



**INTEGRIS *HEALTH*, INC.  
AND CONTROLLED ENTITIES**

Consolidated Financial Statements  
and Supplemental Schedules

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP  
210 Park Avenue, Suite 2650  
Oklahoma City, OK 73102-5683

## Independent Auditors' Report

The Board of Directors  
INTEGRIS *Health*, Inc.:

We have audited the accompanying consolidated financial statements of INTEGRIS *Health*, Inc. and controlled entities, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, 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 consolidated financial statements in accordance 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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

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

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

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of INTEGRIS *Health*, Inc. and controlled entities as of June 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



*Other Matter*

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*KPMG LLP*

Oklahoma City, Oklahoma  
September 26, 2018

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

<b>Assets</b>	<b>2018</b>	<b>2017</b>
Current assets:		
Cash and cash equivalents	\$ 76,645	38,408
Short-term investments	177,176	201,540
Patient accounts receivable, net	211,900	193,190
Inventories	38,234	32,560
Prepaid expenses and other current assets	17,176	15,573
Total current assets	<u>521,131</u>	<u>481,271</u>
Assets whose use is limited	936,233	843,022
Property and equipment:		
Land and improvements	54,962	56,556
Buildings and leasehold improvements	649,187	646,071
Equipment	919,157	883,470
	<u>1,623,306</u>	<u>1,586,097</u>
Less accumulated depreciation and amortization	<u>942,307</u>	<u>903,307</u>
	680,999	682,790
Construction in progress	<u>34,313</u>	<u>62,486</u>
	715,312	745,276
Other assets, net	<u>80,956</u>	<u>77,670</u>
Total assets	<u>\$ 2,253,632</u>	<u>2,147,239</u>

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

<b>Liabilities and Net Assets</b>	<b>2018</b>	<b>2017</b>
Current liabilities:		
Accounts payable, accrued expenses, and other	\$ 202,561	219,994
Employee compensation and related liabilities	59,311	52,513
Current portion of long-term debt	58,190	57,895
Current portion of capital lease obligations	212	380
Due to affiliates	4,962	7,484
Total current liabilities	325,236	338,266
Long-term debt, less current portion	456,220	370,532
Capital lease obligations, less current portion	—	212
Long-term pension liability	256,132	296,506
Other long-term liabilities	160,534	175,476
Total liabilities	1,198,122	1,180,992
Net assets:		
Unrestricted	992,184	900,101
Temporarily restricted	48,800	52,162
Permanently restricted	7,291	6,650
Total net assets of INTEGRIS <i>Health</i>	1,048,275	958,913
Noncontrolling ownership interest in equity of consolidated affiliates – unrestricted	7,235	7,334
Total net assets	1,055,510	966,247
Commitments and contingencies		
Total liabilities and net assets	\$ 2,253,632	2,147,239

See accompanying notes to consolidated financial statements.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidated Statements of Operations

Years ended June 30, 2018 and 2017

(In thousands)

	<b>2018</b>	<b>2017</b>
Operating revenues:		
Patient service revenue (net of contractual allowances and discounts)	\$ 1,657,802	1,513,381
Provision for bad debts	(148,346)	(102,303)
Net patient service revenue	1,509,456	1,411,078
Premium revenue	7,916	2,723
Other operating revenue	156,089	144,728
Total operating revenues	1,673,461	1,558,529
Operating expenses:		
Salaries and related expenses	855,519	805,622
Supplies and other expenses	658,587	628,915
Professional services	46,340	40,837
Depreciation and amortization	90,064	80,013
Interest expense	20,191	16,814
Total operating expenses	1,670,701	1,572,201
Income (loss) from operations	2,760	(13,672)
Nonoperating revenue (expense):		
Net investment income	55,055	132,263
Net equity in loss of affiliates	(2,807)	(1,817)
Other, net	(1,430)	(4,791)
Total net nonoperating revenue	50,818	125,655
Net income	53,578	111,983
Net loss attributable to noncontrolling interest	1,914	1,426
Net income attributable to INTEGRIS Health	\$ 55,492	113,409

See accompanying notes to consolidated financial statements.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

