

CONSOLIDATED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Gundersen Health System  
Years Ended December 31, 2019 and 2018  
With Reports of Independent Auditors

Ernst & Young LLP



# Gundersen Health System

## Consolidated Financial Statements and Supplementary Information

Years Ended December 31, 2019 and 2018

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Ernst & Young LLP  
833 East Michigan Street  
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, 2019 and 2018, 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.; Tweeten Lutheran Healthcare Center, Inc.; and Harmony Community Healthcare, Inc., wholly controlled affiliates, which statements reflect total assets constituting 5.8% and 5.2% in 2019 and 2018, respectively, and total operating revenue constituting 9.3% in 2019 and 2018, 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; Palmer Lutheran Health Center, Inc.; Tweeten Lutheran Healthcare Center, Inc.; and Harmony Community Healthcare, 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, 2019 and 2018, 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.

### **Adoption of ASU No. 2016-02, *Leases (Topic 842)***

As discussed in Note 1 to the consolidated financial statements, Gundersen Health System changed its method for recognizing the rights and obligations arising from the lease contracts, including existing and new arrangements as a result of the adoption of Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, effective January 1, 2019. Our opinion is not modified with respect to this matter.



April 24, 2020

## Gundersen Health System

### Consolidated Balance Sheets (Dollars in Thousands)

|   | December 31  |              |
|---|--------------|--------------|
|   | 2019         | 2018         |
| <b>Assets</b>                                       |              |              |
| Current assets:                                     |              |              |
| Cash and cash equivalents                           | \$ 172,589   | \$ 189,797   |
| Investments   | 732,421      | 624,409      |
| Current portion of investments whose use is limited | 1,476        | 7,170        |
| Patient accounts receivable                         | 184,871      | 177,843      |
| Other current assets                                | 103,656      | 103,809      |
| Total current assets                                | 1,195,013    | 1,103,028    |
| Investments whose use is limited                    | 45,828       | 37,840       |
| Notes receivable, net of current portion            | 1,277        | 1,702        |
| Property and equipment, net                         | 653,467      | 589,952      |
| Right-of-use assets – operating leases              | 16,246       | –            |
| Investment in unconsolidated entities               | 62,307       | 60,249       |
| Other noncurrent assets                             | 23,341       | 20,602       |
| Total assets  | \$ 1,997,479 | \$ 1,813,373 |
| <b>Liabilities and net assets</b>                   |              |              |
| Current liabilities:                                |              |              |
| Accounts payable                                    | \$ 24,969    | \$ 28,338    |
| Accrued payroll                                     | 62,824       | 62,435       |
| Accrued liabilities                                 | 67,673       | 60,990       |
| Current maturities of long-term debt                | 12,170       | 11,951       |
| Current operating lease obligations                 | 3,243        | –            |
| Other current liabilities                           | 11,897       | 2,787        |
| Total current liabilities                           | 182,776      | 166,501      |
| Long-term debt, net of current maturities           | 376,090      | 378,061      |
| Long-term operating lease obligations               | 13,003       | –            |
| Obligation under swap contracts                     | 26,023       | 20,834       |
| Other noncurrent liabilities                        | 18,089       | 20,018       |
| Total liabilities                                   | 615,981      | 585,414      |
| Net assets:   |              |              |
| Without donor restrictions                          | 1,344,502    | 1,195,661    |
| With donor restrictions                             | 36,996       | 32,298       |
| Total net assets                                    | 1,381,498    | 1,227,959    |
| Total liabilities and net assets                    | \$ 1,997,479 | \$ 1,813,373 |

*See accompanying notes.*

## Gundersen Health System

### Consolidated Statements of Operations (Dollars in Thousands)

|  | <b>Year Ended December 31</b> |             |
|--|-------------------------------|-------------|
|  | <b>2019</b>                   | <b>2018</b> |
| Operating revenue:                                     |                               |             |
| Net patient revenue                                    | \$ 950,381                    | \$ 906,368  |
| Capitation revenue                                     | 382,816                       | 366,198     |
| Other revenue  | 32,606                        | 30,478      |
| Total operating revenue and gains                      | 1,365,803                     | 1,303,044   |
| Operating expenses:                                    |                               |             |
| Salaries, wages, and benefits                          | 755,319                       | 722,920     |
| Supplies   | 200,123                       | 189,624     |
| Capitation services                                    | 129,582                       | 109,241     |
| Depreciation and amortization                          | 60,203                        | 63,094      |
| Facilities   | 38,329                        | 39,433      |
| Purchased services                                     | 59,576                        | 56,548      |
| Interest   | 17,495                        | 18,431      |
| Other operating expenses                               | 57,795                        | 58,030      |
| Total operating expenses                               | 1,318,422                     | 1,257,321   |
| Operating income                                       | 47,381                        | 45,723      |
| Nonoperating gains (losses):                           |                               |             |
| Investment gains (losses), net                         | 100,213                       | (16,635)    |
| Unrealized (loss) gain on interest rate swap contracts | (5,189)                       | 5,137       |
| Gain (loss) from unconsolidated entities               | 4,935                         | (1,630)     |
| Other nonoperating gains (losses), net                 | 20                            | (3,866)     |
|  | 99,979                        | (16,994)    |
| Revenue in excess of expenses                          | \$ 147,360                    | \$ 28,729   |

*See accompanying notes.*

## Gundersen Health System

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

|  | <b>Year Ended December 31</b> |              |
|--|-------------------------------|--------------|
|  | <b>2019</b>                   | <b>2018</b>  |
| Net assets without donor restrictions:                                   |                               |              |
| Revenue in excess of expenses  | \$ 147,360                    | \$ 28,729    |
| Net assets released from restrictions to purchase property and equipment | 1,318                         | 373          |
| Other changes  | 163                           | (65)         |
| Increase in net assets without donor restrictions                        | <b>148,841</b>                | 29,037       |
| Net assets with donor restrictions:                                      |                               |              |
| Contributions  | 5,022                         | 6,502        |
| Investment return  | 4,688                         | (1,326)      |
| Net assets released from restriction                                     | (5,566)                       | (4,090)      |
| Other changes  | 554                           | 1,030        |
| Increase in net assets with donor restrictions                           | <b>4,698</b>                  | 2,116        |
| Increase in net assets   | <b>153,539</b>                | 31,153       |
| Net assets at beginning of year  | <b>1,227,959</b>              | 1,196,806    |
| Net assets at end of year  | <b>\$ 1,381,498</b>           | \$ 1,227,959 |

