

**Franciscan Alliance, Inc.  
and Affiliates**

**Consolidated Financial Statements  
December 31, 2015 and 2014**

**Franciscan Alliance, Inc. and Affiliates**  
**Index**  
**December 31, 2015 and 2014**

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## Independent Auditor's Report

Board of Trustees  
Franciscan Alliance, Inc.  
Mishawaka, Indiana

We have audited the accompanying consolidated financial statements of Franciscan Alliance, Inc. and Affiliates (collectively referred to as the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended.

### ***Management's Responsibility for the Consolidated Financial Statements***

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

### ***Auditor's Responsibility***

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

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Corporation at December 31, 2015 and 2014 and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

May 3, 2016

**Franciscan Alliance, Inc. and Affiliates**  
**Consolidated Balance Sheets**  
**Years Ended December 31, 2015 and 2014**  
(In thousands)

	2015	2014	2015	2014
<b>Assets</b>				
Current assets				
Cash and cash equivalents	\$ 44,280	\$ 55,757	\$ 22,576	\$ 23,693
Short-term investments	111,522	129,674	275,322	261,554
Patient accounts receivable, net of allowance for doubtful accounts of \$21,940 in 2015 and \$27,878 in 2014	329,476	298,524	102,247	113,497
Inventories of supplies	44,947	43,238	25,110	25,172
Other current assets	94,974	97,258	425,255	423,916
Total current assets	625,199	624,451	1,059,451	1,077,544
Board designated and other investments	2,260,299	2,246,231	83,274	84,986
Property, plant, and equipment, net	1,591,116	1,557,201	320,338	374,176
Investments in unconsolidated affiliates	16,855	18,522	134,564	118,831
Goodwill	24,541	24,541	57,035	49,635
Intangible assets, net of accumulated amortization of \$11,369 in 2015 and \$16,230 in 2014	3,058	6,608	2,079,917	2,129,088
Other assets	126,984	112,527	2,504,543	2,392,237
Total assets	\$ 4,648,052	\$ 4,590,081	\$ 4,648,052	\$ 4,590,081
<b>Liabilities and Net Assets</b>				
Current liabilities				
Current portion of long-term debt				
Accounts payable and accrued expenses				
Accrued payroll and related expenses				
Estimated third-party payor settlements				
Total current liabilities				
Long-term debt, net of current portion				
Fair value of interest rate swap contracts				
Accrued pension liability				
Estimated insurance liabilities				
Other liabilities				
Total liabilities				
Net assets				
Unrestricted				
Noncontrolling interests in consolidated affiliates				
Total unrestricted net assets				
Temporarily restricted				
Permanently restricted				
Total net assets				
Total liabilities and net assets				

The accompanying notes are an integral part of these consolidated financial statements.

**Franciscan Alliance, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets**  
**Years Ended December 31, 2015 and 2014**  
(In thousands)

	2015	2014
<b>Unrestricted revenues, gains, and other support</b>		
Patient service revenue, net of contractual allowances and discounts	\$ 2,550,684	\$ 2,510,108
Provision for doubtful accounts	<u>(61,374)</u>	<u>(84,799)</u>
Net patient service revenue	2,489,310	2,425,309
Capitation and premium revenue	110,122	109,029
Other operating revenue	171,657	182,781
Equity in losses of investments in unconsolidated affiliates	(41,126)	(1,223)
Net unrealized investment (losses) gains	(11,040)	2,260
Net assets released from restrictions used for operations	<u>111</u>	<u>103</u>
Total unrestricted revenues, gains, and other support	<u>2,719,034</u>	<u>2,718,259</u>
<b>Operating expenses</b>		
Salaries	1,020,966	972,967
Employee benefits	272,882	224,597
Physicians' fees	58,226	52,232
Utilities	40,827	45,202
Repairs and maintenance	42,528	44,452
Drugs and pharmaceuticals	139,163	128,482
Medical supplies	194,325	186,527
Insurance	46,077	32,564
Purchased services	265,774	257,361
Other supplies and expenses	309,276	368,266
Interest	33,918	35,726
Depreciation and amortization	<u>153,033</u>	<u>154,154</u>
Total operating expenses	<u>2,576,995</u>	<u>2,502,530</u>
Operating income	<u>142,039</u>	<u>215,729</u>
<b>Other income (expense)</b>		
Investment income	85,525	64,169
Net unrealized investment (losses) gains on trading securities	(120,972)	9,354
Net unrealized losses and periodic settlements on interest rate swap contracts	(11,645)	(40,397)
(Loss) gain on sale/disposal of assets	(87)	460
Net assets released from restrictions	2,417	3,351
Contributions	5,209	3,695
Other, net	<u>(9,357)</u>	<u>(4,655)</u>
Total other income (expense), net	<u>(48,910)</u>	<u>35,977</u>
Excess of revenues over expenses	<u>\$ 93,129</u>	<u>\$ 251,706</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Franciscan Alliance, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets (continued)**  
**Years Ended December 31, 2015 and 2014**  
(In thousands)

	2015	2014
<b>Unrestricted net assets, controlling interest</b>		
Excess of revenues over expenses	\$ 73,256	\$ 234,914
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	29,276	(293,541)
Acquisition of Jasper County Hospital (see Note 1)	5,878	-
Other, net	2,374	(1)
Contributions of property, plant, and equipment	145	250
Net assets released from restrictions used for purchase of property, plant, and equipment	<u>1,377</u>	<u>4,890</u>
Increase (decrease) unrestricted net assets, controlling interest	<u>112,306</u>	<u>(53,488)</u>
<b>Unrestricted net assets, noncontrolling interest</b>		
Excess of revenues over expenses	19,873	16,792
Distributions	<u>(22,945)</u>	<u>(12,352)</u>
(Decrease) increase in unrestricted net assets, noncontrolling interest	<u>(3,072)</u>	<u>4,440</u>
<b>Temporarily restricted net assets, controlling interest</b>		
Contributions	4,366	5,446
Investment income	61	132
Net assets released from restrictions	(2,518)	(3,454)
Net assets released from restrictions used for purchase of property, plant, and equipment	(1,377)	(4,890)
Net unrealized investment losses	(5)	(7)
Acquisition of Jasper County Hospital (see Note 1)	471	-
Other, net	<u>(2,676)</u>	<u>(168)</u>
Decrease in temporarily restricted	<u>(1,678)</u>	<u>(2,941)</u>
<b>Permanently restricted net assets, controlling interest</b>		
Contributions	192	115
Investment (losses) income	(133)	288
Net assets released from restrictions	(10)	-
Net unrealized investment gains	-	1
Other, net	<u>(463)</u>	<u>(661)</u>
Decrease in permanently restricted net assets, controlling interest	<u>(414)</u>	<u>(257)</u>
Increase (decrease) in net assets	107,142	(52,246)
Net assets, beginning of the year	<u>2,460,993</u>	<u>2,513,239</u>
Net assets, end of the year	<u>\$ 2,568,135</u>	<u>\$ 2,460,993</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Franciscan Alliance, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2015 and 2014**  
(In thousands)

	2015	2014
<b>Cash flows from operating activities</b>		
Increase (decrease) in net assets	\$ 107,142	\$ (52,246)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation of plant, property, and equipment	148,850	148,465
Amortization of bond discounts, deferred financing costs, and other intangible assets	4,183	5,689
Provision for doubtful accounts	61,374	84,799
Gain on sale of investments in unconsolidated affiliates	(1,464)	(16,639)
Loss on sale/disposal of assets	1,551	16,179
Net investment losses (gains)	46,488	(75,783)
Net unrealized (gains) losses on interest rate swap contracts	(1,712)	26,495
Distributions to noncontrolling interests in consolidated affiliates, net of contributions	22,945	12,352
Distributions from unconsolidated affiliates	6,675	5,769
Equity in losses of investments in unconsolidated affiliates	41,126	1,223
Restricted contributions and investment income	(4,486)	(5,981)
Change in pension and postretirement benefits other than net periodic pension costs included in accrued pension liability	(29,276)	293,541
Net assets acquired from Jasper County Hospital	(5,210)	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(89,041)	(71,215)
Inventories of supplies	(581)	(5,302)
Other assets	(11,438)	(29,370)
Accounts payable and accrued expenses	35,836	35,157
Accrued payroll and related expenses	(11,250)	(2,959)
Estimated third-party payor settlements	(672)	(3,871)
Estimated insurance liabilities	15,733	5,545
Accrued pension liability	(24,562)	(26,634)
Other liabilities	7,400	3,055
Total adjustments	<u>212,469</u>	<u>400,515</u>
Net cash provided by operating activities	<u>319,611</u>	<u>348,269</u>
<b>Cash flows from investing activities</b>		
Purchases of investments	(4,943,712)	(5,927,429)
Proceeds from sale of investments	4,901,779	5,722,352
Purchases of property, plant, and equipment	(187,351)	(115,025)
Proceeds from sale of property, plant, and equipment	884	192
Acquisition of physician practices and other healthcare service organizations	-	(109)
Proceeds from sale of investments in unconsolidated affiliates	1,464	16,764
Capital contributions to investment in unconsolidated affiliates	(46,134)	(2,285)
Net cash used by investing activities	<u>(273,070)</u>	<u>(305,540)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of long-term debt	-	50,000
Redemption of long-term debt	-	(50,000)
Principal payments on long-term debt	(25,118)	(22,972)
Redemption of long-term debt - Jasper County Hospital	(14,441)	-
Distributions to noncontrolling interests in consolidated affiliates, net of contributions	(22,945)	(12,352)
Restricted contributions and investment income	4,486	5,981
Net cash used by financing activities	<u>(58,018)</u>	<u>(29,343)</u>
Net (decrease) increase in cash and cash equivalents	<u>(11,477)</u>	<u>13,386</u>
Cash and cash equivalents, beginning of year	<u>55,757</u>	<u>42,371</u>
Cash and cash equivalents, end of year	<u>\$ 44,280</u>	<u>\$ 55,757</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Franciscan Alliance, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

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**1. Description of Organization and Mission**

**Organization**

Franciscan Alliance, Inc. and Affiliates (collectively referred to as the “Corporation”), under the sponsorship of the Sisters of St. Francis of Perpetual Adoration, Inc., is an Indiana non-profit, Catholic health care system. The Corporation is dedicated to providing comprehensive health care services, including emergency, medical, surgical, behavioral, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; and primary and specialty physician services to communities within four geographic regions in Indiana and Illinois (the “Health Centers”). Additionally, the Corporation has various accountable care organizations and physician hospital managed care networks, a non-profit foundation, and a number of support related divisions and affiliates including a corporate office, a consolidated information technology services division, various back office/management support organizations, a construction company, and a captive insurance company. The Corporation also has various investments in consolidated and unconsolidated affiliates (Note 10). The Corporation is incorporated as a not-for-profit corporation under the laws of Indiana and is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the “Code”).

