

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Gundersen Health System
Years Ended December 31, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP



Gundersen Health System

Consolidated Financial Statements and Supplementary Information

Years Ended December 31, 2017 and 2016

Contents

Report of Independent Auditors	1
Consolidated Financial Statements	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7
Supplementary Information	
Report of Independent Auditors on Supplementary Information	35
Consolidating Balance Sheet	36
Consolidating Statement of Operations	37
Consolidating Statement of Changes in Net Assets.....	38



Ernst & Young LLP
875 East Wisconsin Avenue
Milwaukee, WI 53202

Tel: +1 414 273 5900
Fax: +1 414 223 7200
ey.com

Report of Independent Auditors

The Board of Trustees and Board of Governors
Gundersen Health System

We have audited the accompanying consolidated financial statements of Gundersen Health System, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Tri-County Memorial Hospital, Inc.; St. Joseph's Health Services, Inc.; Memorial Hospital of Boscobel; Moundview Memorial Hospital and Clinics; and Palmer Lutheran Health Center, Inc., wholly controlled affiliates, which statements reflect total assets constituting 4.7% and 4.0% in 2017 and 2016, respectively, and total operating revenue constituting 8.1% and 7.9% in 2017 and 2016, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Tri-County Memorial Hospital, Inc.; St. Joseph's Health Services, Inc.; Memorial Hospital of Boscobel; Moundview Memorial Hospital and Clinics; and Palmer Lutheran Health Center, Inc., is based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.



Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Gundersen Health System at December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

May 2, 2018

Gundersen Health System

Consolidated Balance Sheets (Dollars in Thousands)

	December 31	
	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 237,088	\$ 212,764
Investments	647,288	582,031
Current portion of investments whose use is limited	7,352	7,276
Patient accounts receivable, less allowance for uncollectible accounts	176,714	165,452
Other current assets	53,387	46,614
Total current assets	1,121,829	1,014,137
Investments whose use is limited	39,598	40,309
Notes receivable, net of current portion	1,684	1,665
Property and equipment, net	585,799	586,759
Investment in unconsolidated entities	29,378	28,607
Other noncurrent assets	18,981	18,452
Total assets	\$ 1,797,269	\$ 1,689,929
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 24,657	\$ 27,180
Accrued payroll	61,752	58,620
Accrued liabilities	67,891	74,540
Current maturities of long-term debt and capital lease obligations	11,653	10,834
Other current liabilities	1,405	6,632
Total current liabilities	167,358	177,806
Long-term debt and capital lease obligations, net of current maturities	389,563	397,140
Obligation under swap contracts	25,971	29,388
Other noncurrent liabilities	17,571	17,646
Total liabilities	600,463	621,980
Net assets:		
Unrestricted	1,166,624	1,040,846
Temporarily restricted	10,544	9,263
Permanently restricted	19,638	17,840
Total net assets	1,196,806	1,067,949
Total liabilities and net assets	\$ 1,797,269	\$ 1,689,929

See accompanying notes.

Gundersen Health System

Consolidated Statements of Operations (Dollars in Thousands)

	Year Ended December 31	
	2017	2016
Operating revenue:		
Net patient revenue before provision for uncollectible accounts	\$ 881,793	\$ 829,495
Provision for uncollectible accounts	(23,027)	(18,071)
Net patient revenue	858,766	811,424
Premium revenue	–	106,518
Capitation revenue	306,529	186,315
Other revenue	31,787	30,271
Total operating revenue and gains	1,197,082	1,134,528
Operating expenses:		
Salaries, wages, and benefits	676,541	637,899
Supplies	162,282	146,984
Capitation services	99,672	85,749
Depreciation and amortization	62,431	61,161
Facilities	38,220	34,471
Purchased services	41,441	41,395
Interest	18,070	18,006
Other operating expenses	54,598	54,035
Total operating expenses	1,153,255	1,079,700
Operating income	43,827	54,828
Nonoperating gains (losses):		
Investment gain, net	69,660	39,081
Contribution from business combination	9,441	–
Unrealized gain on interest rate swap contracts	3,417	4,443
Loss from unconsolidated entities	(470)	(4,051)
Other nonoperating losses, net	(1,279)	(65)
	80,769	39,408
Revenue in excess of expenses	\$ 124,596	\$ 94,236

See accompanying notes.

Gundersen Health System

Consolidated Statements of Changes in Net Assets (Dollars in Thousands)

	Year Ended December 31	
	2017	2016
Unrestricted net assets:		
Revenue in excess of expenses	\$ 124,596	\$ 94,236
Net assets released from restrictions to purchase property and equipment	973	2,349
Other changes in unrestricted net assets	209	2,026
Increase in unrestricted net assets	125,778	98,611
Temporarily restricted net assets:		
Contributions	4,092	4,096
Investment return	2,298	1,075
Net assets released from restriction	(5,842)	(8,852)
Contribution from business combination	571	-
Other changes in temporarily restricted net assets	162	145
Increase (decrease) in temporarily restricted net assets	1,281	(3,536)
Permanently restricted net assets:		
Contributions	1,130	1,523
Investment return	668	60
Increase in permanently restricted net assets	1,798	1,583
Increase in net assets	128,857	96,658
Net assets at beginning of year	1,067,949	971,291
Net assets at end of year	\$ 1,196,806	\$ 1,067,949

See accompanying notes.

