality and safety, how care is organized and delivered, how research and education are effectuated, and how the organization's value is conveyed to the market. The System is committed to a path not only to respond to the changes in the environment, but also to lead the field with novel approaches that preserve excellence in care while offering sustainable models for others to adopt.

COMMUNITY BENEFIT AND ECONOMIC IMPACT

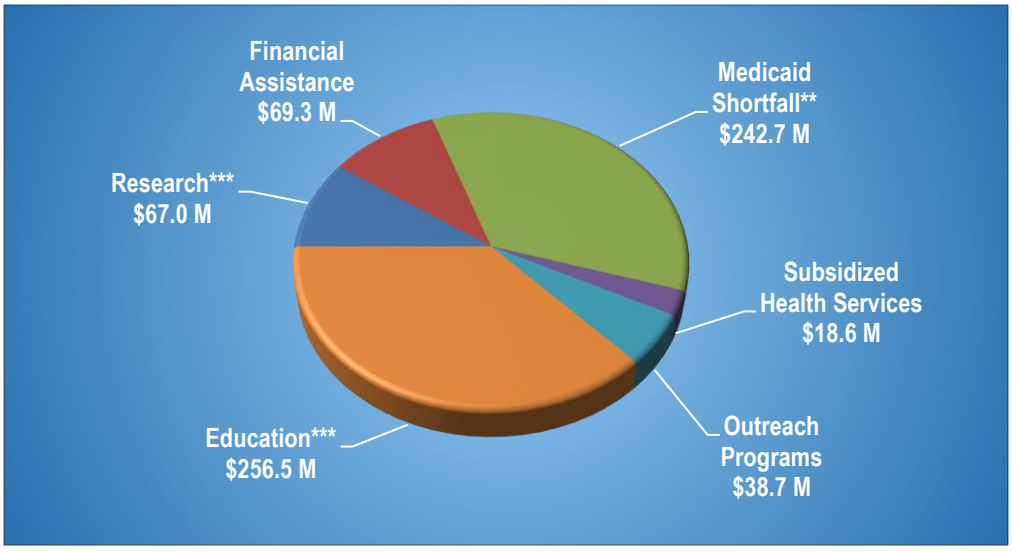
Community Benefit

The Clinic and its hospital affiliates within the System are comprised of charitable, tax-exempt healthcare organizations. The System's mission includes addressing health service needs and providing benefits to the communities it serves. The tax-exempt members of the System must satisfy a community benefit standard to maintain tax-exempt status. Community benefit reporting for the System conforms to Internal Revenue Service requirements.

Community benefit includes activities or programs that improve access to health services, enhance public health, advance generalizable knowledge and relieve government burden. The primary categories for assessing community benefit include financial assistance, Medicaid shortfall, subsidized health services, outreach programs, education and research.

In 2015, the System provided $692.8 million in benefits to the communities it serves. Community benefit information for 2016 was not available at the time of issuance of this Management Discussion and Analysis. The following chart summarizes community benefits for the System:

Cleveland Clinic Health System*
Breakdown of Community Benefit (2015)
$692.8 Million



* Includes all System operations in Ohio, Florida and Nevada, and includes Akron General for the full year of 2015
** Net of Hospital Care Assurance Program benefit of $12.3 million
*** Research and Education are reported net of externally sponsored funding of $144.3 million.

Financial Assistance: Financial Assistance represents the cost of providing free or discounted medically necessary care to patients unable to pay some or all of their medical bills. The System's financial assistance policy provides free or discounted care to uninsured patients with incomes up to 400 percent of the federal poverty level and who meet certain other eligibility criteria by state. This policy covers both hospital care and services provided by the System's employed physicians. As a result of the Affordable Care Act implementation, which requires individuals to obtain healthcare insurance, nonprofit hospitals across the United States saw an increase of individuals covered by Medicaid or health exchange policies. With more persons covered under such programs, there was a decline in the number of patients seeking financial assistance.

Medicaid Shortfall: The System is a leading provider of Medicaid services in Ohio. The Medicaid program provides healthcare coverage for low-income families and individuals and is funded by both the state and federal governments. Medicaid shortfall represents the difference between the costs of providing care to Medicaid beneficiaries and the reimbursement received by the System. Due primarily to the effects of Medicaid expansion in Ohio, the System is providing more Medicaid services to more patients, which has increased the System's Medicaid shortfall in 2015.

Subsidized Health Services: Subsidized health services yield low or negative margins, but these programs are needed in the community. Subsidized health services provided in the System include pediatric programs, psychiatric/behavioral health programs, obstetrical services, chronic disease management and outpatient clinics.

Outreach Programs: The System is actively engaged in a broad array of community outreach programs, including numerous initiatives designed to serve vulnerable and at-risk populations in the community. Outreach programs typically fall into three categories: community health services; cash and in-kind donations; and community building. The System's outreach programs include wellness initiatives, chronic disease management, clinical services, free health screenings, and enrollment assistance for government funded health programs. A few of the System's community outreach initiatives are highlighted below:

- The System provided no-cost clinical care to under- and uninsured families at community sites. For example, the Langston Hughes Health and Education Center, a Fairfax neighborhood site, provided multigenerational prevention and wellness services.
- Health fairs provided thousands of people with free screenings for diabetes, cholesterol, heart disease, and prostate and various cancers. The Cleveland Clinic Minority Men's Health Fair, Celebrating Sisterhood, Tu Familia and dozens of other community health fairs educated community members on the benefits of preventive healthcare.
- Community education classes were offered across the enterprise on chronic disease management in the areas of heart disease, stroke, cancer, diabetes and brain health.
- Wellness initiatives and health lectures were provided to schools, faith-based organizations and community centers in the areas of prevention and behavioral change, including smoking cessation, weight management, teen parenting, family violence and child safety.

- Physical education, training and concussion awareness were provided to high school students by the Clinic's Orthopaedic and Rheumatology Institute. The Pediatric Mobile Unit provided wellness services to local elementary schools.
- The Clinic's Robert J. Tomsich Pathology & Laboratory Medicine Institute donated services to The Free Clinic and Care Alliance, Cleveland area safety-net providers.

Education: The System provides a wide range of high-quality medical education, including accredited training programs for residents, physicians, nurses and other allied health professionals. The System maintains one of the largest graduate medical education programs in the nation. At the postgraduate level, the System's Center of Continuing Education has developed one of the largest and most diverse continuing medical education programs in the world. The System also operates Cleveland Clinic Lerner College of Medicine of Case Western Reserve University, dedicated to the teaching of physician-scientists.

Research: From a community benefit perspective, medical research includes basic, clinical and community health research, as well as studies on healthcare delivery. Community benefits include research activities supported by government and foundation sources; corporate and other grants are excluded from community benefits. The System uses internal funding to cover shortfalls in outside resources for research.

Additional information regarding the System's community benefits is available on the Clinic's website (www.clevelandclinic.org/communitybenefit).

Community Health Needs Assessment

In 2016, the System completed comprehensive community health needs assessments (CHNA) for each of the hospitals in the System that are required to complete an assessment. Internal Revenue Code Section 501(r)(3) requires nonprofit hospital organizations to conduct a CHNA every three years and adopt an implementation strategy to identify the community health needs the hospital will address.

To obtain an in-depth understanding of the community risk indicators, population trends and healthcare needs, the System has gathered and will gather various data, including:

- demographic and health statistical data;
- information on socio-economic barriers to care, including income, culture, language, education, insurance and housing;
- national, state and local disease prevalence;
- health behavior; and
- medical research and health professional education.

Information has and will be gathered from persons representing the broad interests of the community, including those with special knowledge or expertise in public health.

Key 2016 CHNA needs identified throughout the System include:

- chronic disease management (heart disease, cancer, diabetes, asthma, obesity);
- health conditions (mental health, poor birth outcomes, aging)
- wellness (nutrition, exercise, tobacco cessation, preventative care);
- access to affordable health care;
- education (physician shortage, community education); and
- medical research.

Hospital implementation strategies that address the health needs identified in the assessments are currently being developed by individual hospital leadership teams with completion scheduled by the second quarter of 2017. The CHNA reports and implementation strategies for the System hospitals are available on the Clinic's website (www.clevelandclinic.org/CHNAReports).

Economic Impact

According to the System's Economic and Fiscal Impact Report released in 2015, the System is the largest employer in Northeast Ohio and the second largest employer in the State of Ohio. In 2013 the System generated $12.6 billion of the total economic activity in Ohio and has directly and indirectly supported more than 93,000 jobs generating approximately $5.9 billion in wages and earnings. The System's economic activity was accountable for $811 million in total state and local taxes. System-supported households spent almost $4 billion on goods and services. Locally, the System's economic activity within an eight-county region accounted for approximately $757 million of purchased good and services from Northeast Ohio vendors. Visitors to the System's Northeast Ohio facilities spent close to $191 million on hotels, food and other expenses. As a major part of the region's healthcare industry, the System has contributed to the strengthening of Ohio's economy by sustaining a strong workforce and supporting businesses and professional services across the state.

The System's Economic and Fiscal Impact Report is the result of an economic analysis completed by the Silverlode Consulting Corp. The most recent report was commissioned in 2014 and used 2013 data, the most current data available at that time. The report was completed in part using the IMPLAN® economic impact model, which is used by more than 1,000 universities and government agencies to estimate economic and fiscal impacts.

SUSTAINABILITY

The System supports healthy environments for healthy communities, recognizes the link between environmental and human health and strives to responsibly address and mitigate its environmental impacts. As a national leader in healthcare, the System is in a position to lead by example in the adoption of environmental best practices. With a built environment portfolio of more than 22 million square feet and more than 51,000 caregivers,

the impact of the System on the community and ecosystem, both positive and negative, is substantial.

The System's Office for a Healthy Environment (OHE) acknowledges its obligation and opportunity to minimize the health impacts of climate change. The System is working to enhance the resilience of its facilities and communities, engaging its stakeholders to personalize climate action and embedding sustainability into its healthcare delivery model.

As a leader in the healthcare industry, the System has publically committed to compiling an annual sustainability report for its patients, caregivers, communities and global stakeholders through two leading international frameworks: The United Nations Global Compact and the Global Reporting Initiative. The compilation, titled "Serving Our Present, Caring for Our Future," includes performance metrics and stories, highlights accomplishments and communicates challenges as the System strives to reach its goals. The complete report is available on the Clinic's website (www.clevelandclinic.org/ungc).

The Clinic is a member of Practice Greenhealth (PGH), the nation's leading health care community that empowers its members to increase their efficiencies and environmental stewardship while improving patient safety and care through tools, best practices and knowledge. In 2016, the Clinic was awarded the prestigious "Greening the OR" environmental achievement award offered by Practice Greenhealth. This award is given to only one healthcare system in the country for its performance in energy efficiency, materials efficiency and recycling in the operating room. The Clinic also won two Top 25 Environmental Excellence Awards for Best of Sustainability in Health Care designation at the Clinic and Marymount Hospital. The Top 25 Environmental Excellence Awards recognize health care facilities that exemplify environmental excellence and are setting the highest standards for environmental practices in health care. Award winners are chosen from hospitals that have the highest scores using Practice Greenhealth's thorough scoring and evaluation system. The System was honored with twenty-seven additional Practice Greenhealth Environmental Excellence Awards for outstanding performance in health care sustainability, including the System for Change Award, two Emerald Awards for Euclid Hospital and Strongsville Family Health Center, Circles of Excellence in Sustainability Leadership, Environmentally Preferred Purchasing, Chemicals, Greening the OR, Green Building and Climate.

In April 2016, the Clinic received the Environmental Protection Agency's Energy Star Partner of the Year award for its leadership in energy demand reduction and environmental health promotion. This award was granted to less than 1% of the 16,000 participants, and only two organizations in the healthcare industry received this award in 2016.

In July 2016, the Clinic joined Solar.Clinic, a program that will help health care systems to use solar energy and offer solar energy to their employees, patients, and community members with the goal of reducing the environmental impact of practicing medicine. The program is newly launched by Geostellar, an online solar marketplace that provides an online support system for distributing and deploying solar energy.

