Audited Consolidated Financial Statements, Reports, Supplementary Information and Schedule Required by the Uniform Guidance

HonorHealth
Year Ended December 31, 2016
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

HonorHealth

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Reports, Supplementary Information and
Schedule Required by the Uniform Guidance

Year Ended December 31, 2016

Contents

Building a better working world

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Report of Independent Auditors

The Board of Directors and Management
HonorHealth

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of HonorHealth (the Company), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 the auditor's 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, the auditor considers internal control relevant to the entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Building a better working world

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of HonorHealth at December 31, 2016 and 2015, and the consolidated results of its operations, changes in its net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Schedule of Expenditures of Federal Awards as required by Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our report dated April 28, 2017, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

Ernst + Young LLP

April 28, 2017, except for the Schedule of
Expenditures of Federal Awards for which
the date is July 28, 2017

HonorHealth

Consolidated Balance Sheets
(In Thousands)

	December 31	
	2016	**2015**
Assets		
Current assets:		
Cash and cash equivalents	**$ 84,071**	$ 76,731
Short-term investments	**562,929**	337,779
Accounts receivable, less allowance for doubtful accounts of $28,726 in 2016 and $26,790 in 2015	**267,252**	249,665
Inventories	**50,859**	45,171
Assets whose use is limited	**5,762**	4,170
Prepaid expenses and other	**60,592**	39,575
Total current assets	**1,031,465**	753,091
Assets whose use is limited, less current portion	**194,711**	183,323
Trust fund assets, less current portion	**20,597**	20,440
Long-term investments	**100,795**	337,140
Property and equipment, net	**827,701**	743,361
Other assets	**95,138**	85,389
Total assets	**$ 2,270,407**	$ 2,122,744
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 93,552**	$ 85,114
Accrued expenses and other	**99,200**	80,213
Due to Medicare	**6,475**	4,495
Current portion of long-term debt	**12,687**	9,345
Total current liabilities	**211,914**	179,167
Deferred gain, primarily on sale of medical office buildings	**13,154**	14,213
Capital lease obligation	**9,544**	–
Long-term debt, less current portion	**676,009**	652,565
Other liabilities	**108,405**	118,409
Net assets:		
Unrestricted	**1,096,506**	1,009,829
Temporarily restricted	**35,478**	27,481
Permanently restricted	**104,836**	106,414
Total HonorHealth net assets	**1,236,820**	1,143,724
Non-controlling interests – unrestricted	**14,561**	14,666
Total net assets	**1,251,381**	1,158,390
Total liabilities and net assets	**$ 2,270,407**	$ 2,122,744

See accompanying notes.

HonorHealth

Consolidated Statements of Operations
(In Thousands)

	Year Ended December 31	
	2016	2015
Revenues:		
Patient service revenue	**$ 1,720,301**	$ 1,635,529
Less provision for doubtful accounts	**110,235**	99,109
Patient service revenue, less provision for doubtful accounts	**1,610,066**	1,536,420
Other	**106,478**	69,943
Total	**1,716,544**	1,606,363
Expenses:		
Salaries and benefits	**873,553**	805,392
Supplies, services, and other	**679,952**	643,506
Depreciation and amortization	**103,580**	89,327
Interest	**25,435**	26,751
Total	**1,682,520**	1,564,976
Operating income	**34,024**	41,387
Investment income (loss)	**49,138**	(22,829)
Change in fair value of interest rate swaps	**1,971**	(2,111)
Gain on sale of medical office buildings	**2,482**	2,271
Loss on debt defeasance	**–**	(3,707)
Other	**36**	1,302
Excess of revenues over expenses	**87,651**	16,313
Plus excess of revenues over expenses attributable to non-controlling interests	**(2,599)**	(2,274)
Excess of revenues over expenses attributable to HonorHealth	**85,052**	14,039
Net assets released from restriction for purchase of property and equipment	**744**	1,796
Pension-related changes other than net periodic pension cost	**–**	3,056
Amortization of aggregate fair value of interest rate swaps	**201**	201
Board-designated endowment contribution	**526**	772
Other changes	**154**	48
Increase in unrestricted net assets	**$ 86,677**	$ 19,912

See accompanying notes.

HonorHealth

Consolidated Statements of Changes in Net Assets
(In Thousands)

.	Year Ended December 31	
	2016	**2015**
Unrestricted net assets:		
Excess of revenues over expenses attributable to HonorHealth	**$ 85,052**	$ 14,039
Net assets released from restriction for purchase of property and equipment	**744**	1,796
Pension-related changes other than net periodic pension cost	**–**	3,056
Amortization of aggregate fair value of interest rate swaps	**201**	201
Board-designated endowment contribution	**526**	772
Other changes	**154**	48
Increase in unrestricted net assets	**86,677**	19,912
Temporarily restricted net assets:		
Donations received	**14,156**	11,648
Investment income (loss), net	**8,438**	(4,530)
Net assets released from restriction for purchase of property and equipment	**(744)**	(1,796)
Net assets released from restriction for use in operations	**(13,853)**	(11,997)
Increase (decrease) in temporarily restricted net assets	**7,997**	(6,675)
Permanently restricted net assets:		
Donations received	**1,369**	1,578
Transfers of permanently restricted donations	**(2,947)**	–
(Decrease) increase in permanently restricted net assets	**(1,578)**	1,578
Non-controlling interests:		
Excess of revenues over expenses attributable to non-controlling interests	**2,599**	2,274
Distributions to non-controlling partners	**(3,204)**	(1,511)
Contributions	**500**	149
(Decrease) increase in non-controlling interests	**(105)**	912
Increase in net assets	**92,991**	15,727
Net assets, beginning of year	**1,158,390**	1,142,663
Net assets, end of year	**$ 1,251,381**	$ 1,158,390

See accompanying notes.

HonorHealth

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended December 31	
	2016	**2015**
Operating activities		
Increase in net assets	**$ 92,991**	$ 15,727
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Provision for doubtful accounts	**110,235**	99,109
Depreciation and amortization	**103,580**	89,327
Decrease (increase) in investments designated as trading	**11,195**	(12,923)
Change in fair value of interest rate swaps	**(1,971)**	2,111
Pension-related changes other than net periodic pension cost	**–**	3,056
Restricted donations	**(15,525)**	(13,226)
Gain on sale of medical office buildings	**(2,482)**	(2,271)
Gain on Scottsdale Health Partners acquisition	**(8,291)**	–
Loss on debt defeasance	**–**	3,707
Net change in operating assets and liabilities, exclusive of cash	**(141,046)**	(184,913)
Net cash provided by (used in) operating activities	**148,686**	(296)
Investing activities		
Purchases of property and equipment, net	**(171,475)**	(146,957)
(Increase) decrease in trust fund assets	**(157)**	80,800
(Increase) decrease in assets whose use is limited	**(12,980)**	12,368
(Increase) decrease in other assets	**(8,589)**	744
Net cash used in investing activities	**(193,201)**	(53,045)
Financing activities		
Payments on long-term debt and financing obligation	**(7,714)**	(66,321)
Proceeds from line of credit	**34,500**	–
Proceeds from issuance of revenue bonds	**–**	47,740
Proceeds from capital lease obligation	**9,544**	–
Payment of debt issue costs	**–**	(538)
Restricted donations	**15,525**	13,226
Net cash provided by (used in) financing activities	**51,855**	(5,893)
Increase (decrease) in cash and cash equivalents	**7,340**	(59,234)
Cash and cash equivalents at beginning of year	**76,731**	135,965
Cash and cash equivalents at end of year	**$ 84,071**	$ 76,731
Non-cash activity		
Property, plant and equipment and accounts payable	**$ 9,314**	$ 4,431
Acquisition of Scottsdale Health Partners	**$ 8,291**	$ –
Excess insurance receivable and payable	**$ (4,546)**	$ (303)

See accompanying notes.

