Consolidated Financial Statements

Mercy Health
Years Ended June 30, 2017 and 2016
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Mercy Health

Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

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Ernst & Young LLP
The Plaza in Clayton
Suite 1300
190 Carondelet Plaza
St. Louis, MO 63105-3434

Tel: +1 314 290 1000
Fax: +1 314 290 1882
ey.com

Report of Independent Auditors

The Board of Directors
Mercy Health

We have audited the accompanying consolidated financial statements of Mercy Health, which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Ernst & Young LLP

September 22, 2017

Mercy Health

Consolidated Balance Sheets

(In Thousands)

	June 30	
	2017	**2016**
Assets		
Current assets:		
Cash and cash equivalents	**$ 523,451**	$ 543,962
Accounts receivable, net of allowance for uncollectible receivables of $146,144 and $142,518 in 2017 and 2016, respectively	**659,818**	594,873
Inventories	**104,510**	106,544
Short-term investments	**32,610**	34,160
Other current assets	**148,484**	122,316
Total current assets	**1,468,873**	1,401,855
Investments	**2,093,175**	1,753,214
Property and equipment, net	**2,941,387**	2,630,379
Other assets	**579,686**	563,163
Total assets	**$ 7,083,121**	$ 6,348,611
Liabilities and net assets		
Current liabilities:		
Current maturities of long-term obligations	**$ 13,449**	$ 7,167
Accounts payable	**228,872**	170,487
Accrued payroll and related liabilities	**428,141**	418,323
Accrued liabilities and other	**250,878**	247,609
Total current liabilities	**921,340**	843,586
Insurance reserves and other liabilities	**455,828**	449,485
Pension liabilities	**363,384**	436,661
Long-term obligations, less current maturities	**1,524,860**	1,359,288
Total liabilities	**3,265,412**	3,089,020
Net assets:		
Unrestricted	**3,713,187**	3,168,997
Restricted	**104,522**	90,594
Total net assets	**3,817,709**	3,259,591
Total liabilities and net assets	**$ 7,083,121**	$ 6,348,611

See accompanying notes.

Mercy Health

Consolidated Statements of Operations
(In Thousands)

	Year Ended June 30	
	2017	2016
Operating revenues:		
Patient service revenues (net of contractuals and discounts)	**$5,305,455**	$4,983,335
Provision for uncollectible receivables	**(330,078)**	(215,926)
Net patient service revenues	**4,975,377**	4,767,409
Capitation revenues	**258,899**	234,240
Other operating revenues	**293,554**	299,586
Total operating revenues	**5,527,830**	5,301,235
Operating expenses:		
Salaries and benefits	**3,083,012**	3,000,028
Supplies and other	**1,863,582**	1,784,546
Medical claims expense	**84,169**	97,027
Interest	**33,432**	35,394
Depreciation and amortization	**295,763**	311,445
Impairment and restructuring losses, net	**–**	6,351
Total operating expenses	**5,359,958**	5,234,791
Operating income	**167,872**	66,444
Nonoperating gains (losses):		
Investment returns, net	**158,254**	(38,932)
Realized and unrealized gains (losses) on interest rate swaps, net	**20,797**	(36,001)
Inherent contribution of acquired entities	**120,206**	–
Other, net	**(2,244)**	2,978
Total nonoperating gains (losses), net	**297,013**	(71,955)
Excess (deficit) of revenues over expenses	**464,885**	(5,511)
Other changes in unrestricted net assets:		
Pension liability adjustments	**66,706**	(82,662)
Net assets released from restrictions for property acquisitions	**10,104**	8,703
Other	**2,495**	(4,786)
Increase (decrease) in unrestricted net assets	**$ 544,190**	$ (84,256)

See accompanying notes.

Mercy Health

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended June 30	
	2017	**2016**
Increase (decrease) in unrestricted net assets	**$ 544,190**	$ (84,256)
Restricted net assets:		
Pledges, bequests, and gifts for specific purposes	**24,823**	16,745
Investment returns, net	**2,548**	(619)
Net assets released from restrictions	**(20,691)**	(20,784)
Contribution of restricted net assets of acquired entities	**6,725**	–
Other	**523**	(516)
Increase (decrease) in restricted net assets	**13,928**	(5,174)
Increase (decrease) in net assets	**558,118**	(89,430)
Net assets at beginning of year	**3,259,591**	3,349,021
Net assets at end of year	**$ 3,817,709**	$ 3,259,591

See accompanying notes.

Mercy Health

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2017	**2016**
Operating activities		
Change in net assets	**$ 558,118**	$ (89,430)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Pension liability adjustments	**(66,706)**	82,662
Pledges, bequests, and gifts for specific purposes	**(24,823)**	(16,745)
Inherent contribution of acquired entities	**(126,931)**	–
Unrealized (gain) loss on interest rate swap	**(30,154)**	25,525
Depreciation and amortization	**295,763**	311,445
Provision for uncollectible receivables	**330,078**	215,926
Net (gain) loss on disposal of property	**(1,047)**	1,975
Changes in assets and liabilities:		
Accounts receivable	**(342,045)**	(229,132)
Investments classified as trading	**(154,961)**	(20,874)
Inventories and other current assets	**9,217**	(22,824)
Accounts payable	**36,056**	43,098
Accrued liabilities and other	**(68,526)**	37,266
Insurance reserves and other liabilities	**13,284**	4,930
Net cash provided by operating activities	**427,323**	343,822
Investing activities		
Additions to property and equipment, net	**(321,613)**	(230,378)
Net change in notes receivable and other assets	**(2,865)**	(11,524)
Net change in alternative investments	**(146,525)**	124,102
Cash received from contribution of St. Anthony's Medical Center	**10,132**	–
Net cash used in investing activities	**(460,871)**	(117,800)

Mercy Health

Consolidated Statements of Cash Flows (continued)
(In Thousands)

	Year Ended June 30	
	2017	**2016**
Financing activities		
Proceeds from issuance of long-term debt, net of original issue discount and financing costs	**$ 81,790**	$ –
Principal payments on long-term obligations	**(93,576)**	(60,252)
Pledges, bequests, and gifts for specific purposes	**24,823**	16,745
Net cash provided by (used in) financing activities	**13,037**	(43,507)
Net (decrease) increase in cash and cash equivalents	**(20,511)**	182,515
Cash and cash equivalents at beginning of year	**543,962**	361,447
Cash and cash equivalents at end of year	**$ 523,451**	$ 543,962
Supplemental disclosures		
Cash paid for interest	**$ 36,182**	$ 37,504

See accompanying notes.

1. Organization

Mercy Health (Mercy) was incorporated in September 1986 and is the sole corporate member of various health care corporations. Mercy is sponsored by Mercy Health Ministry, a Public Juridic Person whose board members include Sisters of Mercy and lay leaders. Prior to sponsorship by Mercy Health Ministry, Mercy was sponsored by the Institute of the Sisters of Mercy of the Americas, Regional Community of St. Louis, a religious order of the Roman Catholic Church.

Mercy and each of its subsidiaries listed below are incorporated as not-for-profit corporations under the laws of the state of Missouri and are tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code (the Code).