*See accompanying notes.*

# Gundersen Health System

## Consolidated Statements of Cash Flows (Dollars in Thousands)

|   | <b>Year Ended December 31</b> |             |
|---|-------------------------------|-------------|
|   | <b>2019</b>                   | <b>2018</b> |
| <b>Operating activities</b>   |                               |             |
| Increase in net assets  | \$ 153,539                    | \$ 31,153   |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities:             |                               |             |
| Depreciation and amortization   | 60,203                        | 63,094      |
| Unrealized losses (gains) on swap contracts   | 5,189                         | (5,137)     |
| Unrealized (gains) losses on investments, net   | (73,981)                      | 47,750      |
| (Gain) loss from unconsolidated entities  | (4,935)                       | 1,630       |
| Loss on write-down of note receivable   | 425                           | -           |
| Restricted contributions  | (5,022)                       | (6,502)     |
| Loss on sale of assets  | -                             | 4,134       |
| Changes in operating assets and liabilities:  |                               |             |
| Patient accounts receivable   | (7,028)                       | (1,129)     |
| Other current assets  | 146                           | (50,421)    |
| Accounts payable, accrued, and other current liabilities  | 12,813                        | (1,157)     |
| Other noncurrent assets and liabilities   | (4,825)                       | (177)       |
| Net cash provided by operating activities   | 136,524                       | 83,238      |
| <b>Investing activities</b>   |                               |             |
| Purchases of property and equipment, net  | (123,344)                     | (71,381)    |
| Purchases of investments, net   | (33,445)                      | (22,932)    |
| Investment in unconsolidated entities   | -                             | (32,535)    |
| Increase (decrease) in assets limited as to use   | 5,218                         | (3,687)     |
| Other   | 158                           | 962         |
| Net cash used in investing activities   | (151,413)                     | (129,573)   |
| <b>Financing activities</b>   |                               |             |
| Proceeds from issuance of bonds or long-term debt   | 11,519                        | -           |
| Principal payments on long-term debt  | (13,642)                      | (11,145)    |
| Restricted contributions  | 5,022                         | 6,502       |
| Net cash provided by (used in) financing activities   | 2,899                         | (4,643)     |
| Net decrease in cash and cash equivalents   | (11,990)                      | (50,978)    |
| Cash and cash equivalents at beginning of year  | 205,167                       | 256,145     |
| Cash and cash equivalents at end of year  | \$ 193,177                    | \$ 205,167  |
| <b>Reconciliation of cash and cash equivalents and restricted cash to the consolidated balance sheets</b> |                               |             |
| Cash and cash equivalents   | \$ 172,589                    | \$ 189,797  |
| Restricted cash included in investments   | 20,588                        | 15,370      |
| Cash and cash equivalents at end of year  | \$ 193,177                    | \$ 205,167  |
| <b>Supplemental disclosures of cash flow information</b>  |                               |             |
| Interest paid, net of capitalized interest  | \$ 17,504                     | \$ 18,185   |
| Capital assets acquired with capital lease obligation   | \$ 371                        | \$ 526      |

*See accompanying notes.*

# Gundersen Health System

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

December 31, 2019

### 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, 2019:

#### *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

##### *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.

# 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 11).

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

### **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 expose 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.

## Gundersen Health System

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

#### **2. Summary of Significant Accounting Policies (continued)**

##### **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 price concessions. 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.

Accounts receivable are reduced by an allowance for price concessions. 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. 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 price concessions 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, 2019 and 2018, amounts due from Medicare represented 12% and 15%, respectively, 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.

# Gundersen Health System

## Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

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.

Investments include alternative investments and other investments which are valued based on the net asset value (NAV) of the investments, as further discussed in the Fair Value Measurement note. Investments include interests in real estate funds with liquidity ranging from 95 to 125 days in these funds.

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, except for the investment in Recombinetics (see Note 5) that the System recorded under the fair-value method of accounting. These equity and fair-value 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.

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### 2. Summary of Significant Accounting Policies (continued)

##### 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 computed by the straight-line method, including amortization of capital leased assets, 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  |

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.

# Gundersen Health System

## Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

#### **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.

#### **Debt Issuance Costs**

Debt issuance costs are amortized over the period the related debt obligation is outstanding using the straight-line method, which approximates the effective interest rate method.

#### **Leases**

The System leases property and equipment under finance and operating leases. The System determines whether an arrangement is a lease at inception. For leases with terms greater than 12 months, the System records the related right-of-use assets and lease liabilities at the present value of lease payments over the term. Leases may include rental escalation clauses and options to extend or terminate the lease that are factored into the determination of lease payments when appropriate. The System does not separate lease and non-lease components of contracts. As most of the System's leases do not provide an implicit rate, the System uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The System uses the implicit rate when readily determinable.

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

Operating leases are included in right-of-use assets, current operating lease obligations, and long-term operating lease obligations on the consolidated balance sheet. Operating lease expense is recognized on a straight-line basis over the lease term and is included in supplies, facilities, and purchased services on the consolidated statements of operations and changes in net assets.

Finance leases are included in property and equipment, current maturities of long-term debt, and long-term debt, net of current maturities on the consolidated balance sheets. Property and equipment under finance lease obligations are amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation on the accompanying consolidated statements of operations and changes in net assets.

#### **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 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, net assets with donor restrictions are reclassified as net assets without donor restrictions 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.

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

# Gundersen Health System

## Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

#### **Net Assets**

Resources are classified as without donor restrictions and with donor restrictions based on the absence or existence of donor-imposed restrictions.

Net assets without donor restrictions are those whose use by the System has not been limited by donors and are available for general operating use. These consist of net assets that are board-designated funds (endowments) and non-board-designated funds. These are made up of investments and other unrestricted amounts that are available for use in carrying out the mission of the System.

Net assets with donor restrictions are those assets whose use has been limited by donors to a specific purpose or time period, or 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. The primary purpose of these funds is for education, research, community and affiliate programs, and building and equipment.

#### **Net Patient Service Revenue**

Net patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the System bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the System's hospitals receiving inpatient acute care services or patients receiving services in the System's outpatient centers or in their homes (home care). The System measures the performance obligation from admission into the hospital, or the

## Gundersen Health System

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

#### **2. Summary of Significant Accounting Policies (continued)**

commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to the System's patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the System does not believe it is required to provide additional goods or services related to that sale.

Because all of its performance obligations relate to contracts with a duration of less than one year, the System has elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The System has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the System's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the System does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

The System determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the System's policy, and implicit price concessions provided to uninsured patients. The System determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The System determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

## Gundersen Health System

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

#### 2. Summary of Significant Accounting Policies (continued)

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic, and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.
- **Medicaid.** Reimbursements for Medicaid services are generally paid at prospectively determined rates per discharge, per occasion of service, or per covered member.
- **Other.** Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the System. In addition, the contracts the System has with commercial payors also provide for retroactive audit and review of claims.

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant in 2019 or 2018.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The System also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2019 and 2018, changes in estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not material.

Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense, which was not material in 2019 or 2018.

Consistent with the System's mission, care is provided to patients regardless of their ability to pay. Therefore, the System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, co-pays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the System expects to collect based on its collection history with those patients. Patients who meet the System's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

# 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.

#### **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.

#### **Reclassification of Prior Year Presentation**

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications had no effect on the reported results of operations.

