

Essentia Health

Consolidated Financial Report
With Independent Auditor's Report Thereon
With Supplementary Information
June 30, 2018 and 2017

Contents

Independent auditor's report	1-2
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Financial statements	
Consolidated balance sheets	3-4
Consolidated statements of operations and changes in net assets	5-6
Consolidated statements of cash flows	7
Notes to consolidated financial statements	8-35

Independent auditor's report on the supplementary information	36
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Supplementary information	
Schedule of community service and charity care provided (unaudited)	37
Consolidating balance sheets	38-41
Consolidating statements of operations and changes in net assets	42-45



RSM US LLP

Independent Auditor's Report

The Board of Directors
Essentia Health

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Essentia Health, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from 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 Essentia Health as of June 30, 2018 and 2017, and the results of its operations, changes in its net assets, and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Minneapolis, Minnesota
September 11, 2018

Essentia Health

Consolidated Balance Sheets
June 30, 2018 and 2017
(Dollars in Thousands)

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 29,025	\$ 23,922
Short-term investments	29,995	29,660
Current portion of assets whose use is limited (Note 5)	13,096	11,908
Patient accounts receivable, less allowances for uncollectible accounts of \$29,948 and \$34,053 at June 30, 2018 and 2017, respectively (Note 4)	228,948	234,532
Prepaid expenses and other receivables	50,269	51,243
Inventories	50,434	51,013
Total current assets	401,767	402,278
Assets whose use is limited, less current portion (Note 5):		
Funds designated by Board	954,385	892,565
Funds held by trustee	452	425
Funds held under self-insurance program	49,481	37,107
Funds held for deferred compensation and other	109,013	99,895
	1,113,331	1,029,992
Property and equipment, net (Note 7)	714,760	729,461
Other noncurrent assets, net (Note 8)	109,932	102,851
Total assets	\$ 2,339,790	\$ 2,264,582

See notes to consolidated financial statements.

	2018	2017
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 35,651	\$ 33,387
Payable to third-party payors (Note 4)	2,835	17,283
Accrued liabilities:		
Salaries, wages and benefits	157,044	159,636
Interest	8,329	8,484
Current portion of long-term debt (Note 9)	23,156	20,973
Other	24,715	35,201
Total current liabilities	251,730	274,964
Long-term debt (Note 9)	548,987	567,750
Employee benefit plan and deferred compensation liabilities (Note 11)	167,825	187,452
Self-insurance program liabilities (Note 12)	54,525	48,585
Other noncurrent liabilities	53,535	43,271
Total liabilities	1,076,602	1,122,022
Net assets:		
Unrestricted	1,251,666	1,131,257
Temporarily restricted	9,999	9,827
Permanently restricted	1,523	1,476
Total net assets	1,263,188	1,142,560
Total liabilities and net assets	\$ 2,339,790	\$ 2,264,582

Essentia Health

**Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2018 and 2017
(Dollars in Thousands)**

	2018	2017
Unrestricted revenue:		
Patient service revenue	\$ 2,043,182	\$ 1,981,379
Provision for bad debts	(33,034)	(44,346)
Net patient service revenue (Note 4)	2,010,148	1,937,033
Other operating revenue	56,128	53,334
Total unrestricted revenue	2,066,276	1,990,367
Expenses (Note 14):		
Salaries, wages and related benefits	1,299,906	1,259,295
Supplies	336,662	310,622
Purchased services and professional fees	83,946	81,328
Utilities and maintenance	71,059	65,263
Professional liability and general insurance	23,039	14,627
Depreciation and amortization	91,462	88,010
Interest	25,456	24,480
Provider and other taxes	31,928	31,884
Other	79,868	81,490
Campus replacement and other costs (Note 15)	11,986	-
Total expenses	2,055,312	1,956,999
Income from operations	10,964	33,368
Nonoperating gains (losses), net:		
Investment income on funds designated by Board	15,299	10,840
Net realized gains on investments	19,724	27,451
Net change in unrealized gains and losses on trading securities	53,092	63,504
Gain on swap agreements	3,457	3,853
Other, net	(1,383)	12,359
Total nonoperating gains (losses), net	90,189	118,007
Excess of revenue and gains over expenses and losses	101,153	151,375
Other changes in unrestricted net assets:		
Pension and other postretirement liability adjustments	18,380	25,905
Other, net	876	919
Increase in unrestricted net assets	120,409	178,199

(Continued)

Essentia Health

Consolidated Statements of Operations and Changes in Net Assets (Continued)
Years Ended June 30, 2018 and 2017
(Dollars in Thousands)

	2018	2017
Temporarily restricted net assets:		
Contributions	\$ 2,831	\$ 2,508
Net assets released from restrictions and other changes, net	<u>(2,659)</u>	<u>(2,366)</u>
Increase in temporarily restricted net assets	<u>172</u>	<u>142</u>
Permanently restricted net assets:		
Contributions and other changes, net	<u>47</u>	<u>82</u>
Total increase in net assets	120,628	178,423
Net assets at beginning of year	<u>1,142,560</u>	<u>964,137</u>
Net assets at end of year	<u>\$ 1,263,188</u>	<u>\$ 1,142,560</u>

See notes to consolidated financial statements.

Essentia Health

Consolidated Statements of Cash Flows Years Ended June 30, 2018 and 2017 (Dollars in Thousands)

	2018	2017
Cash flows from operating activities:		
Increase in net assets	\$ 120,628	\$ 178,423
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	94,955	88,675
Provision for bad debts	33,034	44,346
Gain on swap agreements	(3,457)	(3,853)
Share of joint ventures and related organizations' net (income) loss, net	(1,486)	181
Loss on refinancing	-	2,189
Net change in unrealized gains and losses on trading securities	(53,092)	(63,504)
Pension and other postretirement liability adjustments	(18,380)	(25,905)
Gain on lease modification	-	(17,503)
Changes in assets and liabilities:		
Patient accounts receivable	(27,450)	(50,897)
Accounts payable and accrued liabilities	(14,931)	(26,943)
Professional, pension and other noncurrent liabilities	(3,098)	9,847
Other, net	(3,637)	(18,288)
Net cash provided by operating activities	123,086	116,768
Cash flows from investing activities:		
Purchase of property and equipment, net	(79,515)	(105,329)
Change in investments in joint ventures and related organizations, net	1,393	4,891
Purchase of trading securities, net	(23,451)	(52,266)
Net cash used in investing activities	(101,573)	(152,704)
Cash flows from financing activities:		
Proceeds from issuance and borrowings of long-term debt	19,500	97,929
Principal payments on long-term debt	(36,448)	(94,205)
Decrease in funds held by trustee	538	3,241
Net cash (used in) provided by financing activities	(16,410)	6,965
Net increase (decrease) in cash and cash equivalents	5,103	(28,971)
Cash and cash equivalents at beginning of year	23,922	52,893
Cash and cash equivalents at end of year	\$ 29,025	\$ 23,922
Supplemental disclosures of cash flow information:		
Interest paid, net of capitalized interest	\$ 24,775	\$ 25,125

See notes to consolidated financial statements.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization

Essentia Health (Essentia), a Minnesota nonprofit corporation headquartered in Duluth, Minnesota, is the parent of an integrated health system serving patients in Minnesota, Wisconsin, North Dakota and Idaho.

Essentia is the parent company of the following entities:

- St. Mary's Duluth Clinic Health System (operating as Essentia Health East [EH East]) in Duluth, Minnesota
- Brainerd Lakes Integrated Health System (operating as Essentia Health Central [EH Central]) in Brainerd, Minnesota
- Innovis Health LLC (operating as Essentia Health West [EH West]) in Fargo, North Dakota
- Critical Access Group (CAG), formerly known as Essentia Community Hospitals & Clinics (ECHC)
- Essentia Health Insurance Services (EHIS), a Cayman-based captive insurance company
- Essentia Health Foundation (EHF), a merger of Innovis Health Foundation, SMDC Foundation, and ECHC Foundation

Many Essentia entities have adopted an operating name as part of a system-wide rebranding strategy using the Essentia brand.

Essentia is a regional leader in the development and advancement of business, clinical and financial models for the delivery of high-quality and cost-effective health care. Essentia provides integrated health care delivery through its physician group practices, ambulatory and outpatient centers, acute care hospitals (including tertiary referral centers), and community, rural and critical access hospitals.