**Acquisition of Jasper County Hospital** – Effective August 31, 2015, Jasper County Hospital, Inc. (“Jasper County Hospital”), a critical access hospital in Rensselaer, Indiana contributed its net assets to Franciscan Health – Jasper County, Indiana, Inc. d/b/a Franciscan Healthcare Rensselaer (“FH Rensselaer”), an Indiana nonprofit corporation, whose sole corporate member is the Corporation. The transaction resulted in a contribution of excess of assets over liabilities of \$6.3 million being recorded in the consolidated statements of operations and changes in net assets during 2015. The following table represents the balance sheet as of August 31, 2015 for FH Rensselaer:

Fair value of identifiable net assets:	(in thousands)
Cash and cash equivalents	\$ 1,139
Patient accounts receivable, net of allowance for doubtful accounts	3,285
Inventory	1,128
Other current assets	1,200
Board designated and other investments	471
Property, plant, and equipment, net	22,101
Current portion of long-term debt	(565)
Accounts payable and accrued expenses	(5,905)
Estimated third-party payor settlements	(610)
Long-term debt due to the Corporation	<u>(15,895)</u>
Contribution of unrestricted and temporarily restricted net assets	<u>\$ 6,349</u>

**Franciscan Alliance, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

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**Mission**

The Corporation's mission statement is as follows:

*Continuing Christ's Ministry in Our Franciscan Tradition*

Consistent with its mission, the Corporation provides medical care to all patients regardless of their ability to pay and continually works to enhance the health status of the communities in which it operates. As illustrated in the following summary of quantifiable community benefits, which has been prepared in accordance with the Catholic Health Association of the United States' policy document, the Corporation commits significant resources to provide services intended to benefit the poor and underserved with benefits measured at the total cost net of any offsetting revenues, donations, or other funds used to defray such costs.

	<b>(Unaudited)</b>	
	<b>2015</b>	<b>2014</b>
	(in thousands)	
<b>Benefits for the poor and underserved</b>		
Unreimbursed costs of Medicaid and other indigent care programs	\$ 113,035	\$ 89,926
Cost of charity care provided	76,199	91,268
Other benefits for the poor and underserved	<u>3,457</u>	<u>5,434</u>
Total benefits for the poor and underserved	<u>192,691</u>	<u>186,628</u>
<b>Benefits for the broader community</b>		
Subsidized health services	16,665	27,813
Health professions education	14,487	12,414
Community health improvement services	5,962	3,251
Financial and in-kind contributions	872	888
Research	1,277	1,384
Community building activities	1,198	913
Community benefit operations	<u>486</u>	<u>226</u>
Total benefits for the broader community	<u>40,947</u>	<u>46,889</u>
Total quantifiable community benefits	<u>233,638</u>	<u>233,517</u>
Unreimbursed costs of Medicare	<u>230,910</u>	<u>237,326</u>
Total quantifiable community benefits including unreimbursed costs of Medicare	<u>\$ 464,548</u>	<u>\$ 470,843</u>

Total quantifiable community benefits including unreimbursed costs of Medicare were approximately 18% and 19% of total operating expenses for the years ended December 31, 2015 and 2014, respectively.

The Corporation also provides a significant amount of uncompensated care to patients which is reported as provision for doubtful accounts in the consolidated statements of operations and changes in net assets and is not reported in the summary of quantifiable community benefits. During the years ended December 31, 2015 and 2014, the Corporation reported approximately \$61.4 million and \$84.8 million, respectively, as provision for doubtful accounts based on accumulated charges.

**Benefits for the poor and underserved** include the cost of providing programs and services to persons who are economically poor or are medically indigent and cannot afford to pay for health care services because they have inadequate resources and/or are uninsured or underinsured.

## Franciscan Alliance, Inc. and Affiliates

### Notes to Consolidated Financial Statements

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**Benefits for the broader community** include the costs of providing programs and services aimed at persons and groups for reasons other than poverty. These persons and groups may include needy populations that may not qualify as poor but need special services and support or broader populations who benefit from healthy community initiatives. These programs and services are not intended to be financially self-supporting.

**Unreimbursed costs of Medicaid and other indigent care programs** represent the cost (determined using a cost to charge ratio) of providing services to beneficiaries of public programs including State Medicaid and indigent care programs in excess of any payments received.

**Charity care** represents the cost (determined using a cost to charge ratio) of health care services, provided in accordance with the Corporation's charity care and uninsured patient discount policy, for which no or partial reimbursement will be received because of the recipient's inability to pay for those services, as further described in Note 2.

**Subsidized health services** are net costs for billed services that are subsidized by the Corporation. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would otherwise not be available in sufficient amount. Examples of services include emergency services, free standing community clinics, hospice care, behavioral health services, prenatal services, women's and children's services, palliative care, and parish nurse programs.

**Health professions education** includes the unreimbursed cost of training health professionals such as medical residents, nursing students, technicians, and students in allied health professions.

**Community health improvement services** are activities and services for which no patient bill exists. These services are not expected to be financially self-supporting, although some may be supported by outside grants or funding, which is netted against any amounts reported. Some examples include health education, health fairs, free or low cost health screening, immunization services, prescription medication assistance programs, and other various community outreach programs. The Corporation actively collaborates with community groups and agencies to assist those in need in providing such services.

**Financial and in-kind contributions** are made by the Corporation on behalf of the poor and underserved to various community agencies. These amounts include funds used for charitable activities as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and underserved. In-kind services include hours donated by staff to the community while on work time, overhead expenses of space donated to community groups, and donations of food, equipment, supplies, and other direct costs.

**Research** includes the unreimbursed cost of clinical and community health research and studies on health care delivery.

**Community building activities** include the costs of programs that improve the physical environment, promote economic development, enhance other community support systems, provide leadership development skills training, and build community coalitions.

**Community benefit operations** include costs associated with dedicated staff, community health needs and/or asset assessments, and other costs associated with community benefit strategy and operations.

# Franciscan Alliance, Inc. and Affiliates

## Notes to Consolidated Financial Statements

### December 31, 2015 and 2014

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**Unreimbursed costs of Medicare** represent the cost (determined using a cost to charge ratio) of providing services primarily to elderly beneficiaries of the Medicare program in excess of any payments received.

## 2. Summary of Significant Accounting Policies

### Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and all wholly owned, majority-owned, and controlled organizations with all significant transactions and accounts between affiliates eliminated in consolidation. Investments in affiliates where the Corporation owns less than or equal to 50% and does not have operational control are recorded under the equity method of accounting unless the Corporation's control or investment percentage is insignificant in which case the Corporation uses the cost method.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Corporation to make assumptions, estimates, and judgments that affect the amounts reported in the consolidated financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The Corporation considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: recognition of net patient service revenue, which includes contractual allowances and a provision for doubtful accounts; recorded values of investments and goodwill; reserves for employee health costs and losses and expenses related to professional and general liabilities; and risks and assumptions for measurement of the pension liabilities. Management relies on historical experience and other assumptions believed to be reasonable in making its judgments and estimates. Actual results could differ materially from those estimates.

### Cash and Cash Equivalents

Cash and cash equivalents primarily consist of cash, treasuries, and other liquid marketable securities including interest bearing securities with original maturities of three months or less. Funds whose use is limited by Board designation or other restrictions are excluded. The carrying amount of cash and cash equivalents approximates fair value because of the short maturities of these instruments.

### Short-Term Investments

Short-term investments primarily consist of certificates of deposit, treasuries, and other highly liquid interest bearing securities with original maturities extending longer than three months. Adequate liquidity is maintained within short-term investments to satisfy daily cash flow needs.

### Inventories of Supplies

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first out method) or market value.

## **Franciscan Alliance, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

#### **December 31, 2015 and 2014**

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#### **Board Designated, Other Investments, and Investment Income**

Board designated investments represents investments set aside by the Corporation primarily for future purposes including capital expenditures, acquisitions, improvements, and amounts held for mission programs. The Corporation's Board of Trustees retains control of these investments and may, at its discretion and in certain circumstances, use them for other purposes. Assets limited as to use include assets under bond indenture and swap agreements, investments maintained for the payment of estimated insurance liabilities, and amounts contributed by donors with stipulated restrictions.

Substantially all of the Corporation's board designated and other investments are invested and managed by professional managers in accordance with agreed-upon investment and socially responsible investing guidelines and are held in custody with a financial institution.

Board designated and other investments are measured at fair value, classified as trading securities, and consist of: cash and cash equivalents; U.S. government, state, municipal, and agency obligations; other fixed income securities; equity securities; asset backed securities; index funds, exchange traded funds, and mutual funds; unregistered mutual funds; real estate investment trusts. Board designated and other investments also include alternative investments, consisting of investments in hedge funds, private credit and private equity investments, and real assets, which are generally measured based on their net asset value as a practical expedient for fair value that is further described in Note 4.