1. Description of Business

On September 30, 2013, Scottsdale Healthcare Hospitals (SHH) entered into an affiliation agreement with John C. Lincoln Health Network and Affiliates (JCL) to form Scottsdale Lincoln Health Network (SLHN). SLHN's wholly owned subsidiaries included SHH and JCL. Effective January 1, 2015, SLHN and JCL were merged into SHH and are doing business as HonorHealth (the Company).

The Company is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. The Company and its subsidiaries own five acute care hospitals located in Scottsdale, Arizona, and Phoenix, Arizona, a captive insurance company; ambulatory care centers; an accountable care organizations (ACO); medical practices; a foundation that conducts fundraising and development programs for the benefit of the Company; and an organization entitled Desert Mission, which provides family services, child care services, and health services for low-income families.

The Company also holds a controlling interest in the following business ventures:

- SHC ASC LLC, formed to create partnerships with physicians and to expand outpatient surgical settings outside of the hospital campuses.
- Global Rehab – Scottsdale, LLC (the Rehab JV), formed to lease a rehab hospital and provides rehabilitation services to patients.

As of December 31, 2016, the Company holds a non-controlling interest in Scottsdale Imaging Services, LLC (SIS) and Imaging Endpoint, LLC (Imaging Endpoint). SIS and Imaging Endpoint are business partnerships that were formed to provide imaging services to patients. The Company records its interest in SIS and Imaging Endpoint using the equity method of accounting. Prior to August 1, 2016, the Company also held a non-controlling interest in Scottsdale Health Partners (SHP), a business partnership formed between the Company and Scottsdale Physicians Organization (SPO). On August 1, 2016, the Company acquired SPO's interest in SHP (see Note 4). The Company recorded its interest in SHP using the equity method of accounting through July 31, 2016. As of August 1, 2016, the financial results of SHP have been included in the Company's consolidated financial statements.

2. Summary of Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of HonorHealth and its wholly owned subsidiaries. HonorHealth also holds controlling interests in various business ventures for which the financial results are included within the Company's consolidated financial statements. The Company records the unrelated investor's share of the business venture as non-controlling interests on the accompanying consolidated balance sheets and statement of operations. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

For the years ended December 31, 2016 and 2015, the Company recorded a reduction to other expense of approximately $7,024,000 and $6,034,000, respectively, representing a change in estimate due to favorable professional and general liability claim experience as part of the Company's self-insurance program. In addition, certain regulatory reimbursement provisions allow the Company to retain receivable overpayments from non-governmental third-party payors after a year from the date of the overpayment. Accordingly, approximately $9,700,000 and $15,500,000 of overpayments from those third-party payors were recognized as an increase to net patient service revenue for the years ended December 31, 2016 and 2015, respectively.

Fair Values

Carrying values of financial instruments classified as current assets and current liabilities approximate fair value due to the short-term liquidity of these instruments. The fair values of other financial instruments are disclosed in their respective notes.

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with a remaining maturity of three months or less at the date of acquisition, excluding assets whose use is limited under trust agreements or by donor restriction.

Short-Term Investments

Short-term investments include securities with maturity dates of one year or less from the balance sheet date and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value, based on quoted market prices in active markets.

Investments

Interest income, realized gains and losses, income on alternative investments, and unrealized gains and losses on investments are included in excess of revenues over expenses attributable to HonorHealth, unless the income is restricted by the donor.

The Company invests in various investment securities that are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the consolidated financial statements.

The Company invests in alternative investments, mainly hedge funds and private equity funds, through limited partnerships. As of December 31, 2016 and 2015, the Company has recorded approximately $82,237,000 and $101,827,000, respectively, in alternative investments. The Company accounts for its ownership interests in these alternative investments under the equity method based on the net asset value per share of the fund held by the Company. The hedge fund net asset value is provided to the Company by each of the hedge fund managers and is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investments in private investment funds whose values have been estimated by the hedge fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed.

2. Summary of Significant Accounting Policies (continued)

The investment income recorded is based on the Company's proportionate share of the hedge fund portfolio net asset value. The Company's share of the income (loss) from these alternative investments amounted to approximately $6,642,000 and ($3,193,000) for the years ended December 31, 2016 and 2015, respectively, of which approximately $6,257,000 and ($3,604,000) is recorded within unrestricted investment income and the remainder is recorded within temporarily restricted net assets, as these funds have been restricted by donors. Certain of the Company's alternative investments include provisions in which the fund can require future capital calls up to approximately $14,550,000. The Company is not aware of any capital calls that will be made through December 31, 2017. Approximately $16,800,000 of alternative investments have a lock up period ranging from 7 to 10 years.

Net Patient Accounts Receivable

Net patient accounts receivable and net patient service revenue have been adjusted to the estimated amounts expected to be received. These estimated amounts are subject to further adjustments upon review by third-party payors. Management estimates the provision for doubtful accounts and the allowance for doubtful accounts based upon a number of factors, including historical collection experience of each hospital, the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with payors, and general economic conditions. Management regularly reviews payment data for each major payor in evaluating the sufficiency of the allowance for doubtful accounts. The Company evaluates a patient's ability to pay for patient services based on an entity-wide assessment and, as part of this assessment, has determined that management does not assess the patient's ability to pay for the majority of self-pay patients. Accordingly, any patient account write off is recorded within the provision for doubtful accounts as a reduction of patient service revenue.

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost or market, determined on a first-in, first-out basis.

Assets Whose Use is Limited

Assets whose use is limited include marketable equity securities, mutual funds, alternative investments, and U.S. Treasury/government obligations that are held by trustees under self-insurance funding arrangements and HonorHealth Foundation's (Foundation) donor restricted funds.

2. Summary of Significant Accounting Policies (continued)

Trust Fund Assets

Trust fund assets include government bonds that have been designated for payments under bond indenture agreements.

Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation and amortization. Upon sale or retirement, cost and accumulated depreciation are eliminated from the respective accounts and any resulting gain or loss is included in excess of revenues over expenses. Depreciation is computed using the straight-line method over the estimated useful life of each class of depreciable asset ranging from 3 to 30 years. Routine maintenance and repairs are charged to expense when incurred. Expenditures that extend useful lives or increase capacities are capitalized. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Bond Issue Costs

Certain costs incurred in connection with long-term financing programs have been capitalized. Bond issue costs, which include bond insurance paid at issuance (included in long-term debt), are amortized using the straight-line method over the term of the related bond issues, which approximates the effective-interest method.

Goodwill

The Company has recorded approximately $18,628,000 and $15,196,000 in goodwill as of December 31, 2016 and 2015, respectively (see Note 10). The Company evaluates goodwill for impairment at least annually and more frequently if certain indicators are encountered. Goodwill is tested at the reporting unit level with the fair value of the reporting unit being compared to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired.

2. Summary of Significant Accounting Policies (continued)

The Company completes its annual impairment test during the fourth quarter using a qualitative assessment to determine whether there are events or circumstances that indicate it is more likely than not that the reporting units' fair values are less than their carrying amounts. Management has determined that there were no impairment charges for the years ended December 31, 2016 and 2015.

Impairment of Long-Lived Assets

The Company assesses whether indicators of impairment of long-lived assets are present. If such indicators are present, it is determined whether the sum of the estimated undiscounted cash flows attributable to the assets in question is less than their carrying value. If less, the Company recognizes an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Management has determined that there were no impairment charges for the years ended December 31, 2016 and 2015.

Self-Insurance Programs

In connection with the Company's self-insurance programs, accounts have been established for the purpose of accumulating assets based on actuarial determinations. These assets can be used only for the payment of professional liability, general liability, workers' compensation, life insurance claims, and related expenses. It is the Company's policy to record the expense and related liability for professional liability, general liability, workers' compensation, and life insurance claims based upon undiscounted actuarial estimates. Self-insurance liabilities include estimates of the ultimate costs for both asserted and incurred but not reported claims for professional liability, workers' compensation, general liability, and life insurance claims (see Note 18).