Mercy's ministry office (headquarters) is located in St. Louis, Missouri. The Health System (Health System) comprises the following corporations and their subsidiaries:

- Mercy Health; St. Louis, Missouri
- Mercy Health Fort Smith Communities; Fort Smith, Arkansas
- Mercy Health Northwest Arkansas Communities; Rogers, Arkansas
- Mercy Health East Communities; St. Louis, Missouri
- Mercy Health Springfield Communities; Springfield, Missouri
- Mercy Health Oklahoma Communities, Inc.; Oklahoma City and Ardmore, Oklahoma
- Mercy Health Southwest Missouri/Kansas Communities; Joplin, Missouri, and Fort Scott, Kansas

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

(Tables in Thousands)

1. Organization (continued)

Significant Acquisitions and Divestitures

On June 1, 2017, the Health System entered into a change in sponsorship agreement with St. Anthony's Medical Center (St. Anthony's), a not-for-profit hospital located in Arnold, Missouri. The acquisition provided Mercy's patients with access to a greater number of specialists and enhanced the coordination of health services. This transaction was accounted for as an acquisition in accordance with Accounting Standards Codification (ASC) Topic 958-805, *Business Combinations – Not-for-Profit Entities*, and acquired assets and liabilities were recorded at fair value, a Level 3 measurement.

The following table summarizes the acquisition date fair values of the assets acquired and liabilities assumed:

Assets acquired:	
Cash and investments	**$ 59,247**
Accounts receivable	**52,978**
Inventory, prepaid expenses, and other current assets	**19,511**
Property, plant, and equipment	**284,111**
Other long-term assets	**13,658**
Total assets acquired	**429,505**
Liabilities assumed:	
Accounts payable	**22,329**
Accrued and other liabilities	**96,605**
Long-term obligations	**183,640**
Total liabilities assumed	**302,574**
	$ 126,931

The fair value of net assets of $126.9 million in the preceding table was recognized in the consolidated statement of operations and changes in net assets for the year ended June 30, 2017, as a nonoperating inherent contribution of acquired entities of $120.2 million and contribution of restricted net assets of acquired entities of $6.7 million.

1. Organization (continued)

The operating results of St. Anthony's are included in the Health System's consolidated financial statements from the date of acquisition. Operating revenues of the entities acquired in fiscal 2017 included in the consolidated statement of operations were $38.6 million for the year ended June 30, 2017.

On an unaudited pro forma basis, had the Health System completed the fiscal 2017 St. Anthony's acquisition as of the beginning of each fiscal year presented, the acquisitions would have reported $473.7 million and $482.3 million in additional operating revenues in fiscal years 2017 and 2016, respectively, and $(58.6 million) and $(11.5 million) in reduction of excess of revenues over expenses for the years ended June 30, 2017 and 2016, respectively. However, the unaudited pro forma information is not necessarily indicative of the historical results that would have been obtained had the transactions actually occurred on those dates, nor of future results.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding amounts classified as investments, are considered cash equivalents. The Health System routinely invests in money market mutual funds. These funds generally invest in highly liquid U.S. government and agency obligations. Financial instruments that potentially subject the Health System to concentrations of credit risk include the Health System's cash and cash equivalents. The Health System places its cash and cash equivalents with institutions with high credit quality. However, at certain times, such cash and cash equivalents are in excess of government-provided insurance limits.

Inventories

Inventories, which consist principally of medical supplies and pharmaceuticals, are stated at the lower of cost or market. Cost is determined principally using the average cost method.

Property and Equipment

Property and equipment are stated at cost or, if donated, at fair value at the date of receipt.

2. Summary of Significant Accounting Policies (continued)

Depreciation is provided using the straight-line method over the estimated useful lives of land and leasehold improvements, buildings, and equipment. The estimated useful lives are as follows: land and leasehold improvements, 2 to 40 years; buildings, 3 to 80 years; and equipment, 2 to 20 years.

Property and equipment under capital lease obligations are amortized using the straight-line method over the lease term or the estimated useful life of the leased asset, whichever period is shorter. Such amortization is included with depreciation on the accompanying consolidated statements of operations.

Asset Impairment

The Health System periodically evaluates the carrying value of its long-lived assets for impairment when indicators of impairment are identified. These evaluations are primarily based on the estimated recoverability of the assets' carrying value based on undiscounted cash flows. Impairment write-downs are recognized in operating income at the time the impairment is identified.

Other Assets

Other assets consist primarily of investment securities held under deferred compensation arrangements, land held for future development, notes receivable, and investments in unconsolidated affiliates. The equity method of accounting is used for investments in unconsolidated affiliates where the Health System does not have significant control or where ownership is 50% or less. The equity income or loss on these investments is recorded in other operating revenues on the consolidated statements of operations.

Goodwill

The Health System records goodwill arising from a business combination as the excess of purchase price and related costs over the fair value of identifiable tangible and intangible assets acquired and liabilities assumed. The Health System has six reporting units. The Health System annually reviews the carrying value of goodwill for impairment. In addition, a goodwill impairment assessment is performed whenever circumstances indicate a potential impairment may exist. If such circumstances suggest that the recorded amounts of any of these assets cannot be recovered, the carrying values of such assets are reduced to fair value. If the carrying value of any of these assets is impaired, a material charge may be incurred to results of operations.

2. Summary of Significant Accounting Policies (continued)

Net Assets

The Health System's net assets and activities are classified into two classes, restricted and unrestricted, based on the existence or absence of donor-imposed restrictions. Restricted net assets include temporarily restricted net assets (76% and 75% of restricted net assets at June 30, 2017 and 2016, respectively), whose use by the Health System has been limited by donors to a specific time period or for a particular purpose, and permanently restricted net assets (24% and 25% of restricted net assets at June 30, 2017 and 2016, respectively), which must be maintained by the Health System in perpetuity with the related investment income available to support the donor-designated purpose. The general nature of the donor restrictions is to support the Health System's indigent care mission and health education programs and to assist with capital projects.

Net Patient Service Revenues and Patient Accounts Receivable

Patient service revenues (net of contractuals and discounts) are recorded during the period the health care services are provided and are reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Estimates of contractual allowances under managed care health plans are based upon the services provided, historical payment rates, and the payment terms specified in the related contractual agreements. Revenues related to uninsured patients have discounts applied in accordance with the Health System's policy. Net patient service revenue is reported net of the provision for uncollectible receivables.

Patient accounts receivable that are deemed uncollectible, including those placed with collection agencies, are initially charged against the allowance for uncollectible accounts in accordance with collection policies of the Health System and, in certain cases, are reclassified to charity care if deemed to otherwise meet the Health System's charity care policy. The provision for uncollectible receivables is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible receivables based upon the payor composition and aging of receivables with consideration of the historical payment and write-off experience by payor category. The results of these reviews are then used to make any modifications to the provision for uncollectible receivables to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the Health System follows established guidelines for placing past-due patient balances with collection agencies.

2. Summary of Significant Accounting Policies (continued)

Retroactive third-party adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known. Adjustments to revenue based on prior periods increased net patient service revenues by approximately $20.8 million and $9.7 million in 2017 and 2016, respectively, due to revised estimates consisting primarily of retroactive third-party adjustments for years that are subject to audits, reviews, and investigations.