Investment earnings consist of dividends, interest, and realized gains and losses. In accordance with industry practice, investment earnings and unrealized gains and losses on assets limited as to use under bond indenture and swap agreements and estimated insurance liability funds are included in other operating revenue in the consolidated statements of operations and changes in net assets. Investment earnings and unrealized gains and losses from all other unrestricted investments and board designated funds are included in other income (expense) in the consolidated statements of operations and changes in net assets. Investment earnings and any associated unrealized gains and losses restricted for specified purposes by donor or legal requirements are recorded as temporarily or permanently restricted in the consolidated statements of operations and changes in net assets.

Board designated and other investments are exposed to various risks such as interest rate, market, liquidity, performance, and credit risk. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term may affect the amounts reported in the consolidated balance sheets and the consolidated statements of operations and changes in net assets.

#### **Securities Lending Program**

The Corporation participates in a securities lending program through its custodian whereby the Corporation lends a portion of its investments to various brokers in exchange for collateral for securities loaned, mostly on a short-term basis. Collateral provided by these brokers consists of cash and is maintained at levels approximating 102-105% of the fair value of the securities on loan, adjusted for any market fluctuations. The Corporation maintains effective control of loaned securities through its custodian during the term of the agreement so that the securities may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. At December 31, 2015 and 2014, the fair value of collateral for loaned securities provided on behalf of the Corporation was approximately \$5.1 million while the liability associated with the obligation to repay such collateral was

## Franciscan Alliance, Inc. and Affiliates

### Notes to Consolidated Financial Statements

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approximately \$5.1 and \$5.2 million, respectively, with the net amount reported in board designated and other investments.

#### **Fair Value Measurement**

The Corporation's consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets measured at fair value on a recurring basis in the Corporation's consolidated balance sheets include: cash and cash equivalents; U.S. government, state, municipal, and agency obligations; other fixed income securities; asset backed securities; index funds, exchange traded funds, and mutual funds; corporate and foreign income securities; various types of equity securities and mutual funds; hedge funds; private credit and private equity investments; real assets; and benefit plan assets.

Fair value measurements reflected in the consolidated financial statements conceptually represent 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. Generally accepted accounting principles establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs.

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

- Level 1 Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial asset or liability.
- Level 3 Valuation is based upon other unobservable inputs that are significant to the fair value measurement.

The categorization of fair value measurements by hierarchy level is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability.

The Corporation applies the guidance in Accounting Standards Codification 820-10-15-4, *Fair Value Measurements of Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)* ("ASU820"). Under this guidance, the Corporation is permitted, as a practical expedient, to estimate the fair value of certain investments on the basis of the net asset value per share. In the normal course of business, the Corporation holds certain investments that qualify for the usage of this practical expedient. Fair value measurements of certain investments for which the measurement was based on net asset value ("NAV") or its equivalent as provided by an external manager are no longer required to be included within the fair value hierarchy leveling tables.

In the event that changes in the inputs used in the fair value measurements of an asset or liability results in a transfer of the fair value measurement to a different categorization (e.g., from Level 3 to Level 2), such transfers between fair value categories are recognized at the end of the reporting period.

## **Franciscan Alliance, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

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#### **Property, Plant, and Equipment**

Property, plant, and equipment (including internal-use software) are recorded at cost if purchased or at fair value at the date of donation, if donated. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Routine maintenance, repairs, and minor equipment replacement costs are charged to expense when incurred. Cost incurred in the development and installation of internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post implementation stage. Upon sale or retirement of property, plant, and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets. Interest costs incurred during the period of construction or development of capital assets are capitalized as a component of the cost of acquiring those assets. Depreciation is provided over the estimated useful lives of the assets utilizing the straight-line method with a useful life range of between 3 to 60 years. Assets under capital lease obligations are amortized utilizing the straight-line method over the shorter of the lease term or estimated useful life of the asset. Amounts capitalized for internal-use software are amortized over the useful life of the developed asset following project completion.

A conditional asset retirement obligation is recorded for any legal obligation associated with the retirement of long-lived assets resulting from the acquisition, construction, development, and/or normal use of the underlying assets. The associated asset retirement costs are capitalized as part of the carrying amount of the underlying asset and depreciated over the asset's estimated useful life. The liability is accreted through charges to operating expense. If the conditional asset retirement obligation is settled for other than the carrying amount of the liability, a gain or loss on sale/disposal of assets is recognized. As of December 31, 2015 and 2014, conditional asset retirement obligations of approximately \$22.3 million and \$22.1 million, respectively, are included within accounts payable and accrued expenses and other liabilities in the consolidated balance sheets.

#### **Goodwill and Intangible Assets**

Goodwill represents the future economic benefits arising from assets acquired that are not individually identified nor separately recognized. Goodwill is not amortized but is subject to an annual impairment test as well as more frequent reviews whenever circumstances indicate a possible impairment may exist.

Intangible assets are comprised primarily of covenants not to compete, which are amortized on a straight-line basis over periods ranging from 2 to 5 years.

#### **Asset Impairment**

**Property and Equipment** – The Corporation evaluates long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from estimated future undiscounted cash flows. If the estimated future undiscounted cash flows are less than the carrying value of the asset, the impairment recognized is calculated as the carrying value of the long-lived assets in excess of the fair value of the assets. The fair value of the assets is estimated based on appraisals, established market values of comparable assets, or internal estimates of future net cash flows expected to result from the use and ultimate disposition of the assets.

## **Franciscan Alliance, Inc. and Affiliates**

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**Goodwill** – Goodwill is tested for impairment on an annual basis or when an event or change in circumstance indicates the value of a reporting unit may have changed. Testing is conducted at the reporting unit level. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Estimates of fair value are based on appraisals, established market prices for comparable assets, internal estimates of future net cash flow, as well as other generally accepted valuation methodologies.

#### **Deferred Financing Costs**

Deferred financing costs incurred with the Hospital and Health System Revenue Bonds and Refunding Bonds are amortized using the bonds outstanding method. Costs associated with securing the direct pay letters of credit to support its variable rate demand bonds are amortized over the term of the associated liquidity facility. Costs associated with the issuance of direct placement bonds are amortized over the associated direct placement period. Deferred financing costs are included in other assets in the consolidated balance sheets.

#### **Estimated Insurance Liabilities**

The provision for estimated insurance liabilities includes actuarial estimates of the ultimate costs for both reported claims and claims incurred but not reported for professional liability, general liability, long-term disability insurance, excess workers' compensation, and amounts self-insured for allocated loss adjustment expenses.

#### **Net Assets**

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity.

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the consolidated financial statements.

During 2015 and 2014, net assets of \$3.9 million and \$8.3 million, respectively, were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes or by the passage of time.

#### **Performance Indicator**

The performance indicator is excess of revenues over expenses, which includes all changes in unrestricted net assets except for the change in pension and postretirement benefits other than net periodic pension costs which is included in accrued pension liability; contributions and distributions to noncontrolling interests in consolidated affiliates; contributions of excess of assets over liabilities of acquired entities; and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

## **Franciscan Alliance, Inc. and Affiliates**

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#### **Operating and Nonoperating Activities**

The Corporation's primary mission is to meet the health care needs in the communities it is privileged to operate through a broad range of general and specialized health care services, including emergency, medical, surgical, behavioral, rehabilitative, and other health services in inpatient and outpatient settings; home health care services; and primary and specialty physician services. Additionally, the Corporation has various accountable care organizations and physician hospital managed care networks. 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 Corporation's primary mission are considered to be nonoperating activities.

#### **Patient Accounts Receivable, Estimated Third-Party Payor Settlements, and Net Patient Service Revenue**

The Corporation has agreements with third-party payors that provide for payments at amounts different from its established rates. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered net of the provision for doubtful accounts and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors and amounts received under various state Medicaid Hospital Assessment and Disproportionate Share Programs. Revenue under certain third-party payor agreements is subject to audit, retroactive adjustments, and significant regulatory actions. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as additional information becomes available and as final settlements are determined.

#### **Allowance for Doubtful Accounts**

The collection of outstanding patient accounts receivable from government, managed care, and other third party payors and patients is the Corporation's primary source of cash. The Corporation's main collection risk relates to uninsured patient accounts and to patient accounts for which the third party payor has paid amounts in accordance with the applicable agreement, however the patient's responsibility, usually in the form of deductibles, copayments, and coinsurance payments, remains outstanding ("self-pay accounts"). The Corporation's patient accounts receivable is reduced by an allowance for amounts, primarily self-pay accounts, which could become uncollectible in the future. Throughout the year, the Corporation estimates this allowance based on the aging of its patient accounts receivable, historical collection experience, and other relevant factors. These factors include changes in the economy and unemployment rates, which have an impact on the number of uninsured and underinsured patients, as well as trends in health care coverage, such as the increased burden of deductibles, copayments, and coinsurance amounts to be paid by patients with insurance. After satisfaction of amounts due from insurance and reasonable efforts to collect from the patient have been exhausted, the Corporation follows established procedures for placing certain past due patient balances with collection agencies, subject to the terms and certain restrictions on collection efforts as determined by the Corporation. Uncollectible patient accounts receivable are written off against the allowance for doubtful accounts with any subsequent recoveries being recorded against the provision for doubtful accounts.

#### **Charity Care**

As an integral part of its mission, the Corporation provides care to patients who meet certain criteria under its charity care and uninsured patient discount policy without charge or at amounts less than its established rates. The cost of charity care is determined based on each Health Center's total cost as a percentage of total charges and that ratio is applied to the charges incurred by patients qualifying for charity care under the Corporation's policy and is not included in net patient service revenue in the consolidated statements of operations and changes in net assets.

## **Franciscan Alliance, Inc. and Affiliates**

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The estimated cost of charity care provided approximated \$76.2 million and \$91.3 million for the years ended December 31, 2015 and 2014, respectively (net of \$0.14 million received to subsidize charity care services). The Corporation maintains records to identify and monitor the level of charity it provides.

#### **Capitation and Premium Revenue**

The Corporation has certain Health Centers that arrange for the delivery of health care services to enrollees through various contracts with providers and common provider entities. Enrollee contracts are negotiated on an annual basis. Premiums are due monthly and are recognized as revenue during the period in which the Corporation is obligated to provide services to enrollees.

