# Novant Health, Inc. and Affiliates

## Consolidated Financial Statements
## December 31, 2016 and 2015

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## Report of Independent Auditors

To the Board of Trustees of
Novant Health, Inc.

We have audited the accompanying consolidated financial statements of Novant Health, Inc. and Affiliates, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

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

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

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company'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 Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Novant Health, Inc. and Affiliates as of December 31, 2016 and 2015, and the results of their operations, changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 24, 2017

*PricewaterhouseCoopers LLP, 800 Green Valley Road, Suite 500, Greensboro, NC 27408*
*T: (336) 665 2700, F: (336) 665 2699, www.pwc.com/us*

# Novant Health, Inc. and Affiliates
## Consolidated Balance Sheets
## December 31, 2016 and 2015

| *(in thousands of dollars)* | **2016** | **2015** |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 260,988 | $ 354,403 |
| Accounts receivable, net of allowance for doubtful accounts of $230,511 in 2016 and $209,606 in 2015 | 511,649 | 432,512 |
| Short-term investments | 260,319 | 465,772 |
| Current portion of assets limited as to use | 18,586 | 13,736 |
| Deferred tax asset | - | 7,311 |
| Current assets held for sale | 14,173 | - |
| Receivable for settlement with third-party payors | 13,897 | 10,599 |
| Other current assets | 181,750 | 170,690 |
| Total current assets | 1,261,362 | 1,455,023 |
| Assets limited as to use | 147,124 | 46,694 |
| Long-term assets held for sale | 57,193 | - |
| Long-term investments | 2,014,688 | 1,806,599 |
| Property and equipment, net | 1,940,642 | 1,854,102 |
| Intangible assets and goodwill, net | 287,466 | 308,215 |
| Investments in affiliates | 32,046 | 33,246 |
| Other assets | 107,011 | 92,091 |
| Total assets | $ 5,847,532 | $ 5,595,970 |
| **Liabilities and Net Assets** | | |
| Current liabilities | | |
| Current portion of long-term debt | $ 66,624 | $ 178,347 |
| Short-term borrowings | 83,627 | 86,785 |
| Accounts payable | 160,192 | 148,529 |
| Accrued liabilities | 358,685 | 383,086 |
| Current liabilities held for sale | 13,498 | - |
| Estimated third-party payor settlements | 33,296 | 24,344 |
| Total current liabilities | 715,922 | 821,091 |
| Long-term debt, net of current portion | 1,325,810 | 1,593,257 |
| Deferred tax liability | - | 3,843 |
| Long-term liabilities held for sale | 1,682 | - |
| Derivative financial instruments | 50,305 | 57,941 |
| Employee benefits and other liabilities | 305,476 | 231,069 |
| Total liabilities | 2,399,195 | 2,707,201 |
| Commitments and contingencies | | |
| Net assets | | |
| Unrestricted - attributable to Novant Health | 3,291,669 | 2,820,367 |
| Unrestricted - noncontrolling interests | 96,620 | 13,663 |
| Total unrestricted net assets | 3,388,289 | 2,834,030 |
| Temporarily restricted | 48,767 | 43,758 |
| Permanently restricted | 11,281 | 10,981 |
| Total net assets | 3,448,337 | 2,888,769 |
| Total liabilities and net assets | $ 5,847,532 | $ 5,595,970 |

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

# Novant Health, Inc. and Affiliates
## Consolidated Statements of Operations and Changes in Net Assets
## Years Ended December 31, 2016 and 2015

| *(in thousands of dollars)* | **2016** | **2015** |
|---|---|---|
| **Operating revenues** | | |
| Patient service revenues (net of contractual allowances and discounts) | $ 4,308,993 | $ 4,061,243 |
| Provision for bad debts | (204,535) | (195,958) |
| Net patient service revenues less provision for bad debts | 4,104,458 | 3,865,285 |
| Other revenue | 235,665 | 262,716 |
| Total operating revenues | 4,340,123 | 4,128,001 |
| **Operating expenses** | | |
| Salaries and employee benefits | 2,290,877 | 2,153,132 |
| Supplies and other | 1,456,401 | 1,405,855 |
| Depreciation expense | 237,416 | 209,888 |
| Amortization expense | 2,972 | 3,644 |
| Impairment charge | 11,850 | 8,572 |
| Interest expense | 81,832 | 88,522 |
| Total operating expenses | 4,081,348 | 3,869,613 |
| Operating income | 258,775 | 258,388 |
| **Non-operating income (expense)** | | |
| Investment income (loss) | 151,073 | (60,039) |
| Income tax expense | (3,371) | (7,022) |
| Gain on extinguishment of debt | 6,304 | - |
| Other, net | 24 | 34 |
| Unrealized gain on non-hedged derivative financial instruments | - | 217 |
| Excess of revenues over expenses | $ 412,805 | $ 191,578 |

*Continued on following page*

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

# Novant Health, Inc. and Affiliates
## Consolidated Statements of Operations and Changes in Net Assets, continued
## Years Ended December 31, 2016 and 2015

| *(in thousands of dollars)* | 2016 | 2015 |
|---|---|---|
| **Unrestricted net assets** | | |
| Excess of revenues over expenses | $ 412,805 | $ 191,578 |
| Change in funded status of defined benefit plans | 47,862 | 23,514 |
| Loss on voluntary pension settlement | (4,396) | - |
| Unrealized gain on derivative financial instruments | 5,564 | 4,140 |
| Formation of Novant Health UVA Health System | 92,187 | - |
| Other changes in unrestricted net assets | 237 | 1,017 |
| Increase in unrestricted net assets | 554,259 | 220,249 |
| **Temporarily restricted net assets** | | |
| Contributions and investment income | 11,131 | 8,930 |
| Formation of Novant Health UVA Health System | 740 | - |
| Net assets released from restrictions for operations | (6,862) | (5,592) |
| Increase in temporarily restricted net assets | 5,009 | 3,338 |
| **Permanently restricted net assets** | | |
| Contributions, net of reclassifications | 300 | 18 |
| Increase in permanently restricted net assets | 300 | 18 |
| Increase in total net assets | 559,568 | 223,605 |
| Net assets, beginning of year | 2,888,769 | 2,665,164 |
| Net assets, end of year | $ 3,448,337 | $ 2,888,769 |

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

# Novant Health, Inc. and Affiliates
## Consolidated Statements of Cash Flows
## Years Ended December 31, 2016 and 2015

*(in thousands of dollars)*

| | 2016 | 2015 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Increase in net assets | $ 559,568 | $ 223,605 |
| Adjustments to reconcile changes in net assets to net cash provided by operating activities | | |
| Depreciation, amortization, and accretion | 241,688 | 220,315 |
| Gain on sale of real estate | (4,234) | (7,605) |
| Gain on sale of business | - | (40,027) |
| Impairment charge | 11,850 | 8,572 |
| Gain on extinguishment of debt | (6,304) | - |
| Loss on voluntary pension settlement | 4,396 | - |
| Change in funded status of defined benefit plans | (47,862) | (23,514) |
| Increase in unrestricted net assets related to consolidated affiliated entities | (92,927) | - |
| Share of earnings in affiliates, net of distributions | 587 | (1,894) |
| Net realized and unrealized (gains) losses on assets limited as to use and investments | (129,464) | 84,734 |
| Change in fair value of interest rate swaps | (7,636) | (2,401) |
| Contributions restricted for capital | (2,314) | (3,856) |
| Provision for bad debts | 204,535 | 195,958 |
| Changes in operating assets and liabilities, net of assets acquired and liabilities assumed | | |
| Accounts receivable | (320,730) | (258,855) |
| Accounts payable and accrued liabilities | (24,227) | 13,682 |
| Deferred taxes, net | 1,627 | (422) |
| Other assets and liabilities, net | 6,542 | 13,725 |
| Net cash provided by operating activities | 395,095 | 422,017 |
| **Cash flows from investing activities** | | |
| Capital expenditures | (288,282) | (227,793) |
| Proceeds from sale of affiliates | - | 80,980 |
| Proceeds from sales of long-term investments | 943,012 | 521,832 |
| Purchase of long-term investments | (1,022,634) | (696,028) |
| Proceeds from sales of short-term investments | 605,914 | 465,050 |
| Purchase of short-term investments | (400,551) | (560,059) |
| Proceeds from sale of property and equipment | 3,503 | 9,338 |
| Cash acquired | 13,198 | 2,568 |
| Other investing activities | (1,182) | (1,863) |
| Net cash used in investing activities | (147,022) | (405,975) |
| **Cash flows from financing activities** | | |
| Principal payments on long-term debt | (374,566) | (36,872) |
| Bond proceeds received from trustee | - | 2,877 |
| Proceeds from sale of accounts receivable, net | 37,709 | 35,086 |
| Cash (payments) receipts for repurchase agreements, net | (3,066) | 3,556 |
| Other financing activities | (1,565) | 4,917 |
| Net cash (used in) provided by financing activities | (341,488) | 9,564 |
| Net (decrease) increase in cash and cash equivalents | (93,415) | 25,606 |
| **Cash and cash equivalents** | | |
| Beginning of year | 354,403 | 328,797 |
| End of year | $ 260,988 | $ 354,403 |

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

# Novant Health, Inc. and Affiliates
## Consolidated Statements of Cash Flows, continued
## Years Ended December 31, 2016 and 2015

*(in thousands of dollars)*

| | | 2016 | | 2015 |
|---|---|---|---|---|
| **Supplemental disclosure of cash flow information** | | | | |
| Interest paid | $ | 89,813 | $ | 87,979 |
| Income taxes paid | | 1,810 | | 7,257 |
| **Supplemental disclosure of noncash operating activities** | | | | |
| Settlement of patient receivables and other liabilities | | 1,108 | | 2,733 |
| **Supplemental disclosure of noncash financing and investing activities** | | | | |
| Property and equipment financed through current liabilities | | 31,685 | | 26,626 |

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

*(in thousands of dollars)*

## 1. Reporting Entity

Novant Health, Inc. ("Novant Health" or the "Company") is a nonprofit, integrated health care network of physician clinics, outpatient centers and hospitals that serves patients and communities in North Carolina, Virginia and South Carolina. Novant Health consists of nearly 1,500 physicians and 25,000 team members at approximately 500 locations, including 14 medical centers and hundreds of outpatient facilities and physician clinics. Headquartered in Winston-Salem, North Carolina, Novant Health is committed to making healthcare remarkable for patients and communities, serving more than 4 million patients annually. Novant Health and its affiliates serve their communities with programs including health education, home health care, prenatal clinics, community clinics and immunization services.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

### Principles of Consolidation

The consolidated financial statements include the accounts of all affiliates controlled by Novant Health. All intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company does not have control or has a 50% or less interest are accounted for by either the equity or cost method.

### Use of Estimates

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

Significant estimates include, but are not limited to, accounts receivable allowances, third-party payor settlements, goodwill and intangible asset valuation and subsequent recoverability, useful lives of intangible assets and property and equipment, medical and professional liability and other self-insurance accruals, and pension related assumptions.

### Fair Value of Financial Instruments

The fair value of financial instruments approximates the carrying amount reported in the consolidated balance sheets for cash and cash equivalents, investments other than alternatives, assets limited as to use and interest rate swaps. More information can be found in Note 8, *Fair Value Measurements*.

### Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less, excluding amounts limited as to use by board designation, donors or trustees.

*(in thousands of dollars)*

**Accounts Receivable**
Accounts receivable consist primarily of amounts owed by various governmental agencies, insurance companies and patients. Novant Health manages these receivables by regularly reviewing the accounts and contracts and by providing appropriate allowances for uncollectible amounts. In evaluating the collectability of accounts receivable from third-party payors, the Company analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for anticipated uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). In evaluating the collectability of accounts receivable from patients (including both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists), Novant Health considers several factors, including historical collection results, the age of the accounts, changes in collection patterns and general industry conditions. Novant Health records a provision for bad debts in the period of service based on the analysis and consideration of these factors. Once collection efforts are complete, any difference between the amount charged and the amount collected is written off against the allowance for doubtful accounts.

**Other Current Assets**
Other current assets include inventories (which primarily consist of hospital and medical supplies and pharmaceuticals), prepaid expenses and other receivables. Inventory costs are determined primarily using the average cost method and are stated at the lower of cost or market value.

**Investments**
Investments are classified as trading securities. All investments are designated as trading at the time of acquisition. Accordingly, unrealized gains and losses on investments are included in excess of revenues over expenses, unless the income or loss is restricted by donor or law. Long-term investments are classified as noncurrent assets as the Company does not expect to use these funds to meet its current liabilities.

Investments in equity and debt securities with readily determinable fair values are measured at fair value in the accompanying consolidated balance sheets. The Company also invests in alternative investments through limited partnerships and limited liability corporations ("LLCs"). These investments are recorded using the equity method of accounting (which approximates fair value) with the related earnings reported as investment income in the accompanying consolidated financial statements. The values provided by the respective partnership or LLC are based on market value or other estimates that require varying degrees of judgment. Because these investments are not readily marketable, the estimated value is subject to additional uncertainty and, therefore, may differ from the value that would have been used had a market for such investments existed. Such differences could be material. The Company believes the carrying amount of these investments is a reasonable estimate of fair value.

Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the investment balances included in the consolidated financial statements.