Essentia has been determined to qualify as a tax-exempt charitable, educational and scientific organization under section 501(c)(3) of the Internal Revenue Code (the Code) and also has been determined to be generally exempt from state income tax under Minnesota Statute 290.05, Subdivision 2.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization (Continued)

EH East directly or indirectly controls the following tax-exempt entities:

Legal Entity	Operating Name, if Applicable	Location
St. Mary's Medical Center	Essentia Health St. Mary's Medical Center	Duluth, Minnesota
The Duluth Clinic, Ltd.	N/A	Duluth, Minnesota
SMDC Medical Center	Essentia Health Duluth	Duluth, Minnesota
Polinsky Medical Rehabilitation Center	Essentia Health Polinsky Medical Rehabilitation Center	Duluth, Minnesota
Midwest Medical Equipment and Supplies, Inc.	Essentia Health Medical Equipment & Supplies	Duluth, Minnesota
Northern Pines Medical Center	Essentia Health Northern Pines	Aurora, Minnesota
Pine Medical Center	Essentia Health Sandstone	Sandstone, Minnesota
St. Mary's Hospital of Superior	Essentia Health St. Mary's Hospital Superior	Superior, Wisconsin
Deer River Healthcare Center, Inc.	Essentia Health Deer River	Deer River, Minnesota
Essentia Health Virginia, LLC	Essentia Health Virginia	Virginia, Minnesota
Essentia Institute of Rural Health	N/A	Duluth, Minnesota
Essentia Health Sandstone Medical, LLC	N/A	Sandstone, Minnesota
Divine Properties, LLC (established December 2017)	N/A	Duluth, Minnesota

EH Central is the sole corporate member of the following tax-exempt entities:

Legal Entity	Operating Name	Location
St. Joseph's Medical Center	Essentia Health St. Joseph's Medical Center	Brainerd, Minnesota
Brainerd Medical Center, Inc.	Essentia Health Brainerd Specialty Clinic	Brainerd, Minnesota

EH West is the sole member of the following tax-exempt entities:

Legal Entity	Operating Name, if Applicable	Location
St. Mary's Regional Health Center	Essentia Health St. Mary's Detroit Lakes	Detroit Lakes, Minnesota
St. Mary's Innovis Health	N/A	Detroit Lakes, Minnesota
Bridges Medical Center	Essentia Health Ada	Ada, Minnesota
First Care Medical Services	Essentia Health Fosston	Fosston, Minnesota
Graceville Health Center	Essentia Health Holy Trinity Hospital	Graceville, Minnesota

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization (Continued)

CAG is the sole corporate member of the following tax-exempt entities:

Operating Name	Location
Clearwater Valley Hospital and Clinics	Orofino, Idaho
St. Mary's Hospital	Cottonwood, Idaho

In addition to their membership rights, Essentia and Benedictine Sisters Benevolent Association (BSBA), a sponsor of Essentia's Catholic hospitals, have retained various reserved powers over Essentia's hospitals.

Essentia's investments in joint ventures and related organizations are recorded in other noncurrent assets in the consolidated balance sheets as follows:

	June 30	
	2018	2017
Benedictine Health System (cost method)	\$ 55,673	\$ 55,673
St. Francis Medical Center (cost method)	4,343	4,343
Park Rapids Area Health Care, LLC (equity method)	3,345	3,657
Brainerd Lakes Surgery Center (equity method)	1,790	1,499
Other joint ventures (equity method)	1,208	1,093
	<u>\$ 66,359</u>	<u>\$ 66,265</u>

Essentia's share of net income (loss) on its investments in joint ventures is included in other operating revenue, and any cost adjustments are included in nonoperating gains (losses), net, in the accompanying consolidated statements of operations and changes in net assets, depending on the nature of the investment, as follows:

	Years Ended June 30	
	2018	2017
Other operating revenue	\$ 1,486	\$ 2,241
Nonoperating (losses) gains, net	-	(2,422)
	<u>\$ 1,486</u>	<u>\$ (181)</u>

In accordance with a reorganization agreement between Benedictine Health System (BHS) and Essentia effective December 31, 2007, upon any subsequent dissolution or sale of BHS or any of BHS' subsidiaries, Essentia would be entitled to receive the net proceeds of the dissolved or sold entity up to BHS' net asset value as of December 31, 2007. Management considers that no material impairment of Essentia's net investment in BHS has occurred as of June 30, 2018 and 2017.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 1. Organization (Continued)

The following is a summary of the combined operating results and balance sheet information of investments accounted for under the equity method as of and for the years ended June 30:

	2018	2017
Total revenue	\$ 24,497	\$ 21,808
Excess of revenue and gains over expenses	3,840	4,689
Total assets	18,132	17,367
Net assets	12,970	12,692

Note 2. Summary of Significant Accounting Policies

Basis of presentation: The consolidated financial statements represent the consolidated financial position, results of operations, and cash flows of Essentia. All significant interaffiliate accounts and transactions have been eliminated in consolidation.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates.

Cash and cash equivalents: Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with maturities of 90 days or less from the date of purchase. Cash deposits are federally insured in limited amounts.

Short-term investments: Short-term investments are stated at fair value and include corporate bonds and notes with maturities of one year or less from the date of purchase, certificates of deposit and certain mutual funds. Short-term investments are available to meet Essentia's operating cash requirements.

Accounts receivable: Accounts receivable are stated at net realizable value. The allowance for uncollectible accounts is based upon management's ongoing assessment of historical and expected net collections for each major payor source considering historical business and economic conditions, trends in health care coverage, and other collection indicators. For receivables associated with services provided to patients who have third-party insurance coverage (including copayment and deductible amounts from patients), Essentia analyzes contractually due amounts and provides an allowance for contractual adjustments and a provision for uncollectible accounts. For receivables associated with private-pay patients, Essentia records a significant provision for uncollectible accounts in the period of service on the basis of its historical experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

Essentia follows established guidelines for placing certain past-due patient balances with collection agencies, subject to certain restrictions on collection efforts as determined by Essentia. Accounts are written off when all reasonable internal and external collection efforts have been performed. These adjustments are accrued on an estimated basis and are revised as needed in future periods. The allowance for uncollectible accounts as a percentage of accounts receivable was 12 percent and 13 percent at June 30, 2018 and 2017, respectively.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Inventories: Inventories, including drugs and supplies, are stated at the lower of cost (using either the average cost basis or the first-in, first-out basis) or net realizable value.

Assets whose use is limited: Assets whose use is limited are composed primarily of investments held for trading, which are stated at fair value, and include assets designated by the Board of Directors (over which the Board retains control and may, at its discretion, subsequently use for other purposes) for future capital improvements and retirement of debt; investments of EHIS, which was formed as a professional liability funding arrangement; assets held by trustee under indenture agreements for construction and debt service payments; and other assets, which consist mainly of deferred compensation assets (designated to fund deferred compensation liabilities) and Foundation assets designated to support health care operations and capital needs.

Investment income earned on funds held by the bond trustee is reported as other operating revenue, since the interest expense on the related bonds is reported as an operating expense. All other investment income (including realized gains and losses on investments, interest, dividends, and net change in unrealized gains and losses) is reported as nonoperating income. Realized gains and losses are determined using the specific-identification method.

Derivative financial instruments: Essentia uses fixed-payor and basis-swap instruments as part of a risk management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt (see Note 9). Derivatives are used to hedge identified and approved exposures and are not used for speculative purposes.

All derivatives are recognized as either assets or liabilities and are measured at fair value. Essentia uses pricing models for various types of derivative instruments that take into account the present value of estimated future cash flows. None of the swaps have been designated as a hedge. Accordingly, all changes in the fair values of the swaps and the net difference between interest received and paid are reported as nonoperating gains or losses on swap agreements in the consolidated statements of operations and changes in net assets.

Property and equipment: Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over estimated useful lives but not for a term in excess of the associated ground leases, if any.

Maintenance and repairs are charged to expense as incurred. Major improvements that extend the useful life of the related item are capitalized and depreciated. The cost and accumulated depreciation of property and equipment retired or disposed of are removed from the related accounts, and any residual value after considering proceeds is charged or credited to nonoperating gains (losses).

Intangible assets: Identifiable intangible assets are amortized on a straight-line basis over a range of 15 to 40 years based on the expected useful lives.

Asset impairment: Essentia periodically evaluates whether events and circumstances have occurred that may affect the estimated useful life or recoverability of the net book value of property and equipment and identifiable intangible assets. If such events or circumstances indicate that the carrying amounts may not be recoverable, an impairment loss is recorded based on an undiscounted cash flow analysis.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

Insurance: The provision for estimated self-insured general and professional liability claims includes actuarially determined estimates of the undiscounted ultimate costs for both reported claims and claims incurred but not reported (IBNR). Most of the entities that comprise Essentia are self-insured for workers' compensation claims, and the estimated liability is discounted.

Costs of borrowing: Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. For the years ended June 30, 2018 and 2017, capitalized interest totaled \$164 and \$689, respectively.

Charity and uncompensated care: Essentia provides health care services to patients who meet certain criteria under its charity care policies without charge or at amounts less than established rates. Since Essentia does not pursue collection of these amounts, they are not reported as revenue.

Excess of revenue and gains over expenses and losses: The consolidated statements of operations and changes in net assets include excess of revenue and gains over expenses and losses. Changes in unrestricted net assets, which are excluded from excess of revenue and gains over expenses and losses, include pension and other postretirement liability adjustments and unrestricted contributions of capital.

Donor-restricted gifts: Unconditional promises to give cash and other assets to Essentia are reported at fair value at the date the promise is received. Conditional promises and indications of intentions to give are reported at fair value at the date the conditions are met.

Gifts are reported as temporarily restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is fulfilled, temporarily restricted net assets are reclassified to other operating revenue or to an increase in unrestricted net assets in the consolidated statements of operations and changes in net assets depending on whether the donor's restriction was for research, education or other operations, or for the purchase of property and equipment.

Permanently restricted net assets are held in perpetuity.

Deferred taxes: Essentia records a valuation allowance for deferred tax assets when it is more likely than not that some portion of the deferred tax assets will not be realized. The ultimate realization of these deferred tax assets depends on the ability of Essentia's affiliates to generate sufficient taxable income in the future.