Certain of the Corporation's Health Centers have entered into capitation agreements whereby they accept the risk for the provision of certain health care services to health plan members. Under these agreements, the Corporation's Health Centers are financially responsible for services provided to health plan members by other health care providers. Capitation revenue is recognized during the period for which the Health Centers are obligated to provide services to health plan enrollees under capitation contracts.

Reserves for incurred but not reported claims have been established to cover the unpaid costs of health care services under capitation and premium arrangements. Capitation and premium arrangement reserves are classified within accounts payable and accrued expenses in the consolidated balance sheets. The liability is estimated based on actuarial studies, historical reporting, and payment trends. Actual claims experience may differ from estimated liabilities due to variances in estimated and actual utilization of health care services, charge amounts, and other factors. As settlements are made and estimates revised, any differences are reflected in current operations. The Corporation limits a portion of its liabilities through stop-loss reinsurance.

#### **Electronic Health Record Incentive Payments**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act ("HITECH"). The provisions were designed to increase the use of electronic health records ("EHR") technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers who adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments. The Corporation recognizes income related to these incentive payments using a grant accounting model that is based upon when the Corporation has reasonable assurance that it will comply with any designated conditions set forth by Medicare and Medicaid and that the dollars will be received. For the years ended December 31, 2015 and 2014, approximately \$8.7 million and \$16.6 million, respectively, of EHR incentive income was recognized and is included in other operating revenue in the consolidated statements of operations and changes in net assets. The Corporation's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were initially calculated. The Corporation has incurred and will continue to incur both capital expenditures and operating expenses in order to implement certified EHR technology and to meet meaningful use requirements. The timing of expense recognition to implement the Corporation's certified EHR technology may not correlate with the receipt of incentive payments and recognition of EHR incentive revenue.

## **Franciscan Alliance, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

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#### **Income Taxes**

The Corporation has established its status as an organization exempt from income taxes under Code Section 501(c)(3) and the laws of the states in which it operates. Certain divisions and affiliates are subject to federal and state income taxes; however, such amounts are not material to the consolidated financial statements.

#### **Derivative Financial Instruments**

Derivative financial instruments consist of interest rate swap contracts that are measured at fair value. The Corporation accounts for any changes in the fair value of derivative financial instruments in other income (expense) in the consolidated statements of operations and changes in net assets. The Corporation has reflected the fair value of its interest rate swap contracts as a long-term liability on the consolidated balance sheets (Note 7).

#### **Consolidated Statements of Cash Flows**

Supplemental disclosure of cash flow information and noncash investing and financing activities are summarized as follows:

Cash paid for interest, net of amounts capitalized, amounted to \$35.2 million and \$35.9 million for the years ended December 31, 2015 and 2014, respectively.

Cash paid for income taxes approximated \$3.1 million and \$.21 million for the years ended December 31, 2015 and 2014, respectively.

Included in accounts payable and accrued expenses and other liabilities at December 31, 2015 and 2014 are approximately \$3.2 million and \$31.1 million, respectively, of costs related to construction in progress and for the acquisition of property, plant, and equipment (including internal-use software).

#### **Adopted Accounting Pronouncements**

On December 31, 2015, the Corporation adopted Accounting Standard Update ("ASU") 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU removes the previous requirement to categorize all investments whose fair value is measured using the net asset value per share practical expedient from the fair value hierarchy disclosure table. The Corporation's early adoption of this guidance resulted in updates to the fair value disclosure presented in Notes 4 and 8.

In April 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposal of Components of an Entity*, which requires that a disposal of a component of an entity or a group of components of an entity be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when it meets the criteria to be classified as held for sale, or is disposed of by sale or other than by sale. It also requires an entity to present, for each comparative period, the assets and liabilities of a disposal group that includes a discontinued operation separately in the asset and liability sections on the consolidated balance sheets. Adoption of ASU 2014-08 was effective for the Corporation beginning January 1, 2015. The Corporation's adoption of this guidance did not have an impact on its consolidated financial statements.

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In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory*. This guidance requires entities to measure most inventories at the lower of cost or net realizable value. This guidance is effective for the Corporation beginning January 1, 2017. The Corporation's early adoption of this guidance did not have a material impact on its consolidated financial statements.

#### **Forthcoming Accounting Pronouncements**

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The objective of this ASU is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under this guidance, there is a requirement for lessees to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases. This guidance is effective for the Corporation beginning January 1, 2019. The Corporation is evaluating the impact this guidance may have on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of the FASB's revenue standard, ASU 2014-09, *Revenue From Contracts With Customers*, by one year for all entities and permits early adoption on a limited basis. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. Given the deferral, this guidance is now effective for the Corporation beginning January 1, 2018. The Corporation is evaluating the impact this guidance may have on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This guidance requires debt issuance costs to be presented as a direct deduction from the related debt rather than as an asset. This guidance is effective for the Corporation beginning January 1, 2016. As of December 31, 2015, the Corporation expects that the adoption of this guidance will result in a reduction to total assets and total liabilities in the consolidated balance sheets by approximately \$7.6 million.

In January 2015, the FASB issued ASU 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. This guidance eliminates the concept of extraordinary items in the presentation of the financial statements while broadening the separate disclosure of transactions which are unusual in nature, infrequent in occurrence, or both. This guidance is effective for the Corporation beginning January 1, 2016. The Corporation does not expect this guidance to have an impact on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*, which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. This guidance is effective for the Corporation beginning January 1, 2017. The Corporation does not expect this guidance to have an impact on its consolidated financial statements.

#### **Reclassifications**

Certain reclassifications were made to prior year balances to conform to current year presentation.

## Franciscan Alliance, Inc. and Affiliates

### Notes to Consolidated Financial Statements

#### December 31, 2015 and 2014

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### 3. Net Patient Service Revenue, Patient Accounts Receivable, and Concentration of Credit Risk

The Corporation has agreements with third-party payors that provide for payments at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

**Medicare** – Acute inpatient, outpatient services, and home health services rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediaries. Professional services rendered by physicians are paid based on the Medicare allowable fee schedule. One of the Corporation's Health Centers was granted Critical Access Status by Medicare and is paid based upon a cost plus reimbursement methodology with final settlement determine after submission of an annual cost report. In addition to these payment methodologies, Medicare has various voluntary accountable care organization ("ACO") value based reimbursement programs available to qualifying providers.

In September 2014, the Corporation ended its participation in the Pioneer ACO program which is a limited shared savings / shared risk model sponsored by the Centers for Medicare and Medicaid Innovation ("CMMI"). After achieving shared savings in its first year of participation in the Pioneer ACO program, the Corporation did not generate shared savings in the second or third years and it recorded a \$6.89 million shared loss liability as of December 31, 2014. In 2015, CMMI provided a final Pioneer ACO participation reconciliation for performance years two and three amounting to a \$3.97 million shared loss liability which was lower than estimated due to the Corporation attaining higher quality scores. As a result of this change in estimate, other operating expense as reflected on the consolidated statements of operations and changes in net assets decreased by \$2.92 million for the year ended December 31, 2015. Effective January 1, 2015, the Corporation migrated to the Centers for Medicare and Medicaid Services ("CMS") Medicare Shared Savings Program ("MSSP") Track 1, which does not have downside risk.

During 2015 and 2014, the Corporation also participated in the CMS MSSP reimbursement program with various unrelated health care providers. The Corporation and these unrelated health care providers have not received the CMS MSSP performance reconciliation for the 2015 participation year and as such have not recorded any gainsharing for the year ended December 31, 2015. The savings generated in the 2014 participation year did not exceed the established minimum savings rate and as such no shared savings were recorded in the consolidated statements of operations and changes in net assets for the year ended December 31, 2014.

**Medicaid** – Reimbursement for services rendered to Medicaid program beneficiaries includes prospectively determined rates per discharge, per diem payments, and fee schedules.

One of the Corporation's Health Centers qualifies as a State of Indiana Medicaid Acute Disproportionate Share and Medicaid Safety Net Hospital ("DSH"). This Health Center qualified as a DSH provider under Indiana code 12-15-16-1, and, as such, is eligible to receive DSH payments linked to the State's fiscal year, which differs from the Corporation's fiscal year. The amount of these additional DSH funds is dependent on regulatory approval by agencies of the federal and state governments, and is determined by the level, extent, and cost of uncompensated care (as defined) and various other factors. The Corporation records such amounts as revenue when payments are received or based upon data from the State of Indiana that payments are determinable and probable of receipt. For the years ended December 31, 2015 and 2014, the

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### Notes to Consolidated Financial Statements

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Corporation recognized unrestricted revenue of approximately \$38.3 million and \$14.5 million, respectively, related to the DSH program in the consolidated statements of operations and changes in net assets.

The Corporation's Indiana Health Centers participate in the State of Indiana's Hospital Assessment Fee ("HAF") program. The HAF program is a supplemental reimbursement program designed to help providers offset a portion of the cost of providing care to Medicaid and indigent patients. The HAF program is funded by a combination of federal and state resources and fees levied on hospital providers. The HAF program was initially effective until June 30, 2013, and was subsequently renewed on March 21, 2014 to continue through June 30, 2017 with a retroactive effective date of July 1, 2013. For the year ended December 31, 2015, the Corporation's Indiana Health Centers recognized supplemental HAF reimbursement of \$68.7 million. For the year ended December 31, 2014, the Corporation's Indiana Health Centers recognized \$119.9 million of supplemental HAF reimbursement of which approximately \$42.0 million related to the year ended December 31, 2013. The supplemental HAF reimbursement is recorded as a component of net patient service revenue in the consolidated statements of operations and changes in net assets. For the year ended December 31, 2015, the Corporation's Indiana Health Centers recognized HAF fees of \$47.1 million. For the year ended December 31, 2014, the Corporation's Indiana Health Centers recognized \$82.9 million of HAF fees of which \$30.3 million was related to the year ended December 31, 2013. The HAF fees are recognized as a component of other supplies and expenses in the consolidated statement of operations and changes in net assets.