*(in thousands of dollars)*

**Assets Limited as to Use**
Assets limited as to use primarily include assets held by trustees under indenture agreements and assets designated for specific purposes by the Board of Trustees.

**Derivatives**
The Company selectively enters into interest rate protection agreements to mitigate changes in interest rates on variable rate borrowings. The notional amounts of such agreements are used to measure the interest to be paid or received and do not represent the amount of exposure to loss. None of these agreements are used for speculative or trading purposes.

Derivatives are recognized on the consolidated balance sheets at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. The Company formally documents the hedging relationships at inception of the contract for derivative transactions, including identifying the hedge instruments and hedged items, as well as the risk management objectives and strategies for entering into the hedge transaction. At inception and on a quarterly basis thereafter, the Company assesses the effectiveness of derivatives used to hedge transactions. If a cash flow hedge is deemed effective, the change in fair value is recorded as an other change in unrestricted net assets. If after assessment it is determined that a portion of the derivative is ineffective, then that portion of the derivative's change in fair value will be immediately recognized in excess of revenues over expenses. The change in fair value of all derivatives that do not qualify for hedge accounting is also recognized in excess of revenues over expenses.

**Property and Equipment**
Property and equipment are recorded at cost, if purchased, or at fair value at the date of donation, if donated. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are amortized over the life of the lease or the useful life of the asset, whichever is shorter.

Following is a summary of the estimated useful lives used in computing depreciation:

| | |
|---|---|
| Buildings | 30–40 years |
| Machinery and equipment | 3–15 years |
| Software | 3–10 years |
| Furniture and fixtures | 7–14 years |

Certain facilities and equipment held under capital leases are classified as property and equipment and amortized on the straight-line method over the period of the lease term or the estimated useful life of the asset, whichever is shorter. The related obligations are recorded as liabilities. Amortization of equipment under capital lease is included in depreciation expense.

The Company also capitalizes the cost of software developed for internal use.

Maintenance and repairs of property and equipment are expensed in the period incurred. Replacements or improvements that increase the estimated useful life of an asset are capitalized. Assets that are sold, retired or otherwise disposed of are removed from the respective asset cost and accumulated depreciation accounts and any gain or loss is included in the results of operations.

*(in thousands of dollars)*

Operating leases are accounted for in accordance with generally accepted accounting principles (“GAAP”), which requires the recognition of fixed rental payments, including rent escalations, on a straight-line basis over the term of the lease.

Under the terms of the 1984 deed in which the Forsyth County Board of County Commissioners conveyed the assets of Forsyth Memorial Hospital (the “Hospital”) to Novant Health, Novant Health is required to operate the Hospital as a community general hospital open to the general public, and if Novant Health is dissolved, a successor nonprofit corporation approved by the Forsyth County Board of County Commissioners must carry out the terms and conditions of this conveyance. If these terms are not met, all ownership rights to the Hospital shall revert to the County, including the buildings and land together with the personal property and equipment associated with the Hospital with a net book value of approximately $239,668 at December 31, 2016.

Gifts of long-lived assets such as land, buildings, or equipment are excluded from the excess of revenues over expenses and are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

**Goodwill and Other Intangible Assets**
Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. Intangible assets generally represent the acquisition date fair value of certain rights or relationships obtained in such business acquisitions.

The Company considers certificates of need, which are required by certain states prior to the acquisition of high cost capital items, to be indefinite-lived intangible assets. The Company also has intangible assets with identifiable useful lives related to business acquisitions. These assets include business relationships and corporate trade names. In accordance with GAAP, the Company amortizes the cost of these intangible assets with identifiable useful lives down to their estimated residual value.

Following is a summary of the estimated useful lives used in computing amortization:

| | |
|---|---|
| Business relationships | 26 years |
| Corporate trade name | 29 years |

On an annual basis, Novant Health tests goodwill and indefinite-lived assets for impairment. If it is more likely than not that the indefinite-lived asset is impaired, additional testing for impairment is required. GAAP prescribes that impairment for indefinite-lived intangibles is evaluated by comparing the fair value of the asset with its carrying amount. If the carrying amount exceeds the fair value, an impairment loss is recognized as the amount of that excess.

*(in thousands of dollars)*

Impairment tests are performed at the reporting unit level for units that have goodwill. If it is more likely than not that the fair value of the reporting unit exceeds the carrying value of the reporting unit, additional impairment testing is not required. If it is more likely than not that the carrying value of the reporting unit exceeds the fair value of the reporting unit, additional testing for impairment is required. GAAP prescribes a two-step process for testing for goodwill impairments after applying the qualitative assessment. The first step is to determine if the carrying value of the reporting unit with goodwill is less than the related fair value of the reporting unit. The fair value of the reporting unit is determined through use of discounted cash flow methods and/or market based multiples of earnings and sales methods. If the carrying value of the reporting unit is less than the fair value of the reporting unit, the goodwill is not considered impaired. If the carrying value is greater than the fair value, the potential for impairment of goodwill exists. The goodwill impairment is determined by allocating the current fair value of the reporting unit among the assets and liabilities based on a purchase price allocation methodology as if the reporting unit was being acquired in a business combination. The fair value of the goodwill is implied from this allocation and compared to the carrying value with an impairment loss recognized if the carrying value is greater than the implied fair value.

**Investments in Affiliates**
Investments in entities which Novant Health does not control, but in which it has a substantial ownership interest and can exercise significant influence, are accounted for using the equity method. Investments in entities of 20% or less and where there are no qualitative indicators of significant influence are accounted for using the cost method.

**Other Assets**
Other assets consist of notes and pledges receivable, insurance receivables, prepaid pension costs and the cash surrender value of insurance policies.

**Compensated Absences**
The Company's employees earn vacation days at varying rates depending on years of service. Vacation time accumulates up to certain limits, at which time no additional vacation hours can be earned. Provided this hourly limit is not met, employees can continue to accumulate vacation hours and time can be carried over to future years. Accrued vacation time is included in accrued liabilities on the Company's consolidated balance sheets.

**Self-Insurance Reserves**
The Company is self-insured for certain employee health benefit options, workers' compensation and malpractice. These costs are accounted for on an accrual basis to include estimates of future payments for claims incurred.

**Temporarily and Permanently Restricted Net Assets**
Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. The earnings on permanently restricted net assets are available for use as specified by the donors. The Company's temporarily restricted and permanently restricted net assets are predominantly held by related foundations for various hospital service costs and community health programs.

*(in thousands of dollars)*

**Contributions Received**

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

**Statement of Operations**

All activities of Novant Health deemed by management to be ongoing, major and central to the provision of healthcare services are reported as operating revenue and expenses. Other activities are deemed to be non-operating and include investment income (loss), change in fair value of non-hedged derivative financial instruments, income tax expense and gain on extinguishment of debt.

Novant Health receives supplemental Medicaid payments from the state of North Carolina through a federally approved disproportionate share program ("Medicaid DSH"). During 2012, the federal government approved an amendment to the Medicaid DSH plan. This amendment, referred to as the Medicaid Gap Assessment Program ("GAP"), provides a new funding model whereby hospitals are assessed an amount based on a percentage of their costs and are then paid supplemental amounts in an effort to reduce Medicaid losses. Novant Health records GAP payments received as net patient service revenue and GAP assessments paid as other operating expense on the consolidated statements of operations and changes in net assets. These supplemental payments are recognized in income when earned, if reasonably estimable and deemed collectible. There can be no assurance that this program will not be discontinued or materially modified. During 2016, Novant Health received $137,002 and paid $67,212 for the GAP program. During 2015, Novant Health received $141,745 and paid $74,008 for the GAP program.

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses include changes in funded status of defined benefit plans, loss on voluntary pension settlement, unrealized gains on derivative financial instruments that apply hedge accounting and the formation of the Novant Health UVA Health System.

**Other Revenue**

Other revenue consists primarily of earnings from investments in affiliates accounted for using the equity method of accounting, pharmacy revenue and contributions.

**Income Taxes**

Novant Health is classified as a nonprofit organization pursuant to Section 501(c)(3) of the Internal Revenue Code and is exempt from income taxes on revenue earned from its tax-exempt purposes. Novant Health also operates various for-profit subsidiaries which operate in service lines that are complimentary to the Company's tax-exempt purpose. Income from activities that are determined by IRS regulations to be unrelated to the tax-exempt purposes as well as income from activities of for-profit subsidiaries of the Company are subject to federal and state taxation.

*(in thousands of dollars)*

The Company provides for income taxes using the asset and liability method. This approach recognizes the amount of federal, state and local taxes payable or refundable for the current year, as well as deferred tax assets and liabilities for the future tax consequences of events recognized in the consolidated financial statements and income tax returns. Deferred income tax assets and liabilities are adjusted to recognize the effects of changes in tax laws or enacted tax rates in the period in which such laws or rates are enacted.

A valuation allowance is required when it is more likely than not that some portion of the deferred tax assets will not be realized. Realization is dependent on generating sufficient future taxable income.

**Reclassifications**
Certain balances in the prior fiscal year have been reclassified to conform to the presentation adopted in the current fiscal year.

## 3. Organizational Changes

**Formation of Novant Health UVA Health System**
Effective January 1, 2016, Novant Health and The Rector and Visitors of the University of Virginia on behalf of its Medical Center ("UVAMC") entered into an integration and joint operating agreement (the "Integration Agreement"). The Integration Agreement provides for the creation of a regional healthcare alliance through the creation of a new not-for-profit corporation, Novant Health UVA Health System. Novant Health and UVAMC are the sole members of Novant Health UVA Health System. Novant Health agreed to exchange its sole membership in Prince William Health System for a 60% membership interest in Novant Health UVA Health System. UVAMC agreed to exchange its sole membership in Culpeper Memorial Hospital for a 40% membership interest in Novant Health UVA Health System.

Novant Health recognized the fair value of Culpeper Memorial Hospital and its subsidiaries ("CMH") in its consolidated balance sheets and included the operations of Novant Health UVA Health System in its consolidated statements of operations and changes in net assets beginning January 1, 2016. This resulted in the recognition of the following amounts in Novant Health's consolidated balance sheet as of January 1, 2016:

| | | |
|---|---|---|
| Cash and cash equivalents | $ | 11,397 |
| Accounts receivable, net of allowance for doubtful accounts | | 11,241 |
| Receivable for settlement with third-party payors | | 2,192 |
| Other current assets | | 3,706 |
| Assets limited as to use | | 796 |
| Property and equipment, net | | 56,924 |
| Long-term investments | | 2,883 |
| Intangible assets and goodwill, net | | 25,280 |
| Current portion of long-term debt | | 217 |
| Accounts payable | | 6,308 |
| Accrued liabilities | | 3,654 |
| Long-term debt | | 739 |
| Employee benefits and other liabilities | | 4,000 |
| Net assets | | 99,501 |

*(in thousands of dollars)*

The integration agreement includes a working capital true-up based on target net assets at the date of formation. This provision resulted in a payable to UVA of $6,574 at the date of formation.

**Divestiture of Georgia Imaging Centers**
In July 2015, the Company divested of its imaging centers in Georgia. These 22 locations with a net carrying value of $35,836 were sold to Northside Hospital, Inc. for cash of $80,500. These imaging centers contributed $29,192 in operating revenues and $(140) in operating loss in 2015. As a result of this transaction, the Company recognized a gain of $43,951. This gain is included in other revenue in the consolidated statements of operations and changes in net assets for the year ended December 31, 2015. Novant Health still manages these Georgia locations.

**Assets Held for Sale**
The Company classifies assets and liabilities (“disposal group”) as held for sale when management, having the authority to approve the action, commits to a plan to sell the disposal group, the sale is probable within one year, and the disposal group is available for immediate sale in its present condition. In addition, the Company considers whether an active program to locate a buyer has been initiated, whether the disposal group is marketed actively for sale at a price that is reasonable in relation to its current value, and whether actions required to complete the plan indicate it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The disposal group is measured at the lower of its carrying amount or fair value less cost to sell and long-lived assets within the disposal group are not depreciated while classified as held for sale. In December 2016, it was determined that MedQuest, Inc. and its subsidiaries met all of the criteria to classify it as an asset held for sale. The disposal group was written down to $56,186, or its fair value less cost to sell. As a result, an impairment charge of $9,400 was recorded.