Gundersen Health System

Consolidated Statements of Cash Flows (Dollars in Thousands)

	Year Ended December 31	
	2017	2016
Operating activities		
Increase in net assets	\$ 128,857	\$ 96,658
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	62,431	61,161
Provision for uncollectible accounts	23,027	18,071
Increase in fair value of swap contracts	(3,417)	(4,443)
Increase in unrealized gains on investments, net	(42,509)	(14,594)
Loss from unconsolidated entities	470	3,909
Contribution from business combination	(10,012)	-
Restricted contributions	(5,222)	(5,625)
Loss on sale of assets	619	168
Changes in operating assets and liabilities:		
Patient accounts receivable	(31,143)	(36,209)
Other current assets	(5,156)	(11,681)
Accounts payable, accrued, and other current liabilities	(13,896)	35,630
Other noncurrent assets and liabilities	6,278	(2,823)
Net cash provided by operating activities	110,327	140,222
Investing activities		
Purchases of property and equipment, net	(62,090)	(60,797)
Purchases of investments, net	(24,101)	(48,566)
Investment in unconsolidated entities	(374)	(5,209)
Cash received upon acquisition of affiliate	4,655	-
Other	1,102	1,313
Net cash used in investing activities	(80,808)	(113,259)
Financing activities		
Proceeds from issuance of bonds or long-term debt	-	40,000
Principal payments on long-term debt and capital lease obligations	(10,417)	(48,073)
Restricted contributions	5,222	5,625
Net cash used in financing activities	(5,195)	(2,448)
Net increase in cash and cash equivalents	24,324	24,515
Cash and cash equivalents at beginning of year	212,764	192,155
Cash balance of Health Plan as of May 2, 2016 (Note 3)	-	(3,906)
Cash and cash equivalents at end of year	\$ 237,088	\$ 212,764
Supplemental disclosures of cash flow information		
Interest paid, net of capitalized interest	\$ 17,910	\$ 17,246
Capital assets acquired with capital lease obligation	\$ 524	\$ 3,587

See accompanying notes.

Gundersen Health System

Notes to Consolidated Financial Statements (Dollars in Thousands)

December 31, 2017

1. Organization and Basis of Presentation

Gundersen Lutheran Health System, Inc. (Gundersen), located in La Crosse, Wisconsin, is the parent of Gundersen Lutheran Health System (the System), an integrated health care system that provides comprehensive medical care to patients primarily in Wisconsin, as well as in Iowa and Minnesota, by operating hospitals, clinics, health plans, long-term care facilities, ambulance services, a foundation, and an energy-producing company, in addition to providing medical and health/wellness education and community outreach, and conducting medical education and clinically based research.

The System operates under the name Gundersen Health System and consists of Gundersen and its wholly controlled affiliates, which are as follows at December 31, 2017:

Obligated Group

Gundersen Clinic, Ltd.
Gundersen Lutheran Medical Center, Inc.
Gundersen Lutheran Administrative Services, Inc.
Gundersen Lutheran Medical Foundation, Inc.

Non-Obligated Group

Critical Access Hospitals

Tri-County Memorial Hospital, Inc.
St. Joseph's Health Services, Inc.
Memorial Hospital of Boscobel
Palmer Lutheran Health Center, Inc.
Moundview Memorial Hospital and Clinics (effective October 1, 2017)

Other Entities

Tweeten Lutheran Healthcare Center, Inc.
Harmony Community Healthcare, Inc.
Community Housing of La Crosse, Inc.
Lutheran Housing of La Crosse, Inc.
Tri-State Ambulance, Inc.
Tri-State Regional Ambulance, Inc.
Gundersen Lutheran Envision, LLC
Gundersen Lutheran Credentialing Services, Inc.
Gundersen Lutheran Health System, Inc.
Degen Berglund, Inc.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

1. Organization and Basis of Presentation (continued)

Gundersen Clinic, Ltd. (the Clinic); Gundersen Lutheran Medical Center, Inc. (the Hospital); Gundersen Lutheran Administrative Services, Inc. (GLAS); and Gundersen Lutheran Medical Foundation, Inc. are members of Gundersen Obligated Group, which holds most of the System's long-term debt (see Note 9).

Gundersen Health Plan, Inc. was incorporated in 1995 and organized under Chapter 613 of the Wisconsin Statutes as a non-stock, not-for-profit health maintenance organization to provide comprehensive health care insurance in Wisconsin. In 2012, Gundersen Health Plan Minnesota, Inc. was formed to sell health insurance in Minnesota. The health plans participate in capitated health insurance plans and point-of-service products and provide third-party administration services. The health plans offer a Medicaid product line in Wisconsin called BadgerCare, a Medicare Advantage product, a commercial line of business in northwest Iowa, individual fee-for-service product lines, and small group fee-for-service or capitation product lines. Effective May 2, 2016, the System's health plans, Gundersen Health Plan, Inc. and Gundersen Health Plan Minnesota, Inc. (collectively, the health plans) merged with Unity Health Plans Insurance Corporation (Unity), an affiliate of University Health Care, Inc. (UW Health), in order to improve access for its enrollees to local health care and better use of available products and services. After the transaction, the System held a 25% ownership interest in the health plans and Unity, and an equal representation with UW Health on the board of directors of the parent company of the health plans and Unity. Effective June 30, 2017, the System's ownership interest percentage in the health plans was changed from 25.00% to 20.53% due to the joining of Unity Point Health to the joint venture in the ownership of the health plans. See Note 3 for discussion of the transactions. The joining of Unity Point Health added Physicians Plus Health Plans, improving greater access to health care and extended products available.

As part of its overall strategy, the System has affiliated with a number of critical access hospitals (CAH) that enable highly trained physicians to provide comprehensive inpatient, outpatient, and clinical care services to patients in their communities.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) *(Dollars in Thousands)*

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues 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 original maturities of 90 days or less from the date of purchase. The System maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation and thereby exposes the System to potential risk of loss in the event the financial institution becomes insolvent. No losses have been incurred to date, and management does not consider the credit risk to be significant to the System.

Patient Accounts Receivable

The collection of receivables from third-party payors and patients is the System's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers' accounts. Patient receivables, including the portion for which a third-party payor is responsible, are carried at net realizable value, determined by the original charge for the service provided less an estimate made for contractual adjustments or discounts provided to third-party payors. Patient receivables due directly from patients are carried on the accompanying consolidated balance sheets at the original charge for the service provided less amounts covered by third-party payors, allowances for other discounts, and an allowance for uncollectible receivables. The System does not charge interest on past-due receivables. Receivables are written off after collection efforts have been followed in accordance with the System's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the System analyzes its past history and identifies trends for each of its major payor sources to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The analysis is performed using a hindsight calculation that utilizes write-off data for all payor classes during a determined time period to calculate the allowance for uncollectible accounts at a point in time. The System grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements.