#### **Performance Indicator**

The performance indicator is revenue in excess of expenses. Changes in net assets without donor restrictions, 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, 2019 and 2018, net deferred tax assets of \$6,900 and \$7,574, respectively, which primarily are related to net operating loss carryforwards, have valuation allowances of \$6,900 and \$6,300, respectively, recorded against them due to the uncertainty of realizing those benefits in the future. At December 31, 2019, the System's federal net operating loss carryforwards were approximately \$28,700, and the state net operating loss carryforwards were approximately \$25,400, which will expire between 2028 and 2037.

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 2014 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%. For tax-exempt entities, the Act requires organizations to 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. Regulations necessary to implement certain aspects of the Act are expected to be promulgated by the Internal Revenue Service (IRS) in 2020. At December 31, 2019, the System 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 IRS guidance is issued.

# Gundersen Health System

## Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

### 2. Summary of Significant Accounting Policies (continued)

#### Recent Adopted Accounting Standards

Effective January 1, 2019, Gundersen Health System adopted Accounting Standards Update No. (ASU) 2016-02, *Leases (Topic 842)*, in conjunction with a subsequent ASU aimed at providing clarification and transition relief. This ASU requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. This ASU also requires additional disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The System adopted this ASU using a modified retrospective approach. The System elected to utilize practical expedients made available, including the package of practical expedients not to reassess whether a contract is or contains a lease, the lease classification, and initial direct costs for any existing leases. The System has not elected the practical expedient to use hindsight to determine the lease term for leases at the date of transition. The primary effect of this ASU was to record right-of-use assets and related obligations of \$18,554 for current operating leases on the consolidated balance sheet at January 1, 2019. Adoption of this standard did not have a material impact on the System's consolidated results of operations and had no impact on the consolidated statement of cash flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. This ASU requires the entity to show the changes in total cash, cash equivalents, restricted cash, and restricted cash equivalents on the statement of cash flows. The System adopted this ASU by applying a retrospective transition method, which requires a restatement of its consolidated statements of cash flows for all periods presented.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. On January 1, 2019, this ASU was adopted by the System on a modified prospective basis. The adoption of this ASU resulted in no material impact to the System's consolidated financial statements.

## Gundersen Health System

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

#### 2. Summary of Significant Accounting Policies (continued)

##### New Accounting Standards Net Yet Adopted

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 intends to improve the effectiveness of disclosures in the notes to the financial statements by modifying disclosure requirements for fair value measurements. ASU 2018-13 is effective for the System for annual and interim reporting periods beginning after December 15, 2019, with early adoption permitted. The System is currently assessing the impact that ASU 2018-13 will have on its consolidated financial statements and will adopt the provisions upon the effective date.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU affects loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and other financial assets that have the contractual right to receive cash. This ASU is effective for the System beginning January 1, 2022. The System is currently evaluating the effects of this standard on its consolidated financial statements.

#### 3. Available Resources and Liquidity

Financial assets available for general expenditure, such as operating expenses, and purchase of property and equipment, within one year of the balance sheet date, comprise the following at December 31:

|   | <u>2019</u>         | <u>2018</u>         |
|---|---------------------|---------------------|
| Cash and cash equivalents                     | \$ 172,585          | \$ 189,793          |
| Short-term investments                        | 732,421             | 624,409             |
| Investments whose use is limited – current    | 1,476               | 7,170               |
| Patient accounts receivable                   | 184,871             | 177,843             |
| Other receivables                             | 50,939              | 63,736              |
| Third-party reimbursement program receivables | 5,155               | 3,868               |
|   | <u>\$ 1,147,447</u> | <u>\$ 1,066,819</u> |

## Gundersen Health System

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

#### 3. Available Resources and Liquidity (continued)

The System considers all cash and cash equivalents, short-term investments, and unrestricted investments to be financial assets available and free from restriction to meet cash needs for operating activities of the System within one year of December 31, 2019 and 2018. The System has long-term investments whose use is limited and cannot be liquidated within one year. The System has cash and cash equivalents included in long-term investments whose use is limited and cannot be liquidated within one year, and are not reflected in the amounts above.

#### 4. Health Plans

During 2016, the System transferred its 100% ownership interest in the health plans to University Health Care, Inc. in exchange for a 25% ownership interest in each of the following health plans: Unity Health Plans Insurance Corporation (Unity) and SPWI TPA, Inc. (d/b/a Quartz), a third-party administrator.

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, at which time the System invested an additional \$374 of paid-in capital to the joint venture. In May 2018, Gundersen invested an additional \$2,528 of paid-in capital to the joint venture to maintain its ownership interest percentage.

Gundersen has recorded its equity interest in the joint venture, an investment of \$29,949 and \$26,272, as of December 31, 2019 and 2018, respectively. Nonoperating gains on its consolidated statements of operations for the years ended December 31, 2019 and 2018, were \$3,677 and \$1,120, respectively.

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 years ended December 31:

|                      | <u>2019</u>  | <u>2018</u>  |
|----------------------|--------------|--------------|
| Total revenue        | \$ 1,800,230 | \$ 1,798,744 |
| Net income           | 17,912       | 6,435        |
| Total assets         | 200,962      | 175,279      |
| Stockholder's equity | 145,881      | 127,970      |

## Gundersen Health System

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

#### 5. Investment in Recombinetics

Effective August 20, 2018, the System became a lead investor in Recombinetics, a gene-editing firm, in exchange for shares of preferred Series A Stock, common stock, and warrants. As of December 31, 2019 and 2018, the System has an undiluted ownership of 25.7% and 19.2%, respectively. The purpose of this transaction was to prepare for future medical advances, such as regenerative medicine, while maintaining the System as an industry leader in patient experience and care. The System has elected the fair-value option to account for the System's equity interest in Recombinetics, and recorded its investment at \$30,000 as of December 31, 2019 and 2018, which is a Level 3 fair value measurement.

#### 6. Patient Care Service Revenue

The System has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors, geography, service lines, method of reimbursement, and timing of when revenue is recognized. Tables providing details of these factors are presented below.

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

|                     | <b>2019</b>       | <b>2018</b>       |
|---------------------|-------------------|-------------------|
| Medicare            | \$ 278,832        | \$ 308,960        |
| Medicaid            | 68,473            | 70,079            |
| Commercial insurers | 553,350           | 499,497           |
| Uninsured           | 11,949            | 19,432            |
| Other               | 37,777            | 8,400             |
|                     | <b>\$ 950,381</b> | <b>\$ 906,368</b> |

Revenues from patients' deductibles and coinsurance are included in the categories presented above based on the primary payor.