Recent accounting pronouncements not yet adopted: In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. ASU 2016-01 also changes certain disclosure requirements and other aspects of current U.S. GAAP. ASU 2016-01 will be effective for Essentia for the fiscal year ending June 30, 2020. For the fiscal year ended June 30, 2017, Essentia elected to early adopt the amendment within ASU 2016-01 that no longer requires disclosure of the fair value of financial instruments that are not measured at fair value, and as such, these disclosures are not included herein. Essentia has started to evaluate the impact that the remaining provisions of this new standard will have on its consolidated financial statements.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 2. Summary of Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The guidance in ASU 2016-02 supersedes the lease recognition requirements in *FASB Accounting Standards Codification (ASC) Topic 840, Leases* (formerly Statement of Financial Accounting Standards No. 13). ASU 2016-02 requires that assets and liabilities be recognized for financing and operating lease arrangements and that additional qualitative and quantitative financial statement disclosures be made. ASU 2016-02 is effective for Essentia for the fiscal year ending June 30, 2020, with early adoption permitted. The primary effect of adopting the new standard will be to record right to use obligations for leases currently accounted for as operating leases.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify revenue recognition principles. The guidance is intended to improve disclosure requirements and enhance the comparability of revenue recognition practices. Improved disclosures under the amended guidance relate to the nature, amount, timing and uncertainty of revenue that is recognized from contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606)*, deferring the effective date of ASU 2014-09 with reporting periods beginning after June 30, 2018, and it will be required to be applied retrospectively (either fully or on a modified approach).

Essentia has closely assessed the new standard and monitored FASB activity, including the interpretations by the FASB Transition Resource Group for Revenue Recognition, throughout fiscal year 2018. Essentia adopted the standard on July 1, 2018, using the modified retrospective method of transition. As part of adopting the standard, Essentia identified revenue streams of like contracts and used a portfolio approach to apply the standard to classes of customers with similar characteristics. The adoption of ASU 2014-09 did not have a material effect on the consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in the ASU are intended to improve the information provided in the financial statements of not-for-profit entities with respect to net asset classification, liquidity, financial performance and cash flows. Essentia adopted the standard on July 1, 2018. The adoption of ASU 2016-14 did not have a material effect on the consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230)*. This guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The ASU will be effective for Essentia's fiscal year ending June 30, 2020. Management is currently evaluating the potential impact the adoption of this update will have on Essentia's financial reporting.

Reclassifications: Certain prior-year amounts in the consolidated financial statements have been reclassified to conform to the 2018 presentation. These reclassifications had no effect on the change in net assets or net assets previously reported.

Note 3. Service to the Community

In the furtherance of its charitable purpose, Essentia provides a wide variety of benefits to the communities it serves, including offering various community-based social service programs, such as free clinics, health screenings, in-home caregiver services, social service and support counseling for patients and families, pastoral care, crisis intervention, transportation to and from the health care campuses, and the donation of space for use by community groups.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 3. Service to the Community (Continued)

In addition, a large number of health-related educational programs are provided for the benefit of the community, including health enhancements and wellness, classes on specific medical conditions, unreimbursed costs of medical education, telephone information services, and costs related to programs designed to improve the general health status of the community.

Essentia also provides medical care without charge or at a reduced cost primarily through (a) services provided at no charge to the uninsured and (b) services provided to patients expressing a willingness to pay but who are determined to be unable to pay because of socioeconomic factors. The cost of providing charity care is measured by applying an overall cost-to-charge ratio to the charges incurred. Total cost includes salaries, wages and related benefits, professional fees, supplies, purchased services, repairs and maintenance, and general and administrative expenses. Charity care provided was approximately \$17,700 and \$13,700 for the years ended June 30, 2018 and 2017, respectively.

Note 4. Net Patient Revenue

Patient service revenue, net of contractual allowances and discounts (but before bad debt), is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews and investigations. Differences between amounts originally recorded and finally settled are included in operations in the year in which the differences become known. Certain reimbursement arrangements are subject to retroactive audits and adjustments.

Essentia derives patient revenue primarily from patients covered under the Medicare and Medicaid programs and agreements with commercial insurers and managed care organizations as well as from private-pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges, and allowable cost.

Essentia provides care to patients under the Medicare and Medicaid programs and contractual arrangements with other third-party payors. The Medicare and Medicaid programs pay for inpatient and most outpatient services at predetermined rates under a prospective payment system.

Essentia has contracted with Blue Cross and Blue Shield of Minnesota, Wisconsin and North Dakota (collectively, BCBS) to provide patient care to its members and is reimbursed based on negotiated rates.

Essentia has negotiated "total cost-of-care" payor contracts with various health plan payors. Under these agreements, Essentia receives a portion of the savings achieved in providing care to enrollees who are attributed to Essentia. Attribution to Essentia is based on receiving the majority of care from Essentia providers. Some of the contracts also have incentives related to the quality of care delivered.

Essentia utilizes a process to identify and appeal settlements by Medicare and other payors. Additional reimbursement is recorded in the year the appeal is successful. During the years ended June 30, 2018 and 2017, additional revenue due to successful appeals and cost report settlements amounted to approximately \$1,400 and \$18,600, respectively.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 4. Net Patient Revenue (Continued)

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. While management believes that Essentia is in material compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in reimbursement from the Medicare program, including reduction of funding levels, could have an adverse effect on Essentia.

The mix of patient revenue from patients and third-party payors, net of contractual allowances (but before bad debt), for the years ended June 30 is summarized below:

	2018		2017	
	Amount	Percent	Amount	Percent
Medicare	\$ 690,007	34	\$ 681,910	34
Medicaid	247,654	12	246,262	12
BCBS	443,038	22	442,564	22
Managed care, commercial insurance and other payors	638,647	31	585,185	31
Private-pay	23,836	1	25,458	1
	<u>\$ 2,043,182</u>	<u>100</u>	<u>\$ 1,981,379</u>	<u>100</u>

Essentia grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30 consists of the following:

	2018		2017	
	Amount	Percent	Amount	Percent
Medicare	\$ 61,348	27	\$ 64,890	29
Medicaid	25,127	11	26,448	11
BCBS	45,002	20	47,398	20
Managed care, commercial insurance and other payors	85,395	38	81,317	35
Private-pay	12,076	5	14,479	6
	<u>\$ 228,948</u>	<u>100</u>	<u>\$ 234,532</u>	<u>100</u>

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 5. Investments and Assets Whose Use Is Limited

At June 30, assets whose use is limited consisted of, and were limited for, the following purposes:

	2018	2017
Cash and cash equivalents	\$ 100,719	\$ 58,042
Domestic equity securities	270,433	234,016
International equity securities	66,098	61,020
Equity mutual funds	334,576	292,750
Debt security mutual funds	97,183	147,718
Hedge funds	185,395	181,684
Other	72,023	66,670
	<u>\$ 1,126,427</u>	<u>\$ 1,041,900</u>
Funds designated by Board	\$ 954,385	\$ 892,565
Funds held by trustee	1,813	2,351
Funds held under self-insurance program	60,991	46,854
Funds held for deferred compensation and other	109,238	100,130
	<u>1,126,427</u>	<u>1,041,900</u>
Less current portion	13,096	11,908
Total noncurrent assets whose use is limited	<u>\$ 1,113,331</u>	<u>\$ 1,029,992</u>

Essentia invests in certain alternative investments, principally funds of hedge funds. Essentia uses the net asset value (NAV) per share of its investments in alternative investments to estimate fair value. As such, alternative investments are excluded from the fair value hierarchy but are included as a reconciling item to arrive at total investments.

At June 30, 2018 and 2017, Essentia's ownership percentage of alternative investments ranged from 0.1 percent to 6.7 percent and from 0.2 percent to 6.8 percent, respectively. Through these investments, Essentia may be indirectly involved in investment activities such as securities lending, short sales of securities, options, warrants, trading in futures and forward contracts, swap contracts, and other derivative products. Derivatives are used to maintain asset mix or adjust portfolio risk exposure. While these financial instruments may contain varying degrees of risk and may be subject to redemption lockups, Essentia's risk is limited to its capital balance in each investment.

At June 30, 2018, alternative investments recorded at NAV consisted of the following:

	Fair Value	Unfunded Commitment	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Absolute return funds (a)	\$ 79,952	\$ -	90–182 days	65–90 days
Hedge funds (b)	105,443	1,500	Monthly to annually	1–105 days
	<u>\$ 185,395</u>	<u>\$ 1,500</u>		

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 5. Investments and Assets Whose Use Is Limited (Continued)

At June 30, 2017, alternative investments recorded at NAV consisted of the following:

	Fair Value	Unfunded Commitment	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Absolute return funds (a)	\$ 75,415	\$ -	90–182 days	65–90 days
Hedge funds (b)	106,269	1,800	Monthly to annually	1–107 days
	<u>\$ 181,684</u>	<u>\$ 1,800</u>		

- (a) This category includes investments in absolute return funds, which are actively managed commingled fund of funds that derive the majority of their returns from factors other than the directional flow of the markets in which they invest. Representative strategies include high-yield credit, distressed debt, merger arbitrage and relative value. The fair values of the investments in this category generally carry “lockup” restrictions that do not allow investors to seek redemption in the first year after acquisition. Following the initial lockup period, liquidity is generally available monthly, quarterly or annually following a redemption request. Over 97 percent of the investments in this category have at least annual liquidity.
- (b) This category includes investments in hedge equity funds, which are actively managed commingled fund of funds that derive the majority of their returns from factors other than the directional flow of the markets in which they invest. Representative strategies include long-short strategies; merger and arbitrage strategies; the use of options; and investing in non-U.S. currencies, commodities, precious metals and stock indices. The fair values of the investments in this category generally carry “lockup” restrictions that do not allow investors to seek redemption in the first year after acquisition. Following the initial lockup period, liquidity is generally available monthly, quarterly or annually following a redemption request. Over 97 percent of the investments in this category have at least annual liquidity.

Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements subsequent to year-end.

Investment return for the years ended June 30 consists of, and was reported in the consolidated statements of operations and changes in net assets, as follows:

	2018	2017
Dividends and interest	\$ 20,921	\$ 16,105
Net realized gains on investments	19,724	27,451
Net change in unrealized gains and losses on trading investments	53,092	63,504
Gross investment income	93,737	107,060
Less investment expenses related to investment return	5,484	5,097
	<u>\$ 88,253</u>	<u>\$ 101,963</u>
Other operating revenue	\$ 17	\$ 16
Nonoperating gains	88,115	101,795
Other changes in temporarily restricted net assets	121	152
	<u>\$ 88,253</u>	<u>\$ 101,963</u>

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Fair Value of Financial Instruments

Fair value is 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. The disclosure framework consists of a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. 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.

Essentia's valuation methodologies for assets and liabilities measured at fair value are as follows:

- Fair value for Level 1 is based upon quoted market prices in active markets for identical instruments.
- Fair value for Level 2 is 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 are obtained from various sources, including market participants, dealers and brokers.
- Fair value for Level 3 is based on unobservable market data, primarily credit valuation adjustments (CVAs) for derivative financial instruments. The fair value is determined by an independent third party utilizing a discounted cash flow methodology for valuing derivative financial instruments. The valuations reflect a credit spread adjustment to the London Interbank Offered Rate (LIBOR) swap curve in order to reflect CVAs for nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds priced in the market. As of June 30, 2018 and 2017, Essentia's fair value of swaps included a CVA of \$173 and \$101, respectively.

The methods described above may produce a fair value calculation that is not indicative of net realizable value or reflective of future fair values. Furthermore, while Essentia 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.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Fair Value of Financial Instruments (Continued)

Financial instruments carried at fair value as of June 30, 2018, for each caption on the consolidated balance sheet, are analyzed by the fair value hierarchy as follows:

	June 30, 2018			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
Short-term investments:				
Domestic equity securities	\$ 9,754	\$ -	\$ -	\$ 9,754
Mutual funds—equity securities	9,500	-	-	9,500
Other	5,049	2,607	-	7,656
Current assets whose use is limited:				
Mutual funds—debt securities	-	-	-	-
Other	6,262	1,513	-	7,775
Long-term assets whose use is limited:				
Domestic equity securities	268,855	-	-	268,855
International equity securities	65,518	-	-	65,518
Mutual funds—equity securities	330,471	-	-	330,471
Mutual funds—debt securities	97,183	-	-	97,183
Preferred equity securities	-	5,542	-	5,542
Certificates of deposit	-	14,229	-	14,229
U.S. government agency debt securities	-	20,051	-	20,051
Corporate debt securities	-	30,688	-	30,688
Swap assets	-	-	3,548	3,548
Total assets valued at fair value	<u>\$ 792,592</u>	<u>\$ 74,630</u>	<u>\$ 3,548</u>	870,770
Investments recorded at fair value based on NAV				185,395
Investments recorded at cost (cash and cash equivalents)				103,805
Total assets				<u>\$ 1,159,970</u>
Liabilities:				
Swap liabilities	\$ -	\$ -	\$ (10,285)	\$ (10,285)

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Fair Value of Financial Instruments (Continued)

Financial instruments carried at fair value as of June 30, 2017, for each caption on the consolidated balance sheet, are analyzed by the fair value hierarchy as follows:

	June 30, 2017			
	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Short-term investments:				
Domestic equity securities	\$ 9,034	\$ -	\$ -	\$ 9,034
Mutual funds—equity securities	9,867	-	-	9,867
Other	6,726	2,570	-	9,296
Current assets whose use is limited:				
Mutual funds—debt securities	2,146	-	-	2,146
Other	2,153	1,484	-	3,637
Long-term assets whose use is limited:				
Domestic equity securities	232,643	-	-	232,643
International equity securities	60,507	-	-	60,507
Mutual funds—equity securities	292,483	-	-	292,483
Mutual funds—debt securities	145,572	-	-	145,572
Preferred equity securities	-	5,710	-	5,710
Certificates of deposit	-	14,415	-	14,415
U.S. government agency debt securities	-	18,677	-	18,677
Corporate debt securities	-	26,383	-	26,383
Swap assets	-	-	2,502	2,502
Total assets valued at fair value	<u>\$ 761,131</u>	<u>\$ 69,239</u>	<u>\$ 2,502</u>	<u>832,872</u>
Investments recorded at fair value based on NAV				181,684
Investments recorded at cost (cash and cash equivalents)				59,506
Total assets				<u>\$ 1,074,062</u>
Liabilities:				
Swap liabilities	\$ -	\$ -	\$ (14,212)	\$ (14,212)

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 6. Fair Value of Financial Instruments (Continued)

The following table is a rollforward of the consolidated balance sheet amounts for financial instruments classified by Essentia in Level 3 of the valuation hierarchy:

	Swap Assets and Liabilities, Net
	<u>Net</u>
Fair value at June 30, 2016	\$ (16,721)
Realized and unrealized gain, net, on swap agreements included in excess of revenue and gains over expenses and losses	3,853
Settlements	1,158
Fair value at June 30, 2017	<u>(11,710)</u>
Realized and unrealized gain, net, on swap agreements included in excess of revenue and gains over expenses and losses	3,457
Settlements	1,516
Fair value at June 30, 2018	<u><u>\$ (6,737)</u></u>

Note 7. Property and Equipment

Property and equipment at June 30 are summarized as follows:

	2018	2017
	<u>2018</u>	<u>2017</u>
Land and land improvements	\$ 50,663	\$ 49,960
Buildings and building improvements	925,556	915,777
Furniture and equipment	575,379	647,731
	<u>1,551,598</u>	<u>1,613,468</u>
Accumulated depreciation and amortization	(860,426)	(913,564)
	691,172	699,904
Construction in progress	23,588	29,557
	<u><u>\$ 714,760</u></u>	<u><u>\$ 729,461</u></u>

In January 2016, Essentia entered into agreements to lease a hospital building in Sandstone, Minnesota. Since the transaction did not qualify for sale-leaseback treatment, the building is treated as a financing transaction. The completed building cost of \$20,677 and \$20,657 at June 30, 2018 and 2017, respectively, and the related other long-term liability of \$20,004 and \$20,600 at June 30, 2018 and 2017, respectively, are included in the accompanying consolidated balance sheets.

In January 2009, Essentia entered into agreements to lease a portion of a medical office building. Since the transaction did not qualify for sale-leaseback treatment, the building is treated as a financing transaction. The completed building cost of \$10,272 at June 30, 2018 and 2017, and the related other long-term liability of \$8,212 and \$8,490 at June 30, 2018 and 2017, respectively, are included in the accompanying consolidated balance sheets.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 8. Other Noncurrent Assets

Other noncurrent assets at June 30 are summarized as follows:

	2018	2017
Notes receivable	\$ 8,223	\$ 8,088
Investment in joint ventures and related organizations (Note 1)	66,359	66,265
Intangible assets, less accumulated amortization of \$1,933 and \$1,532 in 2018 and 2017, respectively	6,762	7,163
Other	28,588	21,335
	<u>\$ 109,932</u>	<u>\$ 102,851</u>

Note 9. Long-Term Debt

Long-term debt at June 30 consists of the following:

	Annual Interest Rate	2018	2017
Essentia Obligated Group Revenue Bonds:			
Senior Secured Notes VVV, due through 2040	3.90%	\$ 89,855	\$ 90,000
Series 2014, due through 2024	Variable rate	26,960	27,685
Series 2014, due through 2019	Variable rate	42,230	43,025
Senior Secured Notes QQQ, due through 2035	3.99%	141,235	154,485
Series 2008A, 2008B and 2008C, due through 2037	3.00% to 5.50%	199,307	199,521
Series 2008D and 2008E, due through 2040	4.75% to 5.00%	42,779	42,790
Other, primarily capital leases and mortgages payable with annual principal payments through 2051	Various	35,997	38,091
Total debt before deferred financing costs		<u>578,363</u>	<u>595,597</u>
Deferred financing costs, less accumulated amortization of \$5,060 and \$4,465 in 2018 and 2017, respectively		<u>(6,220)</u>	<u>(6,874)</u>
Total debt		572,143	588,723
Less current portion		23,156	20,973
		<u>\$ 548,987</u>	<u>\$ 567,750</u>