Capitation Revenues and Medical Claims Expense

Mercy has entered into various risk-based contracts with certain health maintenance organizations (HMOs). Under these arrangements, Mercy receives capitated payments based on the demographic characteristics of covered members in exchange for agreeing to provide certain medical services to those members. These payments are reflected as capitation revenues on the consolidated statements of operations. Mercy recognizes medical claims expense for services provided to members from out-of-network providers. The medical claims expense represents claims paid, claims reported but not yet paid, and an estimate of claims incurred but not reported (IBNR). The claims IBNR amount is estimated based upon prior experience modified for current trends. The claims IBNR amount was $9.6 million and $10.7 million at June 30, 2017 and 2016, respectively, and was included in accrued liabilities and other on the consolidated balance sheets.

Services to the Community

In support of its mission, the Health System provides care to patients who personally bear a significant financial burden relative to their health care services and are deemed to be medically indigent. Traditional charity care includes the cost of services provided to persons who cannot afford health care because of the financial burden of the health care services and/or who are uninsured or underinsured. Traditional charity care also includes services for which the patient may not participate in the charity care process but is otherwise deemed to meet the Health System's charity care policy.

Because the Health System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as net patient service revenue. The cost of traditional charity care was $160.7 million and $207.9 million in 2017 and 2016, respectively. The Health System estimates cost of charity care using a calculated ratio of costs to charges by hospital and clinic and applies that ratio to the relevant gross charges, less any payments received.

2. Summary of Significant Accounting Policies (continued)

Health care services to patients under government programs, such as Medicare and Medicaid, are also considered part of the Health System's benefit provided to the community since a portion of such services are reimbursed at amounts less than cost. In addition, the Health System maintains community benefit programs designed to positively impact the health status of the communities served. These services include various clinics and outreach programs (designed to deliver health care services to underserved communities), medical education and research activities, and direct cash and in-kind charitable contributions.

These community benefit programs also include the activities of Mercy Ministries of Laredo (MML), Mercy Caritas, Catherine's Fund, and Mercy Family Center which are administered by the Health System. These programs finance charitable activities to help meet the needs of the poor, sick, and uneducated.

Investments

Investments include assets set aside through resolution by the Board of Directors for future long-term purposes. In addition, investments include amounts contributed by donors with stipulated restrictions. Investments also include amounts held by trustees under bond indenture agreements, as well as amounts held under the terms of other trust agreements. These assets include investments in equity securities and debt securities, which are measured at fair value. The cost of securities sold is based on the specific-identification method. The Health System accounts for its ownership interest in alternative investments under the equity method. Management has utilized the best available information for reported alternative investment values, which in some instances are valuations as of an interim date.

For purposes of recognizing investment returns as a component of excess of revenues over expenses, substantially all investments, other than alternative investments, are considered to be trading securities. Unrestricted investment returns, including alternative investments, are included in nonoperating gains and losses on the consolidated statements of operations. Investment returns arising from donor-restricted resources are reported as a direct increase or decrease in restricted net assets on the consolidated statements of changes in net assets, consistent with the donors' restrictions. In addition, cash flows from the purchases and sales of marketable securities designated as trading are reported as a component of operating activities on the accompanying consolidated statements of cash flows.

2. Summary of Significant Accounting Policies (continued)

Derivative Financial Instruments

Derivative financial instruments are contracts between the Health System and a third party (counterparty) that provide for economic payments between the parties based on changes in a defined market security or index or combination thereof. The Health System's derivative financial instruments are primarily interest rate swap agreements utilized as part of its debt management process. The Health System recognizes all derivative financial instruments as either assets or liabilities on the consolidated balance sheets at fair value. The Health System does not offset fair value amounts recognized for derivative financial instruments and fair value amounts posted as cash collateral. The Health System does not account for any of its interest rate swap agreements as hedges, and accordingly, realized and unrealized gains (losses) and net settlement payments are reflected as a component of nonoperating gains and losses on the accompanying consolidated statements of operations.

Pledges, Bequests, and Gifts for Specific Purposes

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. Gifts are recorded as an increase in restricted net assets if they are received with donor stipulations that limit the use of the assets. Upon expenditure in accordance with a donor's restrictions and when the asset is placed in service, net assets restricted for capital acquisitions are reported as direct additions to unrestricted net assets, and assets restricted for operating purposes are reported as an increase in other operating revenues. Donor-restricted contributions for operating purposes whose restrictions are met within the same year as received, and contributions received by donors without restrictions, are reflected as other operating revenues on the accompanying consolidated statements of operations.

Functional Classification of Expenses

The Health System provides general health care services to residents within communities served, including acute inpatient, subacute inpatient, physician, outpatient, ambulatory, long-term, and home care, as well as related general and administrative services.

2. Summary of Significant Accounting Policies (continued)

The Health System does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Furthermore, since the Health System receives substantially all of its resources from providing health care services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged its stewardship responsibilities.

Operating Indicator

The Health System's operating indicator (operating income) includes all unrestricted revenue, gains and other support, and expenses directly related to the recurring and ongoing health care operations during the reporting period. The operating indicator excludes nonoperating gains and losses, pension liability adjustments, inherent contribution of acquired entities, and net assets released from restrictions for property acquisitions.

Performance Indicator

The Health System's performance indicator, excess (deficit) of revenues over expenses, includes all changes in unrestricted net assets other than pension liability adjustments, and net assets released from restrictions for property acquisitions.

Operating and Nonoperating Gains (Losses)

The Health System's primary mission is to meet the health care needs in its market areas by providing general health care services to residents within communities served, including acute inpatient, subacute inpatient, physician, outpatient, ambulatory, long-term, and home care, as well as related general and administrative services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to the Health System's primary mission are considered to be nonoperating. Nonoperating activities include net investment returns, net realized and unrealized gains (losses) on interest rate swaps, and inherent contribution of acquired entities.

2. Summary of Significant Accounting Policies (continued)

Restructuring, Impairment, and Other Losses

The Health System periodically evaluates property, equipment, goodwill, and certain other intangible assets to determine whether assets may have been impaired. In September 2015, Mercy announced it would shut down Mercy Hospital Independence and Mercy Clinic Independence (Independence), which operated an acute care hospital and physician clinics in Independence, Kansas. The hospital closed in October 2015, and clinic services closed by December 2015. Management determined there were certain property and equipment impairments in 2015, to the extent that the fair values of those assets were less than the underlying carrying values. During the year ended June 30, 2016, Mercy recorded total charges of $6.4 million, relating to asset and goodwill impairments, and changes in business operations, including reorganization and severance costs.

Use of Estimates

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

Reclassifications

Certain prior year amounts on the accompanying consolidated financial statements have been reclassified to conform to the 2017 presentation. These reclassifications had no effect on excess (deficit) of revenues over expenses and losses or net assets previously reported.