	<b>2018</b>	<b>2017</b>
Changes in unrestricted net assets:		
Net income attributable to INTEGRIS <i>Health</i>	\$ 55,492	113,409
Pension liability adjustment	27,688	35,949
Net assets released from restrictions used for purchase of property and equipment	9,222	2,938
Other changes, net	(319)	(4,218)
Increase in unrestricted net assets	92,083	148,078
Changes in temporarily restricted net assets:		
Contributions received for operations	5,511	12,052
Investment income	1,273	3,411
Change in value of split-interest agreement	(13)	(19)
Net assets released from restrictions	(10,744)	(4,049)
Other changes, net	611	312
Increase (decrease) in temporarily restricted net assets	(3,362)	11,707
Changes in permanently restricted net assets:		
Contributions received for operations	627	61
Investment income	335	706
Other changes, net	(321)	(285)
Increase in permanently restricted net assets	641	482
Increase in net assets of INTEGRIS <i>Health</i>	89,362	160,267
Net assets of INTEGRIS <i>Health</i> , beginning of year	958,913	798,646
Net assets of INTEGRIS <i>Health</i> , end of year	\$ 1,048,275	958,913

See accompanying notes to consolidated financial statements.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(In thousands)

	<b>2018</b>	<b>2017</b>
Cash flows from operating activities:		
Increase in net assets	\$ 89,362	160,267
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Pension liability adjustment	(27,688)	(35,949)
Net unrealized (gain) loss on investments	9,467	(78,852)
Net realized gain on investments	(33,263)	(9,505)
Change in split-interest agreement	18	24
Provision for bad debts, net of recoveries	148,414	102,295
Depreciation and amortization	90,064	80,013
Amortization of bond premiums/discounts	(1,701)	(963)
Net (gain) loss on property and equipment disposal	(1,044)	367
Income from investments in affiliates	(17,235)	(17,293)
Distributions from unconsolidated affiliates	18,705	20,003
Change in fair value of interest rate swap agreements	(13,484)	(25,900)
Net loss attributable to noncontrolling interest	(1,914)	(1,426)
(Increase) decrease in:		
Patient receivables	(167,124)	(108,609)
Other receivables	—	7
Other assets	(6,880)	(4,176)
Increase (decrease) in:		
Accounts payable and other current liabilities	(13,157)	(47,842)
Other noncurrent liabilities	(14,942)	12,918
Net cash provided by operating activities	57,598	45,379
Cash flows from investing activities:		
Purchases of property and equipment	(62,215)	(118,374)
Proceeds from disposal of property and equipment	3,332	138
Purchases of investments in affiliates and contributions to joint ventures	—	(2,163)
Sales of short-term investments and assets limited to use, net	(45,051)	80,119
Net cash used in investing activities	(103,934)	(40,280)
Cash flows from financing activities:		
Principal payments on capital lease obligations	380	(418)
Principal payments on long-term debt	(13,055)	(12,490)
Proceeds from issuance of long-term debt	99,261	—
Distributions to noncontrolling interest holders	(2,013)	(576)
Net cash provided by (used) in financing activities	84,573	(13,484)
Net increase (decrease) in cash and cash equivalents	38,237	(8,385)
Cash and cash equivalents at beginning of year	38,408	46,793
Cash and cash equivalents at end of year	\$ 76,645	38,408
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 20,294	16,638
Federal income taxes	2,794	1,065

See accompanying notes to consolidated financial statements.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(1) Organization and Summary of Significant Accounting Policies**

**(a) Organization and Nature of Business**

INTEGRIS *Health*, Inc. and its controlled entities (INTEGRIS *Health*) operate an integrated delivery system, which provides a wide variety of healthcare services in the state of Oklahoma. INTEGRIS *Health*, except for INTEGRIS Pro*Health*, Inc. and subsidiaries (PHI), INTEGRIS Cardiovascular Physicians, and INTEGRIS *Health* Partners, are not-for-profit private corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

Significant controlled entities include INTEGRIS Baptist Medical Center, Inc. (IBMC), INTEGRIS South Oklahoma City Hospital Corporation d/b/a INTEGRIS Southwest Medical Center, Inc. (ISOCHC), INTEGRIS *Health* Edmond, Inc. (IHE) and INTEGRIS Rural *Health*, Inc. (IRH). IBMC operates a licensed 657-bed healthcare facility in northwest Oklahoma City, ISOCHC operates a licensed 334-bed facility in south Oklahoma City, IHE operates a licensed 40-bed facility in Edmond, OK, and IRH owns INTEGRIS Miami Hospital, Miami, Oklahoma; INTEGRIS Bass Baptist *Health* Center, Enid, Oklahoma; INTEGRIS Grove Hospital, Grove, Oklahoma; and INTEGRIS Canadian Valley Hospital, Yukon, Oklahoma.

**(b) Basis of Presentation**

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP).

**(c) Use of Estimates**

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates for INTEGRIS *Health* include malpractice and liability costs, pension benefit obligation, valuation of interest rate swaps, and valuation of patient accounts receivable.