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Company has been limited by donors to a specific time period or purpose. Permanently restricted net assets, consisting principally of endowment fund donations, have been restricted by donors to be maintained by the Foundation in perpetuity.

2. Summary of Significant Accounting Policies (continued)

Donations are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, temporarily restricted net assets are classified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets. In the absence of a donor specification that restricts income and gains on temporarily restricted donations, such income and gains are reported as unrestricted investment income.

Net Patient Service Revenue

The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, and include estimated retroactive revenue adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as final settlements are determined.

Electronic Health Records Incentive Payment

Certain hospitals and professionals are eligible for an incentive payment from the Medicare and Medicaid programs if meaningful use certified electronic health care (EHR) technology is adopted and utilized. The incentive payment is recognized when management is reasonably assured that the Company has complied with the conditions set forth by the Medicare and Medicaid programs. Approximately $3,368,000 and $7,630,000 in Medicare and Medicaid incentive payments were recognized in other revenues for the years ended December 31, 2016 and 2015, respectively. The Company's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, EHR incentive payments are subject to retrospective adjustment upon final settlement of the applicable cost reports from which payments were initially calculated.

2. Summary of Significant Accounting Policies (continued)

Arizona Benefits Fund – Proposition 202

In 2002, the state of Arizona established an Arizona Benefits Fund which allowed the Arizona Health Care Cost Containment System (AHCCCS) to obtain additional state and Federal funds. These funds are distributed to eligible Level 1 Trauma Centers. For the years ended December 31, 2016 and 2015, the Company recorded $10,700,000 and $5,600,000, respectively, in Arizona Benefits Fund revenue, which is recorded within other revenues.

Charity Care and Community Benefit

In the furtherance of its charitable purpose, the Company provides charity care and other benefits to the community it serves. The Company's charity care policy is designed to provide a discount or waiver of the cost of services for uninsured or underinsured patients without the ability to pay. Because the Company does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

In addition to providing traditional charity care, the Company assumes the unpaid costs of public programs, including Medicare and AHCCCS, and delivers community outreach programs that include health education, diagnostic screenings, community health assessment surveys, and mobile services.

The Company estimates charity care costs based on the Company's cost to charge ratio, which includes both direct and indirect costs. Traditional charity care is estimated based on the average cost of services provided for which charges are written off in accordance with the Company's charity care policy.

Costs incurred for providing charity care and other community benefits consist of the following for the years ended December 31 (in thousands):

	2016	2015
Unpaid costs relating to the AHCCCS program	**$ 105,983**	$ 84,102
Costs of providing community outreach programs	**22,168**	20,339
Traditional charity, at cost	**15,609**	20,149
	143,760	124,590
Unpaid costs relating to the Medicare program	**87,693**	53,816
	$ 231,453	$ 178,406

2. Summary of Significant Accounting Policies (continued)

Performance Indicator

The performance indicator is the excess of revenues over expenses attributable to the Company, which includes all changes in unrestricted net assets other than the net assets released from restriction for purchase of property and equipment, pension-related changes other than net periodic pension cost, amortization of the aggregate fair value of interest rate swaps, and board-designated endowment contribution.

New Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (FASB) issued a new accounting standard relating to the presentation of debt issuance costs. The new accounting standard requires all debt issuance costs to be reported in the consolidated balance sheet as a direct reduction to the debt obligation. The Company adopted the accounting standard on January 1, 2016 in which $4,869,000 of debt issue costs were reclassified to long term debt.

In May 2014, the FASB issued a new revenue accounting standard, together along with subsequent amendments, updates and an extension of the effective date, (collectively, the New Revenue Standard), which supersedes most existing revenue recognition guidance, including industry-specific healthcare guidance. The New Revenue Standard provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

This five-step process will require significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. Additionally, and among other provisions, the New Revenue Standard requires expanded quantitative and qualitative disclosures, including disclosure about the nature, amount, timing and uncertainty of revenue.

2. Summary of Significant Accounting Policies (continued)

The provisions of the New Revenue Standard are effective for annual periods beginning after December 15, 2017, including interim periods within those years by applying either the full retrospective method or the cumulative catch-up transition method. The full retrospective method requires application of the provisions of the New Revenue Standard for all periods presented, while the cumulative catch-up transition method requires the application of the provisions of the New Revenue Standard as of the date of adoption, with the cumulative effect of the retrospective application of the provisions as an adjustment through unrestricted net assets. The Company is currently evaluating the adoption method to be used relating to the New Revenue Standard.

As the Company progresses with its implementation efforts to adopt the New Revenue Standard, management continues to evaluate and refine its estimates of the anticipated impacts it will have on its revenue recognition policies, procedures, consolidated financial position, consolidated results of operations, cash flows, financial disclosures and control framework. Specifically, management is continuing to evaluate its population of revenue sources to determine an appropriate level of stratification, as well as assess all of the potential effects the New Revenue Standard will have on variable consideration arising from settlements with third party payors, disproportionate share hospital payments and bundled payments. However, management does anticipate that, as a result of certain changes required by the New Revenue Standard, the majority of its provision for doubtful accounts will be recognized as a direct reduction to revenues, instead of separately as a deduction to arrive at revenue.

In August 2016, the FASB issued a new financial statement accounting standard for not-for-profit entities. This accounting standard will change the presentation of net assets into two categories, net assets with donor restrictions and net assets without donor restrictions. This accounting standard will also allow companies to elect to use either the direct or indirect cash flow method, and requires additional liquidity disclosures and presentation of expenses by both natural and functional classification. This accounting standard is effective for the Company on January 1, 2018. Management is currently evaluating the impact of adopting this accounting standard.

In February 2016, the FASB issued a new lease accounting standard. This accounting standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in their balance sheets. Lessor accounting remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. This accounting standard will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This accounting standard is effective for the Company on January 1, 2019. Management is currently evaluating the impact of adopting this accounting standard.

2. Summary of Significant Accounting Policies (continued)

Reclassifications

The 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation, primarily relating to reclassification of approximately $4,869,000 of debt issuance costs from other assets to long-term debt due to the adoption of a new accounting standard, reclassification of approximately $3,805,000 of board endowment funds from restricted net assets to unrestricted net assets, and approximately $4,582,000 of long-term prepaid maintenance contracts from other current assets to long-term assets.

Subsequent Events

There are two types of subsequent events: recognized subsequent events, which provide additional evidence about conditions that existed at the balance sheet date, and non-recognized subsequent events, which provide evidence about conditions that did not exist at the balance sheet date but arose before the financial statements were issued. Recognized subsequent events are required to be recognized in the financial statements, and non-recognized subsequent events are required to be disclosed. The Company has evaluated subsequent events through the date of issuance, April 28, 2017. Subsequent to year end, the Company entered into an asset purchase agreement with an oncology medical group to purchase substantially all of the assets and personal property. Total consideration paid for the acquisition was approximately $24,772,000.

3. Net Patient Service Revenue

The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The Company recognizes revenue from governmental agencies and managed care organizations that is significant to the Company's operations, but management does not believe that there are any significant credit risks associated with these payors. A summary of the payment arrangements with major third-party payors follows:

Medicare: Inpatient and outpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Company is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Company and audits thereof by the Medicare fiscal intermediary. Approximately 38% and 35% of the Company's net patient service revenue was derived from the Medicare program for the years ended

3. Net Patient Service Revenue (continued)

December 31, 2016 and 2015, respectively, the continuation of which is dependent on government policies.

The Medicare cost reports of the Company have been primarily audited and settled by the fiscal intermediary through 2013. The estimated settlements for Medicare cost report years 2014 through 2016 have been recorded as due to Medicare on the accompanying consolidated balance sheets. Estimates are continually monitored and reviewed, and any adjustments are reflected in current operations.

Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded third-party payor settlement estimates will change by a material amount in the near term, as cost report adjustments become known or as cost report years are no longer subject to such audit.

AHCCCS: Inpatient services rendered to AHCCCS program beneficiaries are reimbursed based on a prospectively determined rate based on clinical diagnosis starting October 1, 2014. Outpatient services are reimbursed based on a fee schedule. Approximately 13% and 12% of the Company's net patient service revenue was derived from the AHCCCS program for the years ended December 31, 2016 and 2015, respectively.

During 2012, CMS approved direct and indirect graduate medical education payments to the Company pursuant to a Medicaid state plan amendment submitted by AHCCCS. In connection with this plan amendment, the Company recorded in other revenue approximately $13,489,000 and $2,673,000 in AHCCCS payments, for the years ended December 31, 2016 and 2015, respectively.

In connection with the AHCCCS Medicaid Restoration program, certain hospitals within the state of Arizona were required to pay a hospital assessment fee to assist with the funding of the increased Medicaid costs. For the years ended December 31, 2016 and 2015, the Company paid approximately $29,062,000 and $31,382,000, respectively, in AHCCCS hospital assessment fees that are recorded within supplies, services, and other expenses.

Other Third-Party Payors: The Company has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Company under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Approximately 47% and 51% of the Company's net

3. Net Patient Service Revenue (continued)

patient service revenue was derived from commercial and managed care payors for the years ended December 31, 2016 and 2015, respectively.

Self-Pay: Approximately 2% of the Company's net patient service revenue was derived from self-pay patients for the years ended December 31, 2016 and 2015. Self-pay includes patients without insurance and patients with deductibles and coinsurance associated with third-party payor coverage. For self-pay patients that do not qualify for charity care, the Company recognizes revenue on the basis of uninsured discounted or standard rates. The Company records a provision for doubtful accounts related to self-pay patients, at the time services are provided, based on historical collection experience.

4. Accountable Care Organizations

The SHP ACO was previously owned equally by the Company and SPO. On August 1, 2016, the Company entered into a membership transfer agreement with SPO in which the Company acquired all of SPO's membership interests in SHP. As a result of the membership transfer agreement, SHP is currently a wholly-owned entity of the Company and was renamed Innovation Care Partners (ICP). The transaction has been accounted for as an acquisition in accordance with the not-for-profit business combination accounting standards. There was no consideration provided to SPO as a result of the transaction; however, prior to August 1, 2016, the Company had a management agreement with SHP in which SHP owed the Company approximately $17,449,000 and $5,169,000, net of a $7,100,000 bad debt allowance, as of August 1, 2016 and December 31, 2015, respectively. During 2016, management reversed the $7,100,000 bad debt allowance, as an increase to other revenues, based on the estimated recovery of the receivable in connection with the acquisition. As part of the acquisition, the $17,449,000 management fee receivable was not paid to the Company, because it represented the consideration paid to acquire SPO's membership interests. The Company has recorded a gain on the acquisition of approximately $8,291,000, representing the difference between the estimated fair value of SHP and the Company's equity investment balance as of August 1, 2016. The gain on the acquisition is recorded within other revenues for the year ended December 31, 2016. The fair value assigned to the assets acquired and liabilities assumed are as follows (in thousands):

Cash	$	966
Property and equipment		7,130
Goodwill and intangible assets		8,898
Net assets acquired	$	16,994

4. Accountable Care Organizations (continued)

The Company has entered into several shared savings contracts with the Medicare Shared Savings Plan (MSSP) and other commercial insurance companies through ICP ACO. ICP has established a provider network consisting of HonorHealth facilities, employed HonorHealth physicians, and participating independent physician networks. The shared savings contracts outline the payment fee schedules that each of the health care providers will receive for services rendered, as well as the distribution of any gain share settlements. As of December 31, 2016, the Company has not entered into any risk sharing agreements. Each of the commercial insurance companies retains the responsibility to pay the health care provider claims, as well as settle any gain share settlements with the contracting provider network. The Company received approximately $13,043,000 and $2,051,000 of gain share settlements for the years ended December 31, 2016 and 2015, respectively, which have been recorded as an increase to other revenues.

5. Concentration of Credit Risk

The Company grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements that include (i) Medicare and AHCCCS contractors; (ii) third-party payor managed care contracts, including health maintenance and preferred provider organizations; (iii) commercial insurers; and (iv) self-pay. The following table summarizes the percent of net accounts receivable as of December 31:

	2016	2015
Medicare and AHCCCS	**33%**	26%
Managed care	**57**	61
Commercial	**7**	8
Self-pay	**3**	5
	100%	100%

Managed care, self-pay, and commercial amounts consist of receivables from various payors, including individuals involved in diverse activities subject to differing economic conditions. Management does not believe there are any significant credit risks associated with accounts receivable. Furthermore, management continually monitors and adjusts its allowances for doubtful accounts associated with these receivables.

6. Fair Value of Financial Instruments

Fair value measurements used by the Company for all financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements are based on the premise that fair value represents an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the following three-tier fair value hierarchy has been used in determining the input used in measuring fair value:

- *Level 1:* Pricing is based on observable inputs, such as quoted prices in active markets for identical instruments. Financial assets in this category include mutual funds, marketable equity securities, and money market accounts.

- *Level 2:* Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include U.S. Treasury/government obligations, mortgage- and asset-backed securities, corporate bonds and interest rate swaps.

- *Level 3:* Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are, therefore, determined using factors that involve considerable judgment and interpretations, including, but not limited to, private and public comparable activity, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

(a) Market approach – prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

(b) Cost approach – amount that would be required to replace the service capacity of an asset (replacement cost).

6. Fair Value of Financial Instruments (continued)

(c) Income approach – techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing, and excess earnings models).

The Company's alternative investments amounted to approximately $82,237,000 and $101,827,000 as of December 31, 2016 and 2015, respectively, which are omitted from the following schedule, as they are accounted for using the equity method of accounting, based on net asset value. The Company held the following investments as of December 31, 2016 and 2015, which are recorded within the consolidated balance sheets as presented below:

	December 31 2016	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
	(In Thousands)				
Money market	$ 14,428	$ 14,428	$ –	$ –	(a)
Debt securities					
U.S. Treasury/government obligations	38,796	–	38,796	–	(a)
Corporate bonds	31,951	–	31,951	–	(a)
Mortgage- and asset-backed securities	56,901	–	56,901	–	(a)
Equity securities					
Marketable U.S. equity securities	176,298	176,298	–	–	(a)
International equities	31,458	31,458	–	–	(a)
Guaranteed investment contract	3,660	–	–	3,660	(c)
Mutual funds					
Mutual funds – U.S. funds	366,607	366,607	–	–	(a)
Mutual funds – international	100,138	100,138	–	–	(a)
Total investments	$ 820,237	$ 688,929	$ 127,648	$ 3,660	
Short-term investments	$ 562,929				
Assets whose use is limited	200,473				
Trust fund assets	20,948				
Long-term investments	100,795				
Other assets (457(b) Plan)	17,329				
Less alternative investments	82,237				
Total fair value investments	$ $820,237				
Interest rate swap liability (included in other liabilities)	$ (32,266)	$ –	$ (32,266)	$ –	(c)

6. Fair Value of Financial Instruments (continued)

	December 31 2015	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b, c)
		(In Thousands)			
Money market	$ 12,889	$ 12,889	$ –	$ –	a
Debt securities					
U.S. Treasury/government obligations	53,886	–	53,886	–	a
Corporate bonds	29,505	–	29,505	–	a
Mortgage- and asset-backed securities	49,727	–	49,727	–	a
Equity securities					
Marketable U.S. equity securities	146,072	146,072	–	–	a
International equities	21,145	21,145	–	–	a
Guaranteed investment contract	3,728	–	–	3,728	c
Mutual funds					
Mutual funds – U.S. funds	283,522	283,522	–	–	a
Mutual funds – international	196,197	196,197	–	–	a
Total investments	$ 796,671	$ 659,825	$ 133,118	$ 3,728	
Short-term investments	$ 337,779				
Assets whose use is limited	187,493				
Trust fund assets	20,440				
Long-term investments	337,140				
Other assets (457(b) Plan)	15,646				
Less alternative investments	101,827				
Total fair value investments	$ 796,671				
Interest rate swap asset (included in other assets)	$ 104	$ –	$ 104	$ –	c
Interest rate swap liability (included in other liabilities)	$ (34,541)	$ –	$ (34,541)	$ –	c

The fair value of long-term debt amounted to approximately $686,142,000 and $675,781,000 as of December 31, 2016 and 2015, respectively. The estimated long-term debt fair value is based on quoted market prices for the debt issues or, where such prices are not available, on current interest rates for debt with similar remaining maturities (Level 2 in the fair value hierarchy).