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 9. Long-Term Debt (Continued)

Essentia's Obligated Group consists of the following entities:

Legal Entity	Operating Name
Critical Acces Group	CAG
St. Mary's Duluth Clinic Health System	EH East
St. Joseph's Medical Center	Essentia Health St. Joseph's Medical Center
St. Mary's Regional Health Center	Essentia Health St. Mary's Detroit Lakes
St. Mary's Medical Center	Essentia Health St. Mary's Medical Center
SMDC Medical Center	Essentia Health Duluth
Polinsky Medical Rehabilitation Center	EH Polinsky Rehabilitation Center
St. Mary's Hospital of Superior	Essentia Health St. Mary's Hospital Superior
Brainerd Medical Center, Inc.	Essentia Health Brainerd Specialty Clinic
Brainerd Lakes Integrated Health System	EH Central
St. Mary's Innovis Health	St. Mary's Innovis Health
The Duluth Clinic, Ltd.	The Duluth Clinic Ltd.
Innovis Health, LLC	EH West

Certain indebtedness of members of the Obligated Group and related entities is secured by notes issued under the Amended and Restated Master Trust Indenture, dated as of April 1, 1999 (the Master Trust Indenture, or MTI), and related documents, which require Obligated Group members to be jointly and severally obligated for the debt service on all obligations issued thereunder. Certain of Essentia's debt agreements contain "cross-default" provisions that may result in an event of default if there is a failure under other debt agreements to meet payment terms or to observe other covenants that would result in an acceleration of payments due.

All Obligated Group members have pledged certain unrestricted receivables and certain pass-through obligations for payment of long-term indebtedness issued under the MTI. No pass-through obligations were subject to the pledge as of June 30, 2018. Most of the non-Obligated Group's debt is secured by certain assets of the entity that has borrowed the proceeds from the debt issue.

In December 2016, Essentia issued nonrated, taxable Senior Secured Notes VVV in the amount of \$90,000. The outstanding balance on the Series 2008D Revenue Bonds in the amount of \$63,700 was advance refunded with the proceeds.

In July 2014, Essentia issued Variable Rate Revenue Bonds, Series 2014—MN, in the amount of \$29,480. The outstanding balance on the Series 2011 Revenue Bonds in the amount of \$25,155 was refinanced with the proceeds. The bonds are subject to a mandatory tender following an initial period, which ends July 2024, at which time the outstanding principal plus accrued interest becomes due.

In June 2014, Essentia issued Variable Rate Revenue Bonds, Series 2014—ND, in the amount of \$45,000. The bonds are subject to a mandatory tender following an initial period, which ends in July 2019, at which time outstanding principal plus accrued interest becomes due. The loan agreement includes a provision that if Essentia's bond rating drops below BBB+, or its equivalent, Essentia would be deemed in default of this agreement. As discussed in Note 16, Essentia is in the process of issuing new revenue bonds which would use a portion of proceeds to refinance the Series 2014-ND bonds.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 9. Long-Term Debt (Continued)

In February 2013, Essentia issued nonrated, taxable Senior Secured Notes QQQ in the amount of \$159,525. The outstanding Variable Rate Revenue Bonds, Series 2010, in the amount of \$101,305 and certain other revenue bonds totaling \$7,087 were refinanced with the proceeds.

In February 2010, Essentia restructured a portion of the outstanding Variable Rate Demand Revenue Bonds, Series 2008, which included converting \$234,195 of Series 2008A, Series 2008B and Series 2008C-1 Variable Rate Demand Bonds to fixed-rate bonds with annual interest rates ranging from 3.00 percent to 5.50 percent.

In March 2016, Essentia entered into a joint long-term master revolving line of credit with two banks under which it may borrow up to an aggregate of \$90,000. The annual interest rate is based on LIBOR plus an applicable margin (2.64 percent at June 30, 2018). The line of credit terminates in March 2019, with the option of extension upon mutual consent of the banks and Essentia. The line of credit is secured by a note issued under the MTI and is an obligation of the Essentia Obligated Group. As of June 30, 2018 and 2017, there were no amounts outstanding on the line of credit. Subsequent to year-end, Essentia terminated the existing joint long-term master revolving line of credit and entered into a new long-term master revolving line of credit. The new line of credit is with one bank under which Essentia may borrow up to an aggregate of \$90,000. The annual interest is based on LIBOR plus an applicable margin. The line of credit terminates July 2020.

Deferred financing costs, consisting primarily of underwriting fees and discounts, credit enhancement fees and legal fees, are amortized using the interest method over the period that the obligation is outstanding.

The aggregate annual maturities of long-term debt, excluding the line of credit, for the five years subsequent to June 30, 2018, are as follows:

Years ending June 30:

2019	\$	23,156
2020		62,831
2021		19,254
2022		19,665
2023		20,061

The MTI contains various covenants, including the requirement for the Essentia Obligated Group to maintain certain financial ratios, limit the incurrence of significant additional indebtedness, and limit transfers to non-Obligated Group members. Management believes the Obligated Group is in compliance with these covenants as of June 30, 2018. The proceeds of bonds, which were placed in various trust funds to be used in accordance with the applicable indenture provisions, are as follows at June 30:

	2018	2017
Bond interest, principal and construction funds	\$ 1,361	\$ 1,926
Debt service reserve funds	452	425
	1,813	2,351
Less current portion	1,361	1,926
Total long-term portion	\$ 452	\$ 425

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 9. Long-Term Debt (Continued)

The following is a summary of the outstanding positions under swap arrangements at June 30, 2018:

Instrument Type	Notional Amount	Maturity Date	Rate Paid	Rate Received
Fixed-payor swaps	\$ 50,875	2032 to 2037 with mandatory tender to 2023	3.37% to 3.44%	68% of 1-month LIBOR
Basis swaps	31,860	2040 with mandatory tender to 2023	SIFMA	68% of 1-month LIBOR plus 0.61%
Basis swaps	174,023	2030 to 2040	SIFMA	68% of 1-month LIBOR plus 0.14% to 0.17%; 68% of 3-month LIBOR plus 0.11% to 0.56%; 91.25% of 3-month LIBOR

Interest paid and received is based on swap rates, which are derived from LIBOR, the Securities Industry and Financial Markets Association (SIFMA), and the International Swaps and Derivatives Association (ISDA).

Swap assets are reported in prepaid expenses and other receivables and other noncurrent assets. Swap liabilities are reported in other current liabilities and other noncurrent liabilities in the consolidated balance sheets, as follows:

	Notional Amount	Assets		Liabilities		Nonoperating (Loss) Gain	
		2018	2017	2018	2017	2018	2017
Fixed-payor swaps	\$ 50,875	\$ -	\$ -	\$ 9,202	\$ 11,970	\$ 1,565	\$ 4,121
Basis swaps	205,883	3,548	2,502	1,083	2,242	1,892	(268)
Total swaps	<u>\$ 256,758</u>	<u>3,548</u>	<u>2,502</u>	<u>10,285</u>	<u>14,212</u>	<u>\$ 3,457</u>	<u>\$ 3,853</u>
Less current portion		-	790	-	12,655		
Total long-term portion		<u>\$ 3,548</u>	<u>\$ 1,712</u>	<u>\$ 10,285</u>	<u>\$ 1,557</u>		

Certain Essentia derivative instruments contain provisions that require Essentia to post collateral when the net liability of the derivative instruments is greater than predetermined thresholds up to \$10,000. No collateral was required at June 30, 2018 or 2017.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract, which is generally limited to the fair value due from counterparties on outstanding contracts. At June 30, 2018 and 2017, the counterparties with fair values due to Essentia had a Standard & Poor's credit quality rating ranging from AA- to BBB+.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 10. Income Taxes

Deferred tax assets at June 30, 2018 and 2017, relate primarily to federal and state net operating loss (NOL) carryovers. As of June 30, 2018, Essentia had federal NOLs of \$4,245 and state NOLs of \$4,006. Due to the operating performance of Essentia's subsidiaries, a full valuation allowance of \$1,213 and \$2,570 has been established at June 30, 2018 and 2017, respectively, since it is more likely than not that none of the deferred tax assets will be realized.

The statute of limitations for tax years ended June 30, 2015, through June 30, 2018, remains open to examination by the major U.S. taxing jurisdictions to which Essentia is subject. In addition, for all tax years generating an NOL prior to June 30, 2015, tax authorities have the right to adjust the amount of the NOL.

On December 22, 2017, the president of the United States signed into law the Tax Cuts and Jobs Act (TCJA) tax reform legislation. This legislation makes significant changes in U.S. tax law, including a reduction in the corporate tax rates from 35 percent to 21 percent, changes to net operating loss carryforwards and carrybacks, and a repeal of the corporate alternative minimum tax. As a result of the enacted law, Essentia was required to revalue deferred tax assets at the enacted rate. This revaluation resulted in a reduction in the deferred tax asset of \$552. The other provisions of the TCJA did not have a material impact on the 2018 consolidated financial statements.

Note 11. Employee Benefit Plans

Defined benefit retirement plans: Essentia sponsors two defined benefit retirement plans, which cover certain groups of Essentia's employees (collectively, the Plans). Although the defined benefit plans are closed to new participants, certain plan participants continue to accrue benefits.