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### 6. Patient Care Service Revenue (continued)

The composition of patient care service revenue based the System's lines of business, method of reimbursement, and timing of revenue recognition for the years ended December 31 is as follows:

|                                    | <b>2019</b> | <b>2018</b> |
|------------------------------------|-------------|-------------|
| Service lines:                     |             |             |
| Hospital inpatient                 | \$ 347,260  | \$ 236,795  |
| Hospital outpatient                | 493,084     | 563,855     |
| Retail sales                       | 88,429      | 85,220      |
| Residential care                   | 13,064      | 12,230      |
| Ambulatory                         | 8,544       | 8,268       |
|                                    | \$ 950,381  | \$ 906,368  |
| Method of reimbursement:           |             |             |
| Fee for service                    | \$ 863,551  | \$ 821,147  |
| Other                              | 86,830      | 85,221      |
|                                    | \$ 950,381  | \$ 906,368  |
| Timing of revenue and recognition: |             |             |
| Services performed over time       | \$ 831,166  | \$ 791,539  |
| At time services were rendered     | 119,215     | 114,829     |
|                                    | \$ 950,381  | \$ 906,368  |

#### 7. 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 \$4,680 and \$4,600 for 2019 and 2018, respectively.

## Gundersen Health System

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

#### 8. 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):

|   | 2019       | 2018       |
|---|------------|------------|
| Cash equivalents                            | \$ 20,588  | \$ 15,370  |
| Certificates of deposit                     | 36,423     | 35,978     |
| Common stock                                | 14,504     | 11,134     |
| Equity mutual funds                         | 235,230    | 196,714    |
| Equity mutual funds – foreign               | 103,813    | 63,357     |
| Fixed-income securities:                    |            |            |
| U.S. government and agencies obligations    | 92,110     | 75,544     |
| Municipal bonds                             | 772        | 1,089      |
| Corporate bonds                             | 153,810    | 152,605    |
| Residential mortgage-backed securities      | 91,017     | 85,507     |
| Fixed-income mutual funds                   | 1,545      | 3,345      |
| Alternative investments – real estate funds | 29,913     | 28,776     |
| Total investments                           | \$ 779,725 | \$ 669,419 |

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

|  | 2019      | 2018      |
|--|-----------|-----------|
| Restricted by donors   | \$ 24,017 | \$ 22,044 |
| Minimum funding required by Wisconsin Office of the<br>Commissioner of Insurance | 11,342    | 11,125    |
| Collateral posted against insurance claims                                       | 900       | 900       |
| Minimum funding required by Wisconsin Unemployment<br>Reserve Fund               | 4,504     | 4,147     |
| Collateral posted against swap valuations ( <i>Note 13</i> )                     | 4,517     | 950       |
| Principal and interest payments under a bond indenture                           | 1,625     | 1,715     |
| Board designated for medical education and capital<br>improvements               | 257       | 3,958     |
| HUD restricted reserves  | 131       | 160       |
| Restricted for tenant deposits   | 11        | 11        |
|  | \$ 47,304 | \$ 45,010 |

## Gundersen Health System

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

#### 8. 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:

|                                | 2019       | 2018        |
|--------------------------------|------------|-------------|
| Dividends and interest         | \$ 23,944  | \$ 22,264   |
| Net realized gains             | 6,976      | 7,525       |
| Net change in unrealized gains | 73,981     | (47,750)    |
|                                | \$ 104,901 | \$ (17,961) |

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

|                                    | 2019       | 2018        |
|------------------------------------|------------|-------------|
| Nonoperating gains (losses), net   | \$ 100,213 | \$ (16,635) |
| Net assets with donor restrictions | 4,688      | (1,326)     |
|                                    | \$ 104,901 | \$ (17,961) |

#### 9. 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 ASC 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)*

#### 9. 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.
- Net Asset Value (NAV) – Gundersen Health System invests in funds for which the NAV per share represents the fair value of the investment held. Risks and redemption restrictions for these investments are similar to the alternative investments. Management opted to use the NAV per share, or its equivalent, as a practical expedient for the fair value of the interest in certain funds. Valuations provided by the respective fund’s management consider variables, such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information.

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 measurement in its entirety.

## Gundersen Health System

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

#### 9. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis at December 31, 2019, 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             |
|---|-------------------|-------------------|------------------|-------------------|
| <b>Assets</b>   |                   |                   |                  |                   |
| Cash equivalents  | \$ 19,727         | \$ 861            | \$ –             | \$ 20,588         |
| Certificates of deposit                                       | –                 | 36,423            | –                | 36,423            |
| Common stock  | 14,504            | –                 | –                | 14,504            |
| Equity mutual funds   | 235,230           | –                 | –                | 235,230           |
| Equity mutual funds – foreign                                 | 103,813           | –                 | –                | 103,813           |
| Fixed-income securities:                                      |                   |                   |                  |                   |
| U.S. government and agencies obligations                      | 91,803            | 307               | –                | 92,110            |
| Municipal bonds   | 772               | –                 | –                | 772               |
| Corporate bonds   | –                 | 125,334           | –                | 125,334           |
| Fixed-income mutual funds                                     | 1,545             | –                 | –                | 1,545             |
| Residential mortgage-backed securities                        | –                 | 91,017            | –                | 91,017            |
| Investments measured at fair value                            | <u>\$ 467,394</u> | <u>\$ 253,942</u> | <u>\$ –</u>      | <u>721,336</u>    |
| Investments recorded as NAV                                   |                   |                   |                  | <u>58,389</u>     |
| Total investments, including investments whose use is limited |                   |                   |                  | <u>\$ 779,725</u> |
| Investments in unconsolidated entities – fair value (Note 5)  | <u>\$ –</u>       | <u>\$ –</u>       | <u>\$ 30,007</u> | <u>\$ 30,007</u>  |
| <b>Liabilities</b>  |                   |                   |                  |                   |
| Obligation under swap contracts                               | <u>\$ –</u>       | <u>\$ 26,023</u>  | <u>\$ –</u>      | <u>\$ 26,023</u>  |

## Gundersen Health System

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

#### 9. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis at December 31, 2018, 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             |
|---|-------------------|-------------------|------------------|-------------------|
| <b>Assets</b>   |                   |                   |                  |                   |
| Cash equivalents  | \$ 14,035         | \$ 1,335          | \$ –             | \$ 15,370         |
| Certificates of deposit                                       | –                 | 35,978            | –                | 35,978            |
| Common stock  | 11,134            | –                 | –                | 11,134            |
| Equity mutual funds   | 196,714           | –                 | –                | 196,714           |
| Equity mutual funds – foreign                                 | 63,357            | –                 | –                | 63,357            |
| Fixed-income securities:                                      |                   |                   |                  |                   |
| U.S. government and agencies obligations                      | 75,117            | 427               | –                | 75,544            |
| Municipal bonds   | 1,089             | –                 | –                | 1,089             |
| Corporate bonds   | –                 | 127,006           | –                | 127,006           |
| Fixed-income mutual funds                                     | 3,345             | –                 | –                | 3,345             |
| Residential mortgage-backed securities                        | –                 | 85,507            | –                | 85,507            |
| Investments measured at fair value                            | <u>\$ 364,791</u> | <u>\$ 250,253</u> | <u>\$ –</u>      | <u>615,044</u>    |
| Investments recorded as NAV                                   |                   |                   |                  | <u>54,374</u>     |
| Total investments, including investments whose use is limited |                   |                   |                  | <u>\$ 669,418</u> |
| Investments in unconsolidated entities – fair value (Note 5)  | <u>\$ –</u>       | <u>\$ –</u>       | <u>\$ 30,007</u> | <u>\$ 30,007</u>  |
| <b>Liabilities</b>  |                   |                   |                  |                   |
| Obligation under swap contracts                               | <u>\$ –</u>       | <u>\$ 20,834</u>  | <u>\$ –</u>      | <u>20,834</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, 2019 and 2018.