In December 2016, the Clinic and Marymount Hospital were included on a list of 50 of the greenest Hospitals in America compiled by *Becker's Hospital Review*. The list recognizes hospitals for their leadership in sustainability and energy management. A number of factors were considered for the recognition, including sustainability efforts and commitment to the

Healthier Hospitals Initiative as well as awards received from the Environmental Protection Agency, U.S. Green Building Council and Practice Greenhealth.

The System's energy program is designed to enhance patient outcomes and the patient experience while reducing operating expenses. As the model of healthcare evolves, the System is committed to reducing environmental, economic and human impact by reducing energy intensity. The System's commitments to both affordable care and external partnerships with ENERGY STAR and the Better Buildings Challenge have created goals of becoming 20% more energy efficient by 2020 from a 2010 baseline on more than 20 million square feet of facilities. Initiatives include a combination of critical energy efficiency projects and broad occupant education and engagement campaigns. From the December 2010 baseline, the System has realized a 13% reduction in weather normalized source energy use intensity for in-scope and reportable facilities.

In May 2016, the Clinic announced the establishment of a $7.5 million Green Revolving Fund (GRF), which is the largest established fund of its kind in the healthcare industry and one of the largest in any business sector nationally. GRF funds invest in energy efficiency projects to reduce energy consumption. Savings achieved from reduced energy consumption and any rebates received are tracked and used to replenish the GRF fund to invest in future projects. The establishment of the GRF fund is part of the Sustainable Endowments Institute's Billion Dollar Green Challenge. The challenge encourages colleges, universities and other nonprofit institutions to invest in self-managed green revolving funds. The Clinic's GRF fund will help drive the Clinic's continued commitment to energy conservation and overall sustainability, including the goals set forth by the Better Buildings Challenge.

A central component of the Systems' ongoing commitment to responsible energy management is to construct buildings that conform to the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED). LEED is a third-party certification program and the nationally accepted benchmark for design, construction and operation of environmentally responsible and energy-efficient buildings. All new major construction projects for the System follow LEED standards, with a goal of achieving silver certification. Construction projects also emphasize recycling of debris, with current diversion rates of up to 98% in recent years.

The System currently has fifteen LEED-certified buildings, with additional buildings pending certification. The System has four buildings that are certified LEED-Gold, including the Global Cardiovascular Innovations Center, Marymount Hospital Surgical Expansion, Twinsburg Health and Family Surgery Center and the Tomsich Pathology Laboratories building. Additionally, the System has seven buildings that are certified LEED-Silver.

DIVERSITY

The System provides healthcare services to patients and families from a global community. This makes diversity, inclusion and cultural competence a critical part of the System's mission. In 2006, the System created the Office of Diversity and Inclusion (Diversity). Diversity's mission is to provide strategic direction that builds cultural competence,

cultivates an inclusive organization, promotes health equity, develops talent, and supports caregivers to better serve our patients. Its programs include cultural competence training, diversity councils, employee resource groups, language enrichment, and internal and externally focused pipeline development programs.

The System was awarded the American Hospital Association's Equity of Care Award for 2016. Presented annually, this recognition honors hospital systems that have achieved a high level of success in reducing healthcare disparities while promoting diversity throughout the organization. Also in 2016, the System was ranked number two on the list of the country's top ten healthcare organizations for diversity management practices by DiversityInc. The System has made this list for the seventh consecutive year. Rankings are empirically driven and assess performance based on a number of factors including CEO commitment, equitable talent development, talent pipeline and supplier diversity.

The System received the 2016 Leader in LGBT Healthcare Equality recognition. This recognition is based on the Healthcare Equality Index, which is a benchmarking tool that evaluates healthcare facilities for equity and inclusion of lesbian, gay, bisexual and transgender patients, visitors and employees. This is the second consecutive year that the System has received this recognition.

Three of the System's Employee Resource Groups (ERGs) were ranked among the top 25 nationwide by the Association of ERGs & Councils. The African American ERG placed 1st, ClinicPride placed 12th, and SALUD placed 22nd. ERGs are in place to increase the awareness of the patients' diverse healthcare needs, make our system more culturally competent, and give caregivers the opportunity to network with others from similar backgrounds and receive exposure to career development opportunities.

HEALTH INFORMATION TECHNOLOGY

The System is a national leader in the innovative application of health information technology (HIT) systems. Through the development and application of HIT systems, the System is focusing on providing more cost effective healthcare and improving patient safety. HIT systems have received particular attention due to the Health Information Technology for Economic and Clinical Health Act, a part of the American Recovery and Reinvestment Act of 2009 (Recovery Act).

In 2011, the Centers for Medicare & Medicaid Services (CMS) implemented provisions of the Recovery Act that provide annual incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The objectives and clinical quality measures are implemented in stages with increasing requirements for participation. CMS announced Stage 2 electronic health record meaningful use requirements in 2012, which added new objectives and increased the threshold for many of the objectives in Stage 1. In order to be reimbursed, System hospitals are required to meet Stage 2 meaningful use requirements. Further, modifications to the Stage 2 meaningful use requirements were established in 2015.

Currently, all of the System's acute care hospitals meet the Medicare meaningful use

standards for attestation for modified Stage 2. Additionally, all of the System's acute care hospitals meet the Medicaid meaningful use standards for attestation for Stage 2 except for Weston Hospital, which currently does not qualify to participate in the Medicaid EHR incentive program. Cleveland Clinic Children's Hospital for Rehabilitation, a non-acute hospital located near the main campus, also meets the Medicaid meaningful use standards for attestation for modified Stage 2. Edwin Shaw Hospital is a post-acute inpatient rehabilitation facility that does not qualify for meaningful use incentive payments.

Incentive payments for hospitals are subject to retrospective adjustments after the submission of annual cost reports and audits thereof by the Medicare Administrative Contractor. Under meaningful use, annual incentive payments for Medicare and Medicaid are reduced for hospitals and providers in each subsequent year of attestation and are completely phased-out within four to six years of the initial attestation year.

The System utilizes a grant accounting model to recognize EHR incentive revenues. Under this model, the System records EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The System recorded EHR incentive revenues of $4.3 million for the twelve months ended December 31, 2016 and has recorded a total of $144 million since the inception of the program. Throughout the program, the System is expected to receive approximately $146 million in EHR incentive payments.

The System continues to implement improvements to its HIT systems, including several components that can be accessed through the Clinic's website. These components include:

- An electronic medical record system composed of an integrated suite of software modules that virtually align physical locations, physician expertise and nursing and care team skills into a single, coordinated group practice.
- A secure, on-line health management tool that connects patients to portions of their personalized health information.
- A secure, on-line system that allows physicians in private practice to become clinically integrated with the System to treat their patients.

The System participates in the Care Everywhere network, a module offered through Epic Systems Corp. that allows health systems to safely and directly share electronic medical records (EMRs). Through this program, the System has access to hundreds of healthcare organizations nationwide. The System has exchanged over 6 million patient records with more than 870 hospitals, 1,090 emergency rooms, and 24,000 clinics to assist with treating patients in all fifty states across the country since the beginning of 2015. This is believed to have improved patient care by immediately providing more complete medical histories, eliminating the need for unnecessary diagnostic tests, allowing for faster and more accurate diagnosis and aiding in criteria required for Stage 2 meaningful use standards. The System collaborates with both local and national hospitals and health systems to link EMRs via Epic. Since 2013, the System engaged with ClinicSync, Ohio's statewide electronic medical records exchange. Participation in CliniSync links the System to a significant number of hospitals and physician practices across Ohio.

To further broaden its interoperability capabilities, the System has also engaged with Surescripts, a health information service provider that connects the System to over 200,000 providers across the nation via DIRECT messaging. The System is also connected to eHealth Exchange, the national health exchange hub. This connection was implemented in the summer of 2014 and has allowed the System to exchange data with the Social Security Administration.

In 2015, the System connected its electronic medical system, MyPractice, to the Veterans' Administration (VA) electronic medical record system. The connection to the VA has had over 600 exchanges since implementation. This data exchange allows medical information of veteran patients to be securely shared and improves provider-to-provider communication between the Clinic and the VA.

CONFLICT OF INTEREST

The System maintains policies that require internal reporting of outside financial and fiduciary interests to ensure that potential conflicts of interests do not inappropriately influence research, patient care, education, business or professional decision making. In connection with these policies, the System developed the Innovation Management and Conflict of Interest Program, which is designed to promote innovation while at the same time reducing, eliminating or managing real or perceived bias either due to System personnel consulting with pharmaceutical, medical device and diagnostic companies (industry) or the commercialization efforts undertaken by the System to develop discoveries and make them accessible to patients. The Program works with investigators who interact with industry to manage any conflicts. Provisions related to whether or not "compelling circumstances" are required to justify conducting research in the presence of related financial interests have been modified in policies that went into effect in 2013, consistent with the value the System places on beneficial relationships with industry. The System is committed to a process that maintains integrity in innovation and places the interests of our patients first.

The Innovation Management and Conflict of Interest Program reviews situations in which a physician prescribes or uses products of a company in their practice and has a financial relationship with that company. When appropriate, the Program will put management in place to address any conflict (for example, by disclosure). The goal of this policy is not to interfere with the practice of medicine.

An initiative to bring transparency to the System's relationships with industry was implemented in 2008, in which the specific types of interactions that individual physicians and scientists have with industry were disclosed on publicly-accessible web pages on the System's internet site. Information can be accessed by patients that describes the training, type of practice and accomplishments of a specific doctor or scientist, as well as the names of companies with which the doctor has financial or fiduciary relations as an inventor, consultant, speaker or board member. These disclosures are updated regularly. The System was the first academic medical center in the country to have made these interactions public. Many other academic medical centers have followed the System's lead by providing similar disclosures.

The System maintains a Conflict of Interest in Education Policy to reflect its values and represent its and its Staff's best interests. This policy is responsive to guidelines from the Association of American Medical Colleges, the Institute of Medicine and other organizations. It places restrictions on outside speaking activities that are not Accreditation Council for Continuing Medical Education approved and are generally considered marketing. Speakers must present content that is data-driven and balanced; speakers must create their own slides or use only unbranded slides created by industry. This policy puts the System in step with other top academic medical centers that have already banned speaker's bureaus. In addition, the policy requires instructors to disclose relevant financial interests with companies to trainees.

The Innovation Management and Conflict of Interest Committee of the System has also established processes with cross-membership and seamless interactions and communications with the Board of Directors' Conflict of Interest and Managing Innovations Committee.

Board members of the Clinic and the regional hospitals in the System are required to complete annual disclosure questionnaires each year. These questionnaires are designed to identify possible conflicts of interest that may exist and ensure that any such conflicts do not inappropriately influence the operations of the System. The information obtained from these questionnaires is used to respond to the related-party transactions and other disclosures required by the Internal Revenue Service on Form 990. The Forms 990 for the Clinic and the System are available on the Clinic's website, as well as additional information regarding the Clinic's Board of Directors and any business relationships the Directors may have with the System.

ENTERPRISE RISK MANAGEMENT

In 2010 the System began a multi-phase enterprise risk management (ERM) initiative to develop a more formal systematic approach to the identification, assessment, prioritization, and reporting of risks. The process is closely linked with the System's strategic and annual planning. The ultimate objective is to create an enterprise-wide risk management model that contains sustainable reporting and monitoring processes and embeds risk management into the System's culture, in order to more effectively mitigate risks. The System established an ERM Steering Committee and engaged a consulting firm to support this process.

In the ERM process, risk identification is conducted resulting in a System risk profile that categorizes individual risks based on their impact upon the System's ability to meet its strategic objectives. During this process, certain risks are identified as top risks and then further separated into sub-risks and individual risk components. Extensive risk assessments and mitigation analysis are prepared during this process whereby risk components are evaluated according to their likelihood of occurring and potential impact should they occur. Risk mitigation activities, including risk response effectiveness, are examined, reviewed and updated as part of this evaluation. The most recent comprehensive evaluation of top risks was concluded in the third quarter of 2016. ERM is an on-going program, with regular reporting to senior management, including the Audit Committee of the Board of Directors, the body with oversight responsibility for ERM.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The System regularly evaluates its internal control environment over the System's financial reporting processes through an initiative based upon concepts established in the Sarbanes-Oxley Act of 2002. The goals of the initiative are to ensure the integrity and reliability of financial information, strengthen internal control in the reporting process, reduce the risk of fraud and improve efficiencies in the financial reporting process. The initiative reviews all aspects of the financial reporting process, identifies potential risks and ensures that they have been mitigated utilizing a management self-assessment process. As a result of this initiative, management completed a certification of its internal controls over financial reporting as part of the issuance of its audited consolidated financial results for 2016, which is the eighth year the certification process was completed. The certification included 125 members of management, including top leadership. The System is one of the first not-for-profit hospitals to issue a management report on the effectiveness of internal controls over financial reporting, a step that further increases the transparency of the organization. Management updates the certification on a quarterly basis.