Federal Income Tax

Primarily all of the Health System entities are recognized by the Internal Revenue Service (IRS) as exempt from federal income tax under Section 501(a) of the Internal Revenue Code as charitable organizations qualifying under Internal Revenue Code Section 501(c)(3), by virtue of IRS determination letters or inclusion in the Official Catholic Directory. The Health System completed an analysis of its tax positions in accordance with applicable accounting guidance and determined that no amounts were required to be recognized on the consolidated financial statements at June 30, 2017 or 2016.

2. Summary of Significant Accounting Policies (continued)

Accounting Pronouncements Adopted

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. (ASU) 2015-03, *Interest – Imputation of Interest, Simplifying the Presentation of Debt Issuance Costs*. This guidance simplifies the presentation of debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The new guidance became effective for interim and annual periods beginning on or after July 1, 2016 for Mercy. The adoption of the guidance beginning July 1, 2016, had no material effect on Mercy's results of operations, financial condition, cash flows, or financial statement presentation for the June 30, 2017, financial statements.

Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB and International Accounting Standards Board issued ASU 2014-09, *Revenue from Contracts with Customers*, which replaces all existing International Financial Reporting Standards and U.S. GAAP revenue requirements. Mercy is currently evaluating the effects of the standard on its financial statements. The standard is not effective for Mercy until the fiscal year starting July 1, 2018.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which replaces all existing U.S. GAAP lease requirements. Mercy is currently evaluating the effects of the standard on its financial statements. The standard is not effective for Mercy until the fiscal year ending June 30, 2020.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Mercy is currently evaluating the effects of the standard on its financial statements. The standard is not effective for Mercy until the fiscal year ending June 30, 2019.

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*. Mercy is currently evaluating the effects of the standard on its financial statements. The standard is not effective for Mercy until the fiscal year ending June 30, 2019.

(Tables in Thousands)

3. Net Patient Service Revenue and Patient Receivables

The following is a summary of the Health System's patient service revenues, net of contractual allowances and discounts (before the provision for uncollectible receivables), by major payor. Medicare and Medicaid managed plans are grouped with Medicare and Medicaid, respectively.

	Year Ended June 30	
	2017	**2016**
Medicare	**$ 1,964,479**	$ 1,896,359
Medicaid	**466,557**	506,055
Managed care/other	**2,640,932**	2,424,701
Self-pay	**233,487**	156,220
	$ 5,305,455	$ 4,983,335

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Noncompliance with Medicare and Medicaid laws and regulations can make the Health System subject to significant regulatory action, including substantial fines and penalties, as well as exclusion from the Medicare and Medicaid programs.

The Health System provides health care services through inpatient and outpatient care facilities located in several states. The Health System grants credit to patients in return for health care services rendered to said patients, substantially all of whom are residents of the communities served. The Health System does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). At June 30, 2017 and 2016, approximately 38% and 37%, respectively, of net accounts receivable were collectible from governmental payors (including Medicare and Medicaid), with approximately 48% and 53%, respectively, of net accounts receivable collectible from commercial insurance and managed care payors.

The allowance for uncollectible receivables was approximately $146.1 million and $142.5 million as of June 30, 2017 and 2016, respectively. These balances as a percentage of accounts receivable net of contractual allowances were approximately 18% and 19% as of June 30, 2017 and 2016, respectively. The Health System's allowance for uncollectible receivables covered approximately

(Tables in Thousands)

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

68% and 58% of self-pay patient receivables, including patient responsibility, as of June 30, 2017 and 2016, respectively. The Health System has experienced an increase in write-off trends related to charity driven by loss of employer-sponsored insurance plans and rising patient responsibility balances. The Health System reviews and updates its uninsured discount rate on an annual basis. There have been no significant changes to the charity care policies for the years ended June 30, 2017 or 2016. The Health System does not maintain a material allowance for uncollectible receivables from third-party payors, nor did it have significant write-offs from third-party payors.

The following is a summary of the Health System's allowance for uncollectible receivables activity:

Balance at June 30, 2015	$ 171,523
Provision for uncollectible receivables	215,926
Accounts written off, net of recoveries and other	(244,931)
Balance at June 30, 2016	142,518
Provision for uncollectible receivables	**330,078**
Accounts written off, net of recoveries and other	**(326,452)**
Balance at June 30, 2017	**$ 146,144**

4. Investments

The following is a summary of investments:

	June 30	
	2017	**2016**
Board-designated	**$ 2,043,160**	$ 1,732,798
Bond proceeds held under indenture	**–**	4,116
Professional liability trust fund	**15,802**	–
Restricted by donor or grantor	**66,823**	50,460
Total investments	**2,125,785**	1,787,374
Less short-term investments	**(32,610)**	(34,160)
	$ 2,093,175	$ 1,753,214

The professional liability trust fund is related to the current year acquisition of St. Anthony's; refer to Note 1.

(Tables in Thousands)

4. Investments (continued)

During fiscal year 2016, the Mercy Investment Committee approved a new Investment Policy Statement which outlines subasset classification targets for both the Mercy Investment Fund, as well as the Pension Plan. Mercy reallocated the Mercy Investment Fund to be in compliance with the new targets, effective as of July 1, 2016. The following is a summary of investments by classification:

	June 30	
	2017	**2016**
Cash and cash equivalents	**$ 136,653**	$ 180,289
Equities:		
Domestic equities	**275,552**	218,369
International equities – developed	**246,014**	182,050
International equities – emerging markets	**78,091**	74,738
Fixed income:		
Corporate bonds	**371,400**	286,711
Government and agencies	**147,372**	171,701
Real assets – commodities	**108,677**	77,375
Mutual funds – multi-asset class	**56,998**	14,979
Alternative investments:		
Hedge funds	**464,497**	403,334
Private equity investment funds	**75,793**	48,266
Private debt investment funds	**106,583**	90,506
Real assets – limited partnerships private energy	**19,954**	7,900
Real assets – limited partnerships real estate	**17,865**	12,583
Other	**20,336**	18,573
	2,125,785	1,787,374
Less short-term investments	**(32,610)**	(34,160)
Total investments	**$ 2,093,175**	$ 1,753,214

(Tables in Thousands)

4. Investments (continued)

The following is a summary of investment returns:

	Year Ended June 30 2017	2016
Investments:		
Interest and dividends	**$ 23,844**	$ 19,070
Realized gains, net	**39,091**	55,451
Interest expense on Series 2001 bonds	**(2,392)**	(1,578)
Unrealized gains (losses), net	**97,711**	(111,875)
Investment returns included in nonoperating gains (losses), net	**158,254**	(38,932)
Investment returns included in restricted net assets	**2,548**	(619)
Total investment returns	**$ 160,802**	$ (39,551)

The Health System's investments are exposed to various kinds and levels of risk. Fixed income securities expose the Health System to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed income securities is affected, particularly those with fixed rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Equity securities expose the Health System to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets, both foreign and domestic. Performance risk is the risk associated with a company's operating performance. Liquidity risk as previously defined tends to be higher for foreign equities and equities related to small capitalization companies.