## Gundersen Health System

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

#### **9. Fair Value Measurements (continued)**

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.

At December 31, 2019 and 2018, the fair value of fixed interest long-term debt (Level 2), based on quoted market prices for the same or similar instruments, was \$187,840 and \$197,805, respectively, compared with its carrying value of \$197,711 and \$202,619, 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 nonperformance risk and the respective counterparty's nonperformance risk.

The fair value of investments in unconsolidated entities where the fair value option was elected (Level 3) is primarily determined using techniques consistent with both the market and income approaches, based on the System's estimates and assumption in the absence of observable market data. The market approach considers comparable company, comparable transaction, and company-specific information, including, but not limited to, restrictions on disposition and the current financial position and operating results. The income approach considers the projected operating performance of the System. The System purchased its interest in August 2018, and there have been no realized or unrealized gains or losses recognized for the years ended December 31, 2019 or 2018.

## Gundersen Health System

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

#### 10. Property and Equipment

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

|  | <b>2019</b>       | <b>2018</b> |
|--|-------------------|-------------|
| Land and land improvements                     | \$ 38,033         | \$ 37,122   |
| Buildings and building improvements            | 769,503           | 729,476     |
| Equipment and furniture                        | 368,374           | 348,727     |
| Capitalized software                           | 45,726            | 44,543      |
| Finance leases                                 | 5,800             | 5,443       |
|  | <b>1,227,436</b>  | 1,165,311   |
| Less accumulated depreciation and amortization | <b>630,892</b>    | 607,489     |
| Property and equipment – net                   | <b>596,544</b>    | 557,822     |
| Construction-in-progress                       | <b>56,923</b>     | 32,130      |
|  | <b>\$ 653,467</b> | \$ 589,952  |

Accumulated amortization of leased equipment was \$3,717 and \$2,728 at December 31, 2019 and 2018, respectively.

## Gundersen Health System

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

#### 11. Long-Term Debt and Finance Lease Obligations

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

|   | 2019              | 2018              |
|---|-------------------|-------------------|
| <b>Obligated Group</b>  |                   |                   |
| Wisconsin Health and Educational Facilities Authority<br>(WHEFA) Bonds:   |                   |                   |
| Series 2016 (Gundersen Lutheran), adjustable direct placement bonds, principal due starting in 2026 (average annual interest rate in 2019 of 2.70% and 2018 of 2.44%) | \$ 40,000         | \$ 40,000         |
| Series 2015, interest fixed at 2.63% first 5 years then adjustable, maturing in varying amounts through 2026  | 7,380             | 8,500             |
| Series 2012, fixed rate bonds (2.00% to 5.00%), maturing in varying amounts through 2044  | 68,830            | 69,010            |
| Series 2011A, fixed rate bonds (1.00% to 5.25%), maturing in varying amounts through 2039   | 119,010           | 123,795           |
| Series 2009A, adjustable direct placement bonds (average annual interest rate in 2019 and 2018 of 2.24%), maturing in varying amounts through 2033                    | 39,890            | 41,305            |
| Series 2009B, adjustable direct placement bonds (average annual interest rate in 2019 and 2018 of 2.34%), maturing in varying amounts through 2033                    | 27,415            | 28,995            |
| Series 2008B, adjustable direct placement bonds (average annual interest rate in 2019 of 2.19% and 2018 of 2.15%), maturing in varying amounts through 2033           | 61,400            | 61,400            |
|   | <b>363,925</b>    | 373,005           |
| *Non-obligated group  | <b>23,286</b>     | 14,812            |
|   | <b>387,211</b>    | 387,817           |
| Finance lease obligations   | 3,012             | 4,019             |
| Unamortized premium   | 1,392             | 1,536             |
|   | <b>391,615</b>    | 393,372           |
| Total long-term debt and finance lease obligations  | <b>12,170</b>     | 11,951            |
| Less current maturities   | <b>3,355</b>      | 3,360             |
| Less unamortized financing costs  | <b>\$ 376,090</b> | <b>\$ 378,061</b> |

\* As of December 31, 2019, St. Joseph's Health Services, Inc. has drawn down \$11,520 on the 2019 Facilities Revenue Bonds. Additional disbursements are scheduled to be made during 2020 for the purpose of funding the new hospital and medical clinic. The total bond issue is \$25,000.

# Gundersen Health System

## Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

### **11. Long-Term Debt and Finance 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 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.

## Gundersen Health System

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

#### 11. Long-Term Debt and Finance 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 January 2019, the Series 2009A and 2009B bonds were refinanced and the maturity was extended to January 2, 2024 and January 2, 2025, 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. In January 2019, the Series 2008B bonds were refinanced and the maturity was extended to January 2, 2023.

Total interest paid was \$17,804 and \$18,292 during the years ended December 31, 2019 and 2018, respectively. Capitalized interest cost was \$300 and \$107 during the years ended December 31, 2019 and 2018, respectively.

At December 31, 2019, 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:

|            |    |                |
|------------|----|----------------|
| 2020       | \$ | 10,940         |
| 2021       |    | 12,102         |
| 2022       |    | 12,570         |
| 2023       |    | 12,719         |
| 2024       |    | 12,724         |
| Thereafter |    | 326,156        |
|            | \$ | <u>387,211</u> |

## Gundersen Health System

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

#### 12. Leases

The System has operating and finance leases for medical office buildings, administrative offices, warehouses, network information systems, office equipment, and medical/surgical equipment. The leases have remaining lease terms of less than 1 year to 19 years, some of which may include an option to extend.

Rent and lease expense, included in supplies, facilities, and purchased services on the accompanying consolidated statements of operations and changes in net assets, amounted to \$10,234 and \$10,557 for the years ended December 31, 2019 and 2018, respectively.

