Financial Statements

Lakewood Hospital Association
Years Ended December 31, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

Lakewood Hospital Association

Financial Statements

Years Ended December 31, 2015 and 2014

Contents

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Report of Independent Auditors

The Board of Trustees
Lakewood Hospital Association

We have audited the accompanying financial statements of Lakewood Hospital Association, which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lakewood Hospital Association at December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

May 20, 2016

Lakewood Hospital Association

Balance Sheets

(In Thousands)

	December 31	
	2015	**2014**
Assets		
Current assets:		
Cash and cash equivalents	**$ 2,145**	$ 4,055
Patient receivables, net of allowances for uncollectible accounts of $3,472 in 2015 and $3,959 in 2014	**11,425**	18,571
Other current assets	**4,927**	7,685
Total current assets	**18,497**	30,311
Investments:		
Long-term investments	**45,333**	50,454
Donor-restricted assets	**2,966**	3,028
	48,299	53,482
Property, plant, and equipment, net	**27,263**	41,977
Interest in Lakewood Hospital Foundation, Inc.	**–**	33,519
Other noncurrent assets	**796**	998
	796	998
Total assets	**$ 94,855**	$ 160,287

	December 31 2015	December 31 2014
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 2,595**	$ 2,923
Compensation and amounts withheld from payroll	**2,403**	2,905
Estimated amounts due to third-party payors	**1,797**	2,222
Current portion of long-term debt	**1,150**	2,963
Other current liabilities	**4,127**	2,240
Total current liabilities	**12,072**	13,253
Long-term debt:		
Notes payable and capital leases	**1,565**	9,571
	1,565	9,571
Other liabilities	**28,130**	1,166
Total liabilities	**41,767**	23,990
Net assets:		
Unrestricted	**49,732**	96,288
Temporarily restricted	**2,966**	22,058
Permanently restricted	**390**	17,951
Total net assets	**53,088**	136,297
Total liabilities and net assets	**$ 94,855**	$ 160,287

See accompanying notes.

Lakewood Hospital Association

Statements of Operations and
Changes in Net Assets
(In Thousands)

	Year Ended December 31	
	2015	**2014**
Unrestricted revenues		
Net patient service revenue	**$ 100,214**	$ 127,209
Provision for uncollectible accounts	**(4,844)**	(9,082)
Net patient service revenue less provision for uncollectible accounts	**95,370**	118,127
Other	**4,313**	5,962
Total unrestricted revenues	**99,683**	124,089
Expenses		
Salaries, wages, and benefits	**55,503**	60,307
Supplies	**10,857**	14,376
Pharmaceuticals	**3,300**	4,068
Purchased services and other fees	**5,550**	5,723
Administrative services	**24,456**	24,305
Facilities	**6,565**	7,901
Insurance	**1,594**	1,465
	107,825	118,145
Operating (loss) income before interest, depreciation, and amortization expenses	**(8,142)**	5,944
Interest	**592**	666
Depreciation and amortization	**5,434**	5,713
Operating loss before special charges	**(14,168)**	(435)
Special charges	**32,226**	–
Operating loss	**(46,394)**	(435)
Nonoperating gains and losses		
Investment return	**(112)**	3,066
Other, net	**(50)**	(50)
Net nonoperating gains and losses	**(162)**	3,016
(Deficiency) excess of revenues over expenses	**(46,556)**	2,581

Continued on next page.

Lakewood Hospital Association

Statements of Operations and Changes in Net Assets (continued)

(In Thousands)