Certain of the Health System's investments are made through alternative investments, primarily private limited partnership investments (equity, debt, real asset) and absolute return (hedge) funds. These investments provide the Health System with a proportionate share of the investment gains and losses. The fund manager has full discretionary authority (within their given mandate) over the investment decisions and provides the net asset valuation, typically through third-party administrators. The hedge funds and private limited partnership funds present risks similar to those of traditional investments, as well as some additional risks. Due to the fact that these funds are invested through limited partnerships or other limited access-type vehicles, pricing is infrequent and liquidity may also be limited, in some cases, up to 24 months for hedge funds.

4. Investments (continued)

Due to infrequent pricing and illiquidity of underlying investments, it is common practice for private limited partnership funds to require investors to commit to a ten-year investment period, although the distribution of capital is likely to occur prior to the ten-year termination date. Certain hybrid limited partnership funds may invest in liquid securities; however, the investments would be inaccessible for the term of the structure. Terms for these hybrid vehicles could be shorter in duration, lasting up to five years for the full investment and distribution periods. These investments may also employ leverage, which may lead to additional risk of loss. These investments are subject to market risk, default risk, interest rate risk, credit risk, and liquidity risk, as well as various other types of risks. At June 30, 2017, the Health System has commitments to fund $318.9 million in these investments.

At the balance sheet dates, receivables and payables for investment trades not settled are presented with other current assets and accrued liabilities and other. Unsettled sales resulted in receivables due from brokers of $28.7 million and $14.9 million at June 30, 2017 and 2016, respectively. Unsettled buys resulted in payables of $15.8 million and $14.1 million at June 30, 2017 and 2016, respectively.

5. Fair Value Measurements

Fair value is 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. The fair value measurements and disclosures topic of the FASB ASC establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

> Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date.
>
> Level 2 – Pricing inputs other than quoted prices included in Level 1, which are either directly observable or can be derived or supported from observable data as of the reporting date.

(Tables in Thousands)

5. Fair Value Measurements (continued)

Level 3 – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. In evaluating the significance of input, the Health System generally classifies assets or liabilities as Level 3 when their fair value is determined using unobservable inputs that individually, or when aggregated with other unobservable inputs, represent more than 10% of the fair value of the assets or liabilities. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Financial assets and financial liabilities measured at fair value on a recurring basis were determined using the following inputs at June 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	$ 136,653	$ –	$ –	$ 136,653
Equities:				
Domestic equities	275,552	–	–	275,552
International equities – developed	87,220	–	–	87,220
International equities – emerging markets	37,562	–	–	37,562
Fixed income:				
Corporate bonds	9,267	224,584	–	233,851
Government and agencies	7,722	139,650	–	147,372
Real assets – commodities	83,584	–	–	83,584
Mutual funds – multi-asset class	56,998	–	–	56,998
Other	–	4,008	–	4,008
Assets not at fair value:				
Hedge funds				464,497
Private equities				182,376
Real assets				37,819
Commingled funds				361,965
Other				16,328
Total investments				$ 2,125,785
Deferred compensation plan assets:				
Cash and cash equivalents	$ 1,090	$ –	$ –	$ 1,090
Equities – mutual funds	216,792	–	–	216,792
	$ 217,882	$ –	$ –	$ 217,882
Collateral posted on interest rate swap agreements	$ 52,110	$ –	$ –	$ 52,110
Liabilities				
Interest rate swap agreements	$ –	$ 62,906	$ –	$ 62,906

(Tables in Thousands)

5. Fair Value Measurements (continued)

Financial assets and financial liabilities measured at fair value on a recurring basis were determined using the following inputs at June 30, 2016:

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	$ 180,289	$ –	$ –	$ 180,289
Equities:				
Domestic equities	218,369	–	–	218,369
International equities – developed	42,407	–	–	42,407
International equities – emerging markets	43,239	–	–	43,239
Fixed income:				
Corporate bonds	65,539	133,728	–	199,267
Government and agencies	–	171,701	–	171,701
Real assets – commodities	59,091	–	–	59,091
Mutual funds – multi-asset class	14,979	–	–	14,979
Other	–	2,312	–	2,312
Assets not at fair value:				
Hedge funds				403,334
Private equities				138,772
Real assets				20,483
Commingled funds				276,870
Other				16,261
Total investments				$ 1,787,374
Deferred compensation plan assets:				
Cash and cash equivalents	$ 505	$ –	$ –	$ 505
Equities – mutual funds	193,023	–	–	193,023
	$ 193,528	$ –	$ –	$ 193,528
Collateral posted on interest rate swap agreements	$ 81,570	$ –	$ –	$ 81,570
Liabilities				
Interest rate swap agreements	$ –	$ 88,967	$ –	$ 88,967

5. Fair Value Measurements (continued)

Deferred compensation plan assets and interest rate swaps (assets) are reported in other assets, and interest rate swaps (liabilities) are reported in insurance reserves and other liabilities on the consolidated balance sheets.

The following is a description of the Health System's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. The fair value of certain Level 2 securities was determined using multiple price types of bid/offer, last traded, settlement, evaluated, and the official primary exchange close-time pricing, provided by third-party pricing services if quoted market prices were not available. The quality of the prices received is evaluated through price comparisons and tolerance level checks. These Level 2 investments include corporate bonds, treasuries and agencies. The fair values of the interest rate swap contracts, also Level 2 measurements, are determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The valuations reflect a credit spread adjustment to the London Interbank Offered Rate (LIBOR) discount curve in order to reflect non-performance risk.

The credit spread adjustment is derived from the Health System's and other comparable rated entities' bonds priced in the market and adjusted with a gross up of the tax-exempt spread to a taxable equivalent spread for the Health System and counterparty bond trading levels (or credit default swap spreads).

The carrying values of cash and cash equivalents, accounts receivable, pledges receivable, and current liabilities are reasonable estimates of their fair values due to the short-term nature of these financial instruments. The fair value of the Health System's fixed rate bonds is based on quoted market prices for the same or similar issues and approximates $710.8 million and $670.7 million as of June 30, 2017 and 2016, respectively, which is a Level 2 measurement. The carrying amount approximates fair value for all other long-term debt, which is variable rate, and excludes the impact of third-party credit enhancements; this is a Level 2 measurement.

Due to the volatility of the financial market, there is a reasonable possibility of changes in fair value and additional gains and losses in the near term subsequent to June 30, 2017.

(Tables in Thousands)

6. Property and Equipment

The following is a summary of property and equipment:

	June 30			
		2017		**2016**
Land, land improvements, and leasehold improvements	**$**	**319,008**	$	285,179
Buildings		**3,622,827**		3,371,057
Equipment		**2,416,515**		2,308,300
Construction-in-progress		**187,597**		127,092
		6,545,947		6,091,628
Less accumulated depreciation		**(3,604,560)**		(3,461,249)
Property and equipment, net	**$**	**2,941,387**	$	2,630,379

At June 30, 2017, construction and software-related contracts and commitments exist for capital improvements at certain of the Health System's facilities. The remaining commitment on these contracts at June 30, 2017, was approximately $242.7 million, respectively. During the years ended June 30, 2017 and 2016, interest of $1.5 million and $0.6 million, respectively, was capitalized.