Other information related to leases was as follows for the year ended December 31, 2019:

#### Supplemental cash flow information

Cash paid for amounts included in the measurement of lease liabilities:

|  |    |       |
|--|----|-------|
| Operating cash flows from operating leases | \$ | 3,769 |
| Operating cash flows from finance leases   |    | 1,371 |
| Financing cash flows from finance leases   |    | 177   |

Right-of-use assets obtained in exchange for lease obligations:

|                  |    |     |
|------------------|----|-----|
| Operating leases | \$ | 956 |
| Finance leases   |    | 364 |

Weighted average remaining lease term (in years):

|                  |      |
|------------------|------|
| Operating leases | 8.87 |
| Finance leases   | 2.34 |

Weighted average discount rate:

|                  |       |
|------------------|-------|
| Operating leases | 2.68% |
| Finance leases   | 4.48% |

## Gundersen Health System

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

#### 12. Leases (continued)

Future minimum lease payments relating to noncancelable operating and financing obligations for each of the next five years and thereafter are as follows (in thousands):

|                                    | <b>Operating</b> | <b>Finance</b> |
|------------------------------------|------------------|----------------|
| Year ending December 31:           |                  |                |
| 2020                               | \$ 3,629         | \$ 1,537       |
| 2021                               | 2,944            | 1,181          |
| 2022                               | 1,890            | 336            |
| 2023                               | 1,327            | 136            |
| 2024                               | 1,083            | –              |
| Thereafter                         | 7,175            | –              |
| Total lease payments               | 18,048           | 3,190          |
| Less interest                      | 1,802            | 178            |
| Present value of lease liabilities | \$ 16,246        | \$ 3,012       |

#### 13. 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 change in fair value of \$5,189 and \$5,137 for 2019 and 2018, 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:

|   | <b>2019</b> | <b>2018</b> |
|---|-------------|-------------|
| Notional amount \$33,000, fixed annual rate 3.50%, variable interest equal to 67.00% of the one-month LIBOR | \$ 4,201    | \$ 3,375    |
| Notional amount \$40,470, fixed annual rate 3.26%, variable interest equal to 67.00% of the one-month LIBOR | 3,854       | 3,108       |
| Notional amount \$44,750, fixed annual rate 3.28%, variable interest equal to 67.00% of the one-month LIBOR | 7,083       | 5,280       |
| Notional amount \$60,725, annual rate 3.79%, variable interest equal to 67.00% of the one-month LIBOR       | 10,885      | 9,071       |
|   | \$ 26,023   | \$ 20,834   |

## Gundersen Health System

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

#### **13. Derivative Financial Instruments (continued)**

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, 2019 and 2018, the counterparties had a Standard & Poor's credit quality rating of AA-.

Collateral posted by the System was \$4,510 and \$950 at December 31, 2019 and 2018, respectively, which is recorded in the investments whose use is limited on the consolidated balance sheets.

#### **14. 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 2019 and 2018 was \$68,770 and \$59,584, respectively. The System contributes matching funding on a monthly basis, with the remainder contributed annually. At December 31, 2019 and 2018, the liability for employer contributions of \$49,380 and \$42,405, respectively, is included in accrued liabilities on the consolidated balance sheets.

#### **15. 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, 2019 and 2018).

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, 2019 and 2018). 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)*

#### **15. 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 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, 2019 and 2018, the total recorded liability was \$23,899 and \$20,744, respectively, of which a current portion of \$9,964 and \$6,927, respectively, is included in accrued liabilities and the noncurrent portion of \$13,935 and \$13,817, respectively, is included in other noncurrent liabilities on the consolidated balance sheets. At December 31, 2019 and 2018, the estimated receivable related to insurance recoveries of \$586 and \$480, respectively, is included in other current assets on the consolidated balance sheets.

#### **16. Commitments and Contingencies**

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 17 years.

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **17. 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 noncompliance.

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.

#### **18. Net Assets**

The System receives donations from individuals and organizations to support certain programs and services. When specific purposes are needed for donations, the donations are included in the net assets with donor restriction and are released when the specific purpose is met.

## Gundersen Health System

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

#### 18. Net Assets (continued)

Net assets with donor restrictions consisted of the following at December 31:

|  | 2019      | 2018      |
|--|-----------|-----------|
| Subject to expenditures for specific purpose:              |           |           |
| Education  | \$ 2,294  | \$ 920    |
| Research   | 4,144     | 2,978     |
| Community and affiliate programs                           | 1,897     | 1,141     |
| Building and equipment                                     | 2,635     | 3,523     |
| Patient care   | 1,659     | 1,612     |
| Split interest agreements                                  | 519       | 500       |
| Subject to the passage of time:                            |           |           |
| Time restrictions for future periods                       | 92        | 93        |
| Subject to organization spending policy and appropriation: |           |           |
| Education  | 9,679     | 9,116     |
| Research   | 7,044     | 6,239     |
| Community and affiliate programs                           | 3,084     | 2,726     |
| Patient care   | 3,949     | 3,450     |
|  | \$ 36,996 | \$ 32,298 |

Net assets without donor restrictions consisted of the following at December 31:

|                       | 2019         | 2018         |
|-----------------------|--------------|--------------|
| Operating             | \$ 1,312,255 | \$ 1,170,597 |
| Board designated:     |              |              |
| Quasi-endowment funds | 32,247       | 25,064       |
|                       | \$ 1,344,502 | \$ 1,195,661 |

As of December 31, 2019 and 2018, the System's endowments consist of \$56,004 and \$46,595, respectively, of individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Gundersen Health System

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

**18. Net Assets (continued)**

The endowment net asset composition by type of fund consisted of the following as of December 31:

|                                  | <u>2019</u>      | <u>2018</u>      |
|----------------------------------|------------------|------------------|
| Without donor restrictions:      |                  |                  |
| Board-designated endowment funds | \$ 32,247        | \$ 25,064        |
| With donor restrictions:         |                  |                  |
| Donor-restricted endowment funds | 23,757           | 21,531           |
|                                  | <u>\$ 56,004</u> | <u>\$ 46,595</u> |

The changes in endowment net assets are as follows:

|                                    | <b>Net Assets<br/>Without<br/>Donor<br/>Restrictions</b> | <b>Net Assets<br/>With Donor<br/>Restrictions</b> | <b>Total</b>     |
|------------------------------------|--|---|------------------|
| Balance at December 31, 2017       | \$ 30,386  | \$ 19,637   | \$ 50,023        |
| Unrealized loss                    | (1,983)  | (808)   | (2,791)          |
| Investment return, net             | 704  | (43)  | 661              |
| Contributions                      | 22   | 725   | 747              |
| Transfers between endowment funds  | (2,024)  | 2,024   | -                |
| Transfers from non-endowment funds | 154  | -   | 154              |
| Appropriations for expenditures    | (2,195)  | (4)   | (2,199)          |
| Balance at December 31, 2018       | 25,064   | 21,531  | 46,595           |
| Unrealized gain                    | 5,049  | 926   | 5,975            |
| Investment return, net             | 653  | (141)   | 512              |
| Contributions                      | 32   | 1,354   | 1,386            |
| Transfers between endowment funds  | (87)   | 87  | -                |
| Transfers from non-endowment funds | 1,556  | -   | 1,556            |
| Appropriations for expenditures    | (20)   | -   | (20)             |
| Balance at December 31, 2019       | <u>\$ 32,247</u>   | <u>\$ 23,757</u>                                  | <u>\$ 56,004</u> |

## Gundersen Health System

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **18. Net Assets (continued)**

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.