	Net Assets			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Balances at January 1, 2014	$ 93,641	$ 21,785	$ 16,916	$ 132,342
Excess of revenues over expenses	2,581	–	–	2,581
Net assets released from restrictions for capital	66	(66)	–	–
Gifts and bequests	–	26	–	26
Net investment income	–	125	–	125
Net assets released from restrictions used for operations included in other unrestricted revenues	–	(494)	–	(494)
Change in interest in Lakewood Hospital Foundation, Inc.	–	682	1,018	1,700
Change in value of perpetual trusts	–	–	17	17
Increase in net assets	2,647	273	1,035	3,955
Balances at December 31, 2014	96,288	22,058	17,951	136,297
Deficiency of revenues over expenses	**(46,556)**	**–**	**–**	**(46,556)**
Gifts and bequests	**–**	**(3,019)**	**–**	**(3,019)**
Net investment income	**–**	**25**	**–**	**25**
Net assets released from restrictions used for operations included in other unrestricted revenues	**–**	**(122)**	**–**	**(122)**
Change in interest in Lakewood Hospital Foundation, Inc.	**–**	**(15,976)**	**(17,543)**	**(33,519)**
Change in value of perpetual trusts	**–**	**–**	**(18)**	**(18)**
Decrease in net assets	**(46,556)**	**(19,092)**	**(17,561)**	**(83,209)**
Balances at December 31, 2015	**$ 49,732**	**$ 2,966**	**$ 390**	**$ 53,088**

See accompanying notes.

Lakewood Hospital Association

Statements of Cash Flows
(In Thousands)

	Year Ended December 31	
	2015	**2014**
Operating activities		
(Decrease) increase in net assets	**$ (83,209)**	$ 3,955
Adjustments to reconcile (decrease) increase in net assets to net cash (used in) provided by operating activities:		
Change in interest in Lakewood Hospital Foundation, Inc.	**33,519**	(1,700)
Net realized and unrealized losses (gains) on investments	**349**	(2,721)
Loss from equity investee	**140**	76
Depreciation and amortization	**5,434**	5,713
Depreciation reported in special charges	**9,437**	–
Provision for uncollectible accounts	**4,844**	9,082
Change in terms of long-term lease	**(6,856)**	–
Restricted gifts, bequests, and investment income	**2,994**	(151)
Change in value of perpetual trusts	**18**	(17)
Changes in operating assets and liabilities:		
Patient receivables	**2,302**	(11,027)
Other assets	**(255)**	285
Accounts payable and other current liabilities	**854**	(945)
Other liabilities	**26,964**	157
Net cash (used in) provided by operating activities	**(3,465)**	2,707
Financing activities		
Principal payments on long-term debt	**(2,963)**	(2,906)
Change in pledges receivable	**3,053**	14
Restricted gifts, bequests, and investment income	**(2,994)**	151
Net cash used in financing activities	**(2,904)**	(2,741)
Investing activities		
Expenditures for property and equipment	**(375)**	(1,984)
Net change in cash equivalents reported in long-term investments	**62**	395
Purchases of investments	**(228)**	(338)
Sales of investments	**5,000**	3,000
Net cash provided by investing activities	**4,459**	1,073
(Decrease) increase in cash and cash equivalents	**(1,910)**	1,039
Cash and cash equivalents at beginning of year	**4,055**	3,016
Cash and cash equivalents at end of year	**$ 2,145**	$ 4,055

See accompanying notes.

1. Organization

In 2015, Lakewood Hospital Association (the Hospital) was a short-term, acute-care general hospital located in Lakewood, Ohio, offering an expansive range of services from routine inpatient care to the higher levels of acuity care, such as joint replacement surgery, neurosurgery, MRI, major vascular procedures, and numerous specialized medical care capabilities. The Hospital also provided continuum of care services through its inpatient rehabilitation program, skilled nursing unit, and a broad spectrum of specialized community-oriented programs.

The Hospital is a tax-exempt, nonprofit Ohio corporation organized and operated to provide medical and hospital care. In March 1997, the Hospital entered into an agreement with The Cleveland Clinic Foundation (Foundation), whereby the Foundation became the sole corporate member of the Hospital.

The City of Lakewood, Ohio (the City) leases real and personal property to the Hospital for the purpose of enabling the operation of certain health care services at Lakewood Hospital. The real and personal property are included in the Hospital's balance sheets as of December 31, 2015 and 2014. The lease between the City and the Hospital, originally executed in 1987, was amended in 1996 (Amended Lease). In consideration for entering into the Amended Lease, the Hospital has agreed to certain additional payments to the City (Note 12). In 2015, the Amended Lease was further amended to shorten the lease term and to reduce the total payments due under the lease. At the end of the lease term, any remaining personal property and equipment will be transferred to the Foundation, and the real property and improvements then owned by the City and subject to the Amended Lease shall be returned to the City.