At December 31, 2017 and 2016, the allowance for uncollectible accounts was \$38,002 and \$30,083, respectively. The allowance for uncollectible accounts as a percentage of accounts receivable was 18% and 16% at December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, amounts due from Medicare represented 23% of the System's net patient accounts receivable.

Investments and Investments Whose Use Is Limited

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value on the consolidated balance sheets. Investments in equity and debt securities are classified as trading, and accordingly, all gains and losses are recorded as nonoperating investment return, to the extent not restricted by donor or law. The System accounts for investment transactions on a settlement-date basis.

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. 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.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, collateral posted against swap valuations, and internally designated for medical education by the Board of Trustees and Board of Governors, who, at their discretion, can change these designations in the future.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Investments in companies that hold interests in real estate funds are recorded using the equity method of accounting, with the change in value of these investments recorded as investment return on the consolidated statements of operations and changes in net assets. The System generally has liquidity ranging from 95 to 125 days in these funds. The value of each real estate fund is determined by the investment manager or general partner of the respective fund.

Values of some of the underlying investments in the real estate funds may be based on estimates that require varying degrees of judgment, and consequently, these estimates may differ from the values at which investments may be sold. Values of the real estate funds are based on the fair value of the underlying real estate and reflect any net contributions to the investee and an ownership interest share of realized and unrealized investment income and expenses.

Investments in Unconsolidated Entities

Investments in entities in which the System has the ability to exercise significant influence over operating and financial policies, but does not have operational control, are recorded under the equity method of accounting. Equity method investments are recorded as investments in unconsolidated entities on the consolidated balance sheets.

Inventories, Supplies, and Materials

Inventories, supplies, and materials are valued at the lower of cost (first-in, first-out method) or market value and included in other current assets on the consolidated balance sheets.

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. During periods of construction, interest costs are capitalized to the respective property accounts.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5–15 years
Building	30–40 years
Building additions and improvements	10–25 years
Equipment and furniture	3–15 years

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

The System assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an asset's carrying value unlikely. An impairment loss is indicated when the estimated total undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount.

The System capitalizes expenditures for additions and improvements, while replacements, maintenance, and repairs that do not improve the useful lives of the assets are expensed as incurred. The System also capitalizes interest on the financing of major capital, including projects financed with tax-exempt borrowings.

Software Costs

Capitalized computer software costs include internally developed software. Costs incurred in developing and installing internal-use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage.

Derivative Financial Instruments

The System uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable rate debt. All derivative instruments are recorded at fair value on the consolidated balance sheets, with the changes in the fair values recorded in nonoperating gains (losses) on the consolidated statements of operations. The System uses pricing models that take into account the present value of estimated future cash flows and credit valuation adjustments.

Insurance

The provision for estimated self-insured professional liability, workers' compensation, and health care claims includes estimates of the ultimate costs for both reported and incurred but not reported claims. The accrual for self-insured professional liability, workers' compensation, and health care claims represents the estimated ultimate cost for both asserted and unasserted claims.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) *(Dollars in Thousands)*

2. Summary of Significant Accounting Policies (continued)

Donated Assets and Services

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

Net Assets

Resources are classified into unrestricted, temporarily restricted, and permanently restricted net assets, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts that have no donor-imposed restrictions. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those assets for which donors require the principal of the gift to be maintained in perpetuity in order to provide a permanent source of income.

Net Patient Revenue

Net patient revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, excluding charges related to the System's self-insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined. Net patient service revenue is reported net of provision for bad debts.

The provision for bad debts is based upon management's judgmental assessment of historical and expected net collections considering business and general economic conditions in its service area, trends in health care coverage, and other collection indicators.

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Capitation and Premium Revenue

The Clinic and the Hospital provide health care services to enrollees of the health plans under a capitation arrangement, under which they are paid primarily on a capitated basis determined as a percentage of the member premium. Risk is transferred to the Clinic and Hospital under a provider reimbursement agreement. Capitation revenue is recognized in the year in which health care coverage is provided. Although the majority of services are provided to the health plans' enrollees by the Hospital and Clinic, certain services are provided by out-of-network providers on a contracted fee-for-service basis. A reserve is recorded for out-of-network care rendered but not reported as of each year-end. Prior to May 2, 2016, the System recorded net premium revenue earned by its wholly controlled health plans, which was recognized in the year in which health care coverage was provided.

Charity and Uncompensated Care

The System provides health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. The System maintains records to identify and monitor the level of community care provided. These records include the amount of costs incurred for services and supplies furnished under the charity care policy. Since the System does not pursue collection of these amounts, they are not reported as patient revenue.

Functional Expenses

Substantially all of the System's expenses are related to providing health care to the communities it serves and insurance to its enrollees.

Performance Indicator

The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include net assets released from restrictions to purchase property and equipment.

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Income Tax

The System qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (the Code), with the exception of Gundersen Health Plan, Inc. and Gundersen Health Plan Minnesota, Inc., which are tax-exempt organizations under 501(c)(4) of the Code, and Degen Berglund, Inc. and Gundersen Lutheran Envision, LLC, which are for-profit entities.

At December 31, 2017 and 2016, net deferred tax assets of \$5,036 and \$3,493, respectively, which primarily are related to net operating loss carryforwards, have valuation allowances of \$4,000 and \$2,766, respectively, recorded against them due to the uncertainty of realizing those benefits in the future. At December 31, 2017, the System's federal net operating loss carryforwards were approximately \$28,600, and the state net operating loss carryforwards were approximately \$25,200, which will expire between 2026 and 2035.

The System has reviewed its tax positions for all open years and has concluded that no liabilities exist for uncertain tax positions. The System's income tax returns are no longer subject to examination for 2013 and prior years.