**(d) Principles of Consolidation**

The consolidated financial statements include the accounts of the following controlled entities:

- IBMC and subsidiaries
- ISOCHC
- IRH
- Baptist Healthcare of Oklahoma, Inc. (BHO)
- IHE
- INTEGRIS *Health* Foundation, Inc.
- INTEGRIS Ambulatory Care Corporation and subsidiaries (IACC)

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

- INTEGRIS Realty Corporation and subsidiary (Realty)
- PHI
- INTEGRIS *Health* Partners (IHP)
- INTEGRIS Cardiovascular Physicians (ICP)
- Quality Alliance Assurance Company (Cayman), Ltd. (Quality Alliance)
- INTEGRIS Hospice, Inc. (Hospice)

Significant intercompany accounts and transactions have been eliminated.

**(e) Cash and Cash Equivalents**

Cash and cash equivalents include demand deposits, short-term overnight investments, and other investments with original maturities at the date of purchase of three months or less. The majority of cash and cash equivalents are on deposit with one financial institution.

**(f) Short-Term Investments**

Short-term investments are stated at fair value and consist primarily of investments in cash and cash equivalents, U.S. government and agency obligations, and corporate obligations.

**(g) Donor-Restricted Gifts**

Unconditional promises to give cash and other assets to INTEGRIS *Health* and its tax-exempt controlled affiliates are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and are reported in the accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions and other operating revenue.

**(h) Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by INTEGRIS *Health* and its tax-exempt controlled affiliates have been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by INTEGRIS *Health* and its tax-exempt controlled affiliates in perpetuity.

**(i) Net Income**

The consolidated statements of operations and changes in net assets include net income. Changes in unrestricted net assets, which are excluded from net income, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), and other items required by U.S. GAAP to be reported separately.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(j) Net Patient Service Revenue and Patient Accounts Receivable**

Net patient service revenue is recorded at established rates, net of contractual adjustments, charity care adjustments, administrative adjustments, and net patient bad debt. Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered. Adjustments to estimates in future periods are recorded as final settlements are determined or as additional information becomes available.

Net patient service revenue in the accompanying consolidated statements of operations and changes in net assets has been reduced by amounts resulting from contractual allowances related to the participation in Medicare, Medicaid, discount arrangements, and other prospective reimbursement programs as follows:

	<b>2018</b>	<b>2017</b>
Patient service revenue (net of contractual allowances and discounts, before provision for bad debt, in thousands):		
Medicare	\$ 453,559	413,941
Medicaid	190,148	166,239
Managed care	889,302	837,282
Commercial and other	28,357	20,315
Private pay	96,436	75,604
	\$ 1,657,802	1,513,381

Patient accounts receivable are recorded net of contractual allowances and discounts of approximately \$825,482,000 and \$684,757,000 at June 30, 2018 and 2017, respectively. Although INTEGRIS *Health* estimates uncollectible accounts on a reasonable basis, the net patient accounts receivable balance is subject to an accounting loss if patients and third-party payors are unable to meet their contractual obligations.

The allowance, resulting from the provision of bad debts, is based upon a combination of the aging of receivables and management's assessment of historical and expected net collections considering business and economic conditions, trends in healthcare coverage, and other collection indicators. Management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience and payment trends by payor category. Patient accounts are also monitored, and, if necessary, past due accounts are placed with collection agencies in accordance with guidelines established by INTEGRIS *Health*. All patient balances regardless of payor source are collected in accordance with a predefined time limited process designed to give the patient an opportunity to pay the balance before writing off the balance to bad debt expense and turning the account over to a collection agency.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

For receivables associated with services provided to patients who have third-party coverage, INTEGRIS *Health* analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debt, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balance due for which third-party coverage exists for part of the bill), INTEGRIS *Health* records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates (which are discounted from gross charges for all uninsured self-pay patients by 70% and 80%, respectively, in 2018 and 2017 as discussed below) and the amounts actually collected after all reasonable collection efforts have been exhausted is written off against the allowance for doubtful accounts.

The Internal Revenue Service enacted 501(r) guidance for nonprofit hospitals on March 23, 2010, by the Patient Protection and Affordable Care Act. Hospital organizations covered by Section 501(r) may not charge an individual eligible for a financial assistance policy more than the amount generally billed to individuals with insurance covering their healthcare. As a result of this guidance, INTEGRIS *Health* implemented a policy effective July 1, 2011 that discounted all private pay patient charges. This adjustment is considered a contractual adjustment rather than a bad debt adjustment. As of July 1, 2016, this private pay adjustment was 80% of patient charges and as of July 1, 2017, the adjustment was decreased to 70% of patient charges. The adjustment is recorded as a direct reduction to net patient service revenue instead of bad debt.