7. Other Assets

The following is a summary of other assets:

	June 30			
		2017		**2016**
Deferred compensation plan assets	**$**	**217,882**	$	193,528
Goodwill		**140,751**		140,751
Investment in unconsolidated affiliates		**63,622**		60,551
Swap collateral		**52,110**		81,570
Land held for future development		**43,814**		39,636
Notes receivable		**8,414**		11,141
Other		**53,093**		35,986
	$	**579,686**	$	563,163

8. Liability Programs

The Health System administers a liability program to provide for general and professional liability risks within certain limits. Health care professional liabilities in excess of self-insured limits are insured on a claims-made basis subject to an annual maximum of $25.0 million over the self-insured retention of $10.0 million, after which the Health System would again be responsible. The recorded liabilities are based upon actuarial estimates of reported claims and IBNR claims using historical claim experience and other relevant industry and hospital-specific factors and trends, discounted at an interest rate of 4.75% for 2017 and 2016. The discounted general and professional liability was $125.0 million and $134.1 million at June 30, 2017 and 2016, respectively, which is included in accrued liabilities and insurance reserves and other liabilities on the accompanying consolidated balance sheets. In addition, at June 30, 2017 and 2016, Mercy recorded net insurance receivables of $2.3 million and $2.2 million, respectively, which are included in other assets on the accompanying consolidated balance sheets.

St. Anthony's maintains a separate liability program for general and professional liability risks. St. Anthony's is self-insured for the first $4.0 million per occurrence of professional liability claims and purchases insurance coverage above the self-insurance limits. Losses from asserted and unasserted claims are accrued based on estimates that incorporate past experience, the nature of each claim or incident and relevant trend factors. The discounted general and professional liability was $9.7 million at June 30, 2017, which is included in accrued liabilities and insurance reserves and other liabilities.

9. Employee Retirement Plans

The Health System retirement benefits are provided through the frozen Personal Pension Account Plan (the Plan), the 401(k) Plan and the 403(b) Plan.

The Plan is a defined benefit retirement plan that was closed to new entrants and pay credits on June 30, 2011. The Plan was designed to provide retirement benefits to substantially all co-workers under a single plan, including groups acquired in business combinations. The Plan was amended over time to provide service credit for those co-workers who entered the Plan as a result of acquisitions or business combinations. Retirement benefits were originally provided based on a final average pay formula but were later transitioned to a cash balance-type formula. The cash balance formula provided an annual pay credit, based on employee compensation and years of service, and an annual interest credit based on the 30-year U.S. Treasury bill rate, subject to a minimum rate of 5.25%. Co-workers with benefits earned under the cash balance formula continue

9. Employee Retirement Plans (continued)

to earn interest credits each year. The interest credit continues to be based on the 30-year U.S. Treasury bill rate, but the minimum rate was reduced effective January 1, 2016, to comply with government regulations. The Plan is funded consistent with actuarial funding recommendations and the funding policy.

The Health System maintains various non-qualified defined benefit retirement plans that provide retirement income in excess of the limitations on benefits imposed by IRS limitations to certain key executives. These plans are closed to new entrants.

St. Anthony's has a defined benefit pension plan covering all employees. The plan was frozen effective June 30, 2009. The cash balance interest credit is the rate the participant's cash balance account is expected to grow with interest based upon a four-quarter average of the 3-Yr Treasury rates. The interest crediting rate is the rate the plan participant's cash balance account is expected to grow and the change in estimate is anticipated to be based on current market conditions. St. Anthony's also sponsors elective defined contribution plans available to substantially all employees, consisting of both a 401(k) plan and a 403(b) plan.

(Tables in Thousands)

9. Employee Retirement Plans (continued)

The following table sets forth the Plan's and certain other of the Health System's pension plans' benefit obligations, fair value of plan assets, and funded status at the measurement date:

	June 30	
	2017	**2016**
Accumulated benefit obligation	**$ 962,331**	$ 992,780
Changes in projected benefit obligation:		
Projected benefit obligation at beginning of period	**$ 992,780**	$ 976,006
St. Anthony's beginning projected benefit obligation	**41,614**	–
Interest cost	**26,318**	39,195
Plan amendments	**(14,106)**	–
Actuarial (gain) loss	**(19,522)**	53,910
Benefits paid	**(64,753)**	(76,331)
Projected benefit obligation at end of period	**962,331**	992,780
Changes in plan assets:		
Fair value of plan assets at beginning of period	**552,251**	623,996
St. Anthony's beginning fair value of plan assets	**38,886**	–
Actual return on plan assets	**46,638**	(16,697)
Employer contributions	**16,420**	21,283
Benefits paid	**(64,753)**	(76,331)
Fair value of plan assets at end of period	**589,442**	552,251
Funded status of the Plan	**$ (372,889)**	$ (440,529)

Amounts recognized on the accompanying consolidated balance sheets at June 30 consist of:

	2017	**2016**
Accrued liabilities and other	**$ 9,505**	$ 3,868
Pension liabilities	**363,384**	436,661
	$ 372,889	$ 440,529

(Tables in Thousands)

9. Employee Retirement Plans (continued)

No plan assets are expected to be returned to the Health System during the fiscal year ended June 30, 2017.

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic pension cost:

	Year Ended June 30	
	2017	2016
Unrecognized actuarial gain	**$ (435,515)**	$ (483,597)
Prior service cost (credit)	**13,566**	–
	$ (421,949)	$ (483,597)

Changes in plan assets and benefit obligations recognized in unrestricted net assets include:

	Year Ended June 30	
	2017	2016
Current year actuarial gain (loss)	**$ 21,397**	$ (118,609)
Amortization of actuarial loss	**9,078**	7,743
Settlement reduction of net actuarial loss	**22,665**	28,204
Current year prior service cost	**14,105**	–
Amortization of prior service cost (credit)	**(539)**	–
	$ 66,706	$ (82,662)

The estimated net actuarial loss included in unrestricted net assets and expected to be recognized in net periodic benefit cost during the year ending June 30, 2018, is $8.4 million. The impact of the change in discount rate on the projected benefit obligation of the Plan was a decrease of approximately $22.3 million and increase of $60.9 million for the years ended June 30, 2017 and 2016, respectively.

As of June 30, 2016, the Health System refined how it estimates the interest cost component of net periodic benefit costs to a spot discount rate approach for its defined benefit pension plan. Historically, the Health System estimated the interest cost component using a single weighted

(Tables in Thousands)

9. Employee Retirement Plans (continued)

average discount rate derived from a yield curve used to measure the benefit obligation at the beginning of the period. Under the spot discount rate approach, interest cost is estimated by applying the specific spot rates along the yield curve used in the determination of the benefit obligation to the relevant projected cash flows. The Health System made this change to improve the correlation between projected benefit cash flows and the corresponding yield curve spot rates and to provide a more precise measurement of the interest cost component of net periodic benefit costs. This change did not impact the projected benefit obligation or the net periodic benefit costs as of and for the year ended June 30, 2016. The Health System accounted for this change as a change in accounting estimate and, accordingly, accounted for it prospectively starting with the year ended June 30, 2017. This change does not affect measurements of the projected benefit obligation.