The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that was previously tax deferred, and creates new taxes on certain foreign sourced earnings. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. At December 31, 2017, the System has made a reasonable estimate of the tax effects of the enactment of the Act. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. The System may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects initially reported. The System will continue to revise and refine the calculations as additional Internal Revenue Service guidance is issued.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

New Accounting Standards

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this update will make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset clarification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. ASU 2016-14 is effective for the System beginning on January 1, 2018, with early adoption permitted. The System is evaluating the effect that this new standard will have on the presentation and disclosure within its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This update, which was issued jointly with the International Accounting Standards Board, provides guidance that will supersede nearly all previously issued revenue recognition standards under U.S. generally accepted accounting principles, including those related to the presentation of the provision for doubtful accounts. When an entity provides services to patients, the update requires the entity to recognize revenue at an amount that reflects the consideration to which it expects to be entitled in exchange for those services, after assessing for collectability.

The System adopted ASU 2014-09 on January 1, 2018 using the modified retrospective method of transition. The System's process for implementation began with a preliminary evaluation of ASU 2014-09 and considered subsequent interpretations by the FASB Transition Resource Group for Revenue Recognition and the American Institute of Certified Public Accountants. The System performed an analysis of revenue streams and transactions under ASU 2014-09. In particular, for net patient service revenue, the System performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what is currently classified as provision for uncollectible accounts and presented as a reduction to net patient service revenue on the consolidated statements of operations and changes in net assets will be treated as a price concession that reduces the transaction price, which is reported as net patient service revenue. The new standard also requires enhanced disclosures related to the

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

disaggregation of revenue and significant judgments made in measurement and recognition. The impact of adopting ASU 2014-09 is not material to total operating revenue, revenue in excess of expenses or unrestricted net assets.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires an entity to recognize assets and liabilities arising from a lease for both financing and operating leases with additional qualitative and quantitative disclosures. ASU 2016-02 will be effective for the System on January 1, 2019, with early adoption permitted. The System is evaluating the effect that this new standard will have on its consolidated financial statements.

3. Health Plans

Effective May 2, 2016 (closing date), Gundersen transferred its 100% ownership interest in the health plans to University Health Care, Inc. (UHC) in exchange for a 25% ownership interest in each of the health plans: Unity Health Plans Insurance Corporation (Unity) and SPWI TPA, Inc. (d/b/a Quartz), a third-party administrator. Gundersen and UHC have equal representation on the boards of the plan, Unity and Quartz. The purpose of the transaction was to improve the access that enrollees of the health plans and Unity have to health care providers in their local markets and to reduce administrative expenses. The transaction resulted in no gain or loss.

Effective June 30, 2017, the ownership interest percentage in the health plans was changed from 25.00% to 20.53% due to the joining of Unity Point Health to the joint venture in the ownership of the health plans. At time of transaction, Gundersen invested an additional \$374 of paid-in capital to the joint venture.

Gundersen has recorded its equity interest in the joint venture, an investment of \$22,624 and \$22,584, as of December 31, 2017 and 2016, respectively. Nonoperating losses on its consolidated statement of operations for the year ended December 31, 2017, were \$334 and \$3,700 for the eight months ended December 31, 2016.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

3. Health Plans (continued)

The following is a summary of the operating results and balance sheet information of the health plans, Unity and Quartz as of and for the year ended December 2017 and eight months ended December 31, 2016:

	<u>2017</u>	<u>2016</u>
Total revenue	\$ 1,440,379	\$ 819,217
Revenue less than expenses	(13,433)	(12,533)
Total assets	140,990	223,344
Net assets	110,199	90,364

4. Net Patient Revenue

The System participates in the Medicare and Medicaid programs and is reimbursed for outpatient services based on fee schedules or prospectively determined amounts depending on the ambulatory payment classification assigned to each service provided, and is reimbursed for inpatient services based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping of medical conditions. Amounts recorded by the System for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the System appeals certain settlements related to Medicare and other programs.

For self-pay patients, management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and current economic conditions. The System also has policies to provide a discount from established charges to uninsured patients.

The System has determined, based on an assessment at the reporting-entity level, that patient revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for uncollectible accounts is recorded as a deduction from patient revenue on the consolidated statements of operations.

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Net Patient Revenue (continued)

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized from the System's major payor sources for the years ended December 31 is as follows:

	<u>2017</u>	<u>2016</u>
Third-party payors	\$ 844,653	\$ 791,529
Self-pay payors	37,140	37,966
	<u>\$ 881,793</u>	<u>\$ 829,495</u>

During 2017 and 2016, the Medicare program accounted for 30% and 28%, respectively, of the System's net patient revenue. Potential changes in the Medicare program and reduction of funding levels could have a material adverse effect on the System in the near term.

5. Charity Care

The cost of providing charity care, which has been estimated by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients, is estimated to be \$5,000 and \$3,800 for 2017 and 2016, respectively.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

6. Investments, Including Investments Whose Use Is Limited, and Investment Return

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

	2017	2016
Cash equivalents	\$ 19,057	\$ 15,130
Certificates of deposit	34,227	36,759
Common stock	13,797	12,273
Foreign stock	29	–
Equity mutual funds	251,327	229,346
Equity mutual funds – foreign	44,063	37,737
Asset-backed securities	–	56,698
Fixed-income securities:		
U.S. government and agencies obligations	64,984	3,058
Municipal bonds	1,064	–
Corporate bonds	151,600	134,142
Residential mortgage-backed securities	84,846	78,762
Fixed-income mutual funds	1,833	–
Alternative investments – real estate funds	27,411	25,711
Total investments	\$ 694,238	\$ 629,616

At December 31, certain investments are limited as to use for the following purposes:

	2017	2016
Restricted by donors	\$ 20,079	\$ 17,068
Minimum funding required by Wisconsin Office of the Commissioner of Insurance	10,707	10,591
Collateral posted against insurance claims	1,500	1,000
Minimum funding required by Wisconsin Unemployment Reserve Fund	3,978	3,776
Collateral posted against swap valuations (Note 10)	4,656	7,284
Principal and interest payments under a bond indenture	1,707	166
Held for future capital expenditures under a bond indenture	–	2,774
Board designated for medical education and capital improvements	4,066	4,703
HUD restricted reserves	243	212
Restricted for tenant deposits	14	11
	\$ 46,950	\$ 47,585