INDUSTRY OUTLOOK

In December 2016, Moody's Investor Services (Moody's) maintained its stable outlook for the U.S. not-for-profit healthcare sector, an outlook Moody's revised from negative to stable in August 2015. Moody's expects operating cash flow growth of 0%-1% and patient volume growth of about 1%, which will help offset pressure from rising drug costs, pension liabilities and employment expenses. Hospitals are also experiencing rising co-pays and deductibles in employee health plans that is increasing bad debt. Moody's also notes that hospital mergers, acquisitions and affiliations will remain prevalent and can drive volume growth. In March 2017, Moody's released an opinion that the legislation released by the U.S. House of Representatives to repeal and alter aspects of the Affordable Care Act will mostly likely be credit negative for hospitals. The components of the legislation mostly likely to have a negative impact include the Medicaid expansion freeze in 2020, transition of federal Medicaid payments to a per-capita payment to the states and changes to how subsidies are calculated for people who buy coverage on the exchanges.

In January 2017, Standard & Poor's (S&P) maintained its stable outlook for the U.S. not-for-profit healthcare sector, despite seeing a sharp rise in legislative risk due to the potential repeal of the Affordable Care Act and related consequences and other aspects of the health care delivery system. S&P revised its outlook from negative to stable in September 2015. S&P indicated that 2015 financial medians and 2016 ratings and outlook experience continue to support their outlook for sector stability.

The System continues to be impacted by industry challenges that put pressure on the System's financial performance. Management is focused on the recruitment and retention of qualified staff in many clinical areas in order to meet the demands of patient activity, particularly as the Affordable Care Act health insurance mandates and Medicaid expansion programs have been

implemented that have increased the number of insured Americans seeking healthcare services. These efforts pressure the System's salary cost structure, as well as employee benefit costs. Pharmaceutical costs and medical supply costs continue to create challenges to the cost structure. Increases in pharmaceutical costs are driven by utilization, price increases and the specialized nature of many pharmaceuticals used in oncology and hematology. Medical supply costs are primarily driven by utilization and price of implants. For both pharmaceuticals and medical supplies, a sizeable percentage of the cost increase flows through to increases in payments from payors; however, the balance cannot be passed through to payors. Additionally, the healthcare industry is subject to significant regulation by federal, state, and local governmental agencies and independent organizations and accrediting bodies, changes in technology and treatment modes, competition and changes in third-party reimbursement programs. The decline in the population of the Greater Cleveland area, as noted in recent estimates based on the most current census, creates challenges among hospitals to attract patients. Furthermore, although the System maintains a diversified investment portfolio, the System's investments are subject to the inherent risk and volatility associated with global financial markets. The System continuously monitors the environment in which it operates and is engaged in various strategic initiatives to address its cost structure and reimbursement challenges to make healthcare affordable to patients.

Beachwood Family Health Center
Beachwood, Ohio

PATIENT VOLUMES

The following table summarizes patient volumes for the System on a pro forma basis including Akron General for all periods presented:

Utilization Statistics

	For the quarter ended December 31				For the twelve months ended December 31			
	2016	2015	Variance	%	2016	2015	Variance	%
Inpatient admissions[(1)]								
Acute admissions	40,437	41,124	-687	-1.7%	161,674	164,254	-2,580	-1.6%
Post-acute admissions	3,041	3,268	-227	-6.9%	12,487	13,976	-1,489	-10.7%
	43,478	44,392	-914	-2.1%	174,161	178,230	-4,069	-2.3%
Patient days[(1)]								
Acute patient days	208,939	214,660	-5,721	-2.7%	842,403	856,583	-14,180	-1.7%
Post-acute patient days	26,245	27,393	-1,148	-4.2%	105,554	116,802	-11,248	-9.6%
	235,184	242,053	-6,869	-2.8%	947,957	973,385	-25,428	-2.6%
Surgical cases								
Inpatient	14,766	14,985	-219	-1.5%	59,760	60,605	-845	-1.4%
Outpatient	37,004	37,932	-928	-2.4%	147,850	147,030	820	0.6%
	51,770	52,917	-1,147	-2.2%	207,610	207,635	-25	0.0%
Emergency department visits	160,372	160,092	280	0.2%	652,196	638,123	14,073	2.2%
Observations	15,116	12,936	2,180	16.9%	58,385	55,451	2,934	5.3%
Clinic outpatient evaluation and management visits	1,052,094	960,413	91,681	9.5%	4,194,593	3,742,901	451,692	12.1%

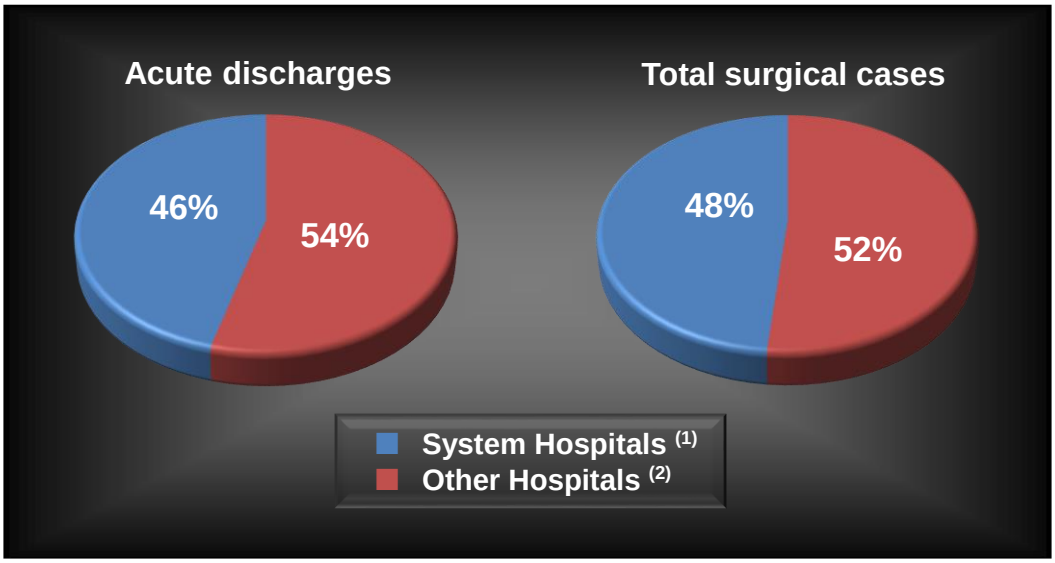
[(1)] Excludes newborns

Proforma inpatient acute admissions for the System decreased 2% in 2016 compared to 2015. In 2016, the Clinic experienced a 3% decrease in acute admissions, and the regional hospitals, which include Akron General, collectively experienced a 1% decrease in acute admissions. The Florida facilities experienced a 1% increase in acute admissions over the same time period.

Proforma post-acute admissions for the System decreased 11% in 2016 compared to 2015. The decrease was primarily due to the cessation of inpatient services at Lakewood Hospital.

Proforma total surgical cases for the System were flat in 2016 compared to 2015. For 2016, total surgical cases were flat at the Clinic's main campus and family health centers, decreased 1% at the regional hospitals collectively, and increased 3% at the Florida facilities compared to 2015. The surgical mix of proforma total surgical cases for the System for 2016 was 29% inpatient and 71% outpatient, which represents a slight shift from inpatient to outpatient compared to the surgical mix in 2015.

The following charts summarize selected statistical information for Northeast Ohio hospitals for the year ended December 31, 2016:



Source: The Center for Health Affairs Volume Statistics

(1) "System Hospitals" excludes Florida and Akron General facilities and includes Ashtabula County Medical Center.
(2) "Other Hospitals" includes all other hospitals in northeast Ohio reported by the Center for Health Affairs that are not included in System hospitals.

LIQUIDITY

Cash and Investments

The System's objectives for its investment portfolio are to target returns over the long-term that exceed the System's capital costs so as to optimize its asset/liability mix and preserve and enhance its strong financial structure. The asset allocation of the portfolio is broadly diversified across global equity and global fixed income asset classes and alternative investment strategies and is designed to maximize the probability of achieving the long-term investment objectives at an appropriate level of risk while maintaining a level of liquidity to meet the needs of ongoing portfolio management. This allocation is formalized into a strategic policy benchmark that guides the management of the portfolio and provides a standard to use in evaluating the portfolio's performance.

Investments are primarily maintained in a master trust fund administered using a bank as trustee. The management of the majority of the System's investments is conducted by numerous external investment management organizations that are monitored by management and an external third-party advisor. The System has established formal investment policies that support the System's investment objectives and provides an appropriate balance between return and risk.

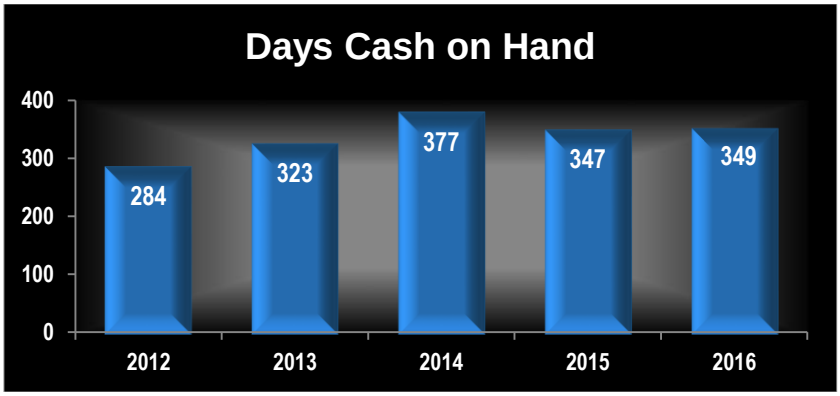
The following table sets forth the allocation of the System's cash and investments at December 31, 2016 and December 31, 2015:

Cash and Investments
(Dollars in thousands)

	December 31, 2016		December 31, 2015	
Cash and cash equivalents	$ 687,410	9%	$ 562,406	8%
Fixed income securities*	2,109,524	27%	1,909,853	26%
Marketable equity securities*	2,785,380	35%	2,503,913	34%
Alternative investments	2,282,940	29%	2,296,184	32%
Total cash and investments	$ 7,865,254	100%	$ 7,272,356	100%
Less restricted investments**	(868,367)		(838,398)	
Unrestricted cash and investments	$ 6,996,887		$ 6,433,958	
Days cash on hand	349		347	

* Fixed income securities and marketable equity securities include mutual funds and commingled investment funds within each investment allocation category.
** Restricted investments include funds held by trustees, assets held for self-insurance and donor restricted assets.

The following chart summarizes days cash on hand for the System at December 31 for the last five years (operating expenses in the days cash on hand calculation for 2016 excludes $104.1 million net periodic pension expense that will be retrospectively reclassified on the statement of operations when the System adopts the provisions of Accounting Standards Update 2017-07 in the first quarter of 2017):



At December 31, 2016, total cash and investments for the System (including restricted investments) were $7.865 billion, an increase of $593 million from $7.272 billion at December 31, 2015. Cash inflows consist of cash provided by operating activities and related investment income of $918 million, a net increase in restricted gifts and income of $113 million, and net proceeds from the issuance of short-term and long-term borrowings of $353 million. Cash inflows were offset by net capital expenditures of $664 million and scheduled principal payments on debt of $127 million.

Included in the System's cash and investments are investments held for self-insurance. These investments totaled $180.3 million at December 31, 2016, with an asset mix of 17% cash and short-term investments, 42% fixed-income securities, 28% equity investments and 13% alternative investments. The asset mix reflects the need for liquidity and the objective to maintain stable returns utilizing a lower tolerance for risk and volatility consistent with insurance regulatory requirements.