The Corporation's Illinois Health Centers are obligated under Illinois Public Act 95-859 to participate in the State of Illinois' Hospital Assessment Program ("HAP") that assists in financing the State's Medicaid Program. This supplemental reimbursement program has been renewed by the State and CMS since its inception in 2004 with the most recent renewal, which only required the State's approval, to extend the program through June 30, 2018. For the years ended December 31, 2015 and 2014, the Corporation's Illinois Health Centers recognized supplemental HAP reimbursement of \$21.3 million, which is a component of net patient service revenue in the consolidated statements of operations and changes in net assets. For the years ended December 31, 2015 and 2014, the Corporation's Illinois Health Centers recognized HAP fees of \$13.3 million and \$13.0 million, respectively, which is a component of other supplies and expenses in the consolidated statement of operations and changes in net assets.

On January 9, 2015, CMS approved an additional Illinois Medicaid supplemental hospital payment program for services provided to individuals who qualify as a Medicaid beneficiary under the Affordable Care Act ("ACA"). The program is retroactive to March 1, 2014 and expires on June 30, 2018. For the year ended December 31, 2015, the Corporation's Illinois Health Centers recognized supplemental ACA reimbursement of \$7.9 million, (approximately \$3.2 million related to the year ended December 31, 2014).

**Other** – Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement includes prospectively determined rates per discharge, discounts from established charges, prospectively determined per diem rates, and fee schedules.

Like Medicare, commercial insurance companies are entering into various fee-for-value reimbursement programs with qualifying providers. In 2015 and 2014, the Corporation participated in various commercial ACO reimbursement programs in which the Corporation receives a care management fee per ACO participant and the opportunity to receive limited gainsharing revenue based upon its performance as compared to established quality and efficiency benchmarks. For

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the year ended December 31, 2015, the Corporation recorded \$3.6 million of gainsharing revenue in other operating revenue in the consolidated statements of operations and changes in net assets related to its' 2014 commercial ACO performance. The Corporation did not record gainsharing revenue for the year ended December 31, 2015 related to that participation year, since it did not receive a final performance reconciliation from these commercial ACO payors.

Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the established charges for services and estimated total payments to be received from third-party payors.

A summary of gross patient service revenue, by payor, for the years ended December 31, 2015 and 2014, is as follows:

	<b>2015</b>	<b>2014</b>
Medicare	36 %	37 %
Medicare managed care	9	8
Medicaid	8	8
Medicaid managed care	6	5
Other third-party payors	37	37
Self-pay	3	4
Other	1	1
	<u>100 %</u>	<u>100 %</u>

The Corporation grants credit without collateral to its patients, most of who are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31, 2015 and 2014, is as follows:

	<b>2015</b>	<b>2014</b>
Medicare	18 %	21 %
Medicare managed care	7	5
Medicaid	8	10
Medicaid managed care	3	2
Other third-party payors	52	48
Self-pay	10	12
Other	2	2
	<u>100 %</u>	<u>100 %</u>

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action including fines, penalties, and/or exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates may change in the near term. Net patient service revenue (decreased)/increased by approximately (\$0.2) million and \$2.0 million for the years ended December 31, 2015 and 2014, respectively, due to changes in estimates related to prior-year settlements with third party payors.

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**4. Short-Term, Board Designated, and Other Investments**

Short-term investments represent highly liquid investments with maturities extending longer than three months. Adequate liquidity is maintained within short-term investments to satisfy daily cash flow needs.

Board designated investments represents investments set aside by policy of the Corporation primarily for future purposes including capital expenditures, acquisitions, improvements and amounts held for mission programs. Assets limited as to use include assets under bond indenture and swap agreements, investments maintained for the payment of estimated insurance liabilities, and amounts contributed by donors with stipulated restrictions.

The composition of short-term, board designated, and other investments, at December 31, 2015 and 2014, is as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Short-term investments	\$ 111,522	\$ 129,674
Board designated investments		
Funded depreciation and other Board projects	2,046,192	2,012,310
Other designated investments	1,691	1,751
	<u>2,047,883</u>	<u>2,014,061</u>
Assets limited as to use		
Estimated insurance liability funds	152,354	170,363
Assets under bond indenture and swap agreements	31,505	30,505
Other restricted investments	28,557	31,302
	<u>212,416</u>	<u>232,170</u>
Short-term, board designated and other investments	<u>2,371,821</u>	<u>2,375,905</u>
Less short-term investments	<u>111,522</u>	<u>129,674</u>
Board designated and other investments, classified as noncurrent	<u>\$ 2,260,299</u>	<u>\$ 2,246,231</u>

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Short-term, board designated, and other investments at December 31, 2015 and 2014, consist of the following:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Cash and cash equivalents	\$ 186,188	\$ 142,151
U.S. government, state, municipal, and agency obligations	378,195	324,113
Other fixed income securities	298,930	251,596
Equity securities	476,695	472,269
Asset-backed securities	258,694	188,709
Index funds, exchange traded funds, and mutual funds	9,232	6,402
Unregistered mutual funds	232,425	487,055
Real estate investment trusts	3,579	1,926
Hedge funds	331,062	297,228
Private credit	21,942	24,441
Private equity	75,637	85,709
Real assets	99,242	94,306
	<u>\$ 2,371,821</u>	<u>\$ 2,375,905</u>

The following tables present the fair value hierarchy of the valuation techniques utilized to determine the fair value of the Corporation's short-term, board designated, and other investments as of December 31, 2015 and 2014:

<b>Asset category</b>	<b>Level 1</b>	<b>Level 2</b> (in thousands)	<b>Balance</b>
			<b>as of December 31, 2015</b>
Cash and cash equivalents	\$ 186,188	\$ -	\$ 186,188
U.S. government, state, municipal, and agency obligations	324,071	54,124	378,195
Other fixed income securities	-	298,930	298,930
Equity securities	476,695	-	476,695
Asset-backed securities	-	258,694	258,694
Real estate investment trusts	3,579	-	3,579
	<u>\$ 990,533</u>	<u>\$ 611,748</u>	1,602,281
Investments measured at net asset value			<u>769,540</u>
Total investments at fair value as of December 31, 2015			<u>\$ 2,371,821</u>

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Asset category	Level 1	Level 2 (in thousands)	Balance as of December 31, 2014
Cash and cash equivalents	\$ 142,151	\$ -	\$ 142,151
U.S. government, state, municipal, and agency obligations	266,922	57,191	324,113
Other fixed income securities	-	251,596	251,596
Equity securities	472,269	-	472,269
Asset-backed securities	-	188,709	188,709
Real estate investment trusts	1,926	-	1,926
	<u>\$ 883,268</u>	<u>\$ 497,496</u>	<u>1,380,764</u>
Investments measured at net asset value			<u>995,141</u>
Total investments at fair value as of December 31, 2014			<u>\$ 2,375,905</u>

Certain investments categorized within Level 2 are not traded in active markets but are measured using pricing sources such as broker quotes or using models with externally verifiable inputs, such as relevant interest or exchange rates.

There were no significant transfers to or from Levels 1 and 2 during the years ended December 31, 2015 and 2014.

The following table summarizes the Corporation's investments calculated on a NAV per share basis (or its equivalent), the unfunded commitments, and the associated redemption provisions:

	Fair Value (in thousands)	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Index funds, exchange funds, and mutual funds	\$ 9,232	\$ -	Monthly	1 day
Unregistered mutual funds	232,425	-	Monthly	1 day
Hedge funds	331,062	-	Monthly, quarterly, annually	5 - 180 days
Private credit	21,942	11,241	Not currently redeemable	
Private equity	75,637	23,468	Not currently redeemable	
Real assets	99,242	34,797	Monthly, quarterly, not currently redeemable	45 days
	<u>\$ 769,540</u>	<u>\$ 69,506</u>		

**Unregistered mutual funds** include funds that primarily invest in domestic and international equities and short-term government, investment grade, high yield, and mortgage-related fixed income securities. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

**Hedge funds** include absolute return and directional hedge funds. Absolute return hedge funds pursue multiple strategies to diversify risks and reduce volatility while directional hedge funds utilize market movement, trends, and inconsistencies when selecting securities across a variety of markets. Directional hedge funds are usually less exposed to the overall market and are likely to include long equity positions hedged with short positions to cancel out short-term uncertainty. The fair values of the investments in this class have been estimated using the NAV per share of the investments.

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**Private credit** includes investments that are secured by high quality assets or backed by a senior claim on stable cash flows. Investments in this asset class will be made opportunistically during periods of broad market or security specific distress. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in the partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 2 to 6 years. However, the individual investments that will be sold have not yet been determined.

**Private equity** includes funds that invest globally using strategies that include leveraged buyouts, venture capital, growth capital, distressed investments, and mezzanine capital. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in the partners' capital. Investments within these funds cannot be currently redeemed. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 5 years. However, the individual investments that will be sold have not yet been determined.

**Real assets** include energy and energy-related investments and private real estate funds that invest in both U.S. and international commercial real estate. Energy and energy-related investment exposure mainly relate to oil and gas properties which include exploration, production, processing, servicing, or transportation of oil, natural gas, and other hydrocarbon fuels. Private real estate investment strategies include core, value-add, and opportunistic real estate which typically seek to earn a return over inflation. The fair values of the investments in this class have been estimated using the NAV of the Corporation's ownership interest in the partners' capital. Investments representing approximately 96% of the value of the investments in this class cannot be redeemed because the investments include redemption restrictions that range from 1 to 11 years after acquisition. After the expiration of the investment period, distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 1 to 4 years. However, the individual investments that will be sold have not yet been determined.