The following table summarizes the carrying amounts of major classes of assets and liabilities held for sale:

| | |
|---|---|
| Cash and cash equivalents | $ 1,898 |
| Accounts receivable, net of allowance for doubtful accounts | 6,316 |
| Deferred tax asset | 3,251 |
| Other current assets | 2,708 |
| Current assets held for sale | 14,173 |
| | |
| Property and equipment, net | 15,482 |
| Intangible assets and goodwill, net | 41,382 |
| Other long-term assets | 329 |
| Long-term assets held for sale | 57,193 |
| | |
| Accrued liabilities | 13,498 |
| Current liabilities held for sale | 13,498 |
| | |
| Employee benefits and other liabilities | 1,682 |
| Long-term liabilities held for sale | 1,682 |

*(in thousands of dollars)*

## 4. Net Patient Service Revenue

Net patient service revenue is presented net of provisions for contractual adjustments and other allowances. Novant Health has agreements with third-party payors that provide for payments at amounts different from its established rates. Retroactive adjustments are accrued on an estimated basis in the period the related service is rendered and adjusted in future periods as final settlements are determined. During 2016 and 2015, Novant Health recorded a favorable change in estimate of $55,000 and $82,000, respectively, related to the net realizable value of patient receivables. This change in estimate is reflected as an increase in net patient service revenues less provision for bad debts in the consolidated statements of operations and changes in net assets and was primarily the result of favorable collections from a previous patient accounting system, as well as from favorable collections from the Company's transition to an electronic health record in 2014 and 2015. For uninsured patients that do not qualify for charity care, Novant Health recognizes revenue on the basis of its standard rates for services provided, less discounts for uninsured patients as provided by the Company's financial assistance policies. Based on historical experience, many of the Company's uninsured patients will be unable or unwilling to pay for the services provided. As a result, Novant Health records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

| | 2016 | 2015 |
|---|---|---|
| Third-party payors | $ 4,227,059 | $ 3,995,854 |
| Self-pay | 81,934 | 65,389 |
| Total | $ 4,308,993 | $ 4,061,243 |

A summary of the payment arrangements with major third-party payors follows:

**Medicare and Medicaid**
Inpatient acute care services rendered to program beneficiaries are paid at prospectively determined rates per diagnosis. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services, and defined capital and medical education costs related to beneficiaries are paid based on a cost reimbursement methodology. Outpatient services are paid at a prospectively determined rate. Novant Health is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Novant Health and audits thereof by the fiscal intermediary. The Company's Medicare cost reports are final settled through 2013 for all facilities except for Novant Health Forsyth Medical Center which is finalized through 2010. Substantially all of the Company's Medicaid cost reports are final settled through 2013.

Revenue from the Medicare and Medicaid programs accounted for approximately 31.0% and 5.3%, respectively, of Novant Health's net patient service revenue for the year ended 2016, and 31.2% and 5.3%, respectively, of Novant Health's net patient service revenue for the year ended 2015. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term.

*(in thousands of dollars)*

In July 2010, the Department of Health and Human Services published final regulations implementing the health information technology provisions of the American Recovery and Reinvestment Act. The regulation defines the "meaningful use" of Electronic Health Records ("EHR") and established the requirements for the Medicare and Medicaid EHR payment incentive programs. These programs allow Medicare and Medicaid incentive payments to be paid to eligible hospitals, physicians, and certain other health professionals that implement and achieve meaningful use of certified EHR technology. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. Novant Health recognizes income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when our eligible providers and hospitals have demonstrated meaningful use of certified EHR technology for the applicable period, and, if applicable, the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available. During 2016 and 2015, Novant Health recognized $12,176 and $16,177, respectively, of revenue related to EHR funds. These amounts are included in other revenue in the accompanying consolidated statements of operations and changes in net assets. This amount represents amounts that were received and/or amounts for which Novant Health has successfully met meaningful use criteria. Included in the Company's consolidated balance sheets at December 31, 2016 and 2015 is deferred revenue of $804 and $8,421, respectively. At December 31, 2016 and 2015, Novant Health had a receivable related to EHR funds of $0 and $5,100, respectively.

**Other Payors**

Novant Health also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to Novant Health under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Payments for services covered by these programs and certain other third-party payor contracts are generally less than billed charges. Provisions for contractual adjustments including Medicare, Medicaid, and managed care total approximately $6,127,154 (or 57%) and $5,528,484 (or 55%) of 2016 and 2015 gross patient service revenue, respectively.

The allowance for doubtful accounts is determined based on management's assessment of historical and expected net collections, business and economic conditions, the age of the accounts, trends in federal and state governmental health care coverage and other collection indicators. The Company's self-pay write-offs (including charity care) were $601,555 in 2016 compared to $586,546 in 2015. Novant Health has not changed its charity care or uninsured discount policies during 2015 or 2016. Novant Health does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

Novant Health has a program of factoring certain patient receivables with recourse to a third-party. Novant Health is obligated to repurchase factored receivables upon occurrence of certain conditions of the program. Accordingly, Novant Health accounts for the factoring as a secured borrowing. The factored receivables are recorded at their estimated net realizable value and are shown as other assets in the consolidated balance sheets. An offsetting liability, representing Novant Health's potential recourse for these receivables, is part of employee benefits and other liabilities in the consolidated balance sheets. As of December 31, 2016, the factored notes and the related liabilities were $42,289 and $51,547, respectively. As of December 31, 2015, the factored notes and the related liabilities were $31,075 and $44,606 respectively.

*(in thousands of dollars)*

## 5. Charity Care and Community Benefit

In accordance with Novant Health's mission to improve the health of its communities one person at a time, Novant Health facilities accept patients regardless of their ability to pay. At acute facilities, uninsured patients qualify for a full write-off of their bills if their household income is at or below 300% of the federal poverty level. Novant Health also offers a catastrophic discount for patients with an account balance greater than $5, flexible payment plans, and discounts for uninsured patients who do not qualify for the charity care program. In addition to these programs for hospitals, Novant Health physician groups and outpatient centers also have charity care programs to assist patients in need. The Company's approximate cost of providing care to indigent patients was $122,017 and $125,317 for the years ended December 31, 2016 and 2015, respectively. Novant Health estimates the costs of providing traditional charity care using each facility's estimated ratio of costs to charges. Funds received from gifts or grants to subsidize charity services provided were $2,124 and $1,300 for the years ended December 31, 2016 and 2015, respectively.

In addition to providing charity care to uninsured patients, Novant Health also provides services to beneficiaries of public programs and various other community health services intended to improve the health of the communities in which the Company operates. Novant Health uses the following four categories to identify the resources utilized for the care of persons who are underserved and for providing community benefit programs to the needy:

- Traditional charity care, which includes the cost of services provided to persons who cannot afford health care because of inadequate resources and who are uninsured.
- Unpaid cost of Medicare, which represents the unpaid cost of services provided to persons through the government program for individuals age 65 and older as well as those that qualify for federal disability benefits.
- Unpaid cost of Medicaid, which represents the unpaid cost of services provided to persons covered by the government program for medically indigent patients.
- Community benefit programs consist of the unreimbursed costs of certain programs and services for the general community, mainly for indigent patients but also for people with chronic health risks. Examples of these programs include health promotion and education, free clinics and screenings, and other community services.

The amount of unpaid cost of Medicare, Medicaid, and other community benefit programs is reported on page 48 in the accompanying other financial information.

*(in thousands of dollars)*

## 6. Other Current Assets

Other current assets consist of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Inventory | $ 82,091 | $ 75,568 |
| Prepaids | 39,541 | 34,827 |
| Other receivables | 60,118 | 60,295 |
| | $ 181,750 | $ 170,690 |

## 7. Assets Limited as to Use and Investments

**Short-Term Investments**
Novant Health holds certain investments that are short-term in nature and have original maturity dates ranging from three to twelve months. Short-term investments consist of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Certificates of deposit | $ 58 | $ 5,064 |
| Fixed income - Government securities | 260,261 | 430,566 |
| Fixed income - Corporate and other | - | 30,142 |
| | $ 260,319 | $ 465,772 |

**Assets Limited as to Use**
The designation of assets limited as to use is as follows:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Current Portion | Long-Term Portion | Current Portion | Long-Term Portion |
| Under general and professional liability funding arrangement held by trustee | $ 12,089 | $ 42,084 | $ 13,541 | $ 39,508 |
| Designated by board to service benefit plans | 6,497 | 105,040 | 195 | 7,186 |
| | $ 18,586 | $ 147,124 | $ 13,736 | $ 46,694 |

Assets limited as to use are invested primarily in cash and cash equivalents and corporate, U.S. government and U.S. agency debt obligations. At December 31, 2016 and 2015, the Company had $0 and $889, respectively, in investments carried at net asset value per share (“NAV”).

*(in thousands of dollars)*

The Company recorded additional current and long-term assets limited as to use in 2016 in the amounts of $6,302 and $98,049, respectively, related to non-qualified deferred compensation plans which had previously been excluded. An equal and offsetting adjustment has been reflected in employee benefits and other liabilities as of December 31, 2016. The uncorrected effect to current and long-term assets limited as to use was $2,508 and $90,290, respectively, at December 31, 2015.

**Long-Term Investments**

Investments are reported at either fair value, the equity method of accounting or at NAV as a practical expedient. The composition of long-term investments is as follows:

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | At Fair Value | On Equity Method | At NAV | Total |
| Cash and cash equivalents | $ 168,714 | $ - | $ - | $ 168,714 |
| U.S. equities | 376,753 | 19,875 | 230,038 | 626,666 |
| International equities | 126,434 | 60,089 | 184,083 | 370,606 |
| Fixed income - Government securities | 127,475 | - | - | 127,475 |
| Fixed income - Corporate and other | 28,604 | 58,764 | 27,013 | 114,381 |
| Hedge funds | - | 362,498 | - | 362,498 |
| Emerging markets | 24,843 | - | 88,889 | 113,732 |
| Real estate and other | 33,558 | 97,058 | - | 130,616 |
| | $ 886,381 | $ 598,284 | $ 530,023 | $ 2,014,688 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | At Fair Value | On Equity Method | At NAV | Total |
| Cash and cash equivalents | $ 122,800 | $ - | $ - | $ 122,800 |
| U.S. equities | 275,374 | 21,810 | 185,494 | 482,678 |
| International equities | 118,568 | 49,530 | 159,915 | 328,013 |
| Fixed income - Government securities | 124,828 | - | - | 124,828 |
| Fixed income - Corporate and other | 28,456 | 51,519 | 15,479 | 95,454 |
| Hedge funds | - | 423,673 | - | 423,673 |
| Emerging markets | 18,789 | 15,078 | 79,011 | 112,878 |
| Real estate and other | 10,478 | 105,797 | - | 116,275 |
| | $ 699,293 | $ 667,407 | $ 439,899 | $ 1,806,599 |

Long-term investments carried at NAV may be redeemed or liquidated only after giving notice to the fund manager. The notice period ranges from 5 to 30 days. These investments have been reported at NAV by each fund as a practical expedient to estimate their fair value. Novant Health has the ability to redeem its interests at or near the financial statement date. Novant Health defines near term as within 90 days of the financial statement date.

*(in thousands of dollars)*

The Company's investments in hedge funds include limited partnerships, limited liability corporations, and off-shore investment funds. The underlying investments of the limited partnerships and limited liability corporations include, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments may result in loss due to changes in the market (market risk). Alternative investments are less liquid than the Company's other investments.

The Company's investments in hedge funds represent 18.0% and 23.5% of total long-term investments held at December 31, 2016 and 2015, respectively. These instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition.

Novant Health is obligated under certain investment agreements to periodically advance additional funding up to specified levels. As of December 31, 2016 and 2015, Novant Health had future commitments of $67,167 and $70,745, respectively, for which capital calls had not been exercised.

Investment income (loss) for assets limited as to use and investments is comprised of the following for the years ended December 31:

| | 2016 | 2015 |
|---|---|---|
| **Income (loss)** | | |
| Interest and dividend income | $ 21,609 | $ 24,695 |
| Net realized gains | 29,251 | 31,081 |
| Net unrealized gains (losses) | 100,213 | (115,815) |
| | $ 151,073 | $ (60,039) |

Investment income (loss) is shown net of related expenses on the consolidated statements of operations and changes in net assets. Investment related administrative expenses were $4,767 and $5,070 for the years ended December 31, 2016 and 2015, respectively.

## 8. Fair Value Measurements

Novant Health categorizes, for disclosure purposes, assets and liabilities measured at fair value in the financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs which are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available in the circumstances.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement of the asset or liability. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

*(in thousands of dollars)*

Novant Health follows the three-level fair value hierarchy to categorize these assets and liabilities recognized at fair value at each reporting period, which prioritizes the inputs used to measure such fair values. Level inputs are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities on the reporting date. Investments classified in this level generally include exchange traded equity securities, futures, pooled short-term investment funds, options and exchange traded mutual funds.

Level 2: Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Investments classified in this level generally include fixed income securities, including fixed income government obligations; asset-backed securities; certificates of deposit; derivatives; as well as certain U.S. and international equities which are not traded on an active exchange.

Level 3: Inputs that are unobservable for the asset or liability. Investments classified in this level generally include investments in preferred stock.

Assets and liabilities classified as Level 1 are valued using unadjusted quoted market prices for identical assets or liabilities in active markets. Novant Health uses techniques consistent with the market approach and income approach for measuring fair value of its Level 2 assets and liabilities. The market approach is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach generally converts future amounts (cash flows or earnings) to a single present value amount (discounted).

As of December 31, 2016 and 2015, the Level 1 and Level 2 assets and liabilities listed in the fair value hierarchy tables below utilize the following valuation techniques and inputs:

**Certificates of deposit**
The fair value of certificates of deposit is based on cost plus accrued interest. Significant observable inputs include security cost, maturity, and relevant short-term interest rates.

**Fixed income and debt securities**
The fair value of investments in fixed income and debt securities is primarily determined using techniques that are consistent with the market approach. Significant observable inputs include benchmark yields, reported trades, observable broker/dealer quotes, issuer spreads, and security specific characteristics, such as early redemption options.

**U.S., international, emerging markets and real estate equity securities**
The fair value of investments in U.S., international, emerging markets and real estate equity securities are primarily determined using either quoted prices in active markets or the calculated net asset value. The values for underlying investments are fair value estimates determined by external fund managers based on operating results, balance sheet stability, growth, and other business and market sector fundamentals. The investments in Level 2 may be redeemed or liquidated on a daily basis with no notice.