In 2015, the City, the Hospital and the Foundation entered into an agreement (Master Agreement) that outlines the transition of health care services in the City. Participation in the Master Agreement by the City was authorized by an ordinance adopted by Lakewood City Council in December 2015. Under the terms of the Master Agreement, the Foundation and the Hospital will make contributions over the next eighteen years for the creation of a new health and wellness community foundation to be used for the benefit of the Lakewood community and its citizens. In addition, the Foundation will construct, own and operate an approximately 62,000-square-foot family health center expected to open in 2018 that will include an emergency department and will be located adjacent to the current site of the hospital building.

1. Organization (continued)

The Hospital ceased inpatient operations at the hospital building in February 2016, while the current emergency department and several outpatient services at the Hospital will continue until the Foundation opens the new family health center and emergency department. The Foundation is providing the emergency department and outpatient services at the Hospital site since the cessation of inpatient operations. The Hospital will bear the costs of terminating and winding down its patient and other operations in accordance with the Master Agreement, with any shortfall to be funded by the Foundation.

2. Affiliations

Lakewood Hospital Foundation, Inc. (LHF) is a not-for-profit organization whose purpose is to seek private gifts to support various activities of the Hospital and health and wellness programs in the City and surrounding communities. In 2014, LHF and the Hospital were deemed to be financially interrelated organizations. Accordingly, the Hospital recorded its interest in the net assets of LHF as a noncurrent asset and as temporarily and permanently restricted net assets on the balance sheet as of December 31, 2014. In 2015, LHF amended its articles of incorporation to expand the purposes of LHF. As a result of the amended articles of incorporation, LHF and the Hospital are no longer deemed to be financially interrelated organizations. As such, the hospital does not have an interest in the net assets of LHF as of December 31, 2015.

The Hospital had a joint-venture agreement with Fairview Hospital, a subsidiary of the Foundation, whereby each party owns 50% of Westlake Imaging Center, LLC (WIC). WIC began operations in July 2003 and provided outpatient radiology services through December 31, 2014. The Hospital accounts for its investment in WIC using the equity method of accounting. The Hospital’s investment in WIC was $0.2 million at December 31, 2014 and is recorded in other noncurrent assets in the balance sheet at December 31, 2014. The Hospital did not have an investment in WIC at December 31, 2015. The Hospital recorded a loss of $0.1 million in other unrestricted revenues in both 2015 and 2014 which represents its 50% share of WIC’s operations. The Hospital received a distribution of $0.1 million from WIC in 2015 representing the Hospital’s return on the investment. The Hospital did not receive a distribution from WIC in 2014.

3. Accounting Policies

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and requires significantly expanded disclosures about revenue recognition. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for the Hospital as of January 1, 2019. The Hospital is currently evaluating the impact on the financial statements and the options of adopting using either a full retrospective or a modified approach.

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU eliminates the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share as a practical expedient. Disclosures about investments in certain entities that calculate net asset value per share are limited under ASU 2015-07 to those investments for which the entity has elected to estimate the fair value using the net asset value practical expedient. The Hospital records its share of the Foundation's Long-Term Investment Pool (LTIP), which contains commingled equity, fixed-income and commodity investment funds that are valued using net asset value per share as a practical expedient. The guidance is effective for fiscal years beginning after December 15, 2015, and early adoption is permitted. The Hospital adopted the provisions of ASU 2015-07 for the year ended December 31, 2015 and retrospectively adjusted all periods presented in the financial statements. As a result of the adoption, commingled investment funds that are valued using net asset value as a practical expedient are no longer reported in the table measuring financial instruments at fair value on a recurring basis in Note 8, *Fair Value Measurements*. The adoption of ASU 2015-07 had no impact on previously reported excess of revenues over expenses or net assets.