Effective July 31, 2002, the St. Mary's Medical Center plan, which is the most significant of the defined benefit retirement plans, received a letter from the Internal Revenue Service ruling this plan a "Church Plan" as defined in the Code section 414(e). As a result, the funding requirements of the Employee Retirement Income Security Act of 1974 and the Pension Protection Act of 2006 do not apply to the St. Mary's Medical Center plan.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

A summary of the change in the benefit obligation, the change in plan assets and the resulting funded status, the amounts recognized in the consolidated balance sheets, and the components of net periodic benefit of the Plans as of and for the years ended June 30 (measurement date) are as follows:

	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 270,606	\$ 283,520
Service cost	753	1,490
Interest cost	8,680	8,152
Actuarial gain	(12,326)	(12,384)
Benefits paid	(10,636)	(9,258)
Settlement	(1,318)	(914)
Benefit obligation at end of year	<u>255,759</u>	<u>270,606</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	168,596	151,184
Actual return on plan assets	12,937	17,281
Contributions	12,075	10,672
Benefits paid	(10,636)	(9,258)
Expenses paid	(670)	(369)
Settlement	(1,318)	(914)
Fair value of plan assets at end of year	<u>180,984</u>	<u>168,596</u>
Net liability recognized (underfunded plans)	<u>\$ (74,775)</u>	<u>\$ (102,010)</u>

Accumulated benefit obligation was \$254,646 and \$268,724 at June 30, 2018 and 2017, respectively.

Essentia offers eligible employees a nonqualified, tax-deferred compensation retirement plan. Employees defer compensation into the plan on a pretax basis. For the most part, the plan operates similar to a defined contribution plan. Essentia has recorded the investments maintained as part of the deferred compensation plan of \$82,056 and \$73,200 for the years ended June 30, 2018 and 2017, respectively, within assets whose use is limited, other, with a corresponding liability being recorded within employee benefit plan liabilities.

Changes in plan assets and benefit obligations recognized in unrestricted net assets during the years ended June 30 consist of the following:

	2018	2017
Current-year actuarial gain	\$ (13,526)	\$ (18,391)
Amortization of unrecognized net actuarial loss	(3,393)	(4,022)
Recognition of net loss	(614)	(445)
Total	<u>\$ (17,533)</u>	<u>\$ (22,858)</u>

Actuarial losses included in unrestricted net assets that have not been recognized in net periodic pension cost at June 30, 2018 and 2017, were \$105,600 and \$123,133, respectively. It is expected that actuarial losses recognized in net periodic pension cost during the year ending June 30, 2019, will be \$2,948. Unrecognized actuarial losses are amortized on a straight-line basis.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

Components of net periodic pension cost for the years ended June 30 are as follows:

	2018	2017
Service cost	\$ 753	\$ 1,490
Interest cost	8,680	8,152
Expected return on plan assets	(11,735)	(10,904)
Amortization of unrecognized net actuarial loss	3,393	4,022
Recognition of net loss	614	445
Net periodic pension cost	<u>\$ 1,705</u>	<u>\$ 3,205</u>

	2018	2017
Weighted-average assumptions:		
Discount rate at end of year (used to determine benefit obligation)	4.23% to 4.25%	3.79% to 3.84%
Discount rate at beginning of year (used to determine net periodic benefit cost)	3.79% to 3.84%	3.62% to 3.69%
Expected annual return on plan assets	6.95%	7.25%
Rate of annual compensation increase	2.60%	2.70%

The components of net periodic pension cost, other than service cost component, are included in the line item "Other, net" in the nonoperating gains (losses), net section in the consolidated statements of operations and changes in net assets. Service cost is reported within salaries, wages and related benefits in the consolidated statements of operations and changes in net assets.

The overall weighted-average return on plan assets is determined by applying management's judgment to the results of computer modeling, historical trends, and benchmarking data.

The Investment Committee of the Plans, which consists of at least two members of the Board of Directors and a minimum of four staff members, annually reviews and approves the investment policy and asset allocation targets. The Investment Committee activities are supported by an independent investment consulting firm. The investment policy covers responsibilities of the investment managers, investment objectives, asset allocation targets and ranges, asset guidelines, and manager review criteria. The Investment Committee reviews asset allocation quarterly to determine if the current structure is appropriate and whether any changes are necessary. All assets are invested with outside managers.

The current target allocation and the actual asset allocation as of June 30 are as follows:

	Asset Allocation Target	2018	2017
Equity securities	0% to 70%	43%	48%
Debt securities	30% to 90%	30%	25%
Cash and cash equivalents	0% to 20%	5%	3%
Other (primarily alternative investments)	0% to 50%	22%	24%
Total		<u>100%</u>	<u>100%</u>

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

The fair value of the Plans' pension plan assets was determined using the fair value hierarchy, as defined in Note 6, as follows, at June 30, 2018:

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Domestic equity securities	\$ 39,651	\$ -	\$ -	\$ 39,651
International equity securities	10,861	-	-	10,861
Mutual funds—equity securities	27,804	-	-	27,804
Mutual funds—debt securities	1,107	-	-	1,107
Corporate debt securities	-	53,805	-	53,805
Immediate participation guarantee contracts	-	-	7,554	7,554
	<u>\$ 79,423</u>	<u>\$ 53,805</u>	<u>\$ 7,554</u>	<u>140,782</u>
Investments recorded at fair value based on NAV				32,030
Investments recorded at cost (cash and cash equivalents)				<u>8,172</u>
				<u>\$ 180,984</u>

The fair value of the Plans' pension plan assets was determined using the fair value hierarchy, as defined in Note 6, as follows, at June 30, 2017:

	June 30, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Domestic equity securities	\$ 37,200	\$ -	\$ -	\$ 37,200
International equity securities	10,595	-	-	10,595
Mutual funds—equity securities	34,966	-	-	34,966
Mutual funds—debt securities	994	-	-	994
Corporate debt securities	-	40,729	-	40,729
Immediate participation guarantee contracts	-	-	7,928	7,928
	<u>\$ 83,755</u>	<u>\$ 40,729</u>	<u>\$ 7,928</u>	<u>132,412</u>
Investments recorded at fair value based on NAV				32,437
Investments recorded at cost (cash and cash equivalents)				<u>3,747</u>
				<u>\$ 168,596</u>

Fair value methodologies for Level 1 and Level 2 investments, as well as investments recorded at NAV, are consistent with the inputs described in Note 6. Fair value for Level 3 immediate participation guarantee contracts (IPGC) is based on the present value of a hypothetical bond with similar characteristics of the underlying assets in an unquoted market.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

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

	Immediate Participation Guarantee Contracts
Fair value at June 30, 2016	\$ 8,131
Purchases, issuances and settlements, net	(22)
Actual return on plan assets	(181)
Fair value at June 30, 2017	7,928
Purchases, issuances and settlements, net	(18)
Actual return on plan assets	(356)
Fair value at June 30, 2018	<u>\$ 7,554</u>
Change in unrealized gains on investments held at June 30, 2018	<u>\$ (356)</u>

At June 30, 2018, alternative investments recorded at NAV consisted of the following:

	Fair Value	Unfunded Commitment	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Absolute return funds (a)	\$ 14,074	\$ -	90–182 days	65 days
Hedge funds (b)	8,503	-	Quarterly to annually	65 days
Private equity funds (c)	9,453	6,607	Not eligible	
	<u>\$ 32,030</u>	<u>\$ 6,607</u>		

At June 30, 2017, alternative investments recorded at NAV consisted of the following:

	Fair Value	Unfunded Commitment	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Absolute return funds (a)	\$ 17,476	\$ -	90–182 days	65–90 days
Hedge funds (b)	7,663	-	Annually	60 days
Private equity funds (c)	7,298	9,651	Not eligible	
	<u>\$ 32,437</u>	<u>\$ 9,651</u>		

(a) and (b) See Note 5 for description of these funds.

(c) This category includes investments in private equity funds. The funds seek U.S. and global exposure to the private asset subclasses of venture capital, buyouts, debt, real estate, and real assets over the course of a market cycle through a diversified fund of funds.

During the year ending June 30, 2019, Essentia expects to make discretionary pension contributions of \$11,600 to the Plans.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

The following benefits, which reflect expected future service, are expected to be paid:

Years ending June 30:		
2019	\$	11,999
2020		12,438
2021		13,180
2022		13,821
2023		14,695
2024–2028		81,159

Other postretirement benefits: In addition to the defined benefit plans, Essentia sponsors various other postretirement benefit plans. The projected benefit obligation related to these plans was approximately \$11,400 and \$12,400 as of June 30, 2018 and 2017, respectively. Expense recognized by Essentia for those plans was approximately \$673 and \$725 for the years ended June 30, 2018 and 2017, respectively.

Other plans: Under a collective bargaining agreement, Essentia contributes to a union-sponsored multiemployer retirement plan. The risks of participating in a multiemployer plan differ from the risks of participating in a single-employer plan in the following aspects: (a) assets contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers; (b) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers; and (c) if Essentia chooses to stop participating in its multiemployer plan and if the plan is underfunded, Essentia may be required to pay the plan an amount based on the underfunded status of the plan, referred to as the withdrawal liability.