7. Trust Fund Assets

Pursuant to the terms of bond indentures, the Company is required to maintain amounts on deposit in separate accounts with trustees. The funds can be used only to satisfy obligations permitted by the respective agreements. Trust fund assets consist of the following as of December 31 (in thousands):

	2016	2015
Held in reserve, principally for debt service and redemption of bonds	**$ 20,597**	$ 20,440
Held in project fund to be used for capital purchases	**–**	111
Held for the payment of principal and interest on bonds	**351**	513
	20,948	21,064
Less current portion (included in prepaid expenses and other)	**351**	624
	$ 20,597	$ 20,440

Interest earned on trust fund assets is included in investment income.

8. Assets Whose Use is Limited

Assets whose use is limited primarily include assets held by the Foundation that are restricted for use as designated by external donors or the Foundation's Board of Trustees, and assets that have been set aside for payment of medical malpractice, general liability, workers' compensation, and life insurance claims, in accordance with the Company's self-insurance programs.

8. Assets Whose Use is Limited (continued)

Assets whose use is limited consists of the following as of December 31 (in thousands):

	2016	2015
Endowment funds	**$ 129,132**	$ 127,279
Donor-restricted funds	**27,569**	20,699
General and professional liability and workers' compensation funds	**41,036**	37,505
Rabbi trust retirement plan funds	**2,736**	2,010
	200,473	187,493
Less current portion	**5,762**	4,170
	$ 194,711	$ 183,323

A summary of investment income (loss) consists of the following for the years ended December 31 (in thousands):

	2016	2015
Interest and dividend income	**$ 11,855**	$ 16,520
Net realized gains on sales of investments	**21,542**	17,489
Income (loss) from alternative investments	**6,257**	(3,604)
Unrealized gains (losses), net	**9,484**	(53,234)
	$ 49,138	$ (22,829)

9. Property and Equipment

Property and equipment consists of the following as of December 31 (in thousands):

	2016	2015
Land and improvements	**$ 158,711**	$ 124,308
Buildings and improvements	**839,514**	827,759
Equipment	**770,151**	656,483
Construction-in-progress	**75,210**	100,883
	1,843,586	1,709,433
Less amortization and accumulated depreciation	**1,015,885**	966,072
	$ 827,701	$ 743,361

A substantial portion of real property and related equipment owned by the Company secures the Company's tax-exempt debt obligations.

10. Other Assets

Other assets consist of the following as of December 31 (in thousands):

	2016	2015
Bond premium insurance, net of amortization	**$ 9,379**	$ 10,155
Insurance recovery receivable	**14,016**	18,562
457(b) retirement plan assets	**17,329**	15,646
Investment in business ventures	**11,502**	8,140
Goodwill	**18,628**	15,196
Physician guarantees	**9,110**	2,340
Fair value of interest rate swaps	**–**	104
Long term prepaid maintenance	**3,087**	4,582
SHP receivable, net of allowance of $7,100	**–**	5,169
Premier investment	**4,301**	3,232
SHP intangible care development costs, net of amortization of $450	**5,016**	–
Other	**2,770**	2,263
	$ 95,138	$ 85,389

10. Other Assets (continued)

The Company is a member of Premier Inc.'s (Premier) group purchasing organization and, in connection with this membership, the Company holds a non-controlling interest in Premier that is accounted for under the equity method of accounting. As of December 31, 2016 and 2015, the Company held 259,302 Class B shares and Class B Units in Premier. The Company has the ability to convert its Class B Units into cash or Premier's Class A Common Stock over a seven-year vesting period, beginning October 2010. The Class B Units in Premier are only held by members of Premier's group purchasing organization, whereby Premier serves as their primary supply vendor. Accordingly, each member receives a vendor incentive for the right to exchange their Class B Units for Class A Common Stock over the seven-year vesting period as long as the member continues to participate in Premier's group purchasing organization. The estimated value of the vendor incentive, representing the difference between Premier's Class A Common Stock and the Company's Class B Unit carrying value, is being amortized over the seven-year vesting period as a reduction to supply expense. The Company's equity investment and cumulative vendor incentive in Premier was approximately $4,301,000 and $3,232,000 as of December 31, 2016 and 2015, respectively. The Company's share of Premier's net income recorded under the equity method of accounting and Class B Units vendor incentive was approximately $1,100,000 and $1,698,000 for the years ended December 31, 2016 and 2015, respectively, and is recorded as a reduction to supplies, service, and other expenses.

During 2016, goodwill increased by approximately $3,432,000 as a result of the SHP acquisition (see Note 4).

11. Deferred Gain on Sale of Buildings

In 2012, the Company entered into a sale-leaseback transaction in which eight of its medical office buildings (MOBs) were sold to an unrelated real estate investment trust (REIT). Since the Company did not have any continuing involvement associated with these MOBs, the transaction was accounted for as a sale, resulting in a gain of approximately $54,372,000, of which approximately $20,031,000 was deferred and is being recognized over the lease term. The Company entered into a ten-year lease for certain space located within seven of the sold MOBs, in which the Company is paying fair market rental rates for the leased space. As of December 31, 2016 and 2015, the deferred gain on sale of medical office buildings amounted to approximately $11,474,000 and $12,373,000, respectively. For the years ended December 31, 2016 and 2015, the amortized portion of the deferred gain recorded in non-operating revenue amounted to approximately $2,482,000 and $2,271,000, respectively.

11. Deferred Gain on Sale of Buildings (continued)

As part of the MOB sale transaction, the Company entered into a 50-year ground lease with the REIT for the land on which the MOBs are located. The ground lease can be renewed for two 25-year periods. The REIT prepaid the 50-year ground lease to the Company. As of December 31, 2016 and 2015, the deferred rental revenue associated with the prepaid ground lease amounted to approximately $4,671,000 and $4,776,000, respectively, which is being recognized as other non-operating revenue over the 50-year ground lease term.

During 2013, construction commenced on the Rehab JV leased facility in which the Rehab JV was considered to be the owner of the facility due to the Rehab JV’s investment in the lessor. Accordingly, the lease was recorded as a financing obligation until 2014 when the Rehab JV leased facility was sold to an unrelated third party. Subsequent to the sale, the Rehab JV lease has been recorded as an operating lease in the consolidated financial statements, as opposed to a financing obligation, which resulted in a $2,000,000 deferred gain that is being recognized into non-operating revenue over the 20-year lease term. As of December 31, 2016 and 2015, the deferred gain on the Rehab JV leased facility amounted to approximately $1,680,000 and $1,840,000, respectively.

12. Capital Lease Obligation

In 2016, the Company entered into a sale-leaseback transaction in which an ambulatory surgery center was sold to an unrelated party and subsequently leased back for a 20-year period, which approximated the estimated useful life of the ambulatory surgery center. The sale-leaseback transaction has been recorded as a financing obligation in which the total sales proceeds of approximately $9,792,000 has been recorded as a capital lease obligation on the consolidated balance sheet. Principal and interest is paid monthly over the term of the lease ranging from approximately $49,000 to $86,000.