3. Accounting Policies (continued)

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

Use of Estimates

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

Net Patient Service Revenue and Patient Receivables

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

3. Accounting Policies (continued)

The Hospital is paid a prospectively determined rate for the majority of inpatient acute care and outpatient, skilled nursing and rehabilitation services provided (principally Medicare, Medicaid, and certain insurers). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for capital are received on a prospective basis for Medicare and a cost reimbursement methodology for Medicaid. The Hospital is paid for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor. Provision for estimated retroactive adjustments, if any, resulting from regulatory matters or other adjustments under payment agreements are estimated in the period the related services are provided. The Hospital recorded an increase in net patient service revenue of $0.7 million and a decrease in net patient service revenue of $0.3 million in 2015 and 2014, respectively, related to changes in estimates.

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

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

3. Accounting Policies (continued)

Electronic Health Record Incentive Program

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

The Hospital utilizes a grant accounting model to recognize EHR incentive revenues. The Hospital records EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. Beginning in 2015, CMS updated the EHR incentive reporting period for all hospitals to be based on the calendar year. For the 2015 program year, CMS established the EHR reporting period for eligible hospitals as any continuous 90-day period between October 1, 2014 and December 31, 2015. Attestations for the 2015 program year were accepted by CMS beginning January 4, 2016. The Hospital attested Stage 2 EHR meaningful use requirements in the 2014 federal fiscal year and believes that it will continue to meet these objectives for the 2015 program year. Therefore, for the year ended December 31, 2015, the Hospital has accrued EHR revenues related to the EHR reporting period in 2015. In 2015, the Hospital recorded EHR incentive revenues of $0.2 million, all of which was Medicare revenue. In 2014, the Hospital recorded EHR incentive revenues of $1.1 million, comprised of $1.0 million in Medicare revenue and $0.1 million of Medicaid revenues. EHR incentive revenues are included in other unrestricted revenues in the accompanying statements of operations and changes in net assets.

3. Accounting Policies (continued)

Charity Care

The Hospital provides care to patients who do not have the ability to pay and who qualify for charity services pursuant to established policies of the Hospital. Charity services are defined as those for which patients have the obligation and willingness to pay but do not have the ability to do so. Charity care amounts are not included in net patient service revenue. The cost of charity care provided in 2015 and 2014 approximated $2.2 million and $3.8 million, respectively. The Hospital estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. The decrease in charity care is primarily attributable to the increase in Medicaid patients due to the expansion of Medicaid eligibility in the state of Ohio and the resulting decrease in the number of patients that qualify for charity care.

The Hospital participates in the Hospital Care Assurance Program (HCAP). Ohio created HCAP to financially support those hospitals that service a disproportionate share of low-income patients unable to pay for care. HCAP funds basic, medically necessary hospital services for patients whose family income is at or below the federal poverty level, which includes Medicaid patients and patients without health insurance. The Hospital recorded HCAP revenues of $1.3 million for both years ended December 31, 2015 and 2014, which is included in net patient service revenue in the accompanying statements of operations and changes in net assets.

Cash and Cash Equivalents

Cash equivalents include short-term investments with maturities when purchased of three months or less. They also include the Hospital’s share in the Foundation’s Short-Term Investment Pool (STIP). The STIP consolidates the management and control of cash and cash equivalents of the Foundation and certain of its controlled affiliates. The STIP primarily consists of money market and overnight investments. Interest earnings are allocated to the participants based on the participants’ relative share of the total STIP. Interest earnings averaged 0.01% in both 2015 and 2014. The Hospital’s share of the STIP is $2.1 million and $4.1 million at December 31, 2015 and 2014, respectively.

Inventories

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

3. Accounting Policies (continued)

Other Current Assets

Other current assets consist primarily of inventories, prepaid expenses, EHR incentive receivables and HCAP receivables.