Essentia's participation in the multiemployer plan for the years ended June 30, 2018 and 2017, is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number, if applicable. Unless otherwise noted, the most recent Pension Protection Act zone status available in 2018 and 2017 is for the plan's year-end at December 31, 2017 and 2016, respectively. The zone status is based on information that Essentia received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the range of expiration dates of various collective bargaining agreements to which the plan is subject.

Pension Fund	EIN/Pension Plan Number	Pension Protection Act Zone Status		FIP/RP Status Pending/Implemented	Contributions of Essentia		Surcharge Imposed	Expiration Date of Collective Bargaining Agreement
		2018	2017		2018	2017		
Steelworkers Pension Trust	23-6648508/499	Green	Green	N/A	\$ 4,161	\$ 4,049	No	June 30, 2018 to January 31, 2021

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 11. Employee Benefit Plans (Continued)

The union-sponsored multiemployer plan was at least 80 percent funded at December 31, 2017 and 2016. Total amounts expensed under the union-sponsored multiemployer plan were \$4,166 and \$4,087 for the years ended June 30, 2018 and 2017, respectively. Essentia is required to make contributions ranging from 3 percent to 5 percent of covered employees' gross earnings for the year ended December 31, 2017. At the date Essentia's consolidated financial statements were issued, the Form 5500 that is filed to satisfy certain reporting requirements was not available for the union-sponsored multiemployer plan's year ended December 31, 2017.

Substantially all of Essentia's entities have individual defined contribution plans covering most of their employees. Contributions are based on a percentage of eligible employees' salaries. Total pension expense relating to the defined contribution pension plans was \$41,123 and \$39,331 for the years ended June 30, 2018 and 2017, respectively.

Note 12. Self-Insurance Program

EHIS provides insurance coverage to most of Essentia's members (except the critical access hospitals) on a claims-made basis with limits of \$5,000 per claim and \$12,000 in the aggregate per policy year for professional liabilities and \$3,000 per claim and \$6,000 in the aggregate for each policy year for general liabilities. Premiums are based on claims experience. Essentia's rural critical access hospitals are insured by a commercial insurance policy with a \$25 deductible and limits of \$2,000 per claim and \$6,000 in the aggregate per policy year on a claims-made basis for both professional liability and general liability risks. Essentia has self-funded the estimated value of professional and general liability claims, which amounted to \$56,896 and \$46,132 at June 30, 2018 and 2017, respectively, based on historical data, and includes IBNR claims. Essentia has purchased excess professional and general liability insurances from the commercial insurance market with limits totaling \$35,000 per claim and in the aggregate per policy year.

Essentia is self-insured for workers' compensation claims, employee health care claims, and unemployment compensation risks, with stop-loss coverage above certain limits. Essentia is required to post security under its self-insured workers' compensation program, which was \$11,919 and \$11,911 at June 30, 2018 and 2017, respectively. Essentia has entered into a surety bond agreement to comply with this requirement.

Note 13. Commitments and Contingencies

Essentia has been working on various remodeling projects as well as a clinic and hospital construction project. The remaining total cost of the projects is anticipated to be \$34,775, most of which will be debt-financed.

Essentia has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$17,019 and \$16,256 for the years ended June 30, 2018 and 2017, respectively.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 13. Commitments and Contingencies (Continued)

Future minimum lease payments on operating leases in effect on June 30, 2018, for each of the five subsequent years and thereafter are as follows:

Years ending June 30:		
2019	\$	10,132
2020		7,527
2021		6,852
2022		6,560
2023		6,280
Thereafter		45,826
	\$	<u>83,177</u>

In connection with a corporate reorganization of BSBA, assets and liabilities of certain facilities were transferred to Essentia in 1985. BSBA retains title to the land occupied by these facilities and has leased the land to the facilities through June 30, 2040. Minimum annual lease payments are \$24,921 over the remaining lease period, adjusted for inflation. Lease payments were \$881 and \$870 for the years ended June 30, 2018 and 2017, respectively.

Essentia is a defendant in legal proceedings arising in the ordinary course of business. Although the outcomes of these proceedings cannot be determined, in the opinion of management, they will not have a material adverse effect on Essentia's consolidated financial position or results of operations. However, there can be no assurance that this will be the case.

At June 30, 2018, 37 percent of employees are represented by 37 collective bargaining agreements, of which 14 will expire within one year.

Note 14. Functional Expenses

Essentia Health provides general health care services to residents within its geographic locations. Expenses related to providing these services included in the consolidated statements of operations and changes in net assets for the years ended June 30 are as follows:

	2018	2017
Health care services	\$ 1,603,140	\$ 1,506,551
General and administrative	451,877	450,143
Fundraising	295	305
	<u>\$ 2,055,312</u>	<u>\$ 1,956,999</u>

Note 15. Campus Replacement and Other Costs

During fiscal year 2018, Essentia incurred certain expenses related to consulting and other fees for the Vision Northland Project (see Note 16), accelerated depreciation on certain property that will be impacted by the Vision Northland Project, and leadership transition costs that occurred in 2018.

Essentia Health

Notes to Consolidated Financial Statements (Dollars in Thousands)

Note 16. Subsequent Events

Essentia's management evaluated events and transactions occurring subsequent to June 30, 2018, through September 11, 2018, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements, except as described in Note 9 and below.

In September 2018, the Essentia Health Board of Directors approved the issuance of revenue bonds to finance a comprehensive facilities construction and relocation project to address aging facilities on the Essentia East medical campus in downtown Duluth, Minnesota (the Vision Northland Project), and the refinancing of certain currently outstanding revenue bonds. The Vision Northland Project is expected to include constructing and equipping a new acute care hospital, clinic and outpatient surgery center, and remodeling existing facilities of Essentia at a cost of \$675,000, plus the cost of issuance and capitalized interest. Essentia anticipates that the sources of capital to finance the Vision Northland Project and refinance \$112,000 of certain currently outstanding revenue bonds will be the recently approved revenue bond proceeds of approximately \$750,000 plus approximately \$110,000 in additional funds from any combination of unrestricted net assets, philanthropy or future debt issuances.

Supplementary Information



RSM US LLP

Independent Auditor's Report on the Supplementary Information

The Board of Directors
Essentia Health

We have audited the consolidated financial statements of Essentia Health as of and for the years ended June 30, 2018 and 2017, and have issued our report thereon, which contains an unmodified opinion on those consolidated financial statements (see pages 1 and 2). Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplementary information, except for that portion marked "unaudited," has been subjected to the auditing procedures applied in the audits 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. The information marked "unaudited" has not been subjected to the auditing procedures applied in the audits of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it. In our opinion, except for that portion marked "unaudited," the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

RSM US LLP

Minneapolis, Minnesota
September 11, 2018

Essentia Health

Schedule of Community Service and Charity Care Provided (Unaudited) Years Ended June 30, 2018 and 2017 (Dollars in Thousands)

Essentia maintains records to identify and monitor the level of community service and charity care provided. These records include management's estimate of the cost of services and supplies furnished for community service programs, the cost to provide charity care and the cost in excess of reimbursement from public programs, which were estimated as follows for the years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Cost of providing charity care	\$ 17,690	\$ 13,657
Costs in excess of Medicaid payments	81,362	83,469
Medicaid surcharge and MinnesotaCare tax	25,226	24,754
Community services	4,658	4,677
Education and work force development	6,019	4,569
Research	1,424	1,555
Cash and in-kind donations	525	730
Total cost of community benefits*	136,904	133,411
Cost in excess of Medicare payments	177,641	163,784
Other care provided without compensation (bad debt, at cost)	14,734	20,265
Discounts offered to uninsured patients (at cost)	15,399	13,339
Taxes and fees	5,768	5,560
Total value of community contributions	\$ 350,446	\$ 336,359
Cost of community benefits as a percent of total operating expenses	<u>6.7%</u>	<u>6.8%</u>
Value of community contributions as a percent of total operating expenses	<u>17.1%</u>	<u>17.2%</u>

*As defined in the Catholic Health Association/VHA Inc. guidelines.