#### **19. 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 \$245,882 and \$248,606 for the years ended December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, amounts due to the health plans were \$0. At December 31, 2019 and 2018, amounts due from the health plans were \$40,289 and \$47,665, respectively, and are included in other current assets on the consolidated balance sheets.

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 \$1,841 and \$4,655 for the years ended December 31, 2019 and 2018, respectively. Amounts due from Quartz as of December 31, 2019 and 2018, related to the administrative services agreement were \$183 and \$1,393, respectively, and are included in other current assets on the consolidated balance sheets.

## Gundersen Health System

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

#### 20. Functional Expenses

The System provides general health care services and medical education and research. The following table presents expenses related to providing these services for the years ended December 31:

|                                  | 2019                    |                           |                               |                             |                     |
|----------------------------------|-------------------------|---------------------------|-------------------------------|-----------------------------|---------------------|
|                                  | Medical                 |                           |                               |                             | Total               |
|                                  | Health Care<br>Services | Education and<br>Research | General and<br>Administration | Non-Health<br>Care Services |                     |
| Salaries and benefits            | \$ 687,135              | \$ 15,007                 | \$ 52,763                     | \$ 414                      | \$ 755,319          |
| Supplies                         | 196,261                 | 728                       | 2,908                         | 226                         | 200,123             |
| Capitation services              | 129,582                 | –                         | –                             | –                           | 129,582             |
| Depreciation and<br>amortization | 51,215                  | 164                       | 8,026                         | 798                         | 60,203              |
| Facilities                       | 33,701                  | 154                       | 3,146                         | 1,328                       | 38,329              |
| Purchased services               | 47,512                  | 5,256                     | 5,874                         | 934                         | 59,576              |
| Interest                         | 17,246                  | 4                         | 182                           | 63                          | 17,495              |
| Other operating expenses         | 38,835                  | 1,280                     | 17,105                        | 575                         | 57,795              |
| Totals                           | <u>\$ 1,201,487</u>     | <u>\$ 22,593</u>          | <u>\$ 90,004</u>              | <u>\$ 4,338</u>             | <u>\$ 1,318,422</u> |
|                                  | 2018                    |                           |                               |                             |                     |
|                                  | Medical                 |                           |                               |                             |                     |
|                                  | Health Care<br>Services | Education and<br>Research | General and<br>Administration | Non-Health<br>Care Services | Total               |
| Salaries and benefits            | \$ 657,530              | \$ 13,748                 | \$ 51,174                     | \$ 468                      | \$ 722,920          |
| Supplies                         | 185,579                 | 821                       | 2,990                         | 234                         | 189,624             |
| Capitation services              | 109,241                 | –                         | –                             | –                           | 109,241             |
| Depreciation and<br>amortization | 52,944                  | 166                       | 8,454                         | 1,530                       | 63,094              |
| Facilities                       | 35,006                  | 215                       | 2,321                         | 1,891                       | 39,433              |
| Purchased services               | 44,371                  | 4,872                     | 6,309                         | 996                         | 56,548              |
| Interest                         | 18,184                  | –                         | 170                           | 77                          | 18,431              |
| Other operating expenses         | 40,420                  | 1,466                     | 15,761                        | 383                         | 58,030              |
| Totals                           | <u>\$ 1,143,275</u>     | <u>\$ 21,288</u>          | <u>\$ 87,179</u>              | <u>\$ 5,579</u>             | <u>\$ 1,257,321</u> |

## Gundersen Health System

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

#### **21. Subsequent Events**

The System has evaluated events and transactions that have occurred subsequent to December 31, 2019, through April 24, 2020, the date on which the accompanying consolidated financial statements were issued.

During this period, there were no subsequent events requiring recognition in the consolidated financial statements, and there were no non-recognized subsequent events requiring disclosure, except for the following:

On March 24, 2020, the System issued a \$25 million bond to finance the Winona Campus building construction, warehouse build-out, and a new pediatric unit.

During April 2020, the System received an advance from the Centers for Medicare & Medicaid Services which will be recouped over the next 365 days. Also, the System received a stimulus grant of from Health and Human Services related to the Coronavirus Aid, Relief, and Economic Security Act. The System is still evaluating the accounting for this stimulus grant.

Due to the global viral outbreak caused by coronavirus disease 2019 (COVID-19) in 2020, there have been resulting effects that could negatively impact the System's consolidated financial condition, including significant stock market exchange volatility, various temporary business closures and event cancellations, supply disruptions, and decisions to defer elective procedures and other medical treatments at the System as the broader economic impact of COVID-19 develops. The timing, source, and rate of reimbursement for COVID-19-related patient care; ability to respond to patient demand; and extent and timing of federal and state grants, reimbursements, and other contributions, if any, to compensate for revenue losses and increased expenses is as yet not fully known, nor is the length of delay and level of attrition in elective procedures, expense increases and acceleration, impact of changes in payor mix, potential risk in uninsured patients and need for charity care, and the effect of the economic downturn on demand for elective procedures and billing cycle. The System is monitoring liquidity and cash flow and is taking steps to protect its financial health, including a focus on maintaining liquidity to meet its obligations. In addition, the System expects to apply for all appropriate COVID-19-related resources, including supplies; financial support; payroll tax deferrals and relief, if any; and other assistance made available through local, state, and federal governments and community partners.

Due to the evolving nature of the COVID-19 response, the ultimate impact of these matters to the System and its consolidated financial condition is presently unknown. The accompanying consolidated financial statements as of and for the year ended December 31, 2019, do not reflect the effects of these subsequent events.

# Supplementary Information



Ernst & Young LLP  
833 East Michigan Street  
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*