Property, Plant, and Equipment

Property, plant, and equipment purchased by the Hospital are stated at cost. Donated property, plant, and equipment are recorded at fair value at the date of donation. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation, including amortization of capital leased assets, is computed by the straight-line method using the estimated lives of individual assets. Buildings and building components are assigned a useful life ranging from five years to forty years. Equipment is assigned a useful life ranging from three to twenty years. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Other Current and Noncurrent Liabilities

Other current liabilities consist primarily of patient account credit balances, state franchise fee liability and the current portion of pledge liabilities.

Other noncurrent liabilities, net of current portion, consist of pledge liabilities, deferred revenue and amounts due to third-party payors.

Investments and Investment Income

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

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

3. Accounting Policies (continued)

Investments include the Hospital's share in the Foundation's LTIP. The LTIP consolidates the management and control of the investment assets of the Foundation and certain of its controlled affiliated entities. Participating entities purchase units of the LTIP at market value. All investment earnings, including dividends, interest, realized and unrealized gains and losses, and investment-related expenses are allocated to participants based on their units held. The LTIP primarily consists of equity and debt securities with readily determinable fair values and direct alternative investments (hedge funds, private equity, and real estate), which are reported using the equity method of accounting. LTIP units are valued based on the underlying (since alternatives are based on equity method versus fair value) value of the LTIP assets (Note 8).

Return on investments, including equity method income on alternative investments, is reported as nonoperating gains and losses. Donor-restricted investment return on temporarily and permanently restricted investments are included in temporarily restricted net assets.

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

Fair Value Measurements

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

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

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

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

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

3. Accounting Policies (continued)

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

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

Contributions

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

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

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Hospital. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Permanently restricted net assets consist of amounts held in perpetuity or for terms designated by donors, including the fair value of a perpetual trust for which the Hospital is an income beneficiary. Earnings on permanently restricted net assets are primarily restricted for various hospital programs.

3. Accounting Policies (continued)

Excess of Revenues Over Expenses

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets).

4. Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for uncollectible accounts by major payor source for the years ended December 31, 2015 and 2014, are as follows (in thousands):

	2015		2014	
Medicare	**$ 45,292**	**45%**	$ 53,874	43%
Medicaid	**13,064**	**13**	14,385	11
Managed care and commercial	**34,310**	**34**	48,413	38
Self-pay	**7,548**	**8**	10,537	8
	$ 100,214	**100%**	$ 127,209	100%

The Hospital has experienced a decrease in self-pay revenue resulting from expansion of Medicaid eligibility in the state of Ohio, which has increased enrollment in the Medicaid program and decreased the number of self-pay patients. The Hospital records an estimated provision for uncollectible accounts in the year of service for patient receivables associated with self-pay patients, including patients with deductible and copayment balances for which third-party coverage provides for a portion of the services provided. The Hospital's allowance for doubtful accounts was 23% and 18% of accounts receivable at December 31, 2015 and 2014, respectively. Write-offs on self-pay accounts receivable decreased $7.3 million in 2015 compared to 2014. The Hospital does not maintain a material allowance for uncollectible accounts from third-party payors.

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

The Hospital's concentration of credit risk relating to patient receivables is limited due to the diversity of patients and payors. Patient receivables consist of amounts due from government programs, commercial insurance companies, private pay patients, and other group insurance programs. Patient receivables due from the Medicare and Medicaid programs, and one commercial payor represents approximately 36%, 12%, and 9% at December 31, 2015, and 35%, 12%, and 9% at December 31, 2014, respectively, of the Hospital's total patient receivables. Revenues from the Medicare and Medicaid programs and one commercial payor accounted for approximately 45%, 13%, and 14%, respectively, in 2015, and 43%, 11%, and 15%, respectively, in 2014 of the Hospital's net patient service revenue. Excluding these payors, no one payor source represents more than 10% of the Hospital's patient receivables or net patient service revenue.