Also included in the System's cash and investments at December 31, 2016 are $75.9 million of funds held by trustees. Funds held by trustees include $75.6 million of posted collateral related to the System's derivative contracts. The derivative contracts require that collateral be posted when the market value of a contract in a liability position exceeds a certain threshold. The collateral is returned as the liability is reduced. Investment objectives of funds held by the trustees are designed to preserve principal by investing in highly liquid cash or fixed-income investments. At December 31, 2016, the asset mix of funds held by trustees was <1% cash and short-term investments and >99% fixed-income securities.

The System invests in alternative investments to increase the portfolio's diversification. Alternative investments are primarily limited partnerships that invest in marketable securities, privately held securities, real estate, and derivative products and are reported using the equity method of accounting based on information provided by the respective partnership.

Alternative investments at December 31, 2016 and December 31, 2015 consist of the following:

Alternative Investments
(Dollars in thousands)

	December 31, 2016		December 31, 2015	
Hedge funds	$ 1,134,136	50%	$ 1,350,427	59%
Private equity/venture capital	696,786	30%	541,009	24%
Real estate	452,018	20%	404,748	17%
Total alternative investments	$ 2,282,940	100%	$ 2,296,184	100%

Alternative investments have varying degrees of liquidity and are generally less liquid than the traditional equity and fixed income classes of investments. Over time, investors may earn a premium return in exchange for this lack of liquidity. Hedge funds typically contain redeemable interests and offer the most liquidity of the alternative investment classes. These investment funds permit holders periodic opportunities to redeem interests at frequencies that can range from daily to annually, subject to lock-up provisions that are generally imposed upon initial investment in the fund. It is common, however, that a small portion (5-10%) of withdrawal proceeds are held back from distribution pending the fund's annual audit, which can be up to a year away. Private equity, venture capital, and real estate funds typically have non-redeemable partnership interests. Due to the inherent illiquidity of the underlying investments, the funds generally contain lock-up provisions that prohibit redemptions during the fund's life. Distributions from the funds are received as the underlying investments in the fund are liquidated. These investments have an initial subscription period, under which commitments are made to contribute a specified amount of capital as called for by the general partner of the fund. The System periodically reviews unfunded commitments to ensure adequate liquidity exists to fulfill anticipated contributions to alternative investments.

Investment Return

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

The System's long-term investment portfolio, which excludes assets held for self-insurance, reported investment losses of 0.1% for the fourth quarter of 2016, which is higher than the portfolio's benchmark loss of 0.6% and lower than investment gains of 1.2% experienced in the fourth quarter of 2015. For the full year of 2016, the System experienced investment gains of 5.7%, which is lower than the portfolio's benchmark gain of 6.5% and higher than the investment losses of 0.6% experienced for the full year of 2015.

Total investment return for the System is comprised of the following:

Investment Return
(Dollars in thousands)

	For the quarter ended December 31		For the year ended December 31	
	2016	2015	2016	2015
Other unrestricted revenue:				
Interest income and dividends	$ 612	$ 390	$ 2,750	$ 2,123
Nonoperating gains and losses, net:				
Interest income and dividends	18,353	13,249	61,430	49,851
Net realized gains on sales of investments	21,220	34,975	157,358	156,710
Net change in unrealized gains (losses) on investments	(49,913)	11,104	100,079	(314,771)
Equity method income on alternative investments	52,999	7,712	104,184	69,600
Investment management fees	(4,114)	(5,059)	(18,860)	(17,718)
	38,545	61,981	404,191	(56,328)
Other changes in net assets:				
Net change in unrealized gains (losses) on nontrading investments	499	(5)	320	(4,947)
Investment income (loss) on restricted investments	3,350	4,775	24,451	(732)
Total investment return	$ 43,006	$ 67,141	$431,712	$ (59,884)

Pension Investments

In 2014, the System updated its investment strategy and modified the allocation of pension plan investments in the CCHS Retirement Plan (Plan), the System's primary defined benefit pension plan. The Plan ceased benefit accruals for substantially all employees as of December 31, 2009, and ceased benefit accruals for remaining employees at various intervals through December 31, 2012. As of December 31, 2016, the Plan had investments of $1.2 billion, which was 88% of the projected benefit obligation. Coincident with the updated investment strategy, the System reduced the asset allocation for common and preferred stocks with a corresponding increase in fixed income securities. The updated investment strategy was implemented because of the funded status of the Plan and the anticipation that such changes in investment strategy will result in lower volatility of future changes in funded status. Once the new investment strategy is fully implemented, it is anticipated that the duration of the investment assets will match the liabilities of the Plan over time. Additional revisions in asset allocations may occur based on future changes in the funded status of the Plan. In September 2016, the System contributed $100 million to the Plan. As of December 31, 2016, the Plan's investments were comprised of 8% cash and cash equivalents, 47% fixed-income investments, 29% equities, and 16% alternative investments.

Long-term Debt

At December 31, 2016, outstanding bonds for the System totaled $3.485 billion, comprised of $2.701 billion (78%) of fixed-rate bonds, $11 million (<1%) of index-rate bonds and $773 million (22%) of variable-rate bonds. The System utilizes various interest rate swap derivative contracts to manage the risk of increased debt service resulting from rising market interest rates on variable-rate bonds and certain variable-rate operating lease payments. The total notional amount on the System's interest rate swap contracts at December 31, 2016 was $633 million. Using an interest rate benchmark, these contracts convert variable-rate debt to a fixed-rate, which further reduces the System's exposure to variable interest rates. The interest rate swap contracts can be unwound by the System at any time, whereas the counterparty has the option to unwind the contracts only upon an event of default as defined in the contracts.

Approximately $390 million of the variable-rate bonds are directly placed with a financial institution or secured by irrevocable direct pay letters of credit or standby bond purchase agreements. Bonds are classified as current liabilities if they are supported by letters of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year, or contain a subjective clause that, if declared by the lender, could cause immediate repayment of the bonds.

The remaining $383 million variable-rate bonds are supported by the System's self-liquidity program. Bonds supported by self-liquidity include the Series 2014A CP Notes and certain variable-rate bonds that are remarketed in commercial paper mode. Bonds in the self-liquidity program are structured with various term dates so that no more than $50 million of bonds mature within a five-day period. Bonds supported by self-liquidity are classified as current liabilities.

In November 2014, the System established the Cleveland Clinic Health System Obligated Group Commercial Paper Program, which provides for the issuance of the Series 2014A CP Notes. The Series 2014A CP Notes may be issued from time to time in a maximum outstanding face amount of $100 million and will be supported by the System's self-liquidity program. At December 31, 2016 the System has $71.0 million in outstanding Series 2014A CP Notes.

Combined current aggregate scheduled principal payments by calendar year, assuming the remarketing of the variable-rate bonds for the five years subsequent to December 31, 2016, are as follows (in millions): 2017 – $59.8; 2018 – $62.0; 2019 – $64.0; 2020 – $66.2; and 2021 – $69.2.

Outstanding hospital revenue bonds for the System as of December 31, 2016 and 2015 consist of the following:

Hospital Revenue Bonds
(Dollars in thousands)

Series	Beneficiary	Type	Final Maturity	December 31 2016	December 31 2015
2016	CCHS Obligated Group	Fixed	2046	$ 325,000	$ -
2016	CCHS Obligated Group	Variable	2026	17,370	-
2014	CCHS Obligated Group	Fixed	2114	400,000	400,000
2014A	CCHS Obligated Group	CP Notes	2044	70,955	-
2014A	Akron General	Variable	2031	-	70,925
2014B	Akron General	Variable	2031	-	20,000
2013A	CCHS Obligated Group	Fixed / Index	2042	73,150	81,225
2013B	CCHS Obligated Group	Variable	2039	201,160	201,160
2013	Keep Memory Alive	Variable	2037	63,135	65,030
2012A	CCHS Obligated Group	Fixed	2039	460,080	469,485
2012TEFR	Akron General	Fixed	2031	-	39,835
2012TVR	Akron General	Variable	2031	-	17,370
2011A	CCHS Obligated Group	Fixed	2032	172,030	181,180
2011B	CCHS Obligated Group	Fixed	2031	29,120	31,250
2011C	CCHS Obligated Group	Fixed	2032	170,995	170,995
2009A	CCHS Obligated Group	Fixed	2039	305,400	305,400
2009B	CCHS Obligated Group	Fixed	2039	366,215	380,455
2008A	CCHS Obligated Group	Fixed	2043	409,740	419,690
2008B	CCHS Obligated Group	Variable	2043	369,250	369,250
2003C	CCHS Obligated Group	Variable	2035	41,905	41,905
2002	CCHS Obligated Group	Variable	2032	9,635	9,940
				$ 3,485,140	$ 3,275,095

At December 31, 2016, the System has notes payable and capital leases totaling $539.3 million. Notes payable and capital leases include $381.3 million of notes payable with interest rates up to 6%, $60 million outstanding on a revolving credit facility and $98.0 million of capital leases primarily related to property.

New financings in 2015 and 2016 include the following:

- In October 2015, the System through a subsidiary entered into a term loan agreement with a financial institution for a principal amount of $375 million. The term loan is recorded in notes payable in the consolidated balance sheets. The proceeds of the term loan were used to finance the System's international business strategy. The term loan matures in 2018 and bears interest at a variable-rate based on the London Interbank Offered Rate (LIBOR) index plus an applicable spread. The Clinic provides a guarantee on the term loan.

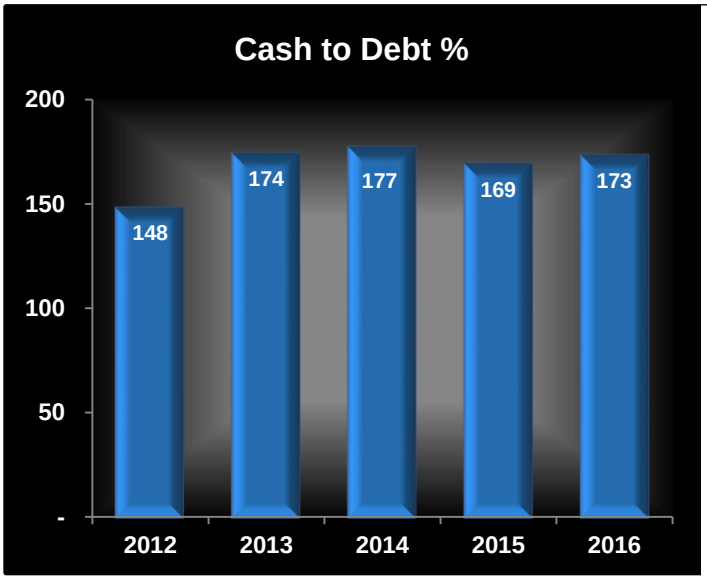
- In January 2016, the System entered into a line of credit with a financial institution totaling $60.0 million. The System drew the full amount on the line of credit and also issued $100.0 million of the Series 2014A CP Notes. The proceeds from the draw on the line of credit and a portion of the proceeds from the issuance of the Series 2014A CP Notes were used to defease the Series 2012 Akron Bonds and redeem the Series 2012 taxable Akron Bonds, the Series 2014A Akron Bonds and the Series 2014B Akron Bonds. The line of credit was terminated in September 2016.