Essentia Health

Consolidating Balance Sheet June 30, 2018 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Assets				
Current assets:				
Cash and cash equivalents	\$ 15,620	\$ 13,405	\$ -	\$ 29,025
Short-term investments	29,378	617	-	29,995
Current portion of assets whose use is limited	1,089	12,007	-	13,096
Patient accounts receivable, less allowances for uncollectible accounts	193,529	35,419	-	228,948
Amounts due from affiliates	1,339	2,000	(3,339)	-
Prepaid expenses and other receivables	42,443	7,977	(151)	50,269
Inventories	44,611	5,823	-	50,434
Total current assets	328,009	77,248	(3,490)	401,767
Assets whose use is limited, less current portion:				
Funds designated by Board	885,275	69,110	-	954,385
Funds held by trustee	-	452	-	452
Funds held under self-insurance program	-	49,481	-	49,481
Funds held for deferred compensation and other	82,090	26,923	-	109,013
	967,365	145,966	-	1,113,331
Property and equipment, net	631,089	83,671	-	714,760
Other noncurrent assets, net	105,401	8,164	(3,633)	109,932
Total assets	\$ 2,031,864	\$ 315,049	\$ (7,123)	\$ 2,339,790

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Liabilities and Net Assets				
Current liabilities:				
Accounts payable	\$ 30,451	\$ 5,200	\$ -	\$ 35,651
Payable to third-party payors	2,449	386	-	2,835
Accrued liabilities:				
Salaries, wages and benefits	146,244	10,800	-	157,044
Interest	8,147	182	-	8,329
Amounts due to affiliates	2,000	1,339	(3,339)	-
Current portion of long-term debt	21,173	2,134	(151)	23,156
Other	9,678	15,037	-	24,715
Total current liabilities	220,142	35,078	(3,490)	251,730
Long-term debt	525,184	27,436	(3,633)	548,987
Employee benefit plan and deferred compensation liabilities	166,533	1,292	-	167,825
Self-insurance program liabilities	31,467	23,058	-	54,525
Other noncurrent liabilities	23,780	29,755	-	53,535
Total liabilities	967,106	116,619	(7,123)	1,076,602
Net assets:				
Unrestricted	1,064,724	186,942	-	1,251,666
Temporarily restricted	-	9,999	-	9,999
Permanently restricted	34	1,489	-	1,523
Total net assets	1,064,758	198,430	-	1,263,188
Total liabilities and net assets	\$ 2,031,864	\$ 315,049	\$ (7,123)	\$ 2,339,790

Essentia Health

Consolidating Balance Sheet June 30, 2017 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Assets				
Current assets:				
Cash and cash equivalents	\$ 6,770	\$ 17,152	\$ -	\$ 23,922
Short-term investments	29,066	594	-	29,660
Current portion of assets whose use is limited	1,056	10,852	-	11,908
Patient accounts receivable, less allowances for uncollectible accounts	195,892	38,640	-	234,532
Amounts due from affiliates	1,714	-	(1,714)	-
Prepaid expenses and other receivables	42,405	8,838	-	51,243
Inventories	45,700	5,313	-	51,013
Total current assets	322,603	81,389	(1,714)	402,278
Assets whose use is limited, less current portion:				
Funds designated by Board	831,340	61,225	-	892,565
Funds held by trustee	-	425	-	425
Funds held under self-insurance program	-	37,107	-	37,107
Funds held for deferred compensation and other	73,233	26,662	-	99,895
	904,573	125,419	-	1,029,992
Property and equipment, net	640,279	89,182	-	729,461
Other noncurrent assets, net	105,546	1,240	(3,935)	102,851
Total assets	\$ 1,973,001	\$ 297,230	\$ (5,649)	\$ 2,264,582

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Liabilities and Net Assets				
Current liabilities:				
Accounts payable	\$ 29,682	\$ 3,727	\$ (22)	\$ 33,387
Payable to third-party payors	15,264	2,019	-	17,283
Accrued liabilities:				
Salaries, wages and benefits	148,609	11,027	-	159,636
Interest	8,289	195	-	8,484
Amounts due to affiliates	-	1,579	(1,579)	-
Current portion of long-term debt	18,956	2,130	(113)	20,973
Other	23,994	11,207	-	35,201
Total current liabilities	244,794	31,884	(1,714)	274,964
Long-term debt	542,138	29,547	(3,935)	567,750
Employee benefit plan and deferred compensation liabilities	186,305	1,147	-	187,452
Self-insurance program liabilities	14,407	34,178	-	48,585
Other noncurrent liabilities	35,509	7,762	-	43,271
Total liabilities	1,023,153	104,518	(5,649)	1,122,022
Net assets:				
Unrestricted	949,814	181,443	-	1,131,257
Temporarily restricted	-	9,827	-	9,827
Permanently restricted	34	1,442	-	1,476
Total net assets	949,848	192,712	-	1,142,560
Total liabilities and net assets	\$ 1,973,001	\$ 297,230	\$ (5,649)	\$ 2,264,582

Essentia Health

Consolidating Statement of Operations and Changes in Net Assets Year Ended June 30, 2018 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Unrestricted revenue:				
Patient service revenue	\$ 1,773,790	\$ 269,392	\$ -	\$ 2,043,182
Provision for bad debts	(26,769)	(6,265)	-	(33,034)
Net patient service revenue	1,747,021	263,127	-	2,010,148
Other operating revenue	80,880	31,140	(55,892)	56,128
Total unrestricted revenue	1,827,901	294,267	(55,892)	2,066,276
Expenses:				
Salaries, wages and related benefits	1,154,087	164,489	(18,670)	1,299,906
Supplies	309,542	27,120	-	336,662
Purchased services and professional services	55,756	47,733	(19,543)	83,946
Utilities and maintenance	63,979	7,305	(225)	71,059
Professional liability and general insurance	18,218	20,991	(16,170)	23,039
Depreciation and amortization	79,613	11,849	-	91,462
Interest	23,846	1,610	-	25,456
Provider and other taxes	27,974	3,954	-	31,928
Other	60,804	20,348	(1,284)	79,868
Campus replacement and other costs	11,870	116	-	11,986
Total expenses	1,805,689	305,515	(55,892)	2,055,312
Income (loss) from operations	22,212	(11,248)	-	10,964
Nonoperating gains (losses), net:				
Investment income on funds designated by Board	13,665	1,634	-	15,299
Net realized gains on investments	17,037	2,687	-	19,724
Net change in unrealized gains and losses on trading securities	45,390	7,702	-	53,092
Gain on swap agreements	3,457	-	-	3,457
Other, net	(1,747)	364	-	(1,383)
Total nonoperating gains (losses), net	77,802	12,387	-	90,189
Excess of revenue and gains over expenses and losses	100,014	1,139	-	101,153
Other changes in unrestricted net assets:				
Pension and other postretirement liability adjustments	18,362	18	-	18,380
Other, net	(3,466)	4,342	-	876
Increase in unrestricted net assets	114,910	5,499	-	120,409

(Continued)

Essentia Health

Consolidating Statement of Operations and Changes in Net Assets (Continued) Year Ended June 30, 2018 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Temporarily restricted net assets:				
Contributions	\$ 385	\$ 2,446	\$ -	\$ 2,831
Net assets released from restrictions and other changes, net	(385)	(2,274)	-	(2,659)
Increase in temporarily restricted net assets	-	172	-	172
Permanently restricted net assets:				
Contributions and other changes, net	-	47	-	47
Total increase in net assets	114,910	5,718	-	120,628
Net assets at beginning of year	949,848	192,712	-	1,142,560
Net assets at end of year	\$ 1,064,758	\$ 198,430	\$ -	\$ 1,263,188

Essentia Health

Consolidating Statement of Operations and Changes in Net Assets Year Ended June 30, 2017 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Unrestricted revenue:				
Patient service revenue	\$ 1,715,696	\$ 265,683	\$ -	\$ 1,981,379
Provision for bad debts	(38,440)	(5,906)	-	(44,346)
Net patient service revenue	1,677,256	259,777	-	1,937,033
Other operating revenue	77,834	30,904	(55,404)	53,334
Total unrestricted revenue	1,755,090	290,681	(55,404)	1,990,367
Expenses:				
Salaries, wages and related benefits	1,116,767	161,619	(19,091)	1,259,295
Supplies	286,322	24,301	(1)	310,622
Purchased services and professional fees	63,099	36,451	(18,222)	81,328
Utilities and maintenance	58,510	6,880	(127)	65,263
Professional liability and general insurance	19,968	11,191	(16,532)	14,627
Depreciation and amortization	76,946	11,064	-	88,010
Interest	23,385	1,095	-	24,480
Provider and other taxes	27,843	4,041	-	31,884
Other	62,764	20,157	(1,431)	81,490
Total expenses	1,735,604	276,799	(55,404)	1,956,999
Income from operations	19,486	13,882	-	33,368
Nonoperating gains (losses), net:				
Investment income on funds designated by Board	9,801	1,039	-	10,840
Net realized gains on investments	24,876	2,575	-	27,451
Net change in unrealized gains and losses on trading securities	55,701	7,803	-	63,504
Gain on swap agreements	3,853	-	-	3,853
Other, net	(6,600)	18,959	-	12,359
Total nonoperating gains (losses), net	87,631	30,376	-	118,007
Excess of revenue and gains over expenses and losses	107,117	44,258	-	151,375
Other changes in unrestricted net assets:				
Pension and other postretirement liability adjustments	25,905	-	-	25,905
Other, net	(5,382)	6,301	-	919
Increase in unrestricted net assets	127,640	50,559	-	178,199

(Continued)

Essentia Health

Consolidating Statement of Operations and Changes in Net Assets (Continued) Year Ended June 30, 2017 (Dollars in Thousands)

	Essentia Health Obligated Group Members	Essentia Health Non-Obligated Group Members	Eliminations	Consolidated Essentia Health
Temporarily restricted net assets:				
Contributions	\$ 73	\$ 2,435	\$ -	\$ 2,508
Net assets released from restrictions and other changes, net	(93)	(2,273)	-	(2,366)
Increase (decrease) in temporarily restricted net assets	(20)	162	-	142
Permanently restricted net assets:				
Contributions and other changes, net	-	82	-	82
Total increase in net assets	127,620	50,803	-	178,423
Net assets at beginning of year	822,228	141,909	-	964,137
Net assets at end of year	<u>\$ 949,848</u>	<u>\$ 192,712</u>	<u>\$ -</u>	<u>\$ 1,142,560</u>