5. Temporarily Restricted Net Assets

Temporarily restricted net assets are comprised of the following at December 31, 2015 and 2014, (in thousands):

	2015	2014
Pledges receivable	**$ –**	$ 3,053
Plant replacement and expansion funds	**1,923**	1,937
Specific-purpose funds	**1,043**	1,093
Interest in Lakewood Hospital Foundation, Inc.'s temporarily restricted net assets	**–**	15,975
	$ 2,966	$ 22,058

6. Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the following at December 31, 2015 and 2014, (in thousands):

	2015	**2014**
Interest in Lakewood Hospital Foundation, Inc.'s permanently restricted net assets	**$ –**	$ 17,544
Perpetual trust	**390**	407
	$ 390	$ 17,951

7. Cash, Cash Equivalents, and Investments

The composition of cash, cash equivalents, and investments at December 31, 2015 and 2014, is as follows (in thousands):

	2015	2014
Cash and cash equivalents	**$ 5,111**	$ 7,083
Cleveland Clinic Foundation Long-Term Investment Pool	**45,333**	50,454
Total cash, cash equivalents, and investments	**$ 50,444**	$ 57,537

Total investment return, including LTIP earnings allocated to the Hospital, is comprised of the following for the years ended December 31, 2015 and 2014 (in thousands):

	2015	2014
Nonoperating gains, net:		
Interest income and dividends	**$ 367**	$ 485
Net realized gains on sales of investments	**1,176**	1,366
Net change in unrealized (losses) gains on investments	**(2,211)**	272
Equity method income on alternative investments	**688**	1,083
Investment management fees	**(132)**	(140)
	(112)	3,066
Other changes in net assets:		
Investment income on restricted investments	**25**	125
	$ (87)	$ 3,191

8. Fair Value Measurements

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

8. Fair Value Measurements (continued)

The fair value of the Hospital's pledges receivable is based on discounted cash flow analysis using treasury yield curve interest rates consistent with the maturities of the pledges receivable and adjusted for consideration of the donor's credit. The fair value of pledges receivable was $3.1 million (see carrying value at Note 10) at December 31, 2014. The Hospital did not have any pledges receivable at December 31, 2015. Pledges receivable would be classified as Level 3 in the fair value hierarchy.

The Hospital's share of the LTIP was $45.3 million and $50.5 million at December 31, 2015 and 2014, respectively. The following tables present the financial instruments that comprise the LTIP measured at fair value on a recurring basis based on the valuation hierarchy:

	December 31, 2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	**6%**	**–%**	**–%**	**6%**
Fixed income securities:				
U.S. treasuries	**44**	**–**	**–**	**44**
U.S. government agencies	**–**	**1**	**–**	**1**
U.S. corporate	**–**	**7**	**–**	**7**
U.S. government agencies asset-backed	**–**	**<1**	**–**	**<1**
Foreign	**–**	**2**	**–**	**2**
Common and preferred stocks:				
U.S.	**23**	**<1**	**–**	**23**
Foreign	**14**	**<1**	**–**	**14**
Equity mutual funds	**3**	**–**	**–**	**3**
Total investments	**90%**	**10%**	**–%**	**100%**

8. Fair Value Measurements (continued)

	December 31, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	9%	–%	–%	9%
Fixed income securities:				
U.S. treasuries	29	–	–	29
U.S. government agencies	–	1	–	1
U.S. corporate	–	8	–	8
U.S. government agencies asset-backed	–	<1	–	<1
Foreign	–	2	–	2
Common and preferred stocks:				
U.S.	30	<1	–	30
Foreign	11	<1	–	11
Equity mutual funds	10	–	–	10
Total investments	89%	11%	–%	100%

The following tables present the financial instruments measured at fair value on a recurring basis, exclusive of the Hospital's share of the LTIP, as of December 31, 2015 and 2014, based on the valuation hierarchy (in thousands):

	December 31, 2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	**$ 5,111**	**$ –**	**$ –**	**$ 5,111**
Perpetual trust	**–**	**390**	**–**	**390**
Total	**$ 5,111**	**$ 390**	**$ –**	**$ 5,501**

8. Fair Value Measurements (continued)

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 7,083	$ –	$ –	$ 7,083
Perpetual trust	–	407	–	407
Total	$ 7,083	$ 407	$ –	$ 7,490

The Hospital's perpetual trust is reported in other noncurrent assets on the balance sheets. Other noncurrent assets include $0.4 million and $0.6 million at December 31, 2015 and 2014, respectively, of assets that are not measured at fair value on a recurring basis.