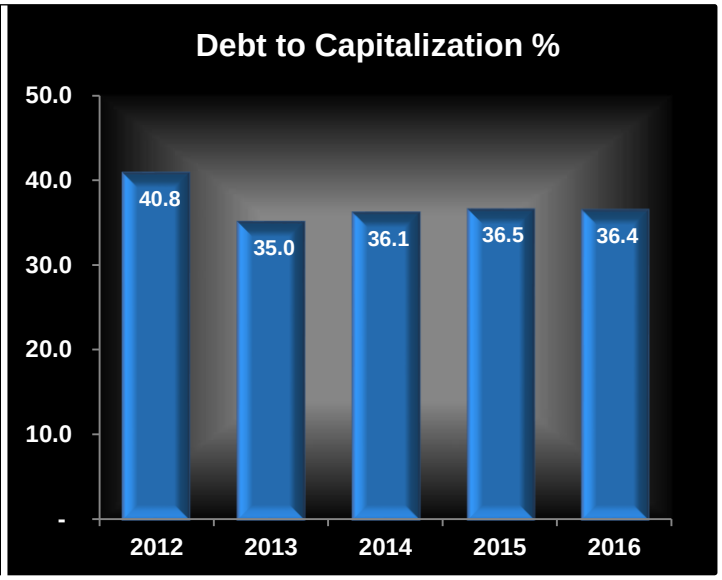
- In August 2016, the Clinic issued private placement debt totaling $325.0 million that was purchased by a financial institution. The private placement debt matures in 2046 and bears interest at a fixed rate of 3.35%. The proceeds of the private placement debt were used for general corporate purposes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

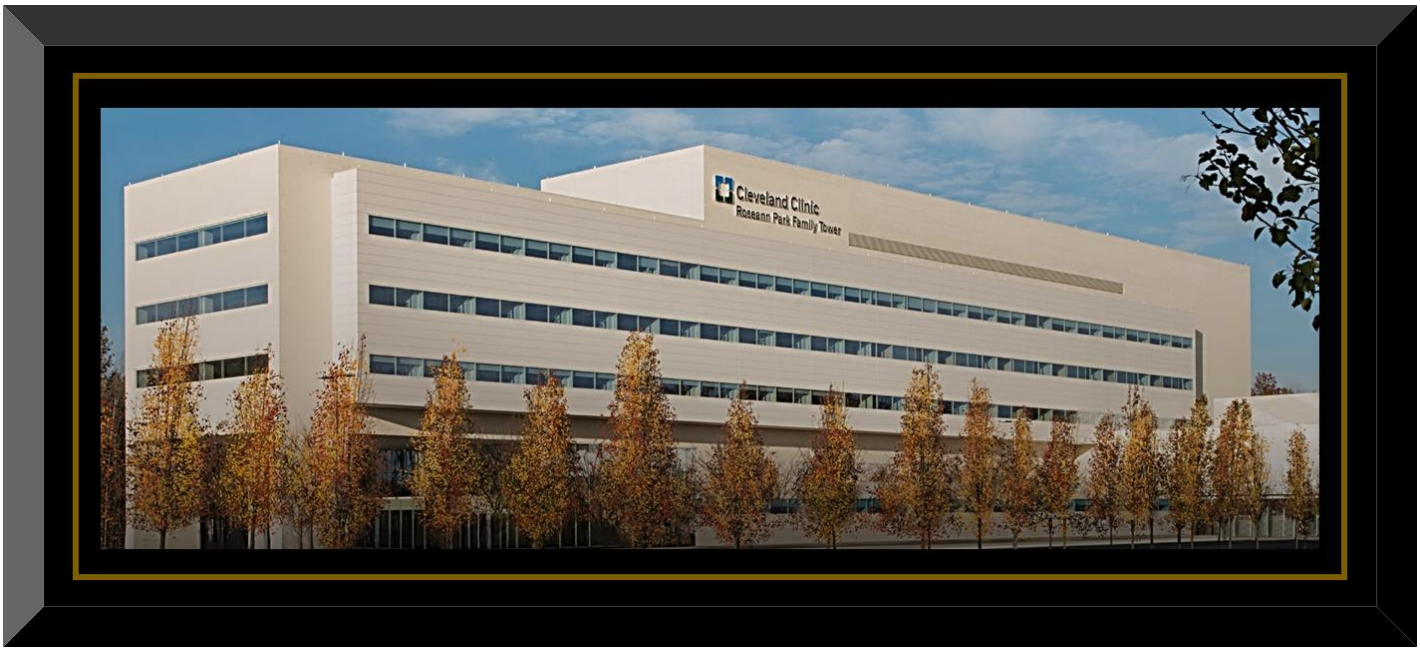
- In September 2016, the Clinic entered into a $300.0 million revolving credit facility with multiple financial institutions. The revolving credit facility expires in 2019 with provisions allowing the Clinic to extend the term for one-year periods. The facility allows the System to enter into short-term loans that automatically renew throughout the term of the facility. The revolving credit facility bears interest at a variable rate based on the LIBOR index plus an applicable spread. Amounts outstanding on the revolving credit facility as of December 31, 2016 totaled $60.0 million and are recorded in notes payable in the consolidated balance sheets. The proceeds were used to pay the full outstanding amount on the line of credit that was executed in January 2016.

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

The following charts summarize cash-to-debt and debt-to-capitalization ratios for the System at December 31 for the last five years:







Avon Hospital – Roseann Park Family Tower
Avon, Ohio

BOND RATINGS

The obligated group's outstanding bonds have been assigned ratings of Aa2 (stable outlook) and AA- (positive outlook) by Moody's and S&P, respectively. In February 2016, Moody's and S&P affirmed their respective rating and outlook.

The following table lists the various bond rating categories for Moody's and S&P:

Bond Ratings

	Rating category		
	Moody's	S&P	Definition
Stongest	Aaa	AAA	Prime
↑	Aa	AA	High grade/high quality
↑	A	A	Upper medium grade
↑	Baa	BBB	Lower medium grade
↑	Ba	BB	Non-investment grade/speculative
↑	B	B	Highly speculative
↑	Caa/Ca	CCC	Extremely speculative
Weakest	C	D	Default or bankruptcy
Cleveland Clinic	Aa2	AA-	

Within each rating category are the following modifiers:
Moody's ratings: 1 indicates higher end, 2 indicates mid-range, 3 indicates lower end
S&P ratings: + indicates higher end, - indicates lower end

Healthcare organizations generally do not achieve a rating of Aaa or AAA from Moody's or S&P, respectively, due to the nature of the healthcare industry. Based on recent ratings summary reports obtained from Moody's and S&P, no healthcare organizations were rated in the prime category.

CONSOLIDATED RESULTS OF OPERATIONS

For the Quarters Ended December 31, 2016 and 2015

The following narrative describes the consolidated results of operations for the System for the quarters ended December 31, 2016 and 2015. The consolidated results of operations for the quarters ended December 31, 2016 and 2015 includes the financial operations of Grosvenor Place and Akron General, which became consolidated entities of the System in October 2015 and November 2015, respectively. For comparative purposes, certain financial activity in the narrative below is also presented on a same facility basis, which excludes the financial operations of Grosvenor Place and Akron General for the quarters ended December 31, 2016 and 2015.

Operating income for the System in the fourth quarter of 2016 was $33.2 million, resulting in an operating margin of 1.6%, as compared to operating income of $163.8 million and an operating margin of 8.1% in the fourth quarter of 2015. On a same facility basis (excluding Akron General operating income of $19.5 million and $5.9 million in the fourth quarters of 2016 and

2015, respectively, and Grosvenor Place operating loss of $5.9 million in the fourth quarter of 2016 and operating income of $0.1 million in the fourth quarter of 2015), operating income for the System for the fourth quarter of 2016 was $19.6 million, resulting in an operating margin of 1.0%, as compared to operating income of $157.8 million and an operating margin of 8.3% in the fourth quarter of 2015. The lower operating income on a same facility basis for the fourth quarter of 2016 primarily resulted from an 8.1% increase in total operating expenses, with notable increases experienced in salaries, wages and benefits, pharmaceutical costs, depreciation and purchased services and other fees. Same facility unrestricted revenues increased 0.2% primarily due to increased outpatient volumes and a strong case mix despite lower inpatient activity and an unfavorable shift in payor mix. Nonoperating gains for the System were $82.8 million in the fourth quarter of 2016 compared to nonoperating gains of $285.9 million in the fourth quarter of 2015. The decrease from the prior year was primarily due to a member substitution contribution and gain on remeasurement of the equity investment in Akron General that was recorded in 2015. Overall, the System reported an excess of revenues over expenses of $116.1 million in the fourth quarter of 2016, or $102.5 million on a same facility basis, compared to an excess of revenues over expenses of $449.7 million in the fourth quarter of 2015, or $265.8 million on a same facility basis.

In March 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2017-07, Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. The new guidance is expected to reduce the impact of changes in discount rates and investment performance on operating income for the System's defined benefit and postretirement benefit plans. ASU 2017-07 is effective for the System for reporting periods beginning after December 15, 2018 with early adoption permitted in the first quarter of 2017. Upon adoption, the System is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements. The System will adopt the provisions of ASU 2017-07 in the first quarter of 2017. The impact of adopting ASU 2017-07 for the System when applied retrospectively to the quarters ended December 31, 2016 and 2015 will decrease salaries, wages and benefits on the consolidated statement of operations by $104.1 million and $21.6 million, respectively, with a corresponding increase to operating income and decrease to net nonoperating gains. As a result, operating income for the fourth quarters of December 31, 2016 and 2015 will be $137.3 million and $185.4 million, respectively, and net nonoperating gains and losses will be a net loss of $21.2 million and a net gain of $264.2 million, respectively, upon retrospective adoption of ASU 2017-07. The adoption of ASU 2017-07 will have no impact on excess of revenues over expenses or net assets.

The System's net patient service revenue increased $98.1 million (5.3%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, net patient service revenue increased $22.9 million (1.3%). The System experienced same facility decreases in inpatient acute admissions of 2.5%, inpatient surgical cases of 2.2% and outpatient surgical cases of 2.2% in the fourth quarter of 2016

compared to the fourth quarter of 2015. Same facility outpatient evaluation and management visits increased 9.5% and emergency department visits increased 1.6% in the fourth quarter of 2016 compared to the fourth quarter of 2015. The System has also experienced an increase in Medicare and Medicaid revenue primarily as a result of the Affordable Care Act and other industry trends. The State of Ohio expanded Medicaid eligibility in 2014, which has increased enrollment in the Medicaid program and allowed former uninsured patients to shift into the expanded Medicaid program. On a combined basis, governmental and self-pay revenue as a percentage of total gross patient revenue has increased 1.5% in the fourth quarter of 2016 compared to the same period in 2015. The System has experienced a corresponding decrease in managed care and commercial gross revenues. This shift in the gross revenue payor mix has negatively impacted the revenue realization of the System. However, net patient revenue has benefited from rate increases on the System's managed care contracts that became effective in 2016. Net patient revenue has also benefited from the recognition of a $20.0 million shared savings distribution related to the Cleveland Clinic Medicare ACO. Over the last few years, the System has initiated national, regional and local revenue management projects designed to improve patient care access throughout the System.

Provision for uncollectible accounts increased $25.5 million (72.5%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, provision for uncollectible accounts increased $24.5 million (85.1%). The increase is primarily attributable to increases in net patient service revenue and in deductible and copayment balances. The growth in high copayment and deductible health plans is an industry trend that will likely continue to accelerate. Employers have also shifted a greater portion of the cost of care to employees to manage health benefit costs resulting in rising patient responsibility balances. These balances are generally more difficult to collect than traditional insurance payors. The System has implemented various initiatives to collect patient responsibility balances and continues to monitor the changing healthcare environment. The System is focused on strategic initiatives that are designed to promote growth and increase value to make healthcare more affordable to patients.

Other unrestricted revenues increased $5.8 million (2.9%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, other unrestricted revenues increased $5.1 million (2.6%). The increase in same facility revenues was primarily due to a $10.7 increase in management service contract revenue and a $5.5 million increase in outpatient pharmacy revenue. These increases were offset by a $6.1 million gain on sale of intangible assets recorded in 2015 related to the establishment of the Select Medical rehabilitation joint venture and a $2.4 million decrease in revenue related to research and education grants.

Total operating expenses increased $208.9 million (11.2%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, total operating expenses increased $141.8 million (8.1%). In 2015 the System implemented salary adjustments to caregivers in nursing and other clinical institutes, which has increased salaries and wages in 2016. The System also had increased pension plan expenses related to the System's defined benefit and postretirement benefit plans, a portion of which will be retrospectively reclassified to other nonoperating gains and losses when the System adopts ASU 2017-07 in the first quarter of 2017. The System's specialty pharmacy had increased activity in the fourth quarter of 2016, which has increased pharmaceutical expenses. The System has also experienced an increase in purchased service expenses and consulting

expenses related to certain strategic projects and initiatives. To address the growth in expenses caused by inflationary pressures in many expense categories such as salaries, benefits and specialized pharmaceuticals, the System has implemented Care Affordability initiatives. Care Affordability initiatives are designed to transform patient care and business models in an effort to provide quality, affordable patient care. The System identifies, quantifies and implements these initiatives through an extensive analysis of the cost structure. The System continues to develop and implement cost management and containment plans designed to make a more affordable care model for patients and to enable investments in key strategic initiatives.