INTEGRIS *Health's* allowance for doubtful accounts for self-pay patients was 98.9% and 99.8% of self-pay accounts receivable at June 30, 2018 and 2017, respectively. Issues experienced in the collection of amounts from self-pay patients continued in fiscal year 2018 and have kept this allowance rate high. INTEGRIS *Health* does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors other than for contractual allowances.

**(k) Charity Care**

Certain healthcare related controlled entities provide care without charge to patients who meet certain criteria under INTEGRIS *Health's* charity care policy. Because these entities do not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net revenue or included in net accounts receivable in the accompanying consolidated financial statements.

**(l) Assets Whose Use Is Limited and Investment Income**

Assets whose use is limited includes assets designated by the board of directors for future capital improvements, self-insurance programs, debt service requirements, and other general purposes, over which the board retains control and may, at its discretion, subsequently use for other purposes; assets restricted by trustee under bond indenture agreement; and assets restricted by donors as to use. Marketable equity securities with readily determinable fair values and all debt securities are recorded at fair value. Fair values are based on quoted market prices, if available, or estimated using quoted

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

market prices for similar securities. Realized and unrealized gains and losses on investments are determined by comparison of the actual cost to the proceeds at the time of disposition, or market values as of the end of the financial statement period. The cost of securities sold is based on the specific-identification method.

Investment income, including income on assets whose use is limited and income on short-term investments, is reported as operating and nonoperating revenue. Investment income includes the gain from the change in fair value of interest rate swaps described in note 1(q) of approximately \$13,484,000 in 2018 and the gain of approximately \$25,900,000 in 2017. All investments are classified as trading securities, and the change in unrealized gains and losses on investments is included in the determination of net income.

INTEGRIS *Health* invests in various securities. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonable to assume that changes in the values of investment securities will occur in the near term and that such changes could be material to the accompanying consolidated financial statements.

**(m) Inventories**

Inventories consist of pharmaceuticals, dietary, and medical supplies and are valued at the lower of cost (first-in, first-out) and net realizable value.

**(n) Property and Equipment**

Property and equipment are recorded at cost or, if donated, at fair value on the date of receipt. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. Depreciation expense was approximately \$89,869,000 and \$79,723,000 for the years ended June 30, 2018 and 2017, respectively. Assets under capital leases are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the assets. Such amortization is included in depreciation and amortization in the consolidated financial statements. Expenditures that increase values, change capacities, or extend useful lives of assets are capitalized. Interest costs are capitalized for construction projects that require a period of time to ready them for their intended use. Routine maintenance, repairs, and renewals are charged to operations.

Long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, INTEGRIS *Health* first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(o) Other Assets**

Interests in earnings and losses, dividends, and contributions to affiliates not controlled by INTEGRIS Health are accounted for using the equity method. These investments are included in other assets.

**(p) Goodwill**

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. There was no impairment of goodwill for the years ended June 30, 2018 or June 30, 2017.

**(q) Derivative Instruments and Hedging Activities**

INTEGRIS Health uses interest rate swap agreements to manage interest rate risk and accounts for derivative instruments utilized in connection with these activities at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it. For hedges of exposure to changes in fair value, the gain or loss on the derivative instrument is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. For hedges of exposure to changes in cash flow, the effective portion of the gain or loss on the derivative instrument is reported initially as a component of other changes in net assets and is subsequently reclassified into earnings when the forecasted transaction affects earnings. Any ineffectiveness of designated hedges is reported in earnings. If the derivative instrument does not qualify or is not designated as part of a hedging relationship, INTEGRIS Health accounts for changes in fair value of the derivative in earnings as they occur.

To qualify as a hedge, the hedge relationship is designated and formally documented at inception detailing the particular risk management objective and strategy for the hedge, which includes the item and risk that is being hedged, the derivative that is being used, as well as how effectiveness is being assessed. A derivative must be highly effective in accomplishing the objective of offsetting either changes in fair value or cash flows for the risk being hedged. The effectiveness of these hedging relationships is evaluated on a retrospective and prospective basis using quantitative measures of correlation. If a hedge relationship is found to be ineffective, it no longer qualifies as a hedge and any excess gains or losses attributable to such ineffectiveness, as well as subsequent changes in fair value, are recognized in earnings.

None of INTEGRIS Health's interest rate swaps are designated as hedges, and all changes in fair value are recorded as an increase or decrease in investment income. The unrealized gain recognized for the year ended June 30, 2018 was approximately \$13,484,000 compared to an unrealized gain for the year ended June 30, 2017 of approximately \$25,900,000. The difference between the fixed rate paid and the floating rate received is recognized as an increase or decrease in interest expense.