*(in thousands of dollars)*

**Derivatives**
The fair value of derivative contracts is primarily determined using techniques consistent with the market approach. Significant observable inputs to valuation models include interest rates, credit spreads, volatilities and maturity.

During 2016 and 2015, there were no transfers between Level 1 and 2.

The following table summarizes fair value measurements, by level, at December 31, 2016 for all financial assets and liabilities measured at fair value on a recurring basis in the financial statements:

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Total |
| **Assets** | | | | |
| Short-term investments: | | | | |
| Certificates of deposit | $ - | $ 58 | $ - | $ 58 |
| Fixed income - Government securities | - | 260,261 | - | 260,261 |
| Total short-term investments | - | 260,319 | - | 260,319 |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | 4,261 | - | - | 4,261 |
| U.S. equities | 96,396 | - | - | 96,396 |
| International equities | 2,157 | - | - | 2,157 |
| Fixed income - Government securities | 9,549 | 38,439 | - | 47,988 |
| Fixed income - Corporate and other | 344 | 14,564 | - | 14,908 |
| Total assets limited as to use | 112,707 | 53,003 | - | 165,710 |
| Long-term investments: | | | | |
| Cash and cash equivalents | 168,714 | - | - | 168,714 |
| U.S. equities | 376,753 | - | - | 376,753 |
| International equities | 126,434 | - | - | 126,434 |
| Fixed income - Government securities | - | 127,475 | - | 127,475 |
| Fixed income - Corporate and other | 22,502 | 6,102 | - | 28,604 |
| Emerging markets | 24,843 | - | - | 24,843 |
| Other exchange-traded funds | 33,558 | - | - | 33,558 |
| Total long-term investments | 752,804 | 133,577 | - | 886,381 |
| Total assets at fair value | $ 865,511 | $ 446,899 | $ - | $ 1,312,410 |
| **Liabilities** | | | | |
| Accrued liabilities | $ 6,302 | $ - | $ - | $ 6,302 |
| Derivative financial instruments | - | 50,305 | - | 50,305 |
| Employee benefits liabilities | 103,373 | - | - | 103,373 |
| Total liabilities at fair value | $ 109,675 | $ 50,305 | $ - | $ 159,980 |

*(in thousands of dollars)*

The following table summarizes fair value measurements, by level, at December 31, 2015 for all financial assets and liabilities measured at fair value on a recurring basis in the financial statements:

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Total |
| **Assets** | | | | |
| Short-term investments: | | | | |
| Certificates of deposit | $ - | $ 5,064 | $ - | $ 5,064 |
| Fixed income - Government securities | - | 430,566 | - | 430,566 |
| Fixed income - Corporate and other | - | 30,142 | - | 30,142 |
| Total short-term investments | - | 465,772 | - | 465,772 |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | 592 | - | - | 592 |
| U.S. equities | 6,018 | - | - | 6,018 |
| International equities | 62 | - | - | 62 |
| Fixed income - Government securities | - | 36,765 | - | 36,765 |
| Fixed income - Corporate and other | 396 | 15,708 | - | 16,104 |
| Total assets limited as to use | 7,068 | 52,473 | - | 59,541 |
| Long-term investments: | | | | |
| Cash and cash equivalents | 122,800 | - | - | 122,800 |
| U.S. equities | 275,374 | - | - | 275,374 |
| International equities | 118,568 | - | - | 118,568 |
| Fixed income - Government securities | - | 124,828 | - | 124,828 |
| Fixed income - Corporate and other | 15,289 | 13,167 | - | 28,456 |
| Emerging markets | 18,789 | - | - | 18,789 |
| Real estate and other | 10,478 | - | - | 10,478 |
| Total long-term investments | 561,298 | 137,995 | - | 699,293 |
| Total assets at fair value | $ 568,366 | $ 656,240 | $ - | $ 1,224,606 |
| **Liabilities** | | | | |
| Derivative financial instruments | $ - | $ 57,941 | $ - | $ 57,941 |
| Employee benefits liabilities | 5,547 | - | - | 5,547 |
| Total liabilities at fair value | $ 5,547 | $ 57,941 | $ - | $ 63,488 |

**Impairment Charges**

As a result of its impairment testing for 2016, the Company recorded impairment charges of $11,850 to reduce the carrying value of long-lived property and equipment assets from their carrying value of $3,250 to their estimated fair value of $800 and to reduce the carrying value of assets held for sale from their carrying value of $65,586 to their estimated fair value, less costs to sell of $56,186. As a result of its impairment testing for 2015, the Company recorded impairment charges of $8,572 to fully write-off long-lived property and equipment assets. These impairment charges are included in the consolidated statements of operations and changes in net assets.

*(in thousands of dollars)*

## 9. Property and Equipment

Property and equipment consists of the following December 31:

| | 2016 | 2015 |
|---|---|---|
| Land and land improvements | $ 278,304 | $ 261,959 |
| Leasehold improvements | 152,892 | 156,010 |
| Buildings and building improvements | 1,784,714 | 1,735,771 |
| Buildings under capital lease obligations | 26,997 | 26,854 |
| Equipment | 1,664,465 | 1,635,544 |
| Equipment under capital lease obligations | 4,537 | 5,307 |
| Software | 500,216 | 465,641 |
| Construction-in-progress | 187,358 | 94,541 |
| | 4,599,483 | 4,381,627 |
| Less: Accumulated depreciation | (2,658,841) | (2,527,525) |
| | $ 1,940,642 | $ 1,854,102 |

Novant Health reviews long-lived assets for recoverability as required when events and changes in circumstances indicate that its carrying value may not be recoverable. As a result of this review, $2,450 and $8,572 were recorded in impairment charges related to property and equipment assets in 2016 and 2015, respectively.

At December 31, 2016 and 2015, land and buildings with a net book value of $25,040 and $27,641 respectively, were leased to various unrelated health care organizations, with terms ranging from six months to five years. Depreciation expense and capital lease related amortization expense for the years ended December 31, 2016 and 2015 amounted to $237,416 and $209,888, respectively. Accumulated amortization for buildings and equipment under capital lease obligations was $22,801 and $22,186 at December 31, 2016 and 2015, respectively. Construction contracts of approximately $323,955 exist for the expansion of existing hospitals and facility renovations. At December 31, 2016, the remaining commitment on these contracts was $146,341.

On June 27, 2009, Novant Health sold a portfolio of 22 medical office buildings to a third-party real estate investor. The combined selling price of the buildings was $122,280. Novant Health is leasing space in each of the buildings from the buyer. The transaction was recorded as a sale-leaseback and resulted in a total gain of $59,889. Novant Health recognized gains from this transaction of $3,997 in 2016 and 2015. The remaining deferred gain of $29,979 will be recognized over the average life of Novant Health's lease agreements with the buyer.

*(in thousands of dollars)*

### 10. Intangible Assets and Goodwill

Intangible assets consist of the following at December 31:

| | Gross Intangible | Accumulated Amortization | Net Intangible |
|---|---|---|---|
| **Balance at December 31, 2016** | | | |
| Unamortized intangible assets | | | |
| Certificates of need | $ 47,228 | $ - | $ 47,228 |
| Total unamortized intangible assets | 47,228 | - | 47,228 |
| Amortized intangible assets | | | |
| Business relationships | 44,132 | (15,472) | 28,660 |
| Corporate trade name and other intangibles | 23,285 | (5,568) | 17,717 |
| Total amortized intangible assets | 67,417 | (21,040) | 46,377 |
| Total intangible assets | $ 114,645 | $ (21,040) | $ 93,605 |
| **Balance at December 31, 2015** | | | |
| Unamortized intangible assets | | | |
| Certificates of need | $ 66,378 | $ - | $ 66,378 |
| Total unamortized intangible assets | 66,378 | - | 66,378 |
| Amortized intangible assets | | | |
| Business relationships | 46,851 | (14,629) | 32,222 |
| Corporate trade name and other intangibles | 24,831 | (8,418) | 16,413 |
| Total amortized intangible assets | 71,682 | (23,047) | 48,635 |
| Total intangible assets | $ 138,060 | $ (23,047) | $ 115,013 |

Amortization expense related to intangible assets was $2,972 and $3,644 for the years ended December 31, 2016 and 2015, respectively. Estimated annual amortization expense for intangible assets for the years 2017 through 2021 is approximately $2,577, $2,566, $2,488, $2,488 and $2,488, respectively.

*(in thousands of dollars)*

The following table summarizes the changes in the carrying amount of goodwill for the years ended December 31:

| | 2016 | 2015 |
|---|---|---|
| **As of January 1** | | |
| Goodwill, net of accumulated amortization | $ 230,765 | $ 261,636 |
| Accumulated impairment losses | (37,563) | (65,260) |
| | 193,202 | 196,376 |
| Goodwill acquired, net of purchase price adjustments and other | 13,822 | (737) |
| Goodwill reclassified as held for sale | (13,163) | - |
| Disposals, net of accumulated amortization | - | (2,437) |
| | 193,861 | 193,202 |
| **As of the end of the period** | | |
| Goodwill, net of accumulated amortization | 208,621 | 230,765 |
| Accumulated impairment losses | (14,760) | (37,563) |
| | $ 193,861 | $ 193,202 |

Novant Health reviews long-lived assets for recoverability as required when events and changes in circumstances indicate that its carrying value may not be recoverable. During 2016 and 2015, no impairment charges to amortizable intangible assets were recorded as a result of this review. Our impairment tests presume stable or improving results at certain Novant Health reporting units which are based on the implementation of programs and initiatives that are designed to achieve projected results. If these projections are not met, or in the future negative trends occur which would impact our future outlook, further impairments of goodwill and other intangible assets may occur. Future restructuring of our markets that could potentially change our reporting units could also result in future impairments of goodwill.

*(in thousands of dollars)*

## 11. Investments in Affiliates

Novant Health has noncontrolling interests in nine healthcare related entities. The Company's ownership interests in the entities range from 9.1% to 51.0%. These investments are accounted for using either the cost or equity method.

A summary of investments, ownership percentages, investment amounts and the Company's share of earnings for the years ended December 31 is as follows:

| | % Ownership | | Investment Balance | | Share of Earnings of Investee | |
|---|---|---|---|---|---|---|
| **Investee** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| Advanced Services | 23% | 24% | $ 22,520 | $ 21,582 | $ 1,170 | $ 2,439 |
| Providence Plaza LLC | 30% | 30% | 4,497 | 4,501 | 203 | 181 |
| Rowan Hospice & Palliative Care LLC | 50% | 50% | 382 | 1,485 | 81 | (140) |
| Other | Various | Various | 4,647 | 5,678 | 213 | (201) |
| | | | $ 32,046 | $ 33,246 | $ 1,667 | $ 2,279 |

The following table presents summarized financial information related to investments in the above noncontrolled entities as of December 31:

| | 2016 | 2015 |
|---|---|---|
| Assets | $ 155,880 | $ 152,510 |
| Liabilities | 48,962 | 52,449 |
| Equity | 106,918 | 100,061 |
| Total revenue | 183,805 | 197,689 |
| Total expenses | 179,939 | 187,754 |
| Net income | 3,866 | 9,935 |
| Novant Health's share of net income | 1,667 | 2,279 |

*(in thousands of dollars)*

## 12. Other Assets

Other assets consist of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Notes receivable and other | $ 54,853 | $ 43,296 |
| Cash surrender value of insurance policies | 21,470 | 19,671 |
| Pledges receivable | 15,111 | 14,234 |
| Reinsurance receivables | 10,047 | 10,645 |
| Prepaid pension costs | 5,530 | 4,245 |
| | $ 107,011 | $ 92,091 |

## 13. Accrued Liabilities

Accrued liabilities consist of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Accrued compensation | $ 214,162 | $ 202,294 |
| Legal accrual | - | 32,000 |
| Payroll taxes and withholdings | 17,025 | 14,791 |
| Interest | 9,550 | 12,146 |
| Postretirement benefit liability | 1,320 | 1,305 |
| Pension liability | 221 | 217 |
| Other accrued liabilities | 82,035 | 82,052 |
| Self-insurance | | |
| Employee medical claims liability | 17,272 | 19,324 |
| Malpractice and workers' compensation liability | 17,100 | 18,957 |
| | $ 358,685 | $ 383,086 |

The legal accrual is discussed further in Note 20, *Commitments and Contingencies*.