Salaries and benefits increased $177.6 million (17.3%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, salaries and benefits increased $147.9 million (15.5%). Same facility salaries, excluding benefits, increased $65.7 million (8.0%) due to annual salary adjustments averaging 2-3% across the System that were awarded in the second quarter of 2016 and a 3.9% increase in average full-time equivalent employees in the fourth quarter of 2016 compared to the same period in 2015. The System has also invested in its caregivers in 2015 by increasing the minimum wage across the System, increasing the starting salary for nurses and providing salary adjustments to current caregivers in nursing and other clinical institutes. Same facility employee benefit costs increased $82.2 million (59.5%). The System recognized $104.1 million and $25.6 million of actuarial losses in 2016 and 2015, respectively, on its defined benefit and postretirement benefit plans. Actuarial losses are recognized when they are outside of the corridor, which is 10% of the greater of the projected benefit obligation or fair value of plan assets. The System's primary defined benefit pension plan ceased benefit accruals as of December 31, 2009 for substantially all employees, with benefit accrual for remaining employees ceasing at various intervals through December 31, 2012. Under the provisions of ASU 2017-07 that the System will adopt in the first quarter of 2017, the System would have reduced benefit costs related to defined benefit and postretirement benefit plans by $104.1 million and $21.6 million in the fourth quarters of 2016 and 2015, respectively. Same facility defined contribution expenses increased $3.7 million and FICA expenses increased $2.9 million primarily due to the increase in salaries and full-time equivalent employees. These increases were offset by an $8.8 million decrease in same facility employee health care costs due to a shift in health care services from external providers to providers within the System.

Supplies expense increased $11.7 million (6.4%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, supplies expense increased $5.7 million (3.4%). The System experienced a $4.3 million increase in same facility implantables and other medical supplies and a $1.4 million increase in same facility non-medical supplies primarily due to increased minor equipment and software costs. To address the challenge of rising supply and service costs in the healthcare industry, management is engaged in an organizational transformation program to identify and implement clinical and non-clinical savings initiatives through renegotiation, product standardization, utilization changes and improvements in procurement to payment processes.

Pharmaceutical costs increased $21.9 million (10.7%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, pharmaceutical costs increased $14.7 million (7.5%). The increase is primarily due to higher costs and increased utilization in the oncology departments. In addition, the System operates a specialty pharmacy that is used to

treat chronic illnesses and complex conditions. Specialty pharmacy expenses increased $7.3 million in the fourth quarter of 2016 compared to the same period in 2015. The System has also experienced a corresponding increase in outpatient pharmacy revenues related to specialty pharmaceuticals.

Purchased services and other fees increased $15.4 million (13.3%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, purchased services and other fees increased $10.4 million (9.7%). The increase in same facility purchased service expenses was primarily due to a $2.6 million increase in purchased medical services primarily related to external lab services and costs related to the System's Medicare Accountable Care Organization, a $2.5 million increase in various purchased non-medical service costs related to certain System projects and initiatives, including the EAPM implementation at the Clinic's main campus and family health centers, a $1.6 million increase is costs related to insurance eligibility screening process for patients and a $0.4 million increase in software and hardware technology costs.

Administrative services decreased $3.0 million (5.0%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, administrative services decreased $12.8 million (22.5%). The decrease in same facility administrative services was primarily due to an $11.5 million decrease in consulting fees and professional services driven by costs incurred in 2015 related to the acquisition of Grosvenor Place, a decrease in expenses related to research activities of $1.0 million and a decrease in travel and professional education expenses of $0.5 million.

Facilities expense increased $2.8 million (3.3%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, facilities expense decreased $1.4 million (1.9%). The decrease in same facility facilities expense was primarily due to decreases in repairs and maintenance and utility costs across the System.

Insurance expense decreased $1.7 million (13.8%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, insurance expense decreased $3.0 million (26.2%). The decrease in same facility insurance expense was primarily due to a decrease in professional malpractice expense. The System utilizes an independent actuarial firm to review professional malpractice loss experience and establish estimated funding levels to the System's captive insurance subsidiary. Over the last several years, the System has undertaken numerous initiatives to manage its medical malpractice insurance expense that resulted in reducing the number of claims and lawsuits and associated costs. These initiatives include hiring additional staff devoted to clinical risk management, promoting patient safety to prevent untoward events, and expanding education programs geared to enhance quality throughout the organization. The System has also taken, where appropriate, a more proactive approach to expedite the settlement of claims, which has reduced claim expenses and has resulted in more favorable settlements.

Interest expense increased $4.8 million (15.3%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, interest expense increased $4.8 million (16.0%). The System issued $325.0 million of fixed-rate private placement debt in the third quarter of 2016. In addition, the System issued $100.0 million of the Series 2014A CP Notes and a $60 million line of credit in January 2016. The line of credit was fully refunded with a revolving credit line in September 2016, and the Series 2014A CP Notes were partially refunded with a $17.4 million taxable loan in November 2016. These increases in debt were offset by $127.0 million of

principal payments on bonds, notes and capital leases in 2016 and $148.3 million for the defeasance and redemption of bonds related to Akron General, which reduced the amount of interest due on outstanding debt.

Depreciation and amortization expenses increased $17.6 million (16.7%) in the fourth quarter of 2016 compared to the same period in 2015. On a same facility basis, depreciation and amortization expenses increased $13.9 million (14.4%). Changes in depreciation include property, plant and equipment that was fully depreciated in 2015, offset by depreciation for property, plant and equipment that was acquired and placed into service in 2016.

Special charges decreased $38.2 million (93.3%) in the fourth quarter of 2016 compared to the same period in 2015. The System incurred and recorded $2.7 million and $40.9 million of special charges in the fourth quarters of 2016 and 2015, respectively. Special charges in the fourth quarter of 2016 are comprised of $0.2 million of statutory compensation payments related to the termination of tenant leases at Grosvenor Place and $2.5 million related to Lakewood Hospital and the agreement between the City of Lakewood, LHA and the Clinic that outlines the transition of healthcare services in the City of Lakewood. For a detailed description of the terms of the agreement, refer to "LAKEWOOD HOSPITAL ASSOCIATION." Special charges incurred and recorded for LHA primarily relate to accelerated depreciation expense and other property, plant and equipment costs on LHA assets. Special charges in 2015 include $33.7 million of pledge liabilities in connection with the agreement, $13.3 million of accelerated depreciation, $0.8 million in employee retention costs, offset by a $6.9 million gain related to changes in terms of the lease between the City of Lakewood and LHA.

Gains and losses from nonoperating activities are recorded below operating income in the statement of operations. These items resulted in a net gain to the System of $82.8 million in the fourth quarter of 2016 compared to a net gain of $285.9 million in 2015, resulting in an unfavorable variance of $203.1 million. Investment returns were unfavorable by $23.4 million in the fourth quarter of 2016 compared to the same period in 2015. The System's long-term investment portfolio reported investment losses of 0.1% for the fourth quarter of 2016, which is higher than the portfolio's benchmark loss of 0.6% but lower than investment gains of 1.2% experienced in the fourth quarter of 2015. Derivative losses were favorable by $40.9 million in the fourth quarter of 2016 compared to the same period in 2015. Derivative gains and losses result from changes in foreign currency exchange rates associated with the System's foreign currency derivative contracts and changes in the interest rate benchmark associated with the System's interest rate swap contracts, including net interest paid or received under the swap agreements. Nonoperating gains and losses in the fourth quarter of 2015 include $281.6 million of gains related to the Akron General equity investment remeasurement and the member substitution contribution. The System also recorded a $63.1 million goodwill impairment loss in the fourth quarter of 2015 related to the acquisition of Grosvenor Place. Under the provisions of ASU 2017-07 that the System will adopt in the first quarter of 2017, the System would have reduced net nonoperating gains by $104.1 million and $21.6 million in the fourth quarters of 2016 and 2015, respectively, with a corresponding decrease in salaries, wages and benefits and increase in operating income.

For the Years Ended December 31, 2016 and 2015

The following narrative describes the consolidated results of operations for the System for the years ended December 31, 2016 and 2015. The consolidated results of operations for the years ended December 31, 2016 and 2015 include the financial operations of Grosvenor Place and Akron General, which became consolidated entities of the System in October 2015 and November 2015, respectively. For comparative purposes, certain financial activity in the narrative below is also presented on a same facility basis, which excludes the financial operations of Grosvenor Place and Akron General for the years ended December 31, 2016 and 2015.

Operating income for the System in 2016 was $139.4 million, resulting in an operating margin of 1.7%, as compared to operating income of $480.2 million and an operating margin of 6.7% in 2015. On a same facility basis (excluding Akron General operating income of $19.5 million and $5.9 million in 2016 and 2015, respectively, and Grosvenor Place operating loss of $16.9 million in 2016 and operating income of $0.1 million in 2015), operating income for the System in 2016 was $136.7 million, resulting in an operating margin of 1.9%, as compared to operating income of $474.3 million and an operating margin of 6.7% in 2015. The lower operating income on a same facility basis for 2016 primarily resulted from a 9.0% increase in total operating expenses, with notable increases experienced in salaries, wages and benefits, pharmaceutical costs and purchased services and other fees. Same facility unrestricted revenues increased 3.6% primarily due to increased outpatient volumes and a strong case mix despite lower inpatient activity and an unfavorable shift in the payor mix. Nonoperating gains for the System were $374.2 million in 2016 compared to nonoperating gains of $138.0 million in 2015. The increase from the prior year was primarily a result of gains and losses on investments attributable to overall changes in the financial markets partially offset by a member substitution contribution and gain on remeasurement of the equity investment in Akron General that was recorded in 2015. Overall, the System reported an excess of revenues over expenses of $513.5 million in 2016, or $504.8 million on a same facility basis, compared to an excess of revenues over expenses of $618.2 million in 2015, or $434.3 million on a same facility basis.

In March 2017, the FASB issued ASU 2017-07, Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. The new guidance is expected to reduce the impact of changes in discount rates and investment performance on operating income for the System's defined benefit and postretirement benefit plans. ASU 2017-07 is effective for the System for reporting periods beginning after December 15, 2018 with early adoption permitted in the first quarter of 2017. Upon adoption, the System is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements. The System will adopt the provisions of ASU 2017-07 in the first quarter of 2017. The impact of adopting ASU 2017-07 for the System when applied retrospectively to the years ended December 31, 2016 and 2015 will decrease

salaries, wages and benefits on the consolidated statement of operations by $103.9 million and $9.7 million, respectively, with a corresponding increase to operating income and decrease to net nonoperating gains. As a result, operating income for the years ended December 31, 2016 and 2015 will be $243.2 million and $490.0 million, respectively, and net nonoperating gains will be $270.3 million and $128.3 million, respectively, upon retrospective adoption of ASU 2017-07. The adoption of ASU 2017-07 will have no impact on excess of revenues over expenses or net assets.

The System's net patient service revenue increased $838.6 million (12.5%) in 2016 compared to the same period in 2015. On a same facility basis, net patient service revenue increased $208.7 million (3.2%). The System experienced same facility decreases in inpatient acute admissions of 2.7% and inpatient surgical cases of 2.3% in 2016 compared to the same period in 2015. However, total acute case mix for the System was strong in 2016, which resulted in more inpatient revenue per patient. Same facility total acute case mix was 1.89 in 2016, which was a 4.4% increase compared to total acute case mix of 1.81 in 2015. Same facility outpatient volumes increased in 2016 compared to the same period in 2015 as outpatient evaluation and management visits increased 12.1%, emergency department visits increased 2.9% and outpatient surgical cases increased 0.7%. The System has also experienced an increase in Medicare and Medicaid revenue primarily as a result of the Affordable Care Act and other industry trends. The State of Ohio expanded Medicaid eligibility in 2014, which has increased enrollment in the Medicaid program and allowed former uninsured patients to shift into the expanded Medicaid program. On a combined basis, governmental and self-pay revenue as a percentage of total gross patient revenue has increased more than 1% in 2016 compared to 2015. The System has experienced a corresponding decrease in managed care and commercial gross revenues. This shift in the gross revenue payor mix has negatively impacted the revenue realization of the System. However, net patient revenue has benefited from rate increases on the System's managed care contracts that became effective in 2016. Over the last few years, the System has initiated national, regional and local revenue management projects designed to improve patient care access throughout the System.