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

6. Investments, Including Investments Whose Use Is Limited, and Investment Return (continued)

Investment return on investments, including those whose use is limited, consists of the following:

	2017	2016
Dividends and interest	\$ 18,102	\$ 16,520
Net realized gains	12,027	9,150
Net change in unrealized gains	42,497	14,546
	\$ 72,626	\$ 40,216

Investment return is reported on the consolidated statements of operations and changes in net assets as follows:

	2017	2016
Nonoperating gains, net	\$ 69,660	\$ 39,081
Temporarily restricted net assets	2,298	1,075
Permanently restricted net assets	668	60
	\$ 72,626	\$ 40,216

7. Fair Value Measurements

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 at the measurement date (i.e., an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy in Accounting Standards Codification Topic 820, *Fair Value Measurement*, are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible to the reporting entity at the measurement date for identical assets and liabilities.

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Fair Value Measurements (continued)

- Level 2 – Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:
 - Quoted prices for similar assets and liabilities in active markets
 - Quoted prices for identical or similar assets or liabilities in markets that are not active
 - Observable inputs other than quoted prices that are used in the valuation of the asset or liabilities (e.g., interest rate and yield curve quotes at commonly quoted intervals)
 - Inputs that are derived principally from or corroborated by observable market data by correlation or other means
- Level 3 – Unobservable inputs for the asset or liability (i.e., supported by little or no market activity). Level 3 inputs include management’s own assumption about the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk.

The level in the fair value hierarchy within which the fair value measurement is classified is determined based on the lowest level of input that is significant to the fair value measure in its entirety.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis at December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents	\$ 17,557	\$ 1,500	\$ –	\$ 19,057
Certificates of deposit	–	34,227	–	34,227
Common stock	13,797	–	–	13,797
Foreign Stock	29	–	–	29
Equity mutual funds	251,327	–	–	251,327
Equity mutual funds – foreign	44,063	–	–	44,063
Fixed-income securities:				
U.S. government and agencies obligations	57,400	7,584	–	64,984
Municipal bonds	1,064	–	–	1,064
Corporate bonds	–	151,600	–	151,600
Fixed-income mutual funds	1,461	372	–	1,833
Residential mortgage-backed securities	–	84,846	–	84,846
Investments measured at fair value	<u>\$ 386,698</u>	<u>\$ 280,129</u>	<u>\$ –</u>	<u>666,827</u>
Investments recorded on an equity basis				<u>27,411</u>
Total investments, including investments whose use is limited				<u>\$ 694,238</u>
Liabilities				
Obligation under swap contracts	<u>\$ –</u>	<u>\$ 25,971</u>	<u>\$ –</u>	<u>\$ 25,971</u>

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis at December 31, 2016, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents	\$ 15,130	\$ –	\$ –	\$ 15,130
Certificates of deposit	–	36,759	–	36,759
Common stock	12,273	–	–	12,273
Equity mutual funds	229,346	–	–	229,346
Equity mutual funds – foreign	37,737	–	–	37,737
Asset-backed securities	50,499	6,199	–	56,698
Fixed-income securities:				
U.S. government and agencies obligations	3,058	–	–	3,058
Corporate bonds	–	134,142	–	134,142
Residential mortgage-backed securities	–	78,762	–	78,762
Investments measured at fair value	<u>\$ 348,043</u>	<u>\$ 255,862</u>	<u>\$ –</u>	<u>603,905</u>
Investments recorded on an equity basis				<u>25,711</u>
Total investments, including investments whose use is limited				<u>\$ 629,616</u>
Liabilities				
Obligation under swap contracts	<u>\$ –</u>	<u>\$ 29,388</u>	<u>\$ –</u>	<u>29,388</u>

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. The carrying value of pledges (Level 2) approximates its fair value at December 31, 2017 and 2016.

Through the System's investments accounted for on an equity basis, the System is indirectly involved in investment activities, such as securities lending, short sales of securities, options, warrants, trading in futures and forward 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, the System's risk is limited to its capital balance in each investment.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Fair Value Measurements (continued)

At December 31, 2017 and 2016, the fair value of fixed interest long-term debt (Level 2), based on quoted market prices for the same or similar instruments, was \$197,610 and \$202,210, respectively, compared with its carrying value of \$212,947 and \$215,426, respectively. Fair value of variable rate long-term debt (Level 2) approximated its carrying value.

The fair value for obligation under swap contracts is determined through the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flow of each derivative. The analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest rate curves. In addition, credit value adjustments are included to reflect both the System's non-performance risk and the respective counterparty's non-performance risk.

8. Property and Equipment

At December 31, property and equipment consists of the following:

	2017	2016
Land and land improvements	\$ 30,152	\$ 28,012
Buildings and building improvements	699,198	656,355
Equipment and furniture	326,654	333,079
Capitalized software	31,725	33,971
Capitalized leases	12,926	12,088
	1,100,655	1,063,505
Less accumulated depreciation	553,764	531,069
Property and equipment – net	546,891	532,436
Construction-in-progress	38,908	54,323
	\$ 585,799	\$ 586,759

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

9. Long-Term Debt and Capital Lease Obligations

At December 31, long-term debt consists of the following:

	2017	2016
Obligated Group		
Wisconsin Health and Educational Facilities Authority (WHEFA) Bonds:		
Series 2016 (Gundersen Lutheran), adjustable direct placement bonds, principal due starting in 2026 (average annual interest rate in 2017 of 1.42% and 2016 of 0.92%)	\$ 40,000	\$ 40,000
Series 2015, interest fixed at 2.63% first 5 years then adjustable, maturing in varying amounts through 2026	9,590	10,650
Series 2012, variable rate demand bonds (2.00% to 5.00%), maturing in varying amounts through 2044	69,185	69,355
Series 2011A, variable rate demand bonds (1.00% to 5.25%), maturing in varying amounts through 2039	128,425	132,855
Series 2009A, adjustable direct placement bonds (average annual interest rate in 2017 of 1.27% and 2016 of 0.88%), maturing in varying amounts through 2033	42,550	44,015
Series 2009B, adjustable direct placement bonds (average annual interest rate in 2017 of 1.34% and 2016 of 0.95%), maturing in varying amounts through 2033	30,660	31,990
Series 2008B, adjustable direct placement bonds (average annual interest rate in 2017 of 1.19% and 2016 of 0.80%), maturing in varying amounts through 2033	61,400	61,400
	381,810	390,265
Non-obligated group	16,571	14,467
	398,381	404,732
Capital lease obligations	4,834	5,369
Unamortized premium	1,697	1,928
	404,912	412,029
Total long-term debt and capital lease obligations	11,653	10,834
Less current maturities	3,696	4,055
Less unamortized financing costs	-	-
	\$ 389,563	\$ 397,140