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

Investments classified as Level 2 are primarily determined using techniques that are consistent with the market approach. Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs, which include broker/dealer quotes, reported/comparable trades and benchmark yields, are obtained from various sources, including market participants, dealers, and brokers. The fair value of the perpetual trust is determined based on the present value of expected cash flows to be received from the trust using a discount rate of 5% at both December 31, 2015 and 2014, which is based on Treasury yield curve rates and adjusted based on the assumed yield of the trust assets.

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

9. Property, Plant, and Equipment

Property, plant, and equipment are comprised of the following at December 31, 2015 and 2014 (in thousands):

	2015	2014
Land and improvements	**$ 2,530**	$ 4,109
Buildings	**94,008**	110,532
Equipment	**28,055**	30,065
Construction-in-progress	**14**	163
Computer hardware and software	**4,208**	9,788
	128,815	154,657
Accumulated depreciation	**(101,552)**	(112,680)
	$ 27,263	$ 41,977

10. Pledges Receivable

Outstanding pledges receivable at December 31, 2015 and 2014 are as follows (in thousands):

	2015	2014
Pledges due in less than one year	**$ –**	$ 3,177
Allowance for uncollectible pledges	**–**	(124)
Current portion (net of allowance for uncollectible pledges)	**–**	(3,053)
Long-term portion	**$ –**	$ –

The current portion of pledges receivable is recorded in other current assets in the accompanying balance sheets.

11. Captive Insurance Company

The Hospital's professional liability and commercial general liability risks are insured by CCHS Indemnity Co., Ltd. (CCHSICo), a captive insurance company and a controlled affiliated entity of the Foundation. CCHSICo provides professional and general liability insurance coverage on a claims-made basis. The Hospital does not have any uninsured risk related to general and professional liability claims. CCHSICo has reinsurance arrangements in place relative to a portion of the risks. Annual premiums charged to the Hospital are based upon an actuarially determined allocation of the total premium assessed to all of the Foundation's affiliates, which are insured by CCHSICo.

In the ordinary course of business, professional and general liability claims have been asserted against the Hospital by various claimants. These claims are in various stages of processing or, in certain instances, are in litigation. In addition, there are known incidents, and there may also be unknown incidents, which may result in the assertion of additional claims. Unasserted claims are accrued on the Foundation's balance sheet, and the Hospital has been charged an allocated portion relative to its risk.

12. Notes Payable and Capital Leases

In connection with the Amended Lease in 1996 with the City (Note 1), the Hospital had agreed to make additional payments to the City. In 2015, the Amended Lease was further amended to shorten the lease term and to reduce the total payments due under the lease. The payments under the current lease as amended range in annual amounts up to $1.2 million through 2018, or until certain provisions in the lease are satisfied. The additional payments under the lease as amended are as follows (in thousands):

2016	$ 1,150
2017	1,150
2018	588
	$ 2,888

The net present value of the additional payments is $2.7 million and $10.1 million at December 31, 2015 and 2014, respectively (discounted at an interest rate of 6%), of which $1.6 million and $9.6 million is included in notes payable and capital leases at December 31, 2015 and 2014, respectively, and $1.2 million and $0.5 million is included in current portion of long-term debt at December 31, 2015 and 2014, respectively. The Hospital recorded a $6.9 million gain in special charges (Note 17) related to the change in lease terms for the year ended December 31, 2015.

12. Notes Payable and Capital Leases (continued)

In October 2013, the Hospital executed a $4.8 million taxable term loan with a financial institution. The proceeds of the term loan were used to pay a portion of the refunding of the Series 2003 Bonds. The current portion of the loan was $2.4 million at December 31, 2014, which is included in the current portion of long-term debt. The loan fully matured in February 2015.

Total interest paid on notes payable and capital leases approximated $0.6 million and $0.7 million in 2015 and 2014, respectively.