By using derivative financial instruments to hedge exposures to changes in interest rates, INTEGRIS Health exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes INTEGRIS Health. When the fair value of the derivative contract is negative, INTEGRIS Health owes the counterparty, and, therefore, INTEGRIS Health is not exposed to

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

the counterparty's credit risk in these circumstances. INTEGRIS *Health* minimizes counterparty credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

INTEGRIS *Health* does not enter into derivative instruments for any purpose other than to manage interest rate risk. INTEGRIS *Health* does not speculate using derivative instruments.

**(r) Asset Retirement Obligations**

INTEGRIS *Health* recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which the obligation is incurred, if a reasonable estimate of the fair value of the obligation can be made. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the accompanying consolidated statements of operations and changes in net assets.

The liability for the asset retirement obligation is approximately \$4,101,000 and \$3,910,000 and the future value of the asset retirement obligation is approximately \$5,437,000 and \$5,354,000 as of June 30, 2018 and 2017, respectively. Substantially all of the obligation relates to estimated costs to remove asbestos and underground storage tanks from various facilities. Changes are primarily due to remediation activities, changes in inflation rates, and revisions to estimates of the amount of asbestos at specific facilities.

**(s) Pension and Other Postretirement Plans**

INTEGRIS *Health* has a frozen defined-benefit pension plan (the Pension Plan) covering certain eligible employees and employees of controlled entities and affiliates upon their retirement. Eligible employees include those over 21 years of age who have attained at least 1,000 hours of service. The benefits are based on the employee's years of service and compensation. INTEGRIS *Health* also offers eligible employees of INTEGRIS *Health* and controlled entities and affiliates certain postretirement healthcare and life insurance benefits.

INTEGRIS *Health* records annual amounts relating to its pension and postretirement plans based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, turnover rates, and healthcare cost trend rates. INTEGRIS *Health* reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded in unrestricted net assets and amortized to net periodic cost over future periods. INTEGRIS *Health* believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The funded status reported on the consolidated balance sheet as of June 30, 2018 and 2017 was measured as the difference between the fair value of the plan assets and the benefit obligation on a plan-by-plan basis. The net periodic costs are recognized as employees render the services necessary to earn the postretirement benefits.

Beginning July 1, 2009, the Pension Plan was closed to new participants. Employees hired or rehired on or after July 1, 2009, will participate in a Retirement Savings Plan. INTEGRIS Health contributes an amount greater than or equal to 3% of pay based on years of vesting service in the Retirement Savings Plan. In order to qualify for this annual contribution the employee must work at least 1,000 hours in the fiscal year and be an active employee on the last day of the fiscal year. Participants are responsible for directing the investment of the funds, using the investment fund options offered in the Retirement Savings Plan.

As of January 1, 2013, the Pension Plan was frozen. All employees now receive a contribution in the Retirement Savings Plan. For the Pension Plan, vesting service and credited service for the purposes of calculating the rule of 85 eligibility continue.

**(t) Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expect to be entitled in exchange for those goods or services. An entity also should disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for INTEGRIS Health July 1, 2018 (as amended in August 2015 by ASU 2015-14, *Deferral of the Effective Date*). The standard permits the use of either the retrospective or cumulative effect transition method. INTEGRIS Health is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Financial Instruments-Overall Subtopic 825-10)*, which is targeted to improve GAAP as follows: require equity investments to be measured at fair value with changes in fair value being recognized in net income, simplify the assessments of equity investments for impairment by requiring qualitative assessments, eliminate the disclosure of financial instruments being measured at amortized costs and clarifies the need to present separately of financial assets and financial liabilities by measurement category on the balance sheet. The guidance is effective for years beginning after December 15, 2018. Early adoption is allowed after December 15, 2017. INTEGRIS Health does not expect ASU 2016-01 to have a material effect on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which supersedes FASB ASC Topic 840, *Leases*, and makes other conforming amendments to U.S. GAAP. ASU 2016-02 requires, among other changes to the lease accounting guidance, lessees to recognize most leases on-balance sheet via a right of use asset and lease liability, and additional qualitative and quantitative disclosures. ASU 2016-02 is effective for INTEGRIS Health for annual periods in fiscal years beginning

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

after December 15, 2018, permits early adoption, and mandates a modified retrospective transition method. INTEGRIS *Health* is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, to improve the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. This ASU makes several improvements to current reporting requirements that address complexities about the use of the currently required three classes of net assets that focus on (a) the absence or presence of donor-imposed restrictions and whether those restrictions are temporary or permanent, (b) deficiencies in the transparency and utility of information useful in assessing an entity's liquidity caused by potential misunderstandings and confusion about the term "unrestricted net assets", (c) inconsistencies in the type of information provided about expenses, and (d) impediment of preparing the indirect method reconciliation if a not-for-profit entity chooses to use the direct method of presenting operating cash flows. The guidance is effective for annual periods in fiscal years beginning after December 15, 2017. INTEGRIS *Health* is evaluating the effect that ASU 2016-14 will have on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU 2016-18 *Statement of Cash Flows (Topic 230)*, which requires that a statement of cash flows explain the change during the period in the total of cash and cash equivalents, which will now include restricted cash and restricted cash equivalents in the beginning and ending balances on the statement of cash flows. The change is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. INTEGRIS *Health* is evaluating the effects that ASU 2016-18 will have on the financial statements and the related disclosures.