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Long-Term Debt and Capital Lease Obligations (continued)

In September 2011, the System entered into a Restated Master Trust Indenture with a bank that established an Obligated Group (see Note 1). Each Obligated Group member is jointly and severally liable for the payment of all obligations issued under the Restated Master Trust Indenture, which are secured ratably by a pledge of the unrestricted receivables of the Obligated Group. The Restated Master Trust Indenture contains, among other things, provisions placing restrictions on additional debt, asset transfers, and liens and requires the maintenance of a debt service coverage ratio. Additional covenants, including liquidity and capitalization, are included in other loan agreements relating to the obligations.

In February 2016, WHEFA issued Series 2016 bonds in the amount of \$40,000 through a direct placement with a bank to refinance the Series 2011B bonds at a variable interest rate, which adjusts monthly as a percentage of the 30-day London Interbank Offered Rate (LIBOR). The bonds are subject to mandatory tender following an initial period, which ends in February 2026, at which time the outstanding principal plus accrued interest will become due.

In December 2015, WHEFA issued Series 2015 bonds on behalf of the Obligated Group in the aggregate amount of \$12,000, bearing interest fixed at an annual rate of 2.63% for the first five years. Interest will reset at a fixed rate for the remaining term of the bonds. The principal is payable through 2026. The proceeds have been used to finance new construction. These bonds are secured with a first mortgage on real estate.

In September 2012, WHEFA issued Series 2012 bonds on behalf of the Obligated Group in an aggregate par amount of \$70,000 that bear interest at fixed rates. The bonds are subject to optional, mandatory, extraordinary redemption, and purchase in lieu of redemption prior to maturity. The proceeds have been used to finance new construction.

In September 2011, WHEFA issued Series 2011A and Series 2011B bonds on behalf of the Obligated Group. The Series 2011A bonds were issued in an aggregate par amount of \$162,430 and bear interest at fixed rates. The Series 2011B bonds were issued in an aggregate amount of \$40,000 and were tendered in 2016.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

9. Long-Term Debt and Capital Lease Obligations (continued)

In May 2009, WHEFA issued Series 2009A and Series 2009B bonds on behalf of GLAS in the aggregate amount of \$78,715. The proceeds of those bonds were used to refund the Series 2003B and Series 2003C bonds. In March 2011, the Obligated Group caused a tender of the Series 2009A and 2009B bonds, which were placed directly with a bank. In March 2015, the Series 2009A and Series 2009B bonds were extended to March 2, 2020 and March 2, 2021, respectively.

In May 2008, WHEFA issued Series 2008A and Series 2008B bonds on behalf of GLAS in the aggregate amount of \$89,300 bearing interest at a variable rate. In August 2010, the Obligated Group caused a tender of the Series 2008A and Series 2008B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2008A bonds from the bank in August 2013. In September 2011, the Series 2008A bonds were refunded with proceeds of the Series 2011A bonds and Series 2011B bonds. In March 2015, the Series 2008B bonds were extended to March 1, 2019.

At December 31, 2017, the aggregate maturities and sinking fund requirements of the System's long-term debt, for each of the five subsequent years and thereafter, are as follows:

2018	\$	10,363
2019		10,803
2020		11,136
2021		11,636
2022		12,100
Thereafter		342,343
	\$	<u>398,381</u>

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

9. Long-Term Debt and Capital Lease Obligations (continued)

At December 31, 2017, future commitments under capital leases are as follows:

2018	\$	1,492
2019		1,341
2020		1,331
2021		979
2022		153
Thereafter		—
		5,296
Amount representing interest		462
Present value of minimum lease payments		4,834
Current portion		1,290
Long-term portion	\$	3,544

10. Derivative Financial Instruments

The System uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable rate debt. All derivative instruments are recorded at fair value as noncurrent liabilities on the consolidated balance sheets, and the decrease in fair value of \$3,417 and \$4,443 for 2017 and 2016, respectively, is recorded in nonoperating gains (losses) on the consolidated statements of operations. At December 31, the System's interest rate swap liability was as follows:

	2017	2016
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed annual rate 3.50%, variable interest equal to 67% of the one-month LIBOR	\$ 4,262	\$ 4,903
Notional amount \$40,470 Series 2011B (previously Series 2000B), fixed annual rate 3.26%, variable interest equal to 67% of the one-month LIBOR	4,063	4,864
Notional amount \$44,750 Series 2009A (previously Series 2003B), fixed annual rate 3.28%, variable interest equal to 67% of the one-month LIBOR	6,530	7,159
Notional amount \$60,725 Series 2008B, fixed annual rate 3.79%, variable interest equal to 67% of the one-month LIBOR	11,116	12,462
	\$ 25,971	\$ 29,388

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Derivative Financial Instruments (continued)

Collateral posted by the System was \$4,656 and \$7,284 at December 31, 2017 and 2016, respectively.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2017 and 2016, the counterparties had a Standard & Poor's credit quality rating of BBB+.

11. Retirement Plans

The System maintains various plans, including a defined contribution plan, a 401(k) plan, and a 403(a) plan. The plans cover substantially all of the System's employees. Total retirement plan expense for 2017 and 2016 was \$59,258 and \$58,679, respectively. The System contributes matching funding on a monthly basis, with the remainder contributed annually. At December 31, 2017 and 2016, the liability for employer contributions of \$44,114 and \$44,489, respectively, is included in accrued liabilities on the consolidated balance sheets.