*(in thousands of dollars)*

## 14. Long-Term Debt

Following is a summary of long-term debt at December 31:

| | 2016 | 2015 |
|---|---|---|
| Tax-exempt revenue bonds | $ 803,630 | $ 1,071,270 |
| Taxable revenue bonds | 500,000 | 600,000 |
| Taxable variable rate demand bonds | 53,800 | 57,800 |
| Total bonds | 1,357,430 | 1,729,070 |
| Capital lease obligations and other notes payable | 35,815 | 36,435 |
| | 1,393,245 | 1,765,505 |
| Unamortized premium or discount, net | 7,020 | 15,888 |
| Unamortized debt issuance costs, net | (7,831) | (9,789) |
| | 1,392,434 | 1,771,604 |
| Less: Current maturities | (66,624) | (178,347) |
| | $ 1,325,810 | $ 1,593,257 |

**Tax-Exempt Revenue Bonds**
Novant Health has tax-exempt financing agreements through conduit issuers. These bonds are comprised of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Series 2013 A and B Current Interest Term Bonds and Serial Bonds, bearing interest at rates ranging from 3.0% to 5.0% payable semi-annually and maturing through 2046; principal payments began in 2014 | $ 279,965 | $ 286,865 |
| Series 2010 A Current Interest Term Bonds and Serial Bonds, bearing interest at rates ranging from 4.0% to 5.0% payable semi-annually and maturing through 2043; principal payments begin in 2023 | 264,165 | 264,165 |
| Series 2008 A, B and C Variable Rate Demand Bonds, bearing interest at variable rates payable monthly and maturing through 2028; principal payments began in 2009 | 124,500 | 135,240 |
| Series 2006 Current Interest Term Bonds, bearing interest at rates ranging from 4.5% to 5.0% payable semi-annually and maturing through 2039; principal payments begin in 2023 | - | 250,000 |
| Series 2004 A and B Variable Rate Demand Bonds, bearing interest at variable rates payable monthly and maturing through 2034; principal payments begin in 2025 | 135,000 | 135,000 |
| | $ 803,630 | $ 1,071,270 |

*(in thousands of dollars)*

In 2003, Novant Health entered into a new Master Trust Indenture (the “Agreement”). The Agreement authorizes the creation of a Combined Group, which consists of the members of the Obligated Group and the Restricted Affiliates. Novant Health and two of its affiliates that operate tertiary care hospitals, Novant Health Forsyth Medical Center and Novant Health Presbyterian Medical Center, are the members of the Obligated Group. The members of the Obligated Group are jointly and severally liable for the payment of all obligations under the Agreement. The Company’s Restricted Affiliates, which include certain other subsidiaries of the Company, are not directly obligated to pay obligations under the Agreement, but the members of the Obligated Group have covenanted in the Agreement to cause the Restricted Affiliates to provide funds to the members of the Obligated Group to pay obligations under the Agreement. All bonds issued by Novant Health subsequent to 2003 are collateralized by the Obligated Group.

The bond agreements provide for early redemption periods of the bonds prior to mandatory redemption, subject to a premium, generally ranging from 0.0% to 2.0%, as defined in the agreements. In accordance with the bond indenture agreements, the bonds are general, unsecured obligations of Novant Health. The bond indentures require Novant Health to cause the Restricted Affiliates to comply with certain covenants, including the maintenance of a minimum debt service coverage ratio and a minimum number of days cash on hand. As of December 31, 2016, Novant Health is in compliance with these bond covenants.

The Series 2004 A and B Variable Rate Demand Bonds are collateralized by a standby purchase agreement (“SBPA”) issued by JP Morgan Chase Bank National Association. The SBPA expires January 31, 2018. If the SBPA should be used to fund tenders due to a failed remarketing, repayment in quarterly installments over three years is required. As a result, the Company has classified $36,818 of the 2004 bonds as current at December 31, 2016 and 2015.

In March 2011, the documents related to the Series 2008 A, B and C Variable Rate Demand Bonds were amended to allow the conversion of the bonds to bank direct purchase index floating rate bonds. In March 2014, the Series 2008 A, B, and C Variable Rate Demand Bonds were refinanced and in September 2016, the Series 2008 A bonds were refinanced. Subsequent to the refinancing, the direct purchase agreement related to the Series 2008 A Variable Rate Demand Bonds has a term of five years and will expire in September 2021. Subsequent to the refinancing, the direct purchase agreement related to the Series 2008 B and 2008 C Variable Rate Demand Bonds has a term of seven years and will expire in March 2021.

In November 2016, Novant called the Series 2006 Current Interest Term Bonds at par and repaid them with cash from operations. This resulted in a $6,304 gain on extinguishment.

**Taxable Revenue Bonds**
On September 23, 2009, Novant Health issued $350,000 of taxable fixed rate bonds (the “2009 A Bonds”). $250,000 of these bonds bear interest at a rate of 5.85% and mature in 2019. The remaining $100,000 of these bonds matured in 2014. Proceeds of the 2009 A Bonds were used to refinance a portion of the Company’s revolving credit facility in January 2010.

On November 12, 2009, Novant Health issued $100,000 of taxable fixed rate bonds (the “2009 B Bonds”). The 2009 B Bonds bear interest at a rate of 5.35% and matured in 2016. Proceeds of the 2009 B Bonds were used to refinance the remaining portion of the Company’s revolving credit facility in January 2010.

*(in thousands of dollars)*

On April 23, 2013, Novant Health issued $250,000 of taxable fixed rate bonds (the “2013 C Bonds”). The 2013 C bonds bear interest at a rate of 4.37% and mature in 2043. Proceeds of the 2013 C Bonds were used for eligible purposes, including the refinancing of long-term debt.

The taxable revenue bonds are subject to the same covenant requirements that are included in the bond agreements for the tax-exempt revenue bonds.

**Taxable Variable Rate Demand Bonds**
In 1997, Novant Health issued Taxable Variable Rate Demand Bonds, totaling $87,800, collateralized by an irrevocable letter of credit issued by Wachovia Bank of North Carolina, N.A. The irrevocable letter of credit is collateralized by the bonds, all income, earnings, profits, interest, premium or other payments on the bonds, and all proceeds arising from the sale, exchange or collection of the bonds. Interest on the bonds is payable on a quarterly basis. Mandatory sinking fund requirements began in 2001 and will continue until their final maturity of June 1, 2022. At December 31, 2016 and 2015, the rate of interest on the variable bonds was 0.76% and 0.42% respectively. The irrevocable letter of credit is currently available through November 1, 2018.

**Other Long-Term Debt**
Other long-term debt consists of a promissory note related to the redemption of a membership interest and various loans and notes on buildings and capital leases, bearing interest at rates ranging from 1.00% to 12.15%.

Scheduled maturities of all long-term debt are as follows:

| **Years Ending December 31** | |
|---|---|
| 2017 | $ 29,817 |
| 2018 | 30,838 |
| 2019 | 277,257 |
| 2020 | 27,192 |
| 2021 | 44,159 |
| Thereafter | 983,982 |
| | $ 1,393,245 |

Novant Health capitalized $1,552 and $889 of interest in 2016 and 2015, respectively.

**Debt Issuance Costs**
Effective January 1, 2016, Novant Health adopted ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires that unamortized debt issuance costs be presented in the balance sheet as a direct deduction from the carrying value of the associated debt. Application of the new guidance is on a retrospective basis, therefore $9,789 of debt issuance costs, net of amortization, were reclassified from other assets to long-term debt at December 31, 2015. Debt issuance costs are amortized using the effective interest method over the life of the related debt agreement and instruments.

**Short-Term Borrowings and Securities Repurchase Transactions**
On June 13, 2013, Novant Health entered into a $200,000 Senior Revolving Credit Facility. The line of credit bears interest at variable rates and has a five year term. At December 31, 2016 and 2015, there were no amounts outstanding.

*(in thousands of dollars)*

Securities repurchase transactions are conducted by the Company under a standardized securities industry master agreement, amended to suit the specificities of each respective counter-party. These agreements generally provide detail as to the nature of the transaction, including provisions for payment netting, established parameters concerning the ownership and custody of the collateral securities, including the right to substitute collateral during the term of the agreement, and provide for remedies in the event of default by either party. The Company's securities repurchase agreements are accounted for as a secured borrowing and are reported in the consolidated balance sheets as a short-term borrowing. The Company posts collateral in the form of U.S. treasury and agency securities and receives an amount equal to approximately 98% of the fair value of the securities to be repurchased with maturities ranging between February 2017 and April 2017 at interest rates ranging from 0.63% to 0.75%. At December 31, 2016 and 2015, the fair value amounts outstanding were $83,528 and $86,588, respectively. Interest rates on the outstanding balances at December 31, 2016 ranged from 0.90% to 0.95%. The maturity dates of the agreements generally range from one to four weeks.

**Interest Rate Swaps**

As of August 18, 2008, concurrent with the 2008 bond issuance, Novant Health entered into two interest rate swap agreements to hedge the variable interest rates of the 2008 bonds. The swaps are based on an aggregate notional amount of $124,500. Novant Health receives a variable rate which is tied to 68% of LIBOR, and pays a fixed rate of 3.679% and 3.621% for the $91,900 and $32,600 notional amounts, respectively. In July 2006, Novant Health entered into a floating-to-fixed swap agreement with a notional amount of $135,000 and a term of 28 years to hedge the floating rate 2004 bonds. Novant Health receives a variable rate which is tied to 64.8% of LIBOR plus 12 basis points and pays a fixed interest rate of 3.8%. The swaps have been designated as cash flow hedges and are carried on the consolidated balance sheets at fair value. These swaps qualify for hedge accounting and were assessed for effectiveness at the time the contracts were entered into and are assessed for effectiveness on an ongoing basis at each quarter end using the hypothetical derivative method. Unrealized gains and losses related to the effective portion of the swaps are recognized as a change in unrestricted net assets and gains or losses related to ineffective portions are recognized in excess of revenues over expenses as interest expense. As of December 31, 2016 and 2015, Novant Health's swaps are recorded as long-term liabilities in the consolidated balance sheets.

In August 2005, Novant Health UVA Health System Prince William Medical Center entered into an interest rate swap agreement in order to hedge its exposure to changes in interest rates. The interest rate swap matured on September 1, 2015. The exchanges of cash flows with the counter party (a commercial bank) began on September 8, 2005. Pursuant to the swap agreement, Novant Health UVA Health System Prince William Medical Center paid the counter party a fixed interest rate of approximately 5.6% and received interest at a variable rate equal to LIBOR plus one percent, calculated on the notional amount. The interest rate swap did not qualify for hedge accounting and therefore changes in the fair value of the interest rate swap were recorded in excess of revenues over expenses.

As of December 31, 2016 and 2015 all interest rate swaps are designated as hedged instruments.

*(in thousands of dollars)*

The following table summarizes the effect of the interest rate swaps on the consolidated statements of operations and changes in net assets for the years ended December 31:

| | Amount of Gain Recognized in Change in Unrestricted Net Assets | | Amount of Gain (Loss) Recognized in Excess of Revenues Over Expenses | |
|---|---|---|---|---|
| **Statement of Operations and Changes in Net Assets Location** | **2016** | **2015** | **2016** | **2015** |
| **Derivatives designated as hedged instruments** | | | | |
| Change in fair value of hedged interest rate swaps | $ 5,564 | $ 4,140 | $ - | $ - |
| Hedge ineffectiveness | - | - | 2,071 | (1,956) |
| **Derivatives not designated as hedged instruments** | | | | |
| Change in fair value of non-hedged interest rate swaps | - | - | - | 217 |
| | $ 5,564 | $ 4,140 | $ 2,071 | $ (1,739) |

## 15. Employee Benefits and Other Liabilities

Employee benefits and other liabilities consist of the following at December 31:

| | 2016 | 2015 |
|---|---|---|
| Deferred gains | $ 64,711 | $ 70,197 |
| Self-insurance malpractice and workers' compensation, net of current portion | 57,499 | 55,949 |
| Deferred compensation liability | 103,373 | 5,547 |
| Employee benefits and other | 56,494 | 46,043 |
| Postretirement benefit liability, net of current portion | 20,167 | 20,599 |
| Pension liability, net of current portion | 3,232 | 32,734 |
| | $ 305,476 | $ 231,069 |

The Company recorded additional employee benefits, net of current portion, in 2016 in the amount of $98,049 related to non-qualified deferred compensation plans which had previously been excluded (see Note 7). An equal and offsetting adjustment has been reflected in long-term assets limited as to use as of December 31, 2016. The uncorrected effect to employee benefits, net of current portion, was $90,290 at December 31, 2015.

*(in thousands of dollars)*

## 16. Income Taxes

The provision for federal and state income taxes is as follows:

| | 2016 | 2015 |
|---|---|---|
| **Current tax expense** | | |
| Federal | $ 1,183 | $ 3,975 |
| State | 561 | 691 |
| | 1,744 | 4,666 |
| **Deferred tax expense (benefit)** | | |
| Federal | 1,607 | 467 |
| State | 20 | (888) |
| | 1,627 | (421) |
| Benefit applied to reduce goodwill | - | 2,777 |
| | $ 3,371 | $ 7,022 |

The components of deferred taxes are as follows:

| | 2016 | 2015 |
|---|---|---|
| **Deferred tax assets** | | |
| Loss carryforwards | $ 37,585 | $ 38,376 |
| Deferred charge for intercompany transfer | - | 12,033 |
| Accounts receivable | - | 5,230 |
| Other long-term assets | 8 | 1,401 |
| Other | 82 | 2,185 |
| Total deferred tax assets | 37,675 | 59,225 |
| **Deferred tax liabilities** | | |
| Property and equipment | - | (2,963) |
| Intangible assets | - | (11,670) |
| Other assets | - | (24) |
| Total deferred tax liabilities | - | (14,657) |
| Valuation allowance | (37,675) | (41,100) |
| Net deferred tax asset | $ - | $ 3,468 |

*(in thousands of dollars)*

GAAP requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are deductible. In making this determination, management considers all available positive and negative evidence affecting specific deferred tax assets, including the Company’s past and anticipated future performance, reversal of deferred tax liabilities, length of carryback and carryforward periods and implementation of tax planning strategies.