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Investment returns including net unrealized gains (losses) included in the consolidated statements of operations and changes in net assets for the years ended December 31, 2015 and 2014, are as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
<b>Unrestricted revenues, gains, and other support</b>		
Investment income in other operating revenue	\$ 6,700	\$ 4,234
Net unrealized investment (losses) gains	(11,040)	2,260
	<u>(4,340)</u>	<u>6,494</u>
<b>Other income (expense)</b>		
Investment income	85,525	64,169
Net unrealized investment (losses) gains on trading securities	(120,972)	9,354
	<u>(35,447)</u>	<u>73,523</u>
<b>Temporarily restricted net assets, controlling interest</b>		
Investment income	61	132
Net unrealized investment losses	(5)	(7)
	<u>56</u>	<u>125</u>
<b>Permanently restricted net assets, controlling interest</b>		
Investment (loss) income	(133)	288
Net unrealized investment gains	-	1
	<u>(133)</u>	<u>289</u>
	<u>\$ (39,864)</u>	<u>\$ 80,431</u>

**5. Property, Plant, and Equipment**

A summary of property, plant, and equipment at December 31, 2015 and 2014, is as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Land and land improvements	\$ 147,308	\$ 140,208
Buildings and building equipment	1,356,532	1,332,154
Departmental equipment	1,353,179	1,272,898
Construction in progress	89,939	65,358
	<u>2,946,958</u>	<u>2,810,618</u>
Less accumulated depreciation	<u>1,355,842</u>	<u>1,253,417</u>
	<u>\$ 1,591,116</u>	<u>\$ 1,557,201</u>

At December 31, 2015, the remaining contractual commitments on construction in progress is approximately \$32.3 million and will be financed by a combination of cash flow from operations, existing funds, and bond proceeds (see Note 14).

Certain leases for facilities and medical equipment are accounted for as capital leases. These leases expire in various years through 2024 and are included in property, plant, and equipment on the consolidated balance sheets. The amortization of assets under capital leases is included in

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depreciation and amortization expense in the consolidated statements of operations and changes in net assets.

**6. Long-Term Debt**

Long-term debt at December 31, 2015 and 2014, consists of the following:

	Year of Final Maturity	Interest Rate Range over Life of Bonds	2015	2014
(in thousands)				
Tax Exempt Hospital and Health System Revenue and Refunding Bonds				
Fixed rate term and serial bonds				
Series 2009	2039	4.000% - 5.375%	\$ 210,295	\$ 213,010
Series 2008C	2032	5.000% - 5.500%	250,815	258,085
Series 2006E, insured	2041	5.125% - 5.250%	84,675	84,675
Less: bond discounts and premiums, net			(3,024)	(3,225)
Total fixed rate term and serial bonds			<u>\$ 542,761</u>	<u>\$ 552,545</u>
		Interest Rate Range 2015	Interest Rate Range 2014	
Variable rate direct placement bonds				
Series 2012A	2048	0.97% - 1.02%	0.96% - 0.97%	\$ 75,000
Series 2012B	2015	0.82% - 0.84%	0.81% - 0.82%	-
Series 2014A	2048	0.89% - 0.94%	0.88% - 0.89%	50,000
Total variable rate direct placement bonds			<u>\$ 125,000</u>	<u>\$ 127,050</u>
Variable rate demand bonds, subject to seven-day put provision supported by direct pay bank letters of credit				
Series 2008A	2041	0.01% - 0.13%	0.03% - 0.13%	\$ 79,650
Series 2008B	2041	0.01% - 0.12%	0.04% - 0.13%	79,540
Series 2008F	2048	0.01% - 0.12%	0.01% - 0.12%	45,200
Series 2008G	2048	0.01% - 0.12%	0.01% - 0.12%	45,250
Series 2008H	2048	0.01% - 0.12%	0.03% - 0.14%	63,895
Series 2008I	2037	0.02% - 0.11%	0.03% - 0.13%	39,240
Series 2008J	2037	0.01% - 0.12%	0.01% - 0.12%	39,250
Total variable rate demand bonds			<u>\$ 392,025</u>	<u>\$ 396,575</u>
Other debt				
Capital lease obligations (excluding imputed interest of \$2,810 and \$3,700 at December 31, 2015 and 2014, respectively)			\$ 20,004	\$ 21,720
Other			2,237	3,347
Total other debt			<u>22,241</u>	<u>25,067</u>
Total long-term debt			1,082,027	1,101,237
Less current portion of long-term debt			(22,576)	(23,693)
Long-term debt, net of current portion			<u>\$ 1,059,451</u>	<u>\$ 1,077,544</u>

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Scheduled principal payments on long-term debt are as follows:

Years ended December 31	Fixed and Variable Rate Bonds	Capital Lease Obligations & Other (in thousands)	Total
2016	\$ 15,735	\$ 6,841	\$ 22,576
2017	18,165	7,564	25,729
2018	18,990	2,940	21,930
2019	19,905	1,341	21,246
2020	20,815	798	21,613
Thereafter	<u>969,200</u>	<u>2,757</u>	<u>971,957</u>
	<u>\$ 1,062,810</u>	<u>\$ 22,241</u>	<u>\$ 1,085,051</u>

Total interest costs incurred on the long-term debt less capitalized interest are as follows:

	2015	2014
	(in thousands)	
Interest costs incurred	\$ 34,801	\$ 36,455
Less capitalized interest	<u>883</u>	<u>729</u>
Interest expense included in operating income	<u>\$ 33,918</u>	<u>\$ 35,726</u>

The fair value of the Corporation's long-term debt at December 31, 2015 and 2014 approximates \$1.153 billion and \$1.166 billion, respectively. The fair values of the Corporation's underlying tax exempt Hospital and Health System Revenue Bonds and Refunding Bonds are based on current traded values for similar types of borrowings which are considered Level 2 inputs as described in Note 2.

**Obligated Group and Designated Group Affiliates and Other Requirements** - The Corporation has long-term debt outstanding under a Master Trust Indenture dated November 1, 1997, as amended and supplemented ("AMTI"). The AMTI permits the Corporation to issue obligations to finance certain activities. Obligations issued under the AMTI are general, direct obligations of the Corporation and any future members of the Franciscan Alliance, Inc. Obligated Group ("Obligated Group"). All members of the Obligated Group are jointly and severally liable with respect to the payment of each obligation issued under the AMTI. In addition, the AMTI provides that certain affiliates of the Corporation may be designated as Designated Group Affiliates from time to time and the Corporation covenants to cause each of its Designated Group Affiliates to pay, loan, or otherwise transfer to the Obligated Group such amounts necessary to pay the obligations issued under the AMTI. The Designated Group Affiliates are not members of the Obligated Group and are not directly liable for payments on the obligations. The Corporation has granted a security interest in its unrestricted receivables, among others, for the benefit of the owners of the obligations. The AMTI includes covenants which require the Corporation to maintain a minimum debt service coverage ratio of 1.10 and limit the Corporation's ability to encumber certain of its assets. As of December 31, 2015 and 2014, the Corporation was in compliance with the terms of the AMTI and there were no other Obligated Group members nor any Designated Group Affiliates.

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**Issuance, Refunding, and Redemption of Long-Term Debt** – In February 2016, the Corporation issued \$285.0 million of its Series 2016A and B fixed rate tax exempt revenue and refunding bonds. The Series 2016A bond proceeds of \$200.0 million, together with other funds, are being used to finance or reimburse the costs of construction, acquisition, renovation and equipping certain capital assets of the Corporation and to pay related cost of issuance. The Series 2016B bond proceeds of \$85.0 million were used to refund the outstanding principal amount of the Corporation's Series 2006E fixed rate bonds and to pay the related cost of issuance. The refunding of the Series 2006E bonds was considered a legal defeasance and will result in a \$8.9 million loss on refunding that will be recognized in the Corporation's 2016 consolidated statements of operations and changes in net assets. In June 2014, the Corporation fully redeemed its Series 2008E variable rate demand bonds of \$50 million and issued in the same amount its Series 2014A variable rate direct placement bonds.

**Variable Rate Demand Bonds** – Included in the Corporation's debt is approximately \$392.0 million of variable rate demand bonds, Series 2008A, Series 2008B, and Series 2008F through Series 2008J. The Corporation has entered into irrevocable letters of credit with multiple financial institutions to secure bond repayment and interest obligations associated with its variable rate demand bonds, which amount to \$397.4 million. These liquidity facilities are available to the Corporation should the obligations be presented for redemption and not remarketed. There were no draws made on the letters of credit as of December 31, 2015. Additionally, these facilities (if utilized) generally have repayment terms for bonds held by the letter of credit banks that amortize ratably over 3 to 5 years, depending on the facility used. Termination dates for the various liquidity facility agreements have expiration dates extending from October 2017 through October 2018. Since the liquidity facilities expire beyond one year from the Corporation's balance sheet date and the Corporation has the intent to continually renew these liquidity facilities, the variable rate demand bonds are classified as long-term debt and are disclosed in accordance with the stated maturities.

#### 7. Other Liabilities and Commitments

**Interest Rate Swap Contracts** – The Corporation utilizes interest rate swaps to manage interest rate risk associated with its variable rate bonds. Cash payments on the interest rate swap contracts totaled \$13.4 million and \$13.9 million for the years ended December 31, 2015 and 2014, respectively. At December 31, 2015 and 2014, the interest rate swap contracts were in a liability position with a fair value of approximately \$83.3 million and \$85.0 million, respectively. The fair value of the Corporation's interest rate swap contracts are based on observable inputs, such as interest rates and credit risk spreads, that fall within Level 2 of the hierarchy of fair value inputs as described in Note 2. Certain of the Corporation's interest rate swap agreements include collateral funding requirements based on the market value of these contracts. At December 31, 2015 and 2014, the Corporation had posted \$31.5 million and \$30.5 million, respectively, to satisfy its collateral funding obligations on these contracts which are included in assets under bond indenture and swap agreements within board designated and other investments on the consolidated balance sheets.