13. Long-Term Debt

	December 31 2016	December 31 2015
	(In Thousands)	
Series 2006C Hospital Revenue Bonds with a fixed interest rate of 5.00%. Interest is due semiannually. Principal due in annual debt service payments ranging from $10,675,000 in September 2031 to $12,700,000 in September 2035. Unamortized discount and issue costs of $502,000 and $881,000 as of December 31, 2016 and 2015, respectively.	**$ 57,514**	$ 57,469
Series 2006F Hospital Revenue Bonds; variable interest rate determined weekly by an auction agent, with interest due weekly. At December 31, 2016 and 2015, the interest rate was 0.64% and 1.26%, respectively. Principal due in annual debt service payments ranging from $14,450,000 in September 2038 to $18,376,000 in September 2045. Unamortized discount and issue costs of $306,000 and $373,000 as of December 31, 2016 and 2015, respectively.	**89,340**	89,327
Series 2008A Hospital Revenue Bonds; fixed interest rates ranging from 5.00% to 5.25%. Interest and principal due in level annual debt service payments of approximately $11,600,000 through 2023. Unamortized premium and issue costs of $674,000 and $846,000 as of December 31, 2016 and 2015, respectively.	**45,895**	51,786
Series 2014A Hospital Revenue Bonds; fixed interest rates ranging from 2.75% to 5.00%. At December 2016 and 2015, the interest rate was 5.00% and 3.00%, respectively. Principal due in annual debt service payments from $1,465,000 in December 2016 to $17,970,000 in December 2034. Unamortized premium and issue costs of $39,408,000 and $40,931,000 as of December 31, 2016 and 2015, respectively.	**328,583**	333,297
2014 taxable note with variable interest rate of 1.73% and 1.14% as of December 31, 2016 and 2015, respectively. Interest is due monthly. Principal payment due in December 2020 for $1,902,000 with the remaining unpaid balance due in December 2022.	**80,962**	80,962

13. Long-Term Debt (continued)

	December 31 2016	December 31 2015
	(In Thousands)	
Rehab JV working capital loan with principal and interest based on the current months, LIBOR plus 2.25%. The interest rate was 4.25% and 2.92% as of December 31, 2016 and 2015. Interest is due monthly through February 2018. Guaranteed by the Company and other joint venture partner, based on proportionate ownership.	**$ 739**	$ 1,360
Rehab JV revolving promissory note with maximum principal amount of $4,000,000 with a fixed interest rate of 5.25% due monthly. Promissory note unpaid balance is due on demand from the lender.	**1,488**	–
Series 2015A Hospital Revenue Bonds with a fixed interest rate of 3.59%. Interest is due semiannually. Principal of $34,380,000 is due December 2039. Unamortized issue costs of $305,000 and $321,000 as of December 31, 2016 and 2015, respectively.	**34,075**	34,059
Series 2015B Hospital Revenue Bonds with a fixed interest rate of 3.35%. Interest is due semiannually. Principal of $13,360,000 is due December 2028. Unamortized issue costs of $90,000 and $102,000 as of December 31, 2016 and 2015, respectively.	**13,270**	13,258
Revolving line of credit with maximum principal amount of $40,000,000. The interest rate was 1.4% as of December 2016. Revolving line of credit terminates March 2018.	**34,500**	–
SHC ASC promissory note with a fixed interest rate of 4.48%. Interest is due monthly. Principal payments of $17,857 paid monthly through April 2023.	**1,357**	–
Other notes payable	**973**	392
	688,696	661,910
Less current portion	**12,687**	9,345
	$ 676,009	$ 652,565

In November 2015, the Company issued $47,740,000 of tax-exempt revenue bonds (Series 2015A and Series 2015B). The proceeds from the Series 2015A and Series 2015B bonds were used to pay off the outstanding principal on the Series 2006D and Series 2006E bonds.

In December 2014, the Company issued $303,550,000 of tax-exempt revenue bonds (Series 2014A) and entered into a taxable note for $80,962,000 (2014 Taxable note). The proceeds from the Series 2014A bonds and 2014 Taxable note were used to (i) pay for capital improvement costs, (ii) redeem a portion of the Series 2008A Hospital Revenue Bonds and the 2012 note payable, and (iii) legally defease by placing monies in an escrow fund to pay the following outstanding obligations:

- Series 2012 Hospital Revenue Bonds, tax-exempt lease agreements and Series 2010 Hospital Revenue Bonds redeemed in January 2015.

13. Long-Term Debt (continued)

- Series 2005 Hospital Revenue Bonds and Series 2005B Hospital Revenue Bonds redeemed in December 2015.

- Series 2007 Hospital Revenue Bonds to be redeemed in December 2017.

All of the bond issues are limited obligations of the Industrial Development Authority of the City of Scottsdale and the Arizona Health Facilities Authority and are payable from payments to be made under related loan agreements by the Company's Obligated Group (the Obligated Group) as defined in the Master Trust Indenture. In connection with the 2014 bond transaction, the master trust indenture was amended to include all of the wholly owned entities of the Company, excluding the Foundation, Desert Mission, ACO and the Captive. The loan agreements provide that the Obligated Group make payments on the notes to the trustee in amounts that are sufficient to pay the principal and interest on the bonds when due. In addition, the loan agreements require the Obligated Group to maintain compliance with certain financial covenants. At December 31, 2016 and 2015, the Obligated Group was in compliance with these debt covenants.

The Series 2006C and Series 2006F Hospital Revenue Bonds are insured by Financial Security Assurance, Inc. (FSA) for scheduled principal and interest payments or mandatory sinking account redemption. FSA holds the right to consent on behalf of bond owners to amendments of the bond indentures, loan agreements, deed of trust, or the Master Trust Indenture without notice or consent of the bond owners. In addition, FSA requires the Obligated Group to maintain compliance with certain financial covenants. At December 31, 2016 and 2015, the Obligated Group was in compliance with these debt covenants. The Series 2008A, Series 2014A, Series 2015A and Series 2015B Hospital Revenue Bonds are not insured.

Future maturities of long-term debt at December 31, 2016, which includes unamortized net premium included within long-term debt of $36,033,000, follow (in thousands):

2017	$ 12,687
2018	44,744
2019	10,808
2020	13,115
2021	13,669
Thereafter	593,673
	$ 688,696

13. Long-Term Debt (continued)

Interest expense consists of the following for the years ended December 31 follows (in thousands):

	2016	2015
Interest paid during the year	**$ 23,479**	$ 25,482
Interest costs capitalized	**(1,721)**	(1,209)
Interest rate swap payments	**3,579**	2,296
Change in accrued interest	**98**	182
	$ 25,435	$ 26,751

Interest Rate Swap Agreements

In May 2006, the Company entered into multiple interest rate swap agreements to hedge changes in the benchmark interest rate on a portion of its outstanding debt (the 2006 Rate Swaps). The agreements swap 61.90% of one-month LIBOR plus 0.31% against a fixed rate of 3.95% (weighted average) based on an aggregate notional amount initially equal to $110,275,000. Settlements with the counterparty are matched with the maturity reset and payment frequency for certain Series 2006 issues. The 2006 Rate Swaps are insured by Assurance Guaranty and are subject to collateral postings if the rating of Assurance Guaranty falls below a threshold defined in the swap agreements. There were no collateral postings as of December 31, 2016 and 2015. The 2006 Rate Swaps have a termination date, ranging from September 2028 to September 2039.

During 2011, the Company entered into three fixed receiver rate swaps (the 2011 Rate Swaps) for a total notional amount of $100,000,000. One of the 2011 Rate Swaps terminated in November 2015 and the remaining two 2011 Rate Swaps terminated in January and February 2016.