13. Retirement Benefit Plans

The Hospital's employees participate in the retirement benefit plans established by the Foundation, including the CCHS Retirement Plan, a defined benefit pension plan covering substantially all employees. The benefits provided are based on age, years of service and compensation. It is the policy of the Foundation to fund at least the minimum amounts required by the Employee Retirement Income Security Act of 1974. The CCHS Retirement Plan ceased benefit accruals as of December 31, 2009 for substantially all employees, with benefit accruals for remaining employees ceasing at various intervals through December 31, 2012.

The Hospital sponsors two noncontributory, defined contribution plans, and a contributory, defined contribution plan. The Cleveland Clinic Investment Pension Plan (IPP) is a noncontributory, defined contribution plan, which covers substantially all of the Hospital's employees. The Hospital's contribution for the IPP is based upon a percentage of employee compensation and years of service. The Hospital sponsors an additional noncontributory, defined contribution plan, which covers certain of its employees. The Hospital's contribution to the plan is based upon a percentage of employee compensation, as defined, determined according to age. The Hospital also sponsors a contributory, defined contribution plan, which covers substantially all employees. Any Hospital contribution to the contributory plan is determined based on employee contributions.

Included in the Hospital's salaries, wages and benefits is retirement benefit expense pertaining to the defined contribution plans of approximately $2.5 million and $2.8 million in 2015 and 2014, respectively.

14. Commitments and Contingencies

The Hospital leases various equipment and facilities under operating lease arrangements. Total rental expense was $0.8 million and $0.9 million in 2015 and 2014, respectively. Minimum future operating lease payments are as follows (in thousands): 2016 – $465; 2017 – $356; and 2018 – $301.

The Hospital recorded pledge liabilities in connection with the Master Agreement. Pledge liabilities include amounts for the creation of a new health and wellness foundation to be used for the benefit of the Lakewood community and its citizens and amounts to be paid to the City for the demolition and/or redevelopment of the Hospital building and other structures on the current hospital site. Pledge liabilities at December 31, 2015 are as follows (in thousands): 2016 – $700; 2017 – $0; 2018 –$14,100; 2019 – $0; 2020 – $4,300; and thereafter – $12,300. The unamortized discount on pledge liabilities at December 31, 2015 was $3.8 million. Pledge liabilities are recorded in other current liabilities and other noncurrent liabilities. See Note 17.

Prior to the signing of the Master Agreement, a lawsuit was filed against the Hospital, Foundation, the City and others (the Defendants) by a few Lakewood residents (the Plaintiffs) seeking to stop the closure of the hospital and money damages. To date, the court has denied the Plaintiffs' Motion for a Temporary Restraining Order. The Plaintiffs' Motion for a Preliminary Injunction is still pending. The Defendants jointly filed Motions to dismiss the lawsuit. The resolution of this matter is not estimable at this time.

15. Related-Party Transactions

The Hospital contracts with the Foundation and its affiliates for certain services in the normal course of business. Expenses include $24.1 million and $25.0 million in 2015 and 2014, respectively, for these services.

16. Functional Expenses

The Hospital's functional expenses are as follows for the years ended December 31, 2015 and 2014 (in thousands):

	2015	2014
Health care services	**$ 127,485**	$ 104,060
Research	**–**	21
General and administrative	**18,592**	20,443
	$ 146,077	$ 124,524

17. Special Charges

The Hospital incurred and recorded $32.2 million of special charges in connection with the Master Agreement. Special charges in 2015 include $27.6 million of pledge liabilities, $10.7 million of accelerated depreciation and other property, plant and equipment costs, $0.8 million in employee retention costs, offset by a $6.9 million gain related to changes in the terms of the lease between the City and the Hospital.

18. Subsequent Events

The Hospital evaluated events and transactions occurring subsequent to December 31, 2015, through May 20, 2016, the date the financial statements were available to be issued. During this period, there were no subsequent events requiring recognition in the financial statements, and, other than those disclosed in Note 1, there were no nonrecognized subsequent events requiring disclosure.

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