The following is a summary of the components of net periodic pension cost:

	Year Ended June 30	
	2017	**2016**
Interest cost on projected benefit obligation	**$ 26,318**	$ 39,195
Expected return on plan assets	**(44,762)**	(48,001)
Amortization of prior service costs	**(539)**	–
Amortization of unrecognized actuarial loss	**9,061**	7,743
Settlement/curtailment	**22,682**	28,204
Net periodic pension cost	**$ 12,760**	$ 27,141

Weighted average assumptions used to determine the Plan's projected benefit obligation and net periodic benefit costs are as follows:

	Projected Benefit Obligation		Net Periodic Benefit Costs	
	2017	**2016**	**2017**	**2016**
Discount rates	**3.42%–3.67%**	3.41%–3.45%	**2.50%–3.20%**	4.10%–4.20%
Expected long-term return on plan assets	**5.00%–7.50%**	7.70%	**5.00%–7.70%**	7.80%

(Tables in Thousands)

9. Employee Retirement Plans (continued)

The Plan's weighted average asset allocations and policy allocation range by asset category are as follows:

Asset Category	Policy Allocation Range	Plan Assets at June 30 2017	2016
Equity securities	**30%–50%**	**33%**	30%
Debt securities	**25–35**	**25**	19
Alternative investments	**17–56**	**34**	40
Other	**0–5**	**8**	11
Total	**100%**	**100%**	100%

The Plan's assets measured at fair value were determined using the following inputs at June 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	**$ 47,249**	**$ –**	**$ –**	**$ 47,249**
Equity securities:				
Domestic equities	**76,944**	**–**	**–**	**76,944**
International equities – developed	**24,484**	**–**	**–**	**24,484**
International equities – emerging markets	**10,800**	**–**	**–**	**10,800**
Fixed income:				
Corporate bonds	**1,801**	**59,797**	**–**	**61,598**
Government and agencies	**2,243**	**21,652**	**–**	**23,895**
Real assets – commodities	**24,215**	**–**	**–**	**24,215**
Mutual funds – multi-asset class	**14,210**	**–**	**–**	**14,210**
Other	**–**	**–**	**2,721**	**2,721**
Assets (fair value determined using NAV practical expedient):				
Hedge funds				**157,130**
Private equities				**52,949**
Real assets				**10,979**
Commingled funds				**82,268**
				$ 589,442

(Tables in Thousands)

9. Employee Retirement Plans (continued)

The following table is a rollforward of the pension plan assets classified within Level 3 of the valuation hierarchy:

		Other
Fair value at July 1, 2016	**$**	**2,738**
Purchases, sales, and settlements, net		**–**
Actual return on plan assets		**(17)**
Transfers in and/or out of Level 3		**–**
Fair value at June 30, 2017	**$**	**2,721**

The Plan's assets measured at fair value were determined using the following inputs at June 30, 2016:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 63,332	$ –	$ –	$ 63,332
Equity securities:				
Domestic equities	74,582	–	–	74,582
International equities – developed	14,423	–	–	14,423
International equities – emerging markets	15,324	–	–	15,324
Fixed income:				
Corporate bonds	8,349	62,859	–	71,208
Government and agencies	–	8,056	–	8,056
Real assets – commodities	20,942	–	–	20,942
Mutual funds – multi-asset class	5,309	–	–	5,309
Other	–	–	2,738	2,738
Assets (fair value determined using NAV practical expedient):				
Hedge funds				142,786
Private equities				49,180
Real assets				7,259
Commingled funds				77,112
				$ 552,251

(Tables in Thousands)

9. Employee Retirement Plans (continued)

The following table is a rollforward of the pension plan assets classified within Level 3 of the valuation hierarchy:

		Other
Fair value at July 1, 2015	$	2,763
Purchases, sales, and settlements, net		–
Actual return on plan assets		(25)
Transfers in and/or out of Level 3		–
Fair value at June 30, 2016	$	2,738

Fair value methodologies for Level 1 and Level 2 assets are consistent with the inputs described in Note 5.

Management opted to use the Net Asset Value (NAV) per share, or its equivalent, as a practical expedient for fair value of the Plan's interest in hedge funds, private limited partnership funds, and commingled funds. Valuations provided by the respective fund's management include variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at period-end provide additional observable market inputs of the exit price. The majority of these funds have restrictions on the timing of withdrawals, which may reduce liquidity, in some cases for up to 24 months in the case of hedge funds and up to 10 years for private limited partnership funds. At June 30, 2017, the Plan has commitments to fund $92.6 million in these investments.

The Plan employs investment managers to invest fund balances in a structured portfolio of equity, fixed income, and alternative investments (which includes hedge funds, private equity, private debt, and real assets). The Plan retains outside consultants to support the overall asset allocation and manager selection process. The performance of all managers is reviewed to test that market performance has been calculated accurately, to monitor performance versus peers and benchmarks, and to evaluate portfolio structure considering current and future needs based on economic forecasts and actuarial projections. The Health System believes that a diversified portfolio will limit the degree of risk to the Plan and stabilize the long-term results. The Plan's diversified blend of marketable securities also takes into consideration the cash flow requirements of the Plan to

(Tables in Thousands)

9. Employee Retirement Plans (continued)

help ensure the ability to meet the monthly payout of benefits required. Projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category.

The Health System expects to contribute at least $13.0 million to the Plans during fiscal 2018.

The following benefit payments, which reflect expected future service, are expected to be paid by the Plan:

	Amount
Year ending June 30:	
2018	$ 81,200
2019	82,500
2020	87,700
2021	80,000
2022	74,400
2023 through 2027	326,300
	$ 732,100

The 401(k) plan and 403(b) plan are offered for the benefit of substantially all employees. The 401(k) plan originally provided for employee contributions and an employer-provided matching contribution. Employee contributions to the 403(b) plan were, and continue to be, eligible for matching contributions to the 401(k) plan. The 401(k) plan was amended effective July 1, 2011, to enhance the matching contribution and add a non-matching service-based contribution designed to replace the pay credit previously earned under the frozen defined benefit plan.

Employees who work at a rate of 1,000 hours during the year or more and are employed on December 15th of the calendar year are eligible for the employer-provided contribution in the 401(k) plan. The matching contribution is equal to 50% of the first 4% of the participant's compensation contributed and 25% of the next 2% of the participant's compensation contributed. The service-based contribution is equal to a percentage of pay based on years of service (1%–9% for employees hired prior to July 1, 2011, and 1%–4% for those hired on July 1, 2011 or later). All contributions to the plan are subject to IRS limitations on contributions and includable compensation. Employees become vested in both matching and service contributions upon the completion of three years of vesting service.

(Tables in Thousands)

9. Employee Retirement Plans (continued)

For the years ended June 30, 2017 and 2016, the total expenses incurred related to the 401(k) and 403(b) plans were $103.6 million and $98.5 million, respectively.

St. Anthony's sponsors elective defined contribution plans available to substantially all employees, consisting of both a 401(k) plan and a 403(b) plan. Contributions under the 401(k) and 403(b) plans include employee contributions, subject to IRS limitations, and a matching contribution equal to 50% up to the first 1% of the participant's compensation and 25% of the next 3%. Employees are eligible to participate upon employment and become fully vested in the matching contribution upon completion of three years of service. St. Anthony's expense related to the match was $0.4 million for the one-month period ended June 30, 2017.