12. Insurance

The System's facilities are either self-insured or have purchased claims-made insurance coverage for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually at December 31, 2017 and 2016).

In addition, under the Wisconsin professional liability, self-insured limits are in place per physician/certified registered nurse anesthetist (CRNA) (\$1,000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA at December 31, 2017 and 2016). The System has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients and Families Compensation Fund has no upper limit on losses.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

12. Insurance (continued)

The System has purchased professional liability insurance on a claims-made basis to cover Iowa and Minnesota risks. In addition, the System has purchased umbrella and excess coverage to minimize exposure for all entities.

The System maintains self-insurance programs for health care costs of its active employees. In addition, the System is insured for workers' compensation exposures under an incurred loss retrospective rating plan.

The liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims and incurred-but-not-reported losses. At December 31, 2017 and 2016, the total recorded liability was \$18,474 and \$24,803, respectively, of which a current portion of \$5,902 and \$12,951, respectively, is included in accrued liabilities and the noncurrent portion of \$12,572 and \$11,852, respectively, is included in other noncurrent liabilities on the consolidated balance sheets. At December 31, 2017 and 2016, the estimated receivable related to insurance recoveries of \$472 and \$541, respectively, is included in other current assets on the consolidated balance sheets.

13. Commitments and Contingencies

The System has leases for equipment and satellite office facilities that are classified as operating leases. Rental expense under these operating leases totaled \$9,591.

Future commitments under non-cancelable operating leases with initial or remaining terms in excess of one year in effect as of December 31, 2017, for each of the five subsequent years and thereafter are as follows:

2018	\$	8,164
2019		5,438
2020		2,241
2021		1,853
2022		1,286
Thereafter		7,066
	\$	<u>26,048</u>

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. Commitments and Contingencies (continued)

The System is a defendant in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be determined, management of the System considers it unlikely that the disposition of these proceedings will have a material adverse effect on the consolidated financial position or operations of the System. However, there can be no assurance that this will be the case.

The System has entered into an agreement with the city of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement creates property tax incentives for taxable development on the La Crosse campus by the System and other developers. The benefit that the System derives from participation in TIF 14 depends on the size of future development over the next 19 years.

14. Compliance With Laws and Regulations

The health care industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government health care programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by health care providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The System has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of non-compliance.

While management believes that the System 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 a reduction of funding levels, could have a material adverse effect on the System.

Gundersen Health System

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

15. Restricted Net Assets

At December 31, 2017 and 2016, temporarily restricted net assets totaling \$10,544 and \$9,263, respectively, were available primarily for the construction of buildings, purchase of medical equipment, medical research, education, and community programs. Permanently restricted net assets totaled \$19,638 and \$17,840, respectively, the income from which was available to be used for medical education and research, community health initiatives, and general operations.

The state of Wisconsin has enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which together with other relevant state laws, guides the System's investment policies for restricted funds. UPMIFA requires the System to exercise ordinary and prudent care in good faith in its discretion to invest and appropriate some or all of the net appreciation or depreciation of investments. In the absence of a relevant law or donor stipulations, fiduciary responsibility to exercise ordinary care and prudence does not extend to donor stipulations to the earnings and losses on investments.

16. Related-Party Transactions

The Clinic and the Hospital have an agreement with the health plans to provide health care services to the health plans' insured enrollees. The Clinic and the Hospital are paid on a capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$700 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital earned under the agreement with the health plans totaled \$208,163 through December 31, 2017.

At December 31, 2017, amounts due to the health plans were \$4,755 and are included in other current liabilities on the consolidated balance sheet. At December 31, 2017, amounts due from the health plans were \$0 and are included in other current assets on the consolidated balance sheet.

Under the terms of an administrative services agreement with Quartz, Gundersen provides certain general and administrative services necessary for Quartz's operations at amounts that are intended to approximate cost. The cost of these services to Quartz was \$4,297 through December 31, 2017. Amounts due from Quartz as of December 31, 2017, related to the administrative services agreement were \$1,617 and are included in other current assets on the consolidated balance sheet.

Gundersen Health System

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

17. Functional Expenses

The System provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended December 31 consisted of the following:

	<u>2017</u>	<u>2016</u>
Health care services	\$ 945,230	\$ 894,024
General administrative	208,025	185,676
Totals	<u>\$ 1,153,255</u>	<u>\$ 1,079,700</u>

18. Subsequent Events

The System has evaluated events and transactions that have occurred subsequent to December 31, 2017, through May 2, 2018, the date on which the accompanying consolidated financial statements were issued.

Supplementary Information



Ernst & Young LLP
875 East Wisconsin Avenue
Milwaukee, WI 53202

Tel: +1 414 273 5900
Fax: +1 414 223 7200
ey.com

Report of Independent Auditors on Supplementary Information

The Board of Trustees and the Board of Governors
Gundersen Health System

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating balance sheet and consolidating statements of operations and changes in net assets are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied by us and the other auditors in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

May 2, 2018

Gundersen Health System

Consolidating Balance Sheet (Dollars in Thousands)