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**Operating Leases** – The Corporation leases various facilities, equipment, and software. Total rental expense under operating leases approximated \$43.4 million and \$42.3 million for the years ended December 31, 2015 and 2014, respectively. Future minimum lease payments under operating leases as of December 31, 2015 that have initial or remaining lease terms in excess of one year are as follows:

	(in thousands)
<b>Years ended December 31</b>	
2016	\$ 39,857
2017	38,894
2018	36,115
2019	35,060
2020	34,884
Thereafter	<u>76,581</u>
	<u>\$ 261,391</u>

**8. Retirement Benefits**

Prior to 2014, the Corporation had various retirement programs in place due to acquisitions it made over the years. Effective January 1, 2014, the Corporation amended its retirement program to have all employees (except for those from two of its Health Centers and its construction company) covered by one comprehensive retirement program that administers benefits under different tracks. Under track A, future employer-provided retirement benefits are provided entirely through the defined benefit pension plan. Under track B, future employer-provided retirement benefits are provided through both the defined benefit pension plan and the defined contribution benefit plan. Effective September 1, 2015, the Corporation further amended its retirement program for all new employees so that employer-provided retirement benefits will be provided entirely through the defined contribution benefit program (track C). These three retirement tracks administered under one comprehensive retirement program include similar benefit levels in aggregate even though they are delivered through different retirement plan types.

**Noncontributory Defined Benefit Pension Plan** – As discussed above, the Corporation has a qualified, noncontributory defined benefit pension plan covering eligible employees in retirement tracks A and B. The plan provides defined benefits based on years of service and final average salary. Certain nonqualified, supplemental plan arrangements also provide retirement benefits to specified groups of participants. Because the noncontributory defined benefit pension plan has church plan status as defined in the Employee Retirement Income Security Act of 1974 (“ERISA”), funding in accordance with ERISA is not required. The Corporation’s funding policy for the qualified plan, which is reviewed annually and may be adjusted as needed, is to fund the normal service cost based on the accumulated benefit obligation for the plan’s year and amortize any under or over funding over a ten year period.

In 2015 and 2014, the Corporation offered a voluntary lump sum payout to certain eligible participants to receive a full distribution of their pension benefits during the program window. To be eligible, a participant must have terminated employment and had a benefit value less than \$100,000 and \$25,000 for the program offered in 2015 and 2014, respectively. As a result of these programs, the plan’s projected benefit obligation decreased by \$59.0 million in 2015 and by \$28.0 million in 2014. For the years end December 31, 2015 and 2014, the Corporation recognized settlement losses of \$0.6 million and \$0.9 million, respectively in the consolidated statements of operations and changes in net assets.

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The Corporation's measurement date for all pension calculations is December 31.

The change in projected benefit obligation, change in plan assets, and funded status of the Corporation's pension plans as of December 31, 2015 and 2014, are as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
<b>Change in benefit obligation</b>		
Benefit obligation, beginning of year	\$ 1,577,378	\$ 1,218,238
Service cost	47,747	35,388
Interest cost	63,957	63,569
Plan amendments	1,906	(1,198)
Plan settlements	(2,256)	(3,297)
Actuarial (gain) loss	(128,933)	323,950
Benefits paid	<u>(92,829)</u>	<u>(59,272)</u>
Benefit obligation, end of year	<u>1,466,970</u>	<u>1,577,378</u>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	1,199,109	1,102,282
Actual (loss) gain on plan assets	(38,048)	106,170
Employer contributions	80,398	53,226
Plan settlements	(2,256)	(3,297)
Benefits paid	<u>(92,829)</u>	<u>(59,272)</u>
Fair value of plan assets, end of year	<u>1,146,374</u>	<u>1,199,109</u>
Funded status	<u>\$ (320,596)</u>	<u>\$ (378,269)</u>
<b>Amounts recognized in the consolidated balance sheets</b>		
Current liabilities	\$ (258)	\$ (4,093)
Noncurrent liabilities	<u>(320,338)</u>	<u>(374,176)</u>
Total amount recognized	<u>\$ (320,596)</u>	<u>\$ (378,269)</u>

The amounts in unrestricted net assets, including amounts arising during the year and amounts reclassified into net periodic benefit cost, are as follows:

	<b>Net</b>	<b>Prior</b>	
	<b>Gain (Loss)</b>	<b>Service</b>	<b>Total</b>
		(in thousands)	
<b>December 31, 2013</b>	\$ (137,176)	\$ 16,441	\$ (120,735)
Amounts reclassified into net periodic benefit cost	4,768	(825)	3,943
Amounts arising during the year	<u>(297,484)</u>	<u>-</u>	<u>(297,484)</u>
<b>December 31, 2014</b>	<u>\$ (429,892)</u>	<u>\$ 15,616</u>	<u>\$ (414,276)</u>

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	<b>Net Gain (Loss)</b>	<b>Prior Service Cost</b> (in thousands)	<b>Total</b>
<b>December 31, 2014</b>	\$ (429,892)	\$ 15,616	\$ (414,276)
Amounts reclassified into net periodic benefit cost	29,585	(4,095)	25,490
Amounts arising during the year	3,786	-	3,786
<b>December 31, 2015</b>	<u>\$ (396,521)</u>	<u>\$ 11,521</u>	<u>\$ (385,000)</u>

The following are estimated amounts to be amortized from unrestricted net assets into net periodic pension cost in the next fiscal year. Unrecognized prior service cost/credit is amortized on a straight line basis over the average remaining service period of participants who are expected to receive a benefit and are active at the date of the plan amendment.

	(in thousands)
Unrecognized prior service cost	\$ 2,012
Unrecognized loss	<u>(29,028)</u>
Total amount expected to be amortized from unrestricted net assets in 2016	<u>\$ (27,016)</u>

The accumulated benefit obligation ("ABO") at December 31, 2015 and 2014 was \$1.37 billion and \$1.47 billion, respectively. The following information is provided for plans with an ABO in excess of plan assets at December 31, 2015 and 2014:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Projected benefit obligation	\$ 1,466,970	\$ 1,577,378
ABO	1,371,878	1,467,380
Fair value of plan assets	1,146,374	1,199,109

Components of net periodic pension cost for the years ended December 31, 2015 and 2014, are as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Service cost	\$ 47,747	\$ 35,388
Interest cost	63,957	63,569
Expected return on plan assets	(87,099)	(79,704)
Amortization of prior service cost	(2,190)	(2,024)
Amortization of net loss	<u>29,012</u>	<u>3,908</u>
Net periodic pension cost included in operating expenses	51,427	21,137
Plan settlement loss recognized in other income (expense)	<u>573</u>	<u>861</u>
Net periodic pension cost	<u>\$ 52,000</u>	<u>\$ 21,998</u>

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The following weighted-average assumptions were used to determine the Corporation's benefit obligations and net periodic pension cost for the years ended December 31:

	2015	2014
<b>Benefit obligation</b>		
Discount rate	4.59 %	4.19 %
Rate of compensation increase	4.70 %	4.50 %
<b>Net periodic pension cost</b>		
Discount rate	4.19 %	5.25 %
Expected rate of return on plan assets	7.16 %	7.15 %
Rate of compensation increase	4.70 %	4.70 %

In developing the expected rate of return on plan assets assumption, the Corporation considered the historical returns and the expectation for future returns on each asset class, as well as the target asset allocation of the pension investment portfolio. The rate of return on plan assets assumption also considers investment and administrative expenses.

The discount rate assumption reflects the yield of a portfolio of high quality bonds matched against the timing and amount of projected future benefit payments as of the measurement date.

As of December 31, 2014, the Corporation adopted the Society of Actuaries RP-2014 Mortality Tables. The new actuarial tables updated longevity expectations related to the pension plans.

The Corporation's pension investment policy considers the long-term nature of the asset pool as well as the liabilities it is designated to fund. In 2014, the Corporation modified its pension investment policy to utilize a liability driven investment strategy to better hedge against interest rate risk on investments and volatility of the pension liability given changes in the discount rate. The Corporation considers the risk and return characteristics of the various asset classes available to institutional investors and seeks guidance from outside investment advisors. The Corporation has established the following targeted asset allocation that categorizes assets into de-risking assets (cash and core fixed income assets) and return seeking/growth assets (equity securities and multi-strategy hedge fund of funds) given different levels of the pension plans' funded status.

Pension PlanFunded Status	De-Risking Assets	Return Seeking/Growth Assets
85%-90%	46%	54%
90%-95%	61%	39%
95%-100%	77%	23%
100%+	95%	5%

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For the years ended December 31, 2015 and 2014, the funded status of the Corporation's pension plans were 78% and 76%, respectively, when measured on a projected benefit obligation basis. The Corporation's asset allocation as of December 31, 2015 and 2014 was as follows:

	<b>Percentage of Plan Assets</b>	
	<b>2015</b>	<b>2014</b>
De-Risking Portfolio	46%	47%
Return Seeking/Growth Portfolio	54%	53%
	<u>100%</u>	<u>100%</u>

Assets are invested to achieve a rate of return consistent with the policy allocation targets which significantly contributes to meeting the current and future obligation of the plan and helps to ensure solvency of the plan over time. It is expected that this objective can be achieved through a well-diversified asset portfolio and an emphasis on long-term capital appreciation as a primary source of return. The plan utilizes a multi-manager structure of complementary investment styles and classes with manager performance judged over an investment market cycle which is generally 3 to 5 years. Plan assets are exposed to risk and fluctuations in market value from year to year. To minimize risk, each manager is required to maintain adequate portfolio diversification to insulate the plan assets from substantial loss in any single security or market sector. Asset allocation is reviewed every quarter and rebalanced as necessary.

**Cash Flows**

During 2016, the Corporation anticipates making contributions of approximately \$26.3 million to fund the normal service cost in accordance with its standard funding policy and \$50 million to fund the first year of a two year, \$100 million total supplemental pension funding commitment approved by the Corporation's Board.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

	(in thousands)
2016	\$ 47,645
2017	52,465
2018	66,085
2019	67,163
2020	69,558
Years 2021-2025	419,339

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The following tables summarize the Corporation's pension assets, measured at fair value as of December 31, 2015 and 2014, respectively.