Effective September 23, 2015, non-elective employer contributions were revised to only allow between 3% and 5% of employee compensation to the 401(k) plan. These contributions are made according to a vesting schedule based on years of service.

10. Long-Term Obligations

The following is a summary of long-term obligations:

	June 30	
	2017	**2016**
Revenue bonds, fixed interest rates of 2.20%–5.00% due 2018 through 2048	**$ 725,006**	$ 628,200
Revenue bonds, variable interest rates with weighted average interest rates of 1.51% and 0.90% in fiscal 2017 and 2016, respectively, due through February 2053	**760,265**	683,125
Capital lease obligations	**43,153**	42,349
Other mortgage notes and notes	**18,597**	21,974
	1,547,021	1,375,648
Less current maturities of long-term obligations	**(13,449)**	(7,167)
Less unamortized debt issuance costs	**(8,712)**	(9,193)
Long-term obligations, less current maturities	**$ 1,524,860**	$ 1,359,288

10. Long-Term Obligations (continued)

Certain of Mercy's subsidiaries have executed a commitment agreement governing certain borrowing arrangements under the Mercy Master Trust Indenture and related agreements (Financing Agreements). While only the revenues of Mercy collateralize the outstanding borrowings of the Health System, each of these subsidiaries has committed to transfer such funds to Mercy to pay the amounts due on borrowings when they come due. The Financing Agreements contain certain restrictive covenants, including debt service coverage and liquidity ratios. At June 30, 2017, Mercy was in compliance with all covenants.

Tax-exempt revenue bonds have been issued by various issuing authorities, the proceeds of which were used by Mercy primarily to finance capital projects and to refinance existing indebtedness of certain subsidiaries.

In June 2016, as part of a purchase agreement of an entity that had been accounted for as a capital lease, Mercy paid off the long-term obligations for $45.8 million, including principal, interest, and penalties.

In June 2017, $81.8 million of variable rate, tax-exempt health facility revenue bonds were issued by the Health and Educational Facilities Authority of the State of Missouri on behalf of Mercy under the Master Trust Indenture. The proceeds of these bonds were used to redeem St. Anthony's Series 2013 bonds in conjunction with the affiliation of Mercy and St. Anthony's. The bonds were directly purchased by one bank and have a final maturity of 2053. Interest is paid monthly at a borrow rate based on a percentage of one-month LIBOR plus an applicable spread. The bonds include mandatory puts by the purchasing bank in 2021 and 2022. Mercy may elect to renegotiate with the initial purchasers, remarket or redeem the bonds at any time.

In June 2017, Mercy issued replacement master notes under its Master Trust Indenture in replacement of and substitution for master notes previously issued by St. Anthony's (Series 2015 bonds). The Series 2015 bonds were originally issued by the Health and Educational Facilities Authority of the State of Missouri and consisted of $101.0 million of fixed rate (ranging from 2.20% to 5.00%), tax-exempt health facility revenue bonds with a final maturity of 2045.

Other notes payable, mortgage notes payable, and capital lease obligations are secured by certain property and equipment of the specific borrowers.

(Tables in Thousands)

10. Long-Term Obligations (continued)

Aggregate maturities of long-term obligations as scheduled at June 30, 2017, are as follows:

	Amount
Year ending June 30:	
2018	$ 13,449
2019	13,166
2020	17,567
2021	18,688
2022	15,035
Thereafter	1,469,116
	$ 1,547,021

The Health System has $120.0 million of unused 364-day lines of credit with four banks. The agreements terminate on December 8, 2017; however, the Health System anticipates renewal of the agreements. During 2017, the Health System had no borrowings against the line of credit. There were no borrowings outstanding under these lines of credit as of June 30, 2017.

11. Derivatives

The Health System has interest rate-related derivative instruments to manage its interest rate exposure on its variable rate debt instruments and does not enter into derivative instruments for any purpose other than risk management. Interest rate swap contracts between the Health System and a third party (counterparty) provide for the periodic exchange of payments between the parties based on changes in a defined index and a fixed rate. These agreements expose the Health System to market risk and credit risk. Credit risk is the risk that contractual obligations of the counterparties will not be fulfilled. Concentrations of credit risk relate to groups of counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Counterparty credit risk is managed by requiring high credit standards for the Health System's counterparties. The Health System will enter into transactions where the counterparty rating is high enough to maintain the rating on Health System bonds. The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. As of June 30, 2017 and 2016, Mercy had collateral posted of $52.1 million and $81.6 million, respectively. The Health System does not anticipate non-performance by its counterparties. Market risk is the adverse effect

(Tables in Thousands)

11. Derivatives (continued)

on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of the Health System's derivative positions in the context of its blended cost of capital.

The following is a summary of the outstanding positions under these interest rate swap agreements:

Interest Rate Swap Type	Expiration Date	Health System Pays	Health System Receives	Notional Value June 30 2017	2016
Fixed payor	June 2, 2031	3.36%–3.75%	70% of one-month LIBOR	**$ 252,200**	$ 252,200
Fixed payor	June 2, 2031	3.85%	70% of one-month LIBOR	**50,000**	50,000
Fixed payor	February 1, 2043	1.847%	67% of one-month LIBOR	**81,790**	–

The fair value of derivative instruments is as follows:

Derivatives Not Designated as Hedging Instruments	Balance Sheet Location	June 30 2017	2016
Collateral posted on interest rate swap agreements	Other assets	**$ 52,110**	$ 81,570
Interest rate swap agreements	Other liabilities	**62,906**	88,967

The effects of derivative instruments on the consolidated statements of operations for the years ended June 30, 2017 and 2016, are reflected in realized and unrealized losses on interest rate swaps on the consolidated statements of operations.

(Tables in Thousands)

12. Operating Leases

Rent expense for the years ended June 30, 2017 and 2016, totaled $105.7 million and $102.1 million, respectively.

Future minimum rental payments under non-cancelable operating leases as of June 30, 2017, that have initial or remaining terms in excess of one year are as follows:

	Amount
Year ending June 30:	
2018	$ 80,013
2019	69,132
2020	60,201
2021	54,583
2022	52,572
Thereafter	188,460
	$ 504,961

13. Commitments and Contingencies

Regulatory Compliance

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigations and compliance audits of health care providers. The Health System is not exempt from these regulatory efforts and has received correspondence from federal agencies with regard to such initiatives. In consultation with legal counsel, management estimates these matters will be resolved without a material adverse effect on the Health System's consolidated financial position or results of operations.

Litigation

The Health System is involved in litigation arising in the normal course of business. After consultation with legal counsel, it is management's opinion that these matters will be resolved without a material adverse effect on the Health System's consolidated financial position or results of operations.

14. Subsequent Events

The Health System evaluated events and transactions occurring subsequent to June 30, 2017 through September 22, 2017, the date the accompanying consolidated financial statements were issued. During this period, there were no subsequent events that required recognition in the consolidated financial statements.

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