December 31, 2017

	Obligated Group	CAH	Health Plans	Others	Eliminations	Total
Assets						
Current assets:						
Cash and cash equivalents	\$ 207,735	\$ 24,827	\$ —	\$ 4,526	\$ —	\$ 237,088
Investments	645,290	1,543	—	455	—	647,288
Current portion of investments whose use is limited	7,063	256	—	33	—	7,352
Patient accounts receivable, less allowance for uncollectible accounts	156,306	17,131	—	3,277	—	176,714
Current portion of notes receivable from affiliates	384	—	—	—	(384)	—
Other current assets	53,614	6,187	—	2,522	(8,936)	53,387
Total current assets	1,070,392	49,944	—	10,813	(9,320)	1,121,829
Investments whose use is limited	37,143	2,231	—	224	—	39,598
Notes receivable from affiliates, net of current portion	3,872	—	—	—	(2,188)	1,684
Property and equipment, net	538,795	30,352	—	16,652	—	585,799
Investment in unconsolidated affiliate	1,662	718	—	26,998	—	29,378
Investment in consolidated affiliate	—	—	—	16,463	(16,463)	—
Other noncurrent assets	16,462	2,010	—	509	—	18,981
Total assets	\$ 1,668,326	\$ 85,255	\$ —	\$ 71,659	\$ (27,971)	\$ 1,797,269
Liabilities and net assets						
Current liabilities:						
Accounts payable	\$ 14,163	\$ 9,255	\$ —	\$ 1,239	\$ —	\$ 24,657
Accrued payroll	56,405	4,380	—	967	—	61,752
Accrued liabilities	67,412	289	—	190	—	67,891
Current maturities of long-term debt and capital lease obligations	9,476	2,374	—	187	(384)	11,653
Other current liabilities	9,317	800	—	224	(8,936)	1,405
Total current liabilities	156,773	17,098	—	2,807	(9,320)	167,358
Long-term debt and capital lease obligations, net of current maturities	373,769	16,332	—	1,650	(2,188)	389,563
Obligation under swap contracts	25,971	—	—	—	—	25,971
Other noncurrent liabilities	16,105	1,226	—	240	—	17,571
Total liabilities	572,618	34,656	—	4,697	(11,508)	600,463
Net assets:						
Unrestricted	1,067,298	48,861	—	66,928	(16,463)	1,166,624
Temporarily restricted	8,772	1,738	—	34	—	10,544
Permanently restricted	19,638	—	—	—	—	19,638
Total net assets	1,095,708	50,599	—	66,962	(16,463)	1,196,806
Total liabilities and net assets	\$ 1,668,326	\$ 85,255	\$ —	\$ 71,659	\$ (27,971)	\$ 1,797,269

Gundersen Health System

Consolidating Statement of Operations (Dollars in Thousands)

Year Ended December 31, 2017

	Obligated Group	CAH	Health Plans	Others	Eliminations	Total
Operating revenue:						
Net patient revenue before provision for uncollectible accounts	\$ 773,903	\$ 98,823	\$ –	\$ 30,781	\$ (21,714)	\$ 881,793
Provision for uncollectible accounts	(17,205)	(4,962)	–	(860)	–	(23,027)
Net patient revenue	756,698	93,861	–	29,921	(21,714)	858,766
Capitation revenue	310,240	36	–	–	(3,747)	306,529
Other revenue	39,881	2,925	–	5,590	(16,609)	31,787
Total operating revenue and gains	1,106,819	96,822	–	35,511	(42,070)	1,197,082
Operating expenses:						
Salaries, wages, and benefits	622,054	45,637	–	14,267	(5,417)	676,541
Supplies	148,975	8,982	–	11,258	(6,933)	162,282
Capitation services	102,154	10,696	–	43	(13,221)	99,672
Depreciation and amortization	56,538	3,612	–	2,281	–	62,431
Facilities	30,737	4,261	–	3,222	–	38,220
Purchased services	39,744	13,915	–	2,769	(14,987)	41,441
Interest	17,361	690	–	121	(102)	18,070
Other operating expenses	47,948	5,755	–	2,407	(1,512)	54,598
Total operating expenses	1,065,511	93,548	–	36,368	(42,172)	1,153,255
Operating income (loss)	41,308	3,274	–	(857)	102	43,827
Nonoperating gains (losses):						
Investment gain, net	69,668	77	–	17	(102)	69,660
Contribution from business combination	–	9,441	–	–	–	9,441
Change in fair value of swap contracts	3,417	–	–	–	–	3,417
Change in equity of consolidated affiliates	–	–	–	(2,501)	2,501	–
Increase (decrease) in equity of unconsolidated affiliates	74	57	–	(601)	–	(470)
Other nonoperating (losses) gains, net	(1,284)	5	–	–	–	(1,279)
	71,875	9,580	–	(3,085)	2,399	80,769
Revenue in excess of (less than) expenses	113,183	12,854	–	(3,942)	2,501	124,596
Net assets released from restrictions to purchase property and equipment						
	913	60	–	–	–	973
Other changes in unrestricted net assets						
	(423)	258	–	374	–	209
Increase (decrease) in unrestricted net assets	\$ 113,673	\$ 13,172	\$ –	\$ (3,568)	\$ 2,501	\$ 125,778

Gundersen Health System

Consolidating Statement of Changes in Net Assets (Dollars in Thousands)

Year Ended December 31, 2017

	Obligated Group	CAH	Health Plans	Others	Eliminations	Total
Unrestricted net assets:						
Revenue in excess of (less than) expenses	\$ 113,183	\$ 12,854	\$ -	\$ (3,942)	\$ 2,501	\$ 124,596
Net assets released from restrictions to purchase property and equipment	913	60	-	-	-	973
Other changes in unrestricted net assets	(423)	258	-	374	-	209
Increase (decrease) in unrestricted net assets	113,673	13,172	-	(3,568)	2,501	125,778
Temporarily restricted net assets:						
Contributions	4,090	2	-	-	-	4,092
Investment return	2,298	-	-	-	-	2,298
Net assets released from restriction	(5,774)	(68)	-	-	-	(5,842)
Contribution from business combination	-	571	-	-	-	571
Other changes in temporarily restricted net assets	-	162	-	-	-	162
Increase in temporarily restricted net assets	614	667	-	-	-	1,281
Permanently restricted net assets:						
Contributions	1,130	-	-	-	-	1,130
Investment gains	543	-	-	-	-	543
Net change in unrealized gains on investments	125	-	-	-	-	125
Increase in permanently restricted net assets	1,798	-	-	-	-	1,798
Increase (decrease) in net assets	116,085	13,839	-	(3,568)	2,501	128,857
Net assets at beginning of year	979,623	36,760	-	70,530	(18,964)	1,067,949
Net assets at end of year	\$ 1,095,708	\$ 50,599	\$ -	\$ 66,962	\$ (16,463)	\$ 1,196,806

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