Objective positive evidence is necessary to support a conclusion that a valuation allowance is not needed for all or a portion of deferred tax assets when significant negative evidence exists.

Cumulative losses in recent years are the most compelling form of negative evidence considered by management in this determination. For the year ended December 31, 2016, management has determined that based on all available evidence, a valuation allowance of $37,675 is appropriate.

As of December 31, 2016, the Company had approximately $98,211 of federal and $73,324 of state loss carryforwards available to reduce taxable income. The loss carryforwards expire through 2036.

Income tax expense reported in the consolidated statements of operations and changes in net assets is shown below:

| | 2016 | 2015 |
|---|---|---|
| Federal taxes | $ 2,790 | $ 4,442 |
| State income taxes | 581 | (197) |
| Other- benefit applied to reduce goodwill | - | 2,777 |
| Income tax expense | $ 3,371 | $ 7,022 |

The Company is required to evaluate uncertain tax positions. This evaluation includes a quantification of tax risk in areas such as unrelated business taxable income and the taxation of our for-profit subsidiaries. This evaluation did not have a material effect on the Company’s consolidated statements of operations and changes in net assets for the years ended December 31, 2016 and 2015.

*(in thousands of dollars)*

### 17. Employee Benefit Plans and Other Postretirement Benefit Plans

Certain Novant Health affiliates participate in the Pension Restoration Plan of Novant Health, Inc. (the “Novant Plan”), a noncontributory defined benefit pension plan covering substantially all the affiliates’ employees of record as of December 1998. Participation is limited to vested employees as of December 31, 1998. Effective January 1, 2008, and July 1, 2009, the Company assumed two noncontributory defined benefit plans, the Pension Plan for the Employees of Rowan Regional Medical Center (the “Rowan Plan”) and the Prince William Hospital Corporation Cash Balance Pension Plan (the “Prince William Plan”), respectively. Participation in the Rowan Plan was closed to new entrants and the accrued benefits were frozen as of December 31, 2003. Participation in the Prince William Plan was closed to new entrants and the accrued benefits were frozen as of April 1, 2010. The assets of the plans are primarily invested in common trust funds, common stocks, bonds, notes and U.S. government securities.

Certain Novant Health affiliates have supplemental retirement income plans covering highly compensated employees. These are nonqualified plans which are not subject to ERISA funding requirements. As such, Novant Health intends only to fund the plans in amounts equivalent to the plans’ annual benefit payments. During 2013, the Company implemented a new supplemental retirement income plan that covers certain highly compensated employees. This plan acts as a defined contribution plan and annual funding requirements are determined under provisions of the plan.

Novant Health also provides fixed dollar amounts for health care and life insurance benefits to certain retired employees. Covered employees may become eligible for these benefits if they meet minimum age and service requirements, and if they are eligible for retirement benefits. Novant Health has the right to modify or terminate these benefits.

Information regarding benefit obligations, plan assets, funded status, expected cash flows and net periodic benefit cost follows within this footnote.

| | Defined Benefit Plans | | Postretirement Healthcare Benefit Plans | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| **Change in benefit obligations** | | | | |
| Projected benefit obligation at beginning of year | $ 336,480 | $ 374,403 | $ 21,904 | $ 23,995 |
| Service cost | 925 | 1,147 | 121 | 147 |
| Interest cost | 14,363 | 13,768 | 841 | 828 |
| Actuarial gain | (867) | (2,243) | (538) | (2,328) |
| Assumption change | (10,595) | (33,023) | - | - |
| Settlements | (36,079) | (3,484) | - | - |
| Benefits paid | (14,567) | (14,088) | (841) | (830) |
| Employee contributions | - | - | - | 92 |
| Projected benefit obligation at end of year | $ 289,660 | $ 336,480 | $ 21,487 | $ 21,904 |

*(in thousands of dollars)*

The assumption change for 2016 is primarily due to a change in the discount rate. The assumption change for 2015 is primarily a result of changes in the discount rate and a modification of the new mortality table that was adopted in 2014. During 2016, the Company announced a limited lump sum window distribution of present valued pension benefits to terminated vested participants of the plans meeting certain criteria. The benefit election window was open from August 29, 2016 to October 31, 2016 and benefit distributions were made in December 2016. Based on the number of plan participants electing to take the lump sum distribution and the total amount of such distributions, the Company incurred a non-cash charge of $4,396 in 2016 when the distributions were made. The reduction in the number of plan participants will reduce the cost of administering the plans in the future.

| Weighted-Average Assumptions Used to Determine End of Year Benefit Obligations | Defined Benefit Plans 2016 | Defined Benefit Plans 2015 | Postretirement Healthcare Benefit Plans 2016 | Postretirement Healthcare Benefit Plans 2015 |
|---|---|---|---|---|
| Discount rate | 3.65% - 4.06% | 2.65% - 4.44% | 3.65% - 4.05% | 3.70% - 4.05% |
| Rate of compensation increase[(1)] | 5.00% | 5.00% | N/A | N/A |
| Health care cost trend on covered charges | N/A | N/A | 9.5% in 2017, grading to 5.0% in 2025 | 10.0% in 2016, grading to 5.0% in 2025 |

(1) The compensation increase does not apply to the Rowan Plan or the Prince William Plan as benefits under these plans were frozen at December 31, 2016 and 2015.

Assumed health care cost trend rates may have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would not have a significant effect on the amounts reported as of December 31, 2016.

**Plan Assets**

| | Defined Benefit Plans 2016 | Defined Benefit Plans 2015 | Healthcare Benefit Plans 2016 | Healthcare Benefit Plans 2015 |
|---|---|---|---|---|
| **Change in plan assets** | | | | |
| Fair value of plan assets at beginning of year | $ 307,774 | $ 337,535 | $ - | $ - |
| Actual return on plan assets | 35,000 | (11,836) | - | - |
| Employer contributions | 184 | 177 | 841 | 738 |
| Employee contributions | - | - | - | 92 |
| Settlements | (36,079) | (3,484) | - | - |
| Benefits paid | (14,567) | (14,088) | (841) | (830) |
| Plan expenses | (575) | (530) | - | - |
| Fair value of plan assets at end of year | $ 291,737 | $ 307,774 | $ - | $ - |

The Company's primary investment objective for the defined benefit plans ("the Plans") is to invest the plan assets so that they will generate sufficient cash flows needed to fund future payments as they come due. The Plans' primary holdings are in fixed income mutual funds that are diversified by issuer and maturity. The Plans also hold equity mutual funds that are diversified by geography, capitalization, style and investment manager. In addition, the Plans may hold Treasury Inflation-Protected Securities, alternative asset, real estate and commodity mutual funds. The investment guidelines, asset allocation, and investment performance are reviewed by the Novant Health Administrative Committee.

*(in thousands of dollars)*

Novant Health's pension plan asset allocation and target allocation by asset category at December 31, 2016 are as follows:

| | Target Range | Percentage of Plan Assets |
|---|---|---|
| **Asset Category** | | |
| Debt securities | 85–100% | 93.0% |
| Equity securities | 0–10% | 6.0% |
| Cash and other | 0–4% | 1.0% |
| | | 100.0% |

The fair values of the Company's plan assets at December 31, 2016, by asset category are as follows:

| | At NAV | Fair Value Measurements at Reporting Date Using Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Total |
|---|---|---|---|---|---|
| Equity securities | | | | | |
| U.S. equity | $ - | $ 10,401 | $ - | $ - | $ 10,401 |
| Developed non-U.S. equity | - | 4,667 | - | - | 4,667 |
| Emerging markets equity | - | 1,109 | - | - | 1,109 |
| Fixed income securities | | | | | |
| U.S. fixed income | 193,784 | - | 77,700 | - | 271,484 |
| Cash and other | - | 4,076 | - | - | 4,076 |
| Total fair value of the Company's plan assets | $ 193,784 | $ 20,253 | $ 77,700 | $ - | $ 291,737 |

The fair values of the Company's plan assets at December 31, 2015, by asset category are as follows:

| | Fair Value Measurements at Reporting Date Using Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Total |
|---|---|---|---|---|
| Equity securities | | | | |
| U.S. equity | $ - | $ 31,371 | $ - | $ 31,371 |
| Developed non-U.S. equity | - | 19,451 | - | 19,451 |
| Emerging markets equity | - | 4,761 | - | 4,761 |
| Fixed income securities | | | | |
| U.S. fixed income | - | 251,731 | - | 251,731 |
| Cash and other | - | 460 | - | 460 |
| Total fair value of the Company's plan assets | $ - | $ 307,774 | $ - | $ 307,774 |

*(in thousands of dollars)*

### Funded Status

The funded status of the plans recognized in the balance sheet and the amounts recognized in unrestricted net assets follows:

| | Defined Benefit Plans | | Postretirement Healthcare Benefit Plans | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| **End of Year** | | | | |
| Fair value of plan assets at end of year | $ 291,737 | $ 307,774 | $ - | $ - |
| Benefit obligation at end of year | 289,660 | 336,480 | 21,487 | 21,904 |
| Funded status | $ 2,077 | $ (28,706) | $ (21,487) | $ (21,904) |
| **Amount recognized in the balance sheets** | | | | |
| Prepaid benefit cost at measurement date | $ 40,027 | $ 52,366 | $ - | $ - |
| Accrued benefit cost | (2,667) | (2,836) | (21,295) | (21,199) |
| Change in unrestricted net assets | (35,283) | (78,236) | (192) | (705) |
| Net asset (liability) recognized | $ 2,077 | $ (28,706) | $ (21,487) | $ (21,904) |
| **Amounts recognized in unrestricted net assets** | | | | |
| Prior service cost | $ 1,539 | $ 2,030 | $ - | $ - |
| Net actuarial loss | 33,744 | 76,206 | 192 | 705 |
| | $ 35,283 | $ 78,236 | $ 192 | $ 705 |
| **Other changes in plan assets and benefit obligations** | | | | |
| Net gain | $ (33,701) | $ (10,484) | $ (538) | $ (2,328) |
| Amortization of net loss (gain) | (8,761) | (10,019) | 25 | (189) |
| Amortization of prior service credit | (491) | (494) | - | - |
| Total recognized in unrestricted net assets | $ (42,953) | $ (20,997) | $ (513) | $ (2,517) |

At the end of 2016 and 2015, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were as follows:

| | **2016** | **2015** |
|---|---|---|
| Projected benefit obligation | $ 289,660 | $ 336,480 |
| Accumulated benefit obligation | 285,846 | 325,349 |
| Fair value of plan assets | 291,737 | 307,774 |

### Cash Flows

The Company does not plan to make any contributions to its defined benefit pension plans in 2017. The Company expects to make contributions to the supplemental retirement income plans of approximately $3,732 for the 2017 fiscal year.

*(in thousands of dollars)*

The following assumed benefit payments, which reflect expected future service, as appropriate, and were used in the calculation of projected benefit obligations, are estimated to be paid as follows:

| | Defined Benefit Plans | Postretirement Healthcare Benefit Plans |
|---|---|---|
| **Expected Benefit Payments** | | |
| 2017 | $ 22,946 | $ 1,214 |
| 2018 | 17,974 | 1,089 |
| 2019 | 18,374 | 1,143 |
| 2020 | 18,760 | 1,195 |
| 2021 | 18,637 | 1,233 |
| 2022–2026 | 92,025 | 6,505 |

| **Net periodic benefit cost** | Defined Benefit Plans | | Postretirement Healthcare Benefit Plans | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Service cost | $ 925 | $ 1,147 | $ 121 | $ 147 |
| Interest cost | 14,363 | 13,768 | 841 | 828 |
| Estimated return on plan assets | (12,186) | (12,414) | - | - |
| Amortization of prior service cost | 491 | 494 | - | - |
| Recognized net actuarial loss | 4,365 | 9,019 | (25) | 189 |
| Settlements | 4,396 | 1,000 | - | - |
| Net periodic benefit cost | $ 12,354 | $ 13,014 | $ 937 | $ 1,164 |
| Total recognized in net periodic benefit cost and unrestricted net assets | $ (30,599) | $ (7,983) | $ 424 | $ (1,353) |

Amounts expected to be amortized from unrestricted net assets into net periodic benefit cost during the year ending December 31, 2017 are as follows:

| | Defined Benefit Plans | Postretirement Healthcare Benefit Plans |
|---|---|---|
| Actuarial net loss (gain) | $ 1,194 | $ (89) |
| Prior service cost | 256 | - |

*(in thousands of dollars)*

The weighted-average assumptions used to determine net periodic benefit cost were as follows:

| | Defined Benefit Plans | | Postretirement Healthcare Benefit Plans | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Discount rate | 2.65% - 4.44% | 2.70% - 3.82% | 3.70% - 4.05% | 3.50% - 3.75% |
| Expected return on plan assets | 4.00% | 4.00% | N/A | N/A |
| Rate of compensation increase(1) | 5.00% | 5.00% | N/A | N/A |
| Health care cost trend on covered charges | N/A | N/A | 10.0% in 2016, grading to 5.0% in 2025 | 7.5% in 2015, grading to 5.0% in 2020 |

(1) The compensation increase does not apply to the Rowan Plan or the Prince William Plan as benefits under these plans were frozen at December 31, 2016 and 2015.