<b>Asset category</b>	<b>Level 1</b>	<b>Level 2</b> (in thousands)	<b>Balance as of December 31, 2015</b>
Cash and cash equivalents	\$ 34,646	\$ -	\$ 34,646
U.S. government, state, municipal, and agency obligations	67,386	43,034	110,420
Other fixed income securities	-	394,537	394,537
Equity securities	433,105	-	433,105
Asset-backed securities	-	1,496	1,496
Real estate investment trusts	4,344	-	4,344
	<u>\$ 539,481</u>	<u>\$ 439,067</u>	<u>978,548</u>
Investments measured at net asset value			<u>167,826</u>
Total investments at fair value as of December 31, 2015			<u>\$ 1,146,374</u>

<b>Asset category</b>	<b>Level 1</b>	<b>Level 2</b> (in thousands)	<b>Balance as of December 31, 2014</b>
Cash and cash equivalents	\$ 64,810	\$ -	\$ 64,810
U.S. government, state, municipal, and agency obligations	89,565	44,213	133,778
Other fixed income securities	-	384,913	384,913
Equity securities	439,601	-	439,601
Asset-backed securities	-	1,853	1,853
Real estate investment trusts	7,880	-	7,880
	<u>\$ 601,856</u>	<u>\$ 430,979</u>	<u>1,032,835</u>
Investments measured at net asset value			<u>166,274</u>
Total investments at fair value as of December 31, 2014			<u>\$ 1,199,109</u>

There were no significant transfers to or from Levels 1 and 2 during the years ended December 31, 2015 and 2014.

**Defined Contribution Benefit Plans** - The Corporation sponsors various defined contribution benefit plans covering eligible employees. These employees may contribute a portion of their pre-tax and/or after-tax compensation to the plans, in accordance with specified guidelines. In addition to any discretionary contributions, these plans provide for established contribution percentages up to certain limits for eligible employees. Contribution expense for the years ended December 31, 2015 and 2014 aggregated \$21.4 million and \$12.4 million, respectively.

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#### **9. Liability Insurance and Contingencies**

The Corporation has a comprehensive risk management and insurance program designed to safeguard its assets and properties. Hills Insurance Company, Inc. ("Hills Inc."), the wholly owned captive insurance subsidiary of the Corporation, provides certain professional and general liability coverage for the Health Centers and its other corporate entities. Hills has limited its exposure by purchasing reinsurance and excess insurance coverage. In the unlikely event that any of the excess insurance coverages fail, the Corporation would be liable for such defaults, however the Corporation purchases its excess insurance policies from highly rated insurance companies to mitigate that risk. In addition, the Corporation is self-insured for its employee health, long-term disability, and workers' compensation employee benefit programs.

The estimated insurance liabilities provide for reported losses and for losses incurred but not reported based on projections by independent actuaries using information provided by the Corporation's management. The estimated insurance liabilities, which consist of professional liability, general liability, long-term disability insurance, workers' compensation, and amounts self-insured for allocated loss adjustment expenses, approximated \$152.5 million and \$135.8 million on an undiscounted basis at December 31, 2015 and 2014, respectively.

From time to time, the Corporation is subject to various legal proceedings and claims arising in the ordinary course of business. Although the outcome of these claims cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material adverse effect on the Corporation's financial condition, results of operations, or cash flow.

Hospitals and health facilities, including those operated by the Corporation, are subject to numerous legal, regulatory, environmental, professional and private licensing, and certification and accreditation requirements. Also, the laws and regulations governing the Medicare, Medicaid, and other governmental health care programs that the Corporation participates in are extremely complex and subject to interpretation, making compliance an ongoing challenge for health care organizations. Recently, the federal government has increased its enforcement activity, including audits and investigations related to billing practices, clinical documentation, and other related matters. Allegations concerning possible violations of regulations can result in the imposition of significant fines and penalties and significant repayment of billed and collected revenues for patient services. The Corporation maintains a compliance program designed to educate its employees and to prevent, detect, and correct possible violations.

In 2015, a vendor of the Corporation experienced a data breach that included protected health information of certain of the Corporation's patients. In response to the data breach, the Corporation worked with the vendor to meet the Corporation's notice requirements under applicable privacy laws.

#### **10. Noncontrolling Interests in Consolidated Affiliates and Investments in Unconsolidated Affiliates**

The Corporation is involved in various health service entity joint ventures that support the Corporation's mission whose operations have been included in the consolidated financial statements.

##### **Noncontrolling Interests in Consolidated Affiliates**

The Corporation's consolidated financial statements include all assets, liabilities, revenues, and expenses of less than 100% owned entities that it controls. Accordingly, the Corporation has

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recorded the noncontrolling interests in the earnings and equities of such entities in its consolidated financial statements.

#### **Investments in Unconsolidated Affiliates**

The Corporation has investments in entities that are recorded under the cost or equity method of accounting.

At December 31, 2015 and 2014, the Corporation had a 33%, economic interest in Alverno Clinical Laboratories, LLC ("ACL, LLC"), an Indiana limited liability company created to direct, operate, maintain, and manage a centralized clinical laboratory in Hammond, Indiana supporting the Corporation and an unrelated healthcare system. The Corporation is also an owner of Alverno Provena Hospital Laboratories, LLC ("APHL"), a non-profit cooperative corporation created to direct, operate, maintain, and manage the on-site laboratories of the owners' health centers. Governance of ACL, LLC and APHL (collectively referred to as the "Laboratories") is shared between the health system members. The Corporation accounts for its investment in ACL, LLC under the equity method, which approximated \$4.6 million and \$4.3 million at December 31, 2015 and 2014, respectively. The Corporation's capital account in APHL approximates \$50,000 at both December 31, 2015 and 2014.

The Corporation had a 7%, economic interest in Preferred Professional Insurance Corporation ("PPIC") which provided professional liability insurance and other related services to physicians and other health care providers associated with its owners. In 2014, the owners of PPIC elected to sell the organization which resulted in the Corporation recording a \$16.6 million gain on sale of investment in this unconsolidated affiliate for the year ended December 31, 2014 which is recorded in other income in the consolidated statements of operations and changes in net assets. As a condition of sale, PPIC needed to establish an escrow to cover any losses related to breach of representation or warranty, nonperformance of any covenant or agreement, or actions against PPIC by a PPIC shareholder. During 2015, the Corporation received a \$1.5 million release from escrow payment which is recorded in other income in the consolidated statements of operations and changes in net assets for the year ended December 31, 2015. Subsequent to December 31, 2015, the Corporation received an additional \$2.0 million release from escrow payment that will be recorded in other income in the 2016 consolidated statements of operations and changes in net assets.

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The Corporation has a 34.5% ownership interest in Advantage Health Solutions, Inc. (“Advantage Health”), an Indiana based, provider-owned health plan. Advantage Health provides prepaid comprehensive health services to enrollees through contracted networks that are primarily compensated on a capitated basis and facilitated a Medicare Advantage plan. In November 2015, Advantage Health launched an orderly process to discontinue its Medicare Advantage business as of January 1, 2016 which had covered approximately 22,000 Medicare Advantage beneficiaries. Also, Advantage Health is in discussions to sell its non-Medicare Advantage business. To facilitate Advantage Health’s transition, its board appointed a corporate transition and strategy consultant who is acting as the new chief executive officer. Advantage Health is working closely with the Indiana Department of Insurance regarding the orderly transition of coverage for the beneficiaries. The Corporation has recorded losses of \$45.6 million and \$4.1 million in Advantage Health for the years ended December 31, 2015 and 2014, respectively, in equity losses of investments in unconsolidated affiliates in the consolidated statements of operations and changes in net assets.

The Corporation’s share of the equity in losses of investments in unconsolidated affiliates accounted for on the equity method is approximately \$41.1 million and \$1.2 million for the years ended December 31, 2015 and 2014, respectively, which is included in total unrestricted revenues, gains, and other support in the consolidated statements of operations and changes in net assets.

The unaudited summarized financial position and results of operations for the entities accounted for under the equity method as of and for the periods ended December 31 is as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Total assets	\$ 141,470	\$ 157,873
Total liabilities	103,577	95,393
Net assets	37,893	62,480
Total unrestricted revenues, gains, and other support	743,137	740,219
Deficiency of revenues over expenses	(68,365)	(1,002)

**11. Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at December 31, 2015 and 2014:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Capital needs and equipment	\$ 1,290	\$ 3,059
Medical education programs	4,565	4,473
Health care operations and patient services	6,044	5,148
Other restrictions - spiritual care and mission related activities	2,897	3,794
	<u>\$ 14,796</u>	<u>\$ 16,474</u>

Permanently restricted net assets of approximately \$16.6 million and \$17.1 million at December 31, 2015 and 2014, respectively, are restricted investments to be held in perpetuity with the income expendable to support the Corporation’s mission.

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**12. Related Party Transactions**

The Corporation's Health Centers incurred clinical laboratory charges from the Laboratories of approximately \$64.5 million and \$65.0 million for the years ended December 31, 2015 and 2014, respectively, which is included in purchased services in the consolidated statements of operations and changes in net assets. The Corporation provides information technology services, central procurement and disbursement services, and rents the core lab facilities to the Laboratories for which the Corporation has recorded approximately \$4.3 million and \$3.7 million for the years ended December 31, 2015 and 2014, respectively, as other operating revenue on the consolidated statements of operations and changes in net assets.

**13. Functional Expenses**

The Corporation provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended December 31, 2015 and 2014, are as follows:

	<b>2015</b>	<b>2014</b>
	(in thousands)	
Health care services	\$ 2,033,749	\$ 1,980,525
General, administrative, and other nonhealth care services	<u>543,246</u>	<u>522,005</u>
Total operating expenses	<u>\$ 2,576,995</u>	<u>\$ 2,502,530</u>

**14. Subsequent Events**

The Corporation has evaluated events and transactions subsequent to December 31, 2015 through May 3, 2016, the date the consolidated financial statements were issued.