Provision for uncollectible accounts increased $70.4 million (30.4%) in 2016 compared to 2015. On a same facility basis, provision for uncollectible accounts increased $45.0 million (20.0%). The increase is primarily attributable to increases in net patient service revenue as well as increases in deductible and copayment balances. The growth in high copayment and deductible health plans is an industry trend that will likely continue to accelerate. Employers have also shifted a greater portion of the cost of care to employees to manage health benefit costs resulting in rising patient responsibility balances. These balances are generally more difficult to collect than traditional insurance payors. The System has implemented various initiatives to collect patient responsibility balances and continues to monitor the changing healthcare environment. The System is focused on strategic initiatives that are designed to promote growth and increase value to make healthcare more affordable to patients.

Other unrestricted revenues increased $112.0 million (16.6%) in 2016 compared to 2015. On a same facility basis, other unrestricted revenues increased $87.2 million (13.1%). The increase in same facility revenues was primarily due to a $48.6 million increase in outpatient pharmacy revenue attributable to increased revenues at the specialized pharmacy, a $41.2 increase in management service contract revenue primarily related to new agreements in late 2015 and throughout 2016, a $12.8 million increase in

revenue related to research grants and a $9.8 million increase in unrestricted gifts and assets released from restriction. These increases were offset by $10.9 million of revenue recorded in 2015 related to the sale of a Cleveland Clinic Innovations spin-off company, a $6.1 million gain on sale of intangible assets recorded in 2015 related to the establishment of the Select Medical rehabilitation joint venture and $5.5 million of equity earnings recorded in 2015 related to the System's investment in Akron General prior to the member substitution.

Total operating expenses increased $1.2 billion (18.3%) in 2016 compared to 2015. On a same facility basis, total operating expenses increased $588.5 million (9.0%). In 2015 the System implemented salary adjustments to caregivers in nursing and other clinical institutes, which has increased salaries and wages in 2016. The System also had increased pension plan expenses related to the System's defined benefit and postretirement benefit plans, a portion of which will be retrospectively reclassified to other nonoperating gains and losses when the System adopts ASU 2017-07 in the first quarter of 2017. The System's specialty pharmacy had increased activity in 2016, which has increased pharmaceutical expenses. The System has also experienced an increase in purchased service expenses and consulting expenses related to certain strategic projects and initiatives. To address the growth in expenses caused by inflationary pressures in many expense categories such as salaries, benefits and specialized pharmaceuticals, the System has implemented Care Affordability initiatives. Care Affordability initiatives are designed to transform patient care and business models in an effort to provide quality, affordable patient care. The System identifies, quantifies and implements these initiatives through an extensive analysis of the cost structure. The System continues to develop and implement cost management and containment plans designed to make a more affordable care model for patients and to enable investments in key strategic initiatives.

Salaries and benefits increased $735.7 million (19.4%) in 2016 compared to 2015. On a same facility basis, salaries and benefits increased $406.8 million (10.9%). Same facility salaries, excluding benefits, increased $303.4 million (9.5%) due to annual salary adjustments averaging 2-3% across the System that were awarded in the second quarter of 2016 and a 4.4% increase in average full-time equivalent employees in 2016 compared to 2015. The System has also invested in its caregivers in 2015 by increasing the minimum wage across the System, increasing the starting salary for nurses and providing salary adjustments to current caregivers in nursing and other clinical institutes. Same facility employee benefit costs increased $103.3 million (11.2%). The System recognized $104.1 million and $25.6 million of actuarial losses in 2016 and 2015, respectively, on its defined benefit and postretirement benefit plans. Actuarial losses are recognized when they are outside of the corridor, which is 10% of the greater of the projected benefit obligation or fair value of plan assets. Other components of net periodic benefit cost for the System's primary defined benefit pension plan increased $13.8 million primarily due to a reduction in the expected return on plan assets in 2016. The System's primary defined benefit pension plan ceased benefit accruals as of December 31, 2009 for substantially all employees, with benefit accrual for remaining employees ceasing at various intervals through December 31, 2012. Under the provisions of ASU 2017-07 that the System will adopt in the first quarter of 2017, the System would have reduced benefit costs related to defined benefit and postretirement benefit plans by $103.9 million and $9.7 million in 2016 and 2015, respectively. Same facility defined contribution expenses increased $21.0 million and FICA expenses increased $17.3 million primarily due to the increase in salaries and full-

time equivalent employees. These increases were offset by a $31.6 million decrease in same facility employee health care costs due to a shift in health care services from external providers to providers within the System.

Supplies expense increased $84.2 million (12.7%) in 2016 compared to 2015. On a same facility basis, supplies expense increased $24.4 million (3.7%). The System experienced a $22.8 million increase in same facility implantables and other medical supplies due to higher surgical and organ transplant expenses and a $1.6 million increase in same facility non-medical supplies primarily due to increased minor equipment and software costs. To address the challenge of rising supply and service costs in the healthcare industry, management is engaged in an organizational transformation program to identify and implement clinical and non-clinical savings initiatives through renegotiation, product standardization, utilization changes and improvements in procurement to payment processes.

Pharmaceutical costs increased $161.5 million (23.0%) in 2016 compared to 2015. On a same facility basis, pharmaceutical costs increased $113.2 million (16.3%). The increase is primarily due to higher costs and increased utilization in the oncology departments. In addition, the System operates a specialty pharmacy that is used to treat chronic illnesses and complex conditions. Specialty pharmacy expenses increased $54.9 million 2016 compared to 2015. The System has also experienced a corresponding increase in outpatient pharmacy revenues related to specialty pharmaceuticals.

Purchased services and other fees increased $107.7 million (27.0%) in 2016 compared to 2015. On a same facility basis, purchased services and other fees increased $40.9 million (10.5%). The increase in same facility purchased service expenses was primarily due to a $18.0 million increase in various purchased non-medical service costs related to certain System projects and initiatives, including the EAPM implementation at the Clinic's main campus and family health centers and initiatives related to the patient scheduling and registration process, a $7.0 million increase in purchased medical services primarily related to external lab services, a $4.8 million increase in software and hardware technology costs and a $3.0 million increase in costs related to insurance eligibility screening process for patients.

Administrative services increased $21.1 million (12.0%) in 2016 compared to 2015. On a same facility basis, administrative services decreased $1.4 million (0.8%). The decrease in same facility administrative services was primarily due to a decrease in consulting fees and other professional services of $5.2 million related to certain strategic initiatives of the System, offset by an increase in travel and professional education expenses of $3.7 million.

Facilities expense increased $42.7 million (14.2%) in 2016 compared to 2015. On a same facility basis, facilities expense increased $1.4 million (0.5%). The increase in same facility facilities expense was primarily due to an increase in same facility lease costs across the System.

Insurance expense increased $4.7 million (7.5%) in 2016 compared to 2015. On a same facility basis, insurance expense decreased $3.3 million (5.3%). The decrease in same facility insurance expense was primarily due to a decrease in professional malpractice expense due to favorable development of outstanding prior year claims. The System utilizes an independent actuarial firm to review professional malpractice loss experience and establish estimated funding levels to the System's captive insurance subsidiary. Over the last several years, the System has undertaken numerous initiatives to

manage its medical malpractice insurance expense that resulted in reducing the number of claims and lawsuits and associated costs. These initiatives include hiring additional staff devoted to clinical risk management, promoting patient safety to prevent untoward events, and expanding education programs geared to enhance quality throughout the organization. The System has also taken, where appropriate, a more proactive approach to expedite the settlement of claims, which has reduced claim expenses and has resulted in more favorable settlements.

Interest expense increased $12.1 million (9.6%) in 2016 compared to 2015. On a same facility basis, interest expense increased $6.3 million (5.1%). The System issued $325.0 million of fixed-rate private placement debt in the third quarter of 2016. In addition, the System issued $100.0 million of the Series 2014A CP Notes and a $60 million line of credit in January 2016. The line of credit was fully refunded with a revolving credit line in September 2016, and the Series 2014A CP Notes were partially refunded with a $17.4 million taxable loan in November 2016. These increases in debt were offset by $127.0 million of principal payments on bonds, notes and capital leases in 2016 and $148.3 million for the defeasance and redemption of bonds related to Akron General, which reduced the amount of interest due on outstanding debt.

Depreciation and amortization expenses increased $66.9 million (16.3%) in 2016 compared to 2015. On a same facility basis, depreciation and amortization expenses increased $23.4 million (5.8%). Changes in depreciation include property, plant and equipment that was fully depreciated in 2015, offset by depreciation for property, plant and equipment that was acquired and placed into service in 2016.

Special charges decreased $15.3 million (37.4%) in 2016 compared to 2015. Special charges in 2016 includes $7.8 million of statutory compensation payments related to the termination of tenant leases at Grosvenor Place. The System is converting the building from office space to a healthcare facility. Special charges also include $17.8 million and $40.9 million in 2016 and 2015, respectively, related to Lakewood Hospital and the agreement between the City of Lakewood, LHA and the Clinic that outlines the transition of healthcare services in the City of Lakewood. For a detailed description of the terms of the agreement, refer to "LAKEWOOD HOSPITAL ASSOCIATION." Special charges in 2016 include $17.8 million of accelerated depreciation expense and other facility costs related to the cessation of services at Lakewood Hospital. Special charges in 2015 include $33.7 million of pledge liabilities in connection with the agreement, $13.3 million of accelerated depreciation, $0.8 million in employee retention costs, offset by a $6.9 million gain related to changes in terms of the lease between the City of Lakewood and LHA.

Gains and losses from nonoperating activities are recorded below operating income in the statement of operations. These items resulted in a net gain to the System of $374.2 million in 2016 compared to a net gain of $138.0 million in 2015, resulting in a favorable variance of $236.2 million. Investment returns were favorable by $460.5 million in 2016 compared to 2015. The System's long-term investment portfolio reported investment gains of 5.7% in 2016, which is lower than the portfolio's benchmark gain of 6.5% and higher than investment losses of 0.6% experienced in 2015. Derivative losses were favorable by $2.2 million in 2016 compared to 2015. Derivative gains and losses result from changes in foreign currency exchange rates associated with the System's foreign currency derivative contracts and changes in the interest rate benchmark associated with the System's interest rate swap contracts, including net

interest paid or received under the swap agreements. Nonoperating gains and losses in 2015 include $281.6 million of gains related to the Akron General equity investment remeasurement and the member substitution contribution. The System also recorded a $63.1 million goodwill impairment loss in 2015 related to the acquisition of Grosvenor Place. Nonoperating gains and losses in 2016 includes a $3.9 million loss on extinguishment of debt related to the defeasance and redemption of Akron General bonds. Under the provisions of ASU 2017-07 that the System will adopt in the first quarter of 2017, the System would have reduced net nonoperating gains by $103.9 million and $9.7 million in 2016 and 2015, respectively, with a corresponding decrease in salaries, wages and benefits and increase in operating income.

BALANCE SHEET – DECEMBER 31, 2016 COMPARED TO DECEMBER 31, 2015

Patient accounts receivable, net of allowances for uncollectible accounts, increased $108.9 million (11.5%) from December 31, 2015 to December 31, 2016. The increase in patient receivables is partially due to the increase in net patient service revenue resulting from rate increases on the System's managed care contracts that became effective in January 2016. The System has also experienced growth in accounts receivable related to governmental payors. Additionally, the System has experienced a growth in patient responsibility accounts receivable. Patient responsibility accounts, which represents the portion of services that is not paid by a patient's insurance company, have increased as a result of employers shifting a greater portion of the cost of care to employees, typically in the form of co-pays and deductibles. These balances are generally more difficult to collect than traditional insurance payors. The System records estimated allowances that result in patient accounts receivable being reported at the net amount expected to be received. Days revenue outstanding for the System increased from 47 days at December 31, 2015 to 51 days at December 31, 2016.