In developing the expected return on plan assets, the Company considers the plan assets' historical actual return, targeted asset allocations, and the anticipated future economic environment and long-term performance of individual asset classes, based on the Company's investment strategy. While appropriate consideration is given to recent and historical investment performance, the assumption represents management's best estimate of the long-term prospective return.

Assumed health care cost trend rates may have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would not have a significant effect on the amounts reported as of December 31, 2016.

In addition to these plans, Novant Health sponsors a number of defined contribution plans. Contributions are determined under various formulas. Costs related to such plans amounted to $65,734 and $62,205 in 2016 and 2015, respectively.

Certain Novant Health affiliates participate in cafeteria plans which provide certain benefits, including basic medical and dental coverage, long-term disability benefits, reimbursement of supplemental dependent care expenses and group life insurance benefits. The affiliates contribute predetermined amounts for each full-time and part-time employee, which is allocated to the various benefit options in accordance with the participant's election. Affiliate contributions to these plans were approximately $207,535 in 2016 and $216,097 in 2015.

Certain Novant Health affiliates participate in non-qualified deferred compensation plans which provide certain individuals meeting specific criteria with the ability to defer compensation. These nonqualified plans are not subject to ERISA funding requirements. The assets of these plans are held in a rabbi trust, which restricts access to the assets. The assets of these plans, along with the associated liabilities, are recorded as current and long-term assets limited as to use, accrued liabilities, and employee benefits and other liabilities on the consolidated balance sheet.

Novant Health is self-insured for medical coverage exposures up to certain limits for all Novant Health employees. The Company has recorded an estimate of the liability for claims incurred but not reported as of December 31, 2016 and 2015.

*(in thousands of dollars)*

## 18. Noncontrolling Interests

The following table reconciles the carrying amounts of the Company's controlling interest and the noncontrolling interests for unrestricted net assets:

| | Total | Controlling Interest | Noncontrolling Interests |
|---|---|---|---|
| **Balance at January 1, 2015** | $ 2,613,781 | $ 2,602,871 | $ 10,910 |
| Excess of revenues over expenses | 191,578 | 189,371 | 2,207 |
| Change in funded status of defined benefit plans | 23,514 | 23,514 | - |
| Unrealized gain on derivative financial instruments | 4,140 | 4,140 | - |
| Other changes in unrestricted net assets | 1,017 | 471 | 546 |
| **Balance at December 31, 2015** | 2,834,030 | 2,820,367 | 13,663 |
| Excess (deficit) of revenues over expenses | 412,805 | 424,962 | (12,157) |
| Change in funded status of defined benefit plans | 47,862 | 45,449 | 2,413 |
| Loss on voluntary pension settlement | (4,396) | (3,733) | (663) |
| Unrealized gain on derivative financial instruments | 5,564 | 5,564 | - |
| Creation of Novant Health UVA Health System | 92,187 | (2,032) | 94,219 |
| Other changes in unrestricted net assets | 237 | 1,092 | (855) |
| **Balance at December 31, 2016** | $ 3,388,289 | $ 3,291,669 | $ 96,620 |

## 19. Professional and General Liability Insurance Coverage

Novant Health is self-insured for professional and general liability exposures up to certain limits. The Company has umbrella policies in place above those limits. The provision for estimated medical malpractice claims includes estimates of the ultimate costs for reported claims and claims incurred but not reported. Novant Health also participates in a self-insured program for workers' compensation and is self-insured for certain health benefits options. A portion of these self-insured professional liabilities is funded through a revocable trust fund operated by Novant Health. Liabilities for self-insured professional and general liability risks, for both asserted and unasserted claims were discounted, assuming a 3% rate for both malpractice and workers' compensation for December 31, 2015, based on historical loss payment patterns. The liabilities were undiscounted for 2016. At December 31, 2016 and 2015, professional and general liability loss reserves of $74,599 and $74,906, respectively, are included in current liabilities and employee benefits and other liabilities on the consolidated balance sheets. These balances included a discount of $0 and $6,740 at December 31, 2016 and 2015, respectively. Expenses related to these plans amounted to $13,252 and $14,858 in 2016 and 2015, respectively.

*(in thousands of dollars)*

## 20. Commitments and Contingencies

The Company and its affiliates are presently involved in various personal injury, regulatory investigations, tort actions and other claims and assessments arising out of the normal course of business. Management believes that Novant Health has adequate legal defenses, self-insurance reserves and/or insurance coverage for these asserted claims, as well as any unasserted claims and does not believe these claims will have a material effect on the Company's operations or financial position. 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 necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. 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.

On March 12, 2014, a putative class action lawsuit was filed in the U.S. District Court, Middle District of North Carolina, against Novant Health and individual fiduciaries regarding alleged breaches of fiduciary duties in the administration of certain Novant Health retirement plans. In 2015, management determined that a loss was probable and recorded a reserve of $32,000 to estimate the Company's exposure to loss related to this claim as of December 31, 2015. As of December 31, 2016, payment has been made for the full amount of the settlement. Discussions with Novant Health's insurance providers to determine if any of this loss will be covered are ongoing.

## 21. Operating Leases

Certain operating properties and equipment are leased under noncancelable operating leases. Total rental expense under operating leases was $90,058 and $84,325 in 2016 and 2015, respectively. Future minimum rentals under noncancelable operating leases with terms of more than one year are as follows:

| **Years Ending December 31** | |
|---|---|
| 2017 | $ 82,985 |
| 2018 | 70,071 |
| 2019 | 55,240 |
| 2020 | 45,788 |
| 2021 | 37,996 |
| Thereafter | 102,577 |
| | $ 394,657 |

*(in thousands of dollars)*

Novant Health leases six plots of land to a third-party under long-term ground lease agreements. Total rental income under these lease agreements was $1,186 and $1,165 in 2016 and 2015, respectively. The future rental income related to the ground leases are as follows:

| **Years Ending December 31** | |
|---|---|
| 2017 | $ 1,207 |
| 2018 | 1,241 |
| 2019 | 1,263 |
| 2020 | 1,286 |
| 2021 | 1,309 |
| Thereafter | 86,570 |
| | $ 92,876 |

## 22. Concentrations of Credit Risk

Novant Health provides services primarily to the residents of various counties within North Carolina, South Carolina and Virginia without collateral or other proof of ability to pay. Most patients are local residents who are insured partially or fully under third-party payor arrangements.

The mix of receivables from patients and third-party payors at December 31 is as follows:

| | **2016** | **2015** |
|---|---|---|
| Medicare | 26.4% | 26.3% |
| Medicaid | 6.2% | 5.5% |
| Other third-party payors | 55.9% | 56.9% |
| Patients | 11.5% | 11.3% |
| | 100.0% | 100.0% |

Novant Health places the majority of its cash and investments with corporate and financial institutions. Novant Health maintains cash balances in excess of FDIC insured limits; however, the Company has not experienced any losses on such deposits.

## 23. Functional Expenses

Novant Health provides general health care services to residents within its geographic region. Expenses relating to providing these services at December 31 are as follows:

| | **2016** | **2015** |
|---|---|---|
| Health care services | $ 2,955,683 | $ 2,752,587 |
| General and administrative | 1,125,665 | 1,117,026 |
| | $ 4,081,348 | $ 3,869,613 |

*(in thousands of dollars)*

### 24. Subsequent Events

The Company evaluated subsequent events and transactions for potential recognition or disclosure in the consolidated financial statements through March 28, 2017, the day the consolidated financial statements were issued.

### 25. Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-9, *Revenue from Contracts with Customers (Topic 606)*. Since that date, the FASB has issued additional guidance to clarify and refine the guidance in Topic 606. This guidance replaces existing industry-specific guidance and provides guidelines based on the core principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration. The guidance also requires expanded qualitative and quantitative disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

This guidance is effective for Novant Health beginning January 1, 2018. Early adoption is permitted at January 1, 2017, however, we have elected not to early adopt this guidance. The guidance allows the use of either the retrospective of modified retrospective (cumulative effect) transition method. We have not yet selected a transition method. Novant Health is continuing to evaluate the effect this guidance will have on its financial statements and believes that the most significant impact will be to the presentation of our income statement where the provision for bad debts will be recorded as a direct reduction of revenue and will not be presented as a separate line item. Novant Health does not believe that the adoption of this guidance will have a significant impact on the recognition of net revenues for any period.

In April 2015, the FASB issued ASU 2015-3, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. This guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that liability, consistent with debt discounts. This guidance was effective for Novant Health on January 1, 2016 with retrospective presentation required. The consolidated balance sheets reflect the reclassification of issuance costs from other assets to long-term debt at December 31, 2015 and December 31, 2016.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes.* This guidance removes the requirement that deferred tax liabilities be separated into current and noncurrent amounts on a classified balance sheet. Instead, deferred tax liabilities and assets are presented as noncurrent. This guidance will be effective for Novant Health on January 1, 2018 and is not expected to have a significant impact on Novant Health's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities*, this guidance requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values. This guidance is effective for Novant Health on January 1, 2019 with prospective application and a cumulative-effect adjustment at the date of adoption. The guidance amends disclosure requirements to no longer require the application of the fair value of financial instruments disclosure guidance (such as fair value of debt) and we have elected to early adopt this provision effective January 1, 2016.

*(in thousands of dollars)*

In February 2016, the FASB issued ASU 2016-2, *Leases (Topic 842)*. The most significant change from current practice is that this guidance requires the recognition of lease assets and liabilities for those leases classified as operating leases under current guidance. The guidance also provides guidance for the measurement of lease assets and liabilities and additional required disclosures. This guidance is effective for Novant Health on January 1, 2019 with modified retrospective presentation required. We are currently evaluating the impact of adopting this guidance on Novant Health's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is effective for Novant Health on January 1, 2018 with retroactive presentation, with exceptions to retroactive presentation for certain disclosures. This guidance requires the presentation of two classes of net assets, rather than the currently required three classes. The guidance also request enhanced disclosures of amounts and nature of donor imposed and internally designated funds and requires new disclosures about information useful for assessing liquidity and availability of resources. We are currently evaluating the impact of adopting this guidance on Novant Health's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. This standard provides additional guidance related to the presentation and classification of certain items in the statement of cash flow for which there is diversity in practice. The provisions of this guidance are effective for Novant Health on January 1, 2019 with early adoption permitted and retroactive application, unless it impracticable. We are currently evaluating the impact of adopting this guidance on Novant Health's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*. The new guidance eliminates the requirement to calculate the implied fair value of goodwill (i.e., Step 2 of the current goodwill impairment test) to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value (i.e., measure the charge based on the current Step 1). This guidance is effective for Novant Health on January 1, 2022. We are currently evaluating the provisions of this guidance to determine how our goodwill impairment testing will be impacted and whether we may elect to adopt this guidance prior to the stated effective date. The adoption of this guidance would only impact Novant Health's consolidated financial statements in situations where an impairment of a reporting unit's assets is determined.

# Other Financial Information

**Report of Independent Auditors**

To the Board of Trustees of
Novant Health, Inc.

We have audited the consolidated financial statements of Novant Health, Inc. and Affiliates as of December 31, 2016 and for the year then ended and our report thereon appears on page 1 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The Schedule of Cost of Community Benefit Programs as of December 31, 2016 and 2015 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The 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 of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

PricewaterhouseCoopers LLP

March 24, 2017

# Novant Health, Inc. and Affiliates
## Schedule of Cost of Community Benefit Programs
## December 31, 2016 and 2015

*(in thousands of dollars)*

The net cost, excluding the provision of bad debts, of providing care to indigent patients and community benefit programs is as follows:

| | 2016 | 2015 |
|---|---|---|
| Traditional charity care | $ 122,017 | $ 125,317 |
| Unpaid cost of Medicare | 400,700 | 389,186 |
| Unpaid cost of Medicaid | 109,992 | 105,417 |
| Community benefit programs | 92,784 | 86,412 |
| | $ 725,493 | $ 706,332 |

As discussed in Note 2 in the accompanying consolidated financial statements, Novant Health received supplemental Medicaid payments during 2016 and 2015 which are included in the community benefit amounts for each year.

**Report of Independent Auditors**

To the Board of Trustees of
Novant Health, Inc.

We have audited the consolidated financial statements of Novant Health, Inc. and Affiliates as of December 31, 2016 and for the year then ended and our report thereon appears on page 1 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating 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 consolidating 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 of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual companies.