In March 2017, the FASB issued ASU 2017-07 *Compensation – Retirement Benefits (Topic 715)* to improve the presentation of the net periodic pension costs and net periodic postretirement benefit costs. This update requires employers to report the service cost component of net benefit costs in the same line item as other compensation costs arising from services rendered by pertinent employees during the period. The other components of net benefit costs are required to be presented separately in the income statement and outside of the subtotal of income from operations. The amendments in this update are effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. INTEGRIS *Health* is evaluating the effects that ASU 2017-07 will have on the consolidated financials and the related disclosures.

In August 2018, the FASB issued ASU 2018-14 *Compensation – Retirement Benefits – Defined Benefit Plans-General (Subtopic 715-20)* which offers further guidance related to FASB Concepts Statement, Conceptual Framework of Financial Reporting-Chapter 8: Notes to the Financial Statements issued in March 2014. The ASU modifies the disclosure requirements for employers who sponsor defined benefit pension or other post retirement plans. The effective date of ASU 2018-14 is for fiscal years beginning after December 15, 2020. Early adoption is permitted. INTEGRIS *Health* is evaluating the effects that ASU 2018-14 will have on the consolidated financial statements and the related disclosures.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(u) Reclassifications**

Certain reclassifications have been made to the June 30, 2017 financial statements to conform to the June 30, 2018 presentation. The reclassifications had no effect on net income or net assets as previously reported. The long-term portion of the liability for malpractice has been reclassified from accounts payable to other long-term liabilities, and the balances due on variable rate demand bonds with self-liquidity provisions have been reclassified to the current portion of long-term debt.

**(2) Net Patient Service Revenue and Premium Revenue**

The healthcare related controlled entities have agreements with third-party payors that provide for reimbursement at amounts different from their established rates. A summary of the basis of reimbursement with major third-party payors is as follows:

- Medicare: Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicare outpatient services are paid under an outpatient prospective payment system, similar to inpatient acute services. Psychiatric services and medical education costs related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. The healthcare related controlled entities of INTEGRIS Health are reimbursed at an interim rate with final settlement determined after submission of annual cost reports by the respective affiliates and audits by the Medicare fiscal intermediary.
- Medicaid: Inpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate per discharge. INTEGRIS Health recognizes income from Medicaid for services provided by primary care physicians employed by INTEGRIS Health. The payments are received in return for services provided in the month of payment. INTEGRIS Health has no obligation to provide services after the month of payment and has no obligation to pay for services of other providers should the patient seek care from another party.
- Commercial Insurance: The healthcare related controlled entities have entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Medicare cost report settlements are estimated in the period services are provided to the program beneficiaries. These estimates are revised as needed until final settlement of the cost report. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue for 2018 and 2017 includes approximately \$10,548,000 and \$774,000, respectively, of adjustments for estimated cost report settlements and final settlements.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The Supplemental Hospital Offset Payment Program (SHOPP) program was created and implemented by the State of Oklahoma in fiscal year 2012 for the purpose of assuring access to quality care for Oklahoma Medicaid members. The program is designed to assess Oklahoma hospitals, unless exempt, a supplemental hospital offset payment program fee. The collected fees are placed in pools and then allocated to hospitals as directed by legislation. The Oklahoma Health Care Authority (OHCA) does not guarantee that allocations will equal or exceed the amount of the supplemental hospital offset payment program fee paid by the hospital. The SHOPP program assessment rate is assessed on a calendar year basis. For calendar years 2018 and 2017, the SHOPP assessment rates are 3.0% and 3.6% of net patient service revenue, respectively. The total fee incurred in 2018 and 2017 was approximately \$38,368,000 and \$37,300,000, respectively, and is included in supplies and other expenses in the consolidated statements of operations. The allocation from the pool in 2018 and 2017 was approximately \$70,418,000 and \$69,133,000, respectively, for all INTEGRIS *Health* facilities and is included in net patient service revenue in the consolidated statements of operations. The SHOPP program is expected to remain in effect through 2020.