Investments for current use decreased $1.7 million (3.2%) from December 31, 2015 to December 31, 2016. Current bond trustee funds decreased $1.6 million due to the timing of principal and interest payments paid in early 2016 related to certain Akron General bonds that were funded to the bond trustee in December 2015. There were no bond trustee funds classified as current at December 31, 2016. Investments for current use also includes assets held for self-insurance that will be used to pay the current portion of estimated claim liabilities. These investments decreased $0.1 million due to reclassifications of investments from current to long-term.

Other current assets decreased $11.2 million (2.8%) from December 31, 2015 to December 31, 2016. The decrease in other current assets was primarily due to a $42.8 million decrease in receivables related to the timing of receipts for various Medicare and Medicaid programs, a $19.0 million decrease in Medicare third-party receivables primarily related to amounts collected on prior year costs reports, collection of a $7.3 million miscellaneous receivable that was accrued in 2015 and a $7.1 million decrease in electronic health record incentive program receivables due to the timing of payments for this program. These decreases were offset by a $20.5 million increase in the current portion of pledges receivable, a $20.0 million receivable related to an estimated shared savings distribution to the System's Medicare Accountable Care Organization, an $11.0 million increase in management service contract

receivables and a $7.5 million increase in inventories.

Unrestricted long-term investments increased $291.9 million (4.7%) from December 31, 2015 to December 31, 2016. Total unrestricted cash, cash equivalents and long-term investments increased $562.9 million from December 31, 2015 to December 31, 2016. The System experienced $918.3 million of net positive cash flow from operations and investment income in 2016. Investment return on the System's long-term investment portfolio was 5.7% in 2016. The System also issued $325 million of private placement notes in August 2016 and used the proceeds for general corporate purposes of the System. These increases were primarily offset by net capital expenditures of $663.1 million and principal payments on long-term debt of $127.0 million.

Funds held by trustees decreased $49.8 million (39.6%) from December 31, 2015 to December 31, 2016. The decrease in funds held by trustees is primarily due to a $24.7 million reduction of collateral related to the termination of a futures and options program within the System's investment portfolio in 2016, an $18.5 million decrease in collateral posted with the counterparties on the System's derivative contracts and a $4.0 million reduction in a debt service reserve fund related to Akron General bonds. The debt service reserve fund was returned to the System in the first quarter of 2016 when the related Akron bonds were defeased.

Assets held for self-insurance increased $34.4 million (36.8%) from December 31, 2015 to December 31, 2016. The increase in self-insurance assets is primarily due to insurance premiums received by the captive insurance subsidiary in excess of reimbursement payments for claims previously settled and paid by other System entities and investment gains experienced in the System's captive insurance subsidiary.

Donor restricted assets increased $47.1 million (8.3%) from December 31, 2015 to December 31, 2016. The increase in donor restricted assets was primarily from the receipt of donor restricted gifts in excess of expenditures from restricted funds and investment gains on restricted investments.

Net property, plant and equipment increased $123.4 million (2.8%) from December 31, 2015 to December 31, 2016. The System had net expenditures for property, plant and equipment of $663.1 million, offset by foreign currency translation adjustments of $59.4 million and depreciation expense of $489.0 million, which includes $15.0 million of accelerated depreciation expense recorded in special charges (and excludes $2.3 million of amortization for intangible assets). Capital expenditures in 2016 include amounts paid on retainage liabilities recorded at December 31, 2015 and exclude assets acquired through capital lease arrangements. Retainage liabilities decreased $9.1 million and new capital leases totaled $15.5 million in 2016. The System also recorded $0.8 million in donated capital in 2016. Expenditures for property, plant and equipment were incurred at numerous facilities across the System and include expenditures for strategic construction, expansion and technological investment as well as replacement of existing facilities and equipment. For a complete description of many of System's current projects, refer to "EXPANSION AND IMPROVEMENT PROJECTS."

Other noncurrent assets increased $46.0 million (7.9%) from December 31, 2015 to December 31, 2016. The increase in noncurrent assets was primarily due to a $26.8 million increase in deferred compensation plan assets, a $23.9 increase in a note receivable related to

construction financing of a hotel on the Clinic's main campus, a $9.2 million increase in long-term pledge receivables and a $4.1 million increase in goodwill related to certain physician practice acquisitions. These increases were offset by a $20.0 million decrease in perpetual and charitable trusts primarily due to reclassifications from long-term to current.

Accounts payable increased $69.9 million (16.9%) from December 31, 2015 to December 31, 2016. The increase in accounts payable was primarily attributable to the timing of payment processing for trade payables and $7.4 million increase in outstanding checks.

Compensation and amounts withheld from payroll increased $26.8 million (9.1%) from December 31, 2015 to December 31, 2016. The change was primarily attributable to the timing of payroll and the growth in employee benefit accruals.

Current portion of long-term debt decreased $14.0 million (14.6%) from December 31, 2015 to December 31, 2016. The decrease in the current portion of long-term debt was comprised of a $1.1 million decrease in current bond payments and a $12.9 million decrease in current notes payable and capital leases. The decrease in the current portion of bond payments primarily relates to regularly scheduled principal payments that include payments on the Akron General bonds that were paid prior to the defeasance and redemption of the bonds in 2016, offset by reclassifications of debt from long-term to current. The decrease in notes payable and capital leases primarily relates to payments on notes and leases that matured in 2016, offset by reclassifications from long-term to current.

Variable rate debt classified as current increased $7.9 million (1.5%) from December 31, 2015 to December 31, 2016. Long-term debt classified as current consists of variable-rate bonds supported by the System's self-liquidity program and bonds with letters of credit or standby bond purchase agreements that expire within one year, require repayment of a remarketing draw within one year or contain a subjective clause that would allow the lender to declare an event of default and cause immediate repayment of such bonds. The increase in the variable rate debt classified as current in 2016 is primarily due to $71.0 million of outstanding Series 2014A CP Notes issued in 2016 that are supported by the System's self-liquidity program and a $25.1 million increase due to a reclassification of debt from long-term that qualifies to be reported as current This was offset by the redemption of the Series 2014A Akron Bonds and the Series 2014B Akron Bonds, which totaled $86.0 million at December 31, 2015.

Other current liabilities decreased $4.5 million (1.0%) from December 31, 2015 to December 31, 2016. The decrease in other current liabilities is primarily due to a $36.7 million decrease in state franchise fee liabilities due to the timing of the payments for this program and a $3.6 million decrease in current third-party cost report liabilities. These decreases were offset by an $11.1 million increase in derivative liabilities associated with the changes in fair value of the System's foreign exchange derivative contracts and a $4.4 million liability related to the System's Medicare Accountable Care Organization.

Hospital revenue bonds increased $199.5 million (7.3%) from December 31, 2015 to December 31, 2016. The increase in hospital revenue bonds is primarily due to the issuance of $325.0 million of private placement debt and $17.4 million of a direct placement loan in 2016. This was offset by the reclassification of $59.8 million from long-term to current for bond payments due within one year, the reclassification of $25.1 million from long-term to variable rate debt classified as current and the defeasance and redemption of $56.5 million of Akron General

bonds that were classified as long-term at December 31, 2015.

Notes payable and capital leases increased $50.7 million (10.9%) from December 31, 2015 to December 31, 2016. The increase is primarily due to a $60.0 million draw on a revolving credit facility and $15.5 million of new capital leases, offset by the reclassification of regularly scheduled principal payments from long-term to current. The revolving credit facility is classified as long-term since it does not expire within one year and the loans automatically renew throughout the term of the facility.

Professional and general insurance liability reserves increased $6.5 million (4.6%) from December 31, 2015 to December 31, 2016. The increase is due to the growth in expected claim liabilities in excess of claim liability payments.

Accrued retirement benefits decreased $11.9 million (2.4%) from December 31, 2015 to December 31, 2016. The change in accrued retirement benefits is comprised of a $0.1 million increase in the System's defined benefit pension plan liabilities and a $12.0 million decrease in other postretirement benefit liabilities. The increase in defined benefit pension plan liabilities was primarily due to $105.6 of net periodic benefit cost, which includes the recognition of $108.5 million of actuarial losses in excess of the corridor, $23.7 million of retirement benefits adjustment for net actuarial gains and losses and prior service credits recorded to unrestricted net assets and a $0.1 million reclassification of liabilities from current to long-term, offset by $129.3 million of employer contributions. The recognition of actuarial losses in net periodic benefit cost for the defined benefit plans resulted from a decrease in the discount rate used to determine the benefit obligation and investment performance that was below expectations. The decrease in other postretirement liabilities was primarily comprised of $9.7 million in employer contributions and a reduction for retirement benefits adjustment for $5.9 million, offset by $2.1 million in net periodic benefit cost, which includes a $4.4 million reduction to other post retirement liabilities for the recognition of actuarial losses outside of the corridor, and $0.4 million reclassification from current to long-term.

Other noncurrent liabilities increased $12.2 million (2.5%) from December 31, 2015 to December 31, 2016. The increase in other noncurrent liabilities is primarily due to a $25.7 million increase in employee benefit related liabilities and an $8.2 million increase in noncurrent third-party cost report liabilities. These increases were offset by a $19.9 million decrease in derivative liabilities associated with changes in the fair value of the System's interest rate swap derivative contracts.

Total net assets increased $516.8 million (6.9%) from December 31, 2015 to December 31, 2016. Unrestricted net assets increased $460.8 million (7.0%) primarily due to an excess of revenues over expenses of $513.5 million and $23.4 million in assets released from restriction for capital purposes, offset by a decrease of $59.2 resulting from foreign currency translation losses and a decrease of $17.8 million for retirement benefits adjustment. Temporarily restricted net assets increased $41.2 million (7.0%), primarily due to $84.3 million in temporarily restricted gifts and $24.5 million in net investment income offset by $68.0 million in assets released from restrictions. Permanently restricted net assets increased $14.8 million (5.0%) primarily due to $16.9 million of permanently restricted gifts offset by a $2.1 million decrease in the value of perpetual trusts.

FORWARD-LOOKING STATEMENTS

Forward-looking statements contained in this report and other written reports and oral statements are made based on known events and circumstances at the time of release, and as such, are subject in the future to unforeseen uncertainties and risks. All statements regarding future performance, events or developments are forward-looking statements. It is possible that the System's future performance may differ materially from current expectations depending on economic conditions within the healthcare industry and other factors. Among other factors that might affect future performance are:

- Changes to the Medicare and Medicaid reimbursement systems resulting in reductions in payments and/or changes in eligibility of patients to qualify for Medicare and Medicaid;
- Legislative reforms or actions that reduce the payment for, and/or utilization of, healthcare services, such as the Patient Protection and Affordable Care Act and/or draft legislation to address reimbursement cuts related to the Sustainable Growth Rate Formulas;
- Possible repeal and/or replacement of the Patient Protection and Affordable Care Act;
- Adjustments resulting from Medicare and Medicaid reimbursement audits, including audits initiated by the Medicare Recovery Audit Contractor program;
- Increased competition in the areas served by the System and limited options to respond to the same in part due to uncertainty in the enforcement of antitrust laws;
- The ability of the System to access capital for the funding of capital projects;
- Availability of malpractice insurance at reasonable rates, if at all;
- The System's ability to recruit and retain professionals;
- General economic and business conditions, internationally, nationally and regionally, including the impact of interest rates, foreign currencies, financial market conditions and volatility and increases in the number of self-pay patients;
- The increasing number and severity of cyber threats and the costs of preventing them and protecting patient and other data;
- The declining population in the Greater Cleveland area;
- Impact of federal laws on tax-exempt organizations and state law relating to exemption from income taxes, sales taxes and real estate taxes;
- Management, utilization and increases in the cost of medical drugs and devices as technological advancement progresses without concurrent increases in federal reimbursement;
- Ability of the System to adjust its cost structure and reduce operating expenses; and
- Changes in accounting standards or practices.

The System undertakes no obligation to update or publicly revise these forward-looking statements to reflect events or circumstances that arise after the date of this report.