April 24, 2020

# Gundersen Health System

## Consolidating Balance Sheet (Dollars in Thousands)

December 31, 2019

|  | Obligated<br>Group | CAH        | Others    | Eliminations | Total        |
|--|--------------------|------------|-----------|--------------|--------------|
| <b>Assets</b>  |                    |            |           |              |              |
| Current assets:  |                    |            |           |              |              |
| Cash and cash equivalents  | \$ 139,877         | \$ 30,062  | \$ 2,650  | \$ –         | \$ 172,589   |
| Investments  | 729,103            | 1,562      | 1,756     | –            | 732,421      |
| Current portion of investments whose use is limited                    | 1,400              | 42         | 34        | –            | 1,476        |
| Patient accounts receivable, less allowance for uncollectible accounts | 165,645            | 16,181     | 3,045     | –            | 184,871      |
| Current portion of notes receivable from affiliates                    | 497                | –          | –         | (497)        | –            |
| Other current assets   | 102,672            | 4,029      | 455       | (3,500)      | 103,656      |
| Total current assets   | 1,139,194          | 51,876     | 7,940     | (3,997)      | 1,195,013    |
| Investments whose use is limited                                       | 43,378             | 2,343      | 107       | –            | 45,828       |
| Notes receivable from affiliates, net of current portion               | 3,010              | –          | –         | (1,733)      | 1,277        |
| Property and equipment, net  | 591,071            | 51,591     | 10,805    | –            | 653,467      |
| Right-of-use assets  | 15,957             | 848        | 83        | (642)        | 16,246       |
| Investment in unconsolidated affiliate                                 | 30,378             | –          | 31,929    | –            | 62,307       |
| Investment in consolidated affiliate                                   | –                  | –          | 4,163     | (4,163)      | –            |
| Other noncurrent assets  | 19,388             | 3,406      | 547       | –            | 23,341       |
| Total assets   | \$ 1,842,376       | \$ 110,064 | \$ 55,574 | \$ (10,535)  | \$ 1,997,479 |
| <b>Liabilities and net assets</b>                                      |                    |            |           |              |              |
| Current liabilities:   |                    |            |           |              |              |
| Accounts payable   | \$ 19,761          | \$ 7,334   | \$ 1,296  | \$ (3,422)   | \$ 24,969    |
| Accrued payroll  | 57,344             | 4,700      | 780       | –            | 62,824       |
| Accrued liabilities  | 65,654             | 1,921      | 176       | (78)         | 67,673       |
| Current maturities of long-term debt                                   | 10,247             | 2,179      | 241       | (497)        | 12,170       |
| Current operating lease obligations                                    | 3,113              | 504        | 28        | (402)        | 3,243        |
| Other current liabilities  | 9,273              | 2,568      | 56        | –            | 11,897       |
| Total current liabilities  | 165,392            | 19,206     | 2,577     | (4,399)      | 182,776      |
| Long-term debt, net of current maturities                              | 353,833            | 22,932     | 1,058     | (1,733)      | 376,090      |
| Long-term operating lease obligations                                  | 12,844             | 344        | 55        | (240)        | 13,003       |
| Obligation under swap contracts  | 26,023             | –          | –         | –            | 26,023       |
| Other noncurrent liabilities   | 17,121             | 741        | 227       | –            | 18,089       |
| Total liabilities  | 575,213            | 43,223     | 3,917     | (6,372)      | 615,981      |
| Net assets:  |                    |            |           |              |              |
| Net assets without donor restrictions                                  | 1,233,341          | 63,705     | 51,619    | (4,163)      | 1,344,502    |
| Net assets with donor restrictions                                     | 33,822             | 3,136      | 38        | –            | 36,996       |
| Total net assets   | 1,267,163          | 66,841     | 51,657    | (4,163)      | 1,381,498    |
| Total liabilities and net assets                                       | \$ 1,842,376       | \$ 110,064 | \$ 55,574 | \$ (10,535)  | \$ 1,997,479 |

# Gundersen Health System

## Consolidating Statement of Operations (Dollars in Thousands)

Year Ended December 31, 2019

|   | Obligated<br>Group | CAH        | Others     | Eliminations | Total      |
|---|--------------------|------------|------------|--------------|------------|
| Operating revenue:                              |                    |            |            |              |            |
| Net patient service revenue                     | \$ 829,001         | \$ 115,775 | \$ 16,671  | \$ (11,066)  | \$ 950,381 |
| Capitation revenue                              | 385,650            | –          | –          | (2,834)      | 382,816    |
| Other revenue                                   | 40,184             | 3,034      | 4,355      | (14,967)     | 32,606     |
| Total operating revenue and gains               | 1,254,835          | 118,809    | 21,026     | (28,867)     | 1,365,803  |
| Operating expenses:                             |                    |            |            |              |            |
| Salaries, wages, and benefits                   | 689,324            | 58,498     | 10,836     | (3,339)      | 755,319    |
| Supplies  | 186,472            | 12,157     | 1,613      | (119)        | 200,123    |
| Capitation services                             | 139,768            | –          | –          | (10,186)     | 129,582    |
| Depreciation and amortization                   | 54,605             | 3,934      | 1,664      | –            | 60,203     |
| Facilities                                      | 31,456             | 4,468      | 2,405      | –            | 38,329     |
| Purchased services                              | 44,811             | 24,545     | 3,560      | (13,340)     | 59,576     |
| Interest  | 16,801             | 684        | 97         | (87)         | 17,495     |
| Other operating expenses                        | 51,679             | 4,812      | 3,187      | (1,883)      | 57,795     |
| Total operating expenses                        | 1,214,916          | 109,098    | 23,362     | (28,954)     | 1,318,422  |
| Operating income (loss)                         | 39,919             | 9,711      | (2,336)    | 87           | 47,381     |
| Nonoperating gains (losses):                    |                    |            |            |              |            |
| Investment gains, net                           | 100,074            | 167        | 59         | (87)         | 100,213    |
| Unrealized loss on interest rate swap contracts | (5,189)            | –          | –          | –            | (5,189)    |
| Gain from unconsolidated affiliates             | 1,163              | 150        | 3,622      | –            | 4,935      |
| Other nonoperating (losses) gains, net          | (20)               | 219        | (3,268)    | 3,089        | 20         |
|   | 96,028             | 536        | 413        | 3,002        | 99,979     |
| Revenue in excess of (less than) expenses       | \$ 135,947         | \$ 10,247  | \$ (1,923) | \$ 3,089     | \$ 147,360 |

# Gundersen Health System

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

Year Ended December 31, 2019

|  | <b>Obligated<br/>Group</b> | <b>CAH</b> | <b>Others</b> | <b>Eliminations</b> | <b>Total</b> |
|--|----------------------------|------------|---------------|---------------------|--------------|
| Net assets without donor restrictions:                                   |                            |            |               |                     |              |
| Revenue in excess of (less than) expenses                                | \$ 135,947                 | \$ 10,247  | \$ (1,923)    | \$ 3,089            | \$ 147,360   |
| Net assets released from restrictions to purchase property and equipment | 1,135                      | 183        | –             | –                   | 1,318        |
| Other changes in unrestricted net assets                                 | (945)                      | 35         | 1,337         | (264)               | 163          |
| Increase (decrease) in net assets without donor restrictions             | 136,137                    | 10,465     | (586)         | 2,825               | 148,841      |
| Net assets with donor restrictions:                                      |                            |            |               |                     |              |
| Contributions  | 5,018                      | 4          | –             | –                   | 5,022        |
| Investment return  | 4,642                      | 46         | –             | –                   | 4,688        |
| Net assets released from restriction                                     | (5,406)                    | (160)      | –             | –                   | (5,566)      |
| Other changes  | –                          | 554        | –             | –                   | 554          |
| Increase in net assets with donor restrictions                           | 4,254                      | 444        | –             | –                   | 4,698        |
| Increase (decrease) in net assets  | 140,391                    | 10,909     | (586)         | 2,825               | 153,539      |
| Net assets at beginning of year  | 1,126,772                  | 55,932     | 52,243        | (6,988)             | 1,227,959    |
| Net assets at end of year  | \$ 1,267,163               | \$ 66,841  | \$ 51,657     | \$ (4,163)          | \$ 1,381,498 |

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