**(3) Investments**

**(a) Assets Whose Use is Limited**

Assets whose use is limited include the following at June 30 (in thousands):

	<u>2018</u>		<u>2017</u>	
	<u>Cost</u>	<u>Fair value</u>	<u>Cost</u>	<u>Fair value</u>
Board designated:				
Cash and cash equivalents	\$ 18,736	18,736	26,451	26,451
U.S. government and agency obligations	92,276	90,965	78,837	78,417
Marketable equity securities	302,301	338,533	280,825	317,806
Corporate and other obligations	235,158	221,902	238,233	236,195
Accrued interest receivable	1,273	1,273	1,088	1,088
	<u>649,744</u>	<u>671,409</u>	<u>625,434</u>	<u>659,957</u>
Amounts held as collateral by counterparties to interest rate swaps and held in escrow for purchase transactions:				
Cash and cash equivalents	—	—	8,720	8,720
Amounts held for construction:				
Cash and cash equivalents	98,495	98,495	—	—

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	2018		2017	
	Cost	Fair value	Cost	Fair value
By donors:				
Cash and cash equivalents	\$ 958	958	2,907	2,907
U.S. government and agency obligations	5,245	5,252	4,807	4,896
Marketable equity securities	24,941	27,628	19,235	20,260
Corporate and other obligations	16,035	15,364	12,820	12,769
Accrued interest receivable	87	87	76	76
	<u>47,266</u>	<u>49,289</u>	<u>39,845</u>	<u>40,908</u>
By INTEGRIS Health Foundation boards:				
Cash and cash equivalents	256	256	1,200	1,200
U.S. government and agency obligations	1,401	1,403	1,982	2,019
Marketable equity securities	6,659	7,380	7,928	8,349
Corporate and other obligations	4,283	4,104	5,286	5,265
Accrued interest receivable	23	23	31	31
	<u>12,622</u>	<u>13,166</u>	<u>16,427</u>	<u>16,864</u>
By board for self-insurance program:				
Cash and cash equivalents	2,744	2,744	3,438	3,438
U.S. government and agency obligations	18,719	18,565	6,715	6,965
Marketable equity securities	57,557	69,231	71,129	79,998
Corporate and other obligations	13,250	13,192	26,132	26,034
Accrued interest	142	142	138	138
	<u>92,412</u>	<u>103,874</u>	<u>107,552</u>	<u>116,573</u>
Total assets whose use is limited	<u>\$ 900,539</u>	<u>936,233</u>	<u>797,978</u>	<u>843,022</u>

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(b) Short-Term Investments**

Short-term investments, which are reported at fair value at June 30, include (in thousands):

	<u>2018</u>	<u>2017</u>
Board designated:		
Cash and cash equivalents	\$ 36,768	36,391
Corporate and other obligations	140,090	164,897
Accrued interest receivable	<u>318</u>	<u>252</u>
Short-term investments	<u>\$ 177,176</u>	<u>201,540</u>

**(c) Investment Income**

Investment income, and gains and losses on short-term investments and assets whose use is limited are comprised of the following for the years ended June 30 (in thousands):

	<u>2018</u>	<u>2017</u>
Interest and dividend income, net	\$ 17,775	18,006
Unrealized gain on derivatives	13,484	25,900
Net realized gains on sales of securities	33,263	9,505
Net unrealized gain (loss) on trading securities	<u>(9,467)</u>	<u>78,852</u>
	<u>\$ 55,055</u>	<u>132,263</u>

**(4) Long-Term Debt**

Long-term debt includes the following at June 30 (in thousands):

	<u>2018</u>	<u>2017</u>
Health System Revenue and Refunding Bonds (Series 2017A) of the Oklahoma Development Finance Authority in the aggregate amount of \$100,000 at variable rates as determined by the remarketing agent (2.46% as of June 30, 2018). Issued December 2017, maturing at various dates through 2047.	\$ 100,000	—
Health System Revenue Refunding Bond Series (2015A) of the Oklahoma Development Finance Authority in the aggregate amount of \$200,060 at stated rates ranging from 1.00% to 5.00%, issued April 2015, maturing at various dates between August 2015 and August 2038, including a premium of \$19,010 and \$19,972 at June 30, 2018 and 2017, respectively.	199,725	206,872