PricewaterhouseCoopers LLP

March 24, 2017

# Novant Health, Inc. and Affiliates
## Consolidating Balance Sheet
## December 31, 2016

| *(in thousands of dollars)* | Combined Group | Unrestricted Affiliates | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ 210,738 | $ 50,250 | $ - | $ 260,988 |
| Accounts receivable, net of allowance for doubtful accounts | 460,672 | 50,977 | - | 511,649 |
| Short-term investments | 260,261 | 58 | - | 260,319 |
| Current portion of assets limited as to use | 6,496 | 12,090 | - | 18,586 |
| Current assets held for sale | - | 14,173 | - | 14,173 |
| Receivable for settlement with third-party payors | 9,734 | 4,163 | - | 13,897 |
| Other current assets | 166,382 | 15,456 | (88) | 181,750 |
| Total current assets | 1,114,283 | 147,167 | (88) | 1,261,362 |
| Assets limited as to use | 105,207 | 41,917 | - | 147,124 |
| Long-term assets held for sale | - | 57,193 | - | 57,193 |
| Long-term investments | 1,750,494 | 264,194 | - | 2,014,688 |
| Property and equipment, net | 1,653,746 | 287,146 | (250) | 1,940,642 |
| Intangible assets and goodwill, net | 246,015 | 41,814 | (363) | 287,466 |
| Investments in affiliates | 68,272 | 19,118 | (55,344) | 32,046 |
| Other assets | 82,592 | 24,419 | - | 107,011 |
| Total assets | $ 5,020,609 | $ 882,968 | $ (56,045) | $ 5,847,532 |
| **Liabilities and Net Assets** | | | | |
| Current liabilities | | | | |
| Current portion of long-term debt | $ 64,735 | $ 1,889 | $ - | $ 66,624 |
| Short-term borrowings | 83,528 | 99 | - | 83,627 |
| Accounts payable | 142,429 | 17,763 | - | 160,192 |
| Accrued liabilities | 320,334 | 38,439 | (88) | 358,685 |
| Current liabilities held for sale | - | 13,498 | - | 13,498 |
| Estimated third-party payor settlements | 28,462 | 4,834 | - | 33,296 |
| Due to (from) related organizations | (146,500) | 146,500 | - | - |
| Total current liabilities | 492,988 | 223,022 | (88) | 715,922 |
| Long-term debt, net of current portion | 1,294,663 | 31,147 | - | 1,325,810 |
| Long-term liabilities held for sale | - | 1,682 | - | 1,682 |
| Derivative financial instruments | 50,305 | - | - | 50,305 |
| Employee benefits and other liabilities | 248,052 | 57,424 | - | 305,476 |
| Total liabilities | 2,086,008 | 313,275 | (88) | 2,399,195 |
| Net assets | | | | |
| Unrestricted - attributable to Novant Health | 2,931,737 | 479,258 | (119,326) | 3,291,669 |
| Unrestricted - noncontrolling interests | 675 | 32,576 | 63,369 | 96,620 |
| Total unrestricted net assets | 2,932,412 | 511,834 | (55,957) | 3,388,289 |
| Temporarily restricted | 2,189 | 46,578 | - | 48,767 |
| Permanently restricted | - | 11,281 | - | 11,281 |
| Total net assets | 2,934,601 | 569,693 | (55,957) | 3,448,337 |
| Total liabilities and net assets | $ 5,020,609 | $ 882,968 | $ (56,045) | $ 5,847,532 |

See accompanying notes to consolidating supplemental schedules.

# Novant Health, Inc.
## Consolidating Statement of Operations
## Year Ended December 31, 2016

| *(in thousands of dollars)* | Combined Group | Unrestricted Affiliates | Eliminations | Total |
|---|---|---|---|---|
| **Operating revenues** | | | | |
| Net patient service revenue | $ 3,838,129 | $ 470,864 | $ - | $ 4,308,993 |
| Provision for bad debts | (180,110) | (24,425) | - | (204,535) |
| Net patient service revenues less provision for bad debts | 3,658,019 | 446,439 | - | 4,104,458 |
| Other revenue | 184,251 | 78,018 | (26,604) | 235,665 |
| Total operating revenues | 3,842,270 | 524,457 | (26,604) | 4,340,123 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | 2,051,828 | 278,349 | (39,300) | 2,290,877 |
| Supplies and other | 1,233,763 | 209,086 | 13,552 | 1,456,401 |
| Depreciation expense | 197,009 | 40,324 | 83 | 237,416 |
| Amortization expense | 2,288 | 684 | - | 2,972 |
| Impairment charge | - | 11,850 | - | 11,850 |
| Interest expense | 66,792 | 15,040 | - | 81,832 |
| Total operating expenses | 3,551,680 | 555,333 | (25,665) | 4,081,348 |
| Operating income (loss) | 290,590 | (30,876) | (939) | 258,775 |
| **Non-operating income (expense)** | | | | |
| Investment income | 132,406 | 17,563 | 1,104 | 151,073 |
| Income tax expense | (1,090) | (2,281) | - | (3,371) |
| Gain on extinguishment of debt | 6,304 | - | - | 6,304 |
| Other, net | (5) | 29 | - | 24 |
| Excess (deficit) of revenues over expenses | $ 428,205 | $ (15,565) | $ 165 | $ 412,805 |

See accompanying notes to consolidating supplemental schedules.

# Novant Health, Inc.
## Combined Group Combining Balance Sheet
## December 31, 2016

| *(in thousands of dollars)* | Obligated Group | Restricted Affiliates | Eliminations | Combined Group Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | $ 206,667 | $ 4,071 | $ - | $ 210,738 |
| Accounts receivable, net of allowance for doubtful accounts | 298,113 | 162,559 | - | 460,672 |
| Short-term investments | 260,261 | - | - | 260,261 |
| Current portion of assets limited as to use | 6,423 | 73 | - | 6,496 |
| Deferred tax asset | - | - | - | - |
| Receivable for settlement with third-party payors | 7,845 | 1,889 | - | 9,734 |
| Other current assets | 144,050 | 24,009 | (1,677) | 166,382 |
| Total current assets | 923,359 | 192,601 | (1,677) | 1,114,283 |
| Assets limited as to use | 104,601 | 606 | - | 105,207 |
| Long-term investments | 1,750,494 | - | - | 1,750,494 |
| Property and equipment, net | 1,189,130 | 464,616 | - | 1,653,746 |
| Intangible assets and goodwill, net | 49,242 | 196,773 | - | 246,015 |
| Investments in affiliates | 159,570 | 3,917 | (95,215) | 68,272 |
| Other assets | 209,233 | 20,433 | (147,074) | 82,592 |
| Total assets | $ 4,385,629 | $ 878,946 | $ (243,966) | $ 5,020,609 |
| **Liabilities and Net Assets** | | | | |
| Current liabilities | | | | |
| Current portion of long-term debt | $ 64,704 | $ 1,708 | (1,677) | $ 64,735 |
| Short-term borrowings | 83,528 | - | - | 83,528 |
| Accounts payable | 131,483 | 10,946 | - | 142,429 |
| Accrued liabilities | 234,249 | 86,085 | - | 320,334 |
| Estimated third-party payor settlements | 21,614 | 6,848 | - | 28,462 |
| Due to (from) related organizations | (378,411) | 231,911 | - | (146,500) |
| Total current liabilities | 157,167 | 337,498 | (1,677) | 492,988 |
| Long-term debt, net of current portion | 1,294,433 | 147,304 | (147,074) | 1,294,663 |
| Derivative financial instruments | 50,305 | - | - | 50,305 |
| Employee benefits and other liabilities | 225,192 | 22,860 | - | 248,052 |
| Total liabilities | 1,727,097 | 507,662 | (148,751) | 2,086,008 |
| Net assets | | | | |
| Unrestricted - attributable to Novant Health | 2,658,521 | 368,431 | (95,215) | 2,931,737 |
| Unrestricted - noncontrolling interests | - | 675 | - | 675 |
| Total unrestricted net assets | 2,658,521 | 369,106 | (95,215) | 2,932,412 |
| Temporarily restricted | 11 | 2,178 | - | 2,189 |
| Total net assets | 2,658,532 | 371,284 | (95,215) | 2,934,601 |
| Total liabilities and net assets | $ 4,385,629 | $ 878,946 | $ (243,966) | $ 5,020,609 |

See accompanying notes to consolidating supplemental schedules.

# Novant Health, Inc.
## Combined Group Combining Statement of Operations
## Year Ended December 31, 2016

| *(in thousands of dollars)* | Obligated Group | Restricted Affiliates | Eliminations | Combined Group Total |
|---|---|---|---|---|
| **Operating revenues** | | | | |
| Net patient service revenue | $ 2,369,983 | $1,468,146 | $ - | $ 3,838,129 |
| Provision for bad debts | (91,842) | (88,268) | - | (180,110) |
| Net patient service revenues less provision for bad debts | 2,278,141 | 1,379,878 | - | 3,658,019 |
| Other revenue | 167,128 | 37,060 | (19,937) | 184,251 |
| Total operating revenues | 2,445,269 | 1,416,938 | (19,937) | 3,842,270 |
| **Operating expenses** | | | | |
| Salaries and employee benefits | 1,157,934 | 893,894 | - | 2,051,828 |
| Supplies and other | 817,893 | 435,807 | (19,937) | 1,233,763 |
| Depreciation expense | 124,863 | 72,146 | - | 197,009 |
| Amortization expense | - | 2,288 | - | 2,288 |
| Interest expense | 43,538 | 23,254 | - | 66,792 |
| Total operating expenses | 2,144,228 | 1,427,389 | (19,937) | 3,551,680 |
| Operating income (loss) | 301,041 | (10,451) | - | 290,590 |
| **Non-operating income (expense)** | | | | |
| Investment income | 132,399 | 7 | - | 132,406 |
| Income tax expense | (1,090) | - | - | (1,090) |
| Gain on extinguishment of debt | 6,304 | - | - | 6,304 |
| Other, net | (5) | - | - | (5) |
| Excess (deficit) of revenues over expenses | $ 438,649 | $ (10,444) | $ - | $ 428,205 |

See accompanying notes to consolidating supplemental schedules.

### 1. Consolidated Financial Statements Reporting Entity

Novant Health, Inc. ("Novant Health" or the "Company") is a nonprofit, integrated health care network of physician clinics, outpatient centers and hospitals that serves patients and communities in North Carolina, Virginia and South Carolina. Novant Health consists of nearly 1,500 physicians and 25,000 team members at approximately 500 locations, including 14 medical centers and hundreds of outpatient facilities and physician clinics. Headquartered in Winston-Salem, North Carolina, Novant Health is committed to making healthcare remarkable for patients and communities, serving more than 4 million patients annually. Novant Health and its affiliates serve their communities with programs including health education, home health care, prenatal clinics, community clinics and immunization services.

### 2. Basis of Presentation and Summary of Significant Accounting Policies

***Novant Health, Inc. Consolidating Balance Sheet and Consolidating Statement of Operations (which Combines the Information of the Combined Group and Unrestricted Affiliates)***

The Total column reconciles to the consolidated financial statements of Novant Health, Inc. and includes the accounts of all affiliates controlled by Novant Health, Inc. The Total is comprised of the Combined Group (as described below, which is comprised of the Obligated Group and Restricted Affiliates) and the Unrestricted Affiliates, which represent affiliates not meeting the definition of the Obligated Group or Restricted Affiliates as defined below.

The Eliminations column represents the elimination of intercompany transactions and balances between the Combined Group and the Unrestricted Affiliates.

The consolidating balance sheet and consolidating statement of operations are otherwise prepared in accordance with accounting policies described in the accompanying notes to the consolidated financial statements. These schedules are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America, as a result of the exclusion of all required disclosures.

***Combined Group Combining Balance Sheet and Statement of Operations***

As noted in footnote 14 to the consolidated financial statements, the Company is subject to a Master Trust Indenture (the "Agreement") which authorizes the creation of a Combined Group, which consists of the members of the Obligated Group and the Restricted Affiliates.

The members of the Obligated Group are jointly and severally liable for the payment of all obligations under the Agreement. The members of the Obligated Group are Novant Health and its two affiliates that operate tertiary care hospitals, Forsyth Memorial Hospital, Inc. d/b/a Novant Health Forsyth Medical Center and The Presbyterian Hospital d/b/a Novant Health Presbyterian Medical Center, both of which are North Carolina nonprofit corporations. In the accompanying Combined Group combining balance sheet and combining statement of operations, the Obligated Group column presents information of the aforementioned entities.

Restricted Affiliates represent entities that are not directly obligated to pay obligations under the Agreement, but the members of the Obligated Group have covenanted in the Agreement to cause the Restricted Affiliates to provide funds to the members of the Obligated Group to pay obligations under the Agreement. The Company has designated twelve of its affiliates as Restricted Affiliates. Seven of these Restricted Affiliates, Medical Park Hospital, Inc. d/b/a Novant Health Medical Park Hospital, Community General Health Partners, Inc. d/b/a Novant Health Thomasville Medical Center, Presbyterian Medical Care Corp. d/b/a Novant Health Matthews Medical Center, Brunswick Community Hospital d/b/a Novant Health Brunswick Medical Center, Presbyterian Orthopaedic Hospital, LLC d/b/a Novant Health Charlotte Orthopaedic Hospital, Prince William Hospital Corporation d/b/a Novant Health UVA Prince William Medical Center, and Prince William Health System, operate, or maintain a significant investment in, hospitals. The other five Restricted Affiliates, Carolina Medicorp Enterprises, Inc., Forsyth Medical Group, LLC, Foundation Health Systems Corp., Novant Medical Group, Inc. f/k/a Presbyterian Regional Healthcare Corp. and Salem Health Services, Inc., provide, or invest in subsidiaries or joint ventures which provide health care and ancillary services. All of the members of the Combined Group, except Salem Health Services, Inc., are exempt from federal and state income taxation.

The Eliminations column represents the elimination of intercompany transactions and balances between the Obligated Group and the Restricted Affiliates.

The Combined Group combining balance sheet and combining statement of operations are otherwise prepared in accordance with accounting policies described in the accompanying notes to the consolidated financial statements. These schedules are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America, as a result of the exclusion of all required disclosures.