The interest rate swap agreements swap interest rates determined by the Securities Industry and Financial Markets Association against fixed rates that range from 1.182% to 1.852%. The net effect of both the 2006 and 2011 Rate Swaps resulted in cash payments of approximately $3,579,000 and $2,296,000 that were recorded as an increase to interest expense for the years ended December 31, 2016 and 2015, respectively.

13. Long-Term Debt (continued)

As of December 31, 2016 and 2015, the estimated fair value of the 2006 Rate Swaps resulted in a net imputed obligation of approximately $32,266,000 and $34,541,000, respectively, which is recorded in other long-term liabilities in the accompanying consolidated balance sheets. Included within other assets is an imputed fair value asset of approximately $104,000, as of December 31, 2015, relating to the estimated fair value on the 2011 Rate Swaps. The fair value of the interest rate swaps is based on the forward LIBOR curve, with a blended average duration of approximately 20.2 years for the 2006 Rate Swaps. For the years ended December 31, 2016 and 2015, respectively, the Company recognized a gain (loss) of approximately $1,971,000 and ($2,111,000) for the aggregate change in the fair value of the interest and basis rate swaps. Since the 2006 and 2011 interest rate swaps do not qualify for hedge accounting, the change in fair value is recorded within excess of revenues over expenses.

14. Other Liabilities

Other liabilities consist of the following as of December 31 (in thousands):

	2016	2015
Accrued medical malpractice and general insurance liability	**$ 26,978**	$ 30,226
Executive deferred compensation 457(b)	**17,329**	15,646
Supplemental executive retirement plan	**2,153**	1,262
Fair value of interest and basis rate swaps	**32,266**	34,541
Deferred ground lease revenue	**8,008**	8,130
Deferred revenue	**4,995**	3,612
Accrued workers' compensation liability	**14,814**	15,748
Charitable gift annuities and other	**1,862**	9,244
	$ 108,405	$ 118,409

15. Net Assets

Temporarily restricted net assets are available for the following purposes as of December 31 (in thousands):

	2016	2015
Hospital programs	**$ 17,915**	$ 15,689
Education and research	**4,739**	5,205
Facilities and equipment	**6,781**	6,140
Community service	**6,043**	447
	$ 35,478	$ 27,481

Permanently restricted net assets consist of donor restricted endowment funds to be held in perpetuity, for which the investment earnings are used to support the following as of December 31 (in thousands):

	2016	2015
Hospital programs	**$ 85,797**	$ 87,726
Education and research	**10,231**	10,006
Community service	**8,526**	8,400
Facilities and equipment	**282**	282
	$ 104,836	$ 106,414

The Foundation's endowment consists of 87 individual funds as of December 31, 2016 and was established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. The foundation has interpreted the Arizona State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently net restricted assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) earning accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift directive or based on the foundation's policy. The Foundation adopted a policy that provides, in the absence of donor-imposed restrictions, for a percentage of the endowment fund investment earnings, as determined annually by the Foundation, to be allocated to temporarily restricted net assets and to be appropriated for distribution as determined by the Foundation. Any excess investment earnings are to be allocated to the permanent endowment fund.

15. Net Assets (continued)

In accordance with SPMIFA, the Foundation consider the following factors in making a determination as to the annual endowment fund distribution:

(1) The duration and preservation of the fund

(2) The purposes of the foundation and the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation and deflation

(5) The expected total return from income and the appreciation of investments

(6) The investment policies of the foundation

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Foundation must hold in perpetuity or for a donor-specific period. Under this policy, the endowment assets are invested in a manner that is intended to produce a rate of return, net of inflation and investment management costs, to retain the purchasing power of the endowment assets.

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

15. Net Assets (continued)

Changes in endowment net assets for the year ended December 31, 2016 and 2015 consisted of the following (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, January 1, 2015	$ 14,002	$ 13,033	$ 104,836	$ 131,871
Investment losses, net	(10)	(4,488)	–	(4,498)
Contributions	772	–	1,578	2,350
Appropriation of endowment assets for expenditure	–	(2,444)	–	(2,444)
Endowment net assets, December 31, 2015	14,764	6,101	106,414	127,279
Investment income, net	**–**	**8,438**	**–**	**8,438**
Contributions	**526**	**–**	**1,369**	**1,895**
Appropriation of endowment assets for expenditure	**(349)**	**(5,184)**	**(2,947)**	**(8,480)**
Endowment net assets, December 31, 2016	**$ 14,941**	**$ 9,355**	**$ 104,836**	**$ 129,132**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the foundations to retain as a fund of perpetual duration. No deficiencies of this nature were reported as of December 31, 2016.

16. Functional Expenses

The Company provides health care services and charitable services to residents within its geographic location. The Company incurs general and administrative expenses for various activities, including management and administrative activities that support the provision of health care services. A summary of expenses related to providing these services for the years ended December 31 follows (in thousands):

	2016	2015
Health care services	**$ 1,318,277**	$ 1,276,838
General and administrative	**346,937**	270,837
Charitable	**17,306**	17,301
	$ 1,682,520	$ 1,564,976

17. Commitments and Contingent Liabilities

Operating Lease Commitments

Future minimum payments under non-cancelable operating leases consist of the following at December 31, 2016 (in thousands):

2017	$ 15,285
2018	15,232
2019	13,480
2020	12,052
2021	10,442
Thereafter	57,677
	$ 124,168

Rent expense was approximately $17,456,000 and $22,107,000 for the years ended December 31, 2016 and 2015, respectively, and rental income was approximately $3,507,000 and $3,653,000 for the year ended December 31, 2016 and 2015, respectively. Rent expense and rent revenue are recorded on a straight-line basis over the respective lease terms.

Health Care Regulatory Environment

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, and government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Company is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

In addition to general and professional liability claims, the Company is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

18. Medical Malpractice Claims

The Company currently self-insures medical malpractice and general liability claims for the first $3,000,000 per occurrence, with no aggregate. Prior to June 2014, the JCL facilities were self-insured for the first $2,000,000 per occurrence. Insurance coverage has been purchased by the Company to cover excess claim settlements up to $20,000,000 per occurrence and in aggregate.

It is the Company's policy to record the expense and related liability for medical malpractice losses based on actuarial estimates on an undiscounted basis. Included in the accompanying consolidated balance sheets is an actuarially computed accrual of approximately $30,515,000 and $35,792,000 at December 31, 2016 and 2015, respectively, for medical malpractice and general liability claims, which includes approximately $5,490,000 and $8,207,000 estimated obligation for medical malpractice and general liability claims that will be covered by the excess insurance carrier. Of the amounts recorded at December 31, 2016 and 2015, approximately $3,537,000 and $5,566,000, respectively, represents the current portion of the medical malpractice and general liability claims recorded in accrued expenses.

19. Retirement Plans

Defined Contribution Plan

The Company has a defined contribution plan covering all eligible employees who elect to contribute at least 2% of defined earnings to the plan. The Company matched 100% of eligible employee contributions up to 4% in 2016 and 2015. Company contributions to the defined contribution plan amounted to approximately $19,335,000 and $19,386,000 for the years ended December 31, 2016 and 2015, respectively.

457(b) Retirement Plans

The Company has a 457(b) retirement plan that covers certain members of management who elect to participate under the terms of the plan. Both the eligible employees and the Company contribute to the plan in order to meet the future benefit obligation. The Company retains title to all of the assets and obligations of these plans. At December 31, 2016 and 2015, plan investments and liabilities amounted to approximately $17,329,000 and $15,646,000, respectively.

19. Retirement Plans (continued)

Supplemental Executive Retirement Plans

The Company has a supplemental executive retirement defined contribution plan (Plan), whereby the Company will make an annual base contribution to each of the eligible executives as outlined in the Plan agreement. The Plan agreement also allows the Company to make discretionary contributions in addition to the base contribution; however, there were no discretionary contributions made during 2016 or 2015. Each of the eligible executives will fully vest in the annual base contribution five years after each contribution date. Plan expense for the years ended December 31, 2016 and 2015 was approximately $2,272,000 and $3,774,000, respectively.

The Company's supplemental executive non-contributory retirement plan (SERP) was terminated in September 2013 and plan obligations were paid to the participants in January 2015. Total SERP obligations paid to participants in January 2015 amounted to approximately $16,521,000. In addition, the unrecognized cumulative SERP plan loss of approximately $3,056,000 was recorded within the Company's salaries and benefit expense for the year ended December 31, 2015.

Reports Required by the Uniform Guidance

Building a better working world

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Directors and Management
HonorHealth

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of HonorHealth (the Company), which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 28, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

April 28, 2017

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Report of Independent Auditors on Compliance for Each Major Federal Program and Report on Internal Control Over Compliance Required by the Uniform Guidance

The Board of Directors and Management
HonorHealth

Report on Compliance for Each Major Federal Program

We have audited HonorHealth's (the Company) compliance with the types of compliance requirements described in the US Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on the Company's major federal program for the year ended December 31, 2016. The Company's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Company's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Company's compliance.

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Opinion on the Major Federal Program

In our opinion, the Company complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the major federal program for the year ended December 31, 2016.

Report on Internal Control Over Compliance

Management of the Company is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Company's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Ernst + Young LLP

July 28, 2017

Supplementary Information

HonorHealth

Schedule of Expenditures of Federal Awards

December 31, 2016

Federal Grantor/Program Title/Cluster Title/Pass-Through Grantor	CFDA	Pass-Through Entity Contract/Employer Identification Number	Total Expenditures
U.S. Department of Agriculture			
SNAP Cluster:			
Supplemental Nutrition Assistance Program Pass-Through Program:			
Arizona Community Action and Arizona Department of Economic Safety	10.551	FFY15SNAP	$ 4,827
State Administrative Matching Grants for the Supplemental Nutritional Assistance Program Pass-Through Program:			
Arizona Department of Health Services	10.561	C86-13-029-3-03	31,718
Total SNAP Cluster			36,545
Child and Adult Care Food Program Pass-Through Programs:			
Arizona Department of Education	10.558	CTD-07-22-06	58,096
Arizona Department of Education	10.558	CTD-07-93-01	18,451
Total Child and Adult Care Food Program			76,547
Food Distribution Cluster:			
Commodity Supplemental Food Program Pass-Through Program:			
Westside Food Bank (a)	10.565	CSFP 50605	248,692
Emergency Food Assistance Program (administrative costs) Pass-Through Program:			
Westside Food Bank (a)	10.568	TEFAP 50002	1,084,731
Total Food Distribution Cluster			1,333,423
Total U.S. Department of Agriculture			1,446,515
U.S. Department of Housing and Urban Development			
Housing Counseling Assistance Program	14.169		3,162
Home Investments Partnership Program Pass-Through Program:			
State of Arizona	14.239	306-13	79,500
Total U.S. Department of Housing and Urban Development			82,662
U.S. Department of Veteran Affairs			
Veterans Home Based Primary Care Pass-Through Program:			
Carl T. Hayden VA Medical Center	64.022	PAADC644005	148,605
Total U.S. Department of Veteran Affairs			148,605
U.S. Department of Education			
Preschool Development Grants Pass-Through Program:			
Arizona Department of Education	84.419	17FPRSDG-714931-40C	88,403
Total U.S. Department of Education			88,403
U.S. Department of Health and Human Services			
Aging Cluster:			
Special Programs for the Aging – Title III, Part B, – Grants for Supportive Services and Senior Centers	93.044		9,833
Total Aging Cluster			9,833
National Family Caregiver Support, Title III, Part E	93.052		16,350
Mental Health Research Grant and Research and Development Cluster Pass-Through Programs:			
University of Washington	93.242	UWSC8618	6,750
Social Services Block Grant Pass-Through Program:			
Area Agency on Aging, Region One, Incorporated	93.667	201621- HHL	9,161
National Bioterrorism Hospital Preparedness Pass-Through Programs:			
Arizona Department of Health and Human Services	93.889	ADHSIS-080528	39,929
Arizona Department of Health and Human Services	93.889	ADHS-080529	42,013
Total National Bioterrorism Hospital Preparedness Program:			81,942
Total U.S. Department of Health and Human Services			124,036
U.S. Department of Homeland Security			
Emergency Food & Shelter National Board Program Pass-Through Program:			
WHEAT	97.024	025600-004	34,907
Total U.S. Department of Homeland Security			34,907
Total Expenditures of Federal Awards			$ 1,925,128

(a) Represents a non-cash federal award. Total expenditures reflected in the Schedule of Expenditures of Federal Awards is based on the total pounds of food distributed multiplied by the $1.70 and $1.67 cost rate per pound during the year as determined by Feeding America to the Arizona Association of Foodbanks.

See notes to Schedules of Expenditures of Federal Awards.

HonorHealth

Notes to Schedule of Expenditures of Federal Awards

Year Ended December 31, 2016

Organization

HonorHealth (the Company) is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. The Company and its subsidiaries own five acute care hospitals located in Scottsdale, Arizona and Phoenix, Arizona; a captive insurance company, ambulatory care centers, accountable care organizations, medical practices, a foundation and an organization entitled Desert Mission which provides family services, child care services, and health services for low-income families.

Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal grant activity of the Company and is presented using the accrual basis of accounting. The information on this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements of the Company. For purposes of the Schedule, federal awards include any assistance provided by a federal agency directly or indirectly in the form of grants, contracts, cooperative agreements, loan and loan guarantees, or other non-cash assistance.

The Company has reimbursement-type federal grant contracts and non-cash federal grant contracts. Payments of federal awards received under the terms of the reimbursement-type grant contracts are used to reimburse the Company’s allowable program expenditures. Non-cash federal expenditures are reported on the Schedule based on the total pounds of food distributed by the Company multiplied by an estimated cost rate per pound of food as determined by Feeding America to the Arizona Association of Foodbanks.

The Company does not pass any federal awards to subrecipients.

The Schedule includes Federal awards subject to the requirements of the Uniform Guidance, as well as Federal awards that were funded prior to the Uniform Guidance effective date of December 26, 2014. The Company does not use the 10% de minimis indirect cost rate provided for in the Uniform Guidance.

Schedule Required by the Uniform Guidance

Section I – Summary of Auditor's Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP (*unmodified, qualified, adverse or disclaimer*)	Unmodified
Internal control over financial reporting:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified?	None reported
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major federal program:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified?	None reported
Type of auditor's report issued on compliance for major federal program *(unmodified, qualified, adverse or disclaimer*)	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	No

Identification of major federal program:

CFDA Number(s)	Name of Federal Program or Cluster
10.565 and 10.568	Food Distribution Cluster

Dollar threshold used to distinguish between Type A and Type B programs	$ 750,000
Auditee qualified as low-risk auditee?	No

Section II—Financial Statement Findings

This section identifies the significant deficiencies, material weaknesses, fraud, noncompliance with provisions of laws, regulations, contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* requires reporting.

None noted.

Section III—Federal Award Findings and Questioned Costs

This section identifies the audit findings required to be reported by the 2 CFR 200.516(a) (for example, significant deficiencies, material weaknesses, material instances of noncompliance, including questioned costs, and material abuse).

None noted.

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HonorHealth
Summary of Schedule of Prior Audit Findings
December 31, 2016

Finding 2015-001

Criteria or Specific Requirement: The preparation of Company financial statements involves having a timely financial statement close process which includes the preparation and review of financial account analyses. As part of the audit, there were several post close adjustments identified which management ultimately recorded in the December 31, 2015 consolidated audited financial statements.

Condition: The Company should be reviewing all general ledger accounts and related account reconciliations as of year-end in order to reduce or eliminate the number of post close adjustments recorded.

Current Year Status:
The Company's financial close process now includes a workflow to ensure that all general ledger accounts are reviewed and reconciled on a monthly basis.

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