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	<b>2018</b>	<b>2017</b>
Health System Revenue Refunding Bond Series (2015B) of the Oklahoma Development Finance Authority in the aggregate amount of \$48,425 as multi-modal, variable rates that may bear interest at a Window Rate, Daily Rate, Weekly Rate, Direct Purchase Rate, Indexed Rate, Commercial Paper Rate, or Long Term Rate. At June 30, 2018 and 2017 windows rate was 1.86% and 1.26%, respectively. Issued April 2015, maturing at various dates through 2033.	\$ 44,840	46,075
Health System Revenue Refunding bonds Series (2015C) of the Oklahoma Development Finance Authority in the aggregate amount of \$89,880 at variable rates as determined by the remarketing agent (2.86% and 1.59% as of June 30, 2018 and 2017, respectively). Issued June 2015, maturing at various dates through August 2033.	83,450	85,685
Health System Revenue and Refunding Bonds (Series 2013A) of the Oklahoma Development Finance Authority in the aggregate amount of \$48,990 at variable rates as determined by the remarketing agent (2.58% and 1.66% at June 30, 2018 and 2017 respectively). Issued May 2013, maturing at various dates through 2035.	43,215	44,915
Health System Revenue and Refunding Bonds (Series 2013B) of the Oklahoma Development Finance Authority in the aggregate amount of \$48,955 at variable rates as determined by the remarketing agent (2.58% and 1.73% as of June 30, 2018 and 2017, respectively). Issued May 2013, maturing at various dates through 2035.	43,180	44,880
	514,410	428,427
Less current portion	58,190	57,895
Long-term portion	\$ 456,220	370,532

All debt is secured by the revenues and receivables of the Obligated Group and the members of the Obligated Group are jointly and severally liable for the entire debt. The Obligated Group is comprised of IBMC, ISOCHC, IRH and IHE as of June 30, 2018 and 2017. In connection with the various bonds, the Obligated Group must comply with financial covenants and other various covenants that may require, restrict, limit, or prohibit certain transactions or activities. As of June 30, 2018, management believes the Obligated Group was in compliance with all debt covenants. In addition, management believes INTEGRIS Health was in compliance with debt covenants on other outstanding indebtedness as of June 30, 2018. The Obligated Group represents approximately 87% and 83% of total operating revenues of INTEGRIS Health as of and for the years ended June 30, 2018 and 2017, respectively.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

In December 2017, the Obligated Group issued series 2017A *Health* System Revenue Refunding Bonds of the Oklahoma Development Finance Authority in the amount of \$100,000,000. Proceeds will be used to fund future expansion on the INTEGRIS Edmond campus as well as a replacement bed tower on the INTEGRIS Baptist Hospital Campus. The 2017 Bonds were purchased by a single financial institution in a direct, private placement transaction and will bear interest at variable rates of interest calculated monthly pursuant to a floating rate at a percentage of one month LIBOR plus a spread. The spread is based on the rating of the long-term debt of the Obligated Group. The Series 2017A bonds are subject to a mandatory tender by the holder of the bonds in 2025, unless the holding period is renewed and extended by the bondholder. Upon a mandatory tender the Obligated Group will have the ability to convert to another interest mode (daily, weekly, term rate, flexible rate, or fixed rate) and remarket the bonds.

In April 2015, the Obligated Group issued the Series 2015A and Series 2015B *Health* System Revenue Refunding Bonds of the Oklahoma Development Finance Authority in the amounts of \$200,060,000 and \$48,425,000, respectively. Proceeds of the 2015 Bonds were used to refund the Series 2008B, 2008C, and 2007A-3 Bonds. INTEGRIS *Health* recognized a loss of approximately \$26,000,000 related to the extinguishment of the debt. The Series 2015A was issued as fixed rate debt. The Series 2015B was issued as variable debt with the initial sale at a Window Rate. The series 2015B bonds are variable rate demand bonds. Liquidity for payment of the Series 2015B bonds tendered for purchase and not remarketed is provided by INTEGRIS under a self-liquidity program. As a result, INTEGRIS has classified the Series 2015B bonds as a current liability in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2019 to 2034.

In June 2015, the Obligated Group issued the Series 2015C *Health* System Revenue Refunding Bonds of the Oklahoma Development Finance Authority in the amount of \$89,880,000. Proceeds of the 2015C Bonds were used to refund the Series 2011A and 2011B bonds. The Series 2015C Bonds were purchased by a single financial institution in a direct, private placement transaction and will bear interest at variable rates of interest calculated monthly pursuant to a floating rate at a percentage of one month LIBOR plus a spread. The spread is based on the rating of the long-term debt of the Obligated Group. The Series 2015C bonds are subject to a mandatory tender by the holder of the bonds in 2030, unless the holding period is renewed and extended by the bondholder. Upon a mandatory tender the Obligated Group will have the ability to convert to another interest mode (daily, weekly, term rate, flexible rate, or fixed rate) and remarket the bonds.

In May 2013, the Obligated Group issued the Series 2013A and Series 2013B *Health* System Revenue and Refunding Bonds of The Oklahoma Development Finance Authority in the amounts of \$48,990,000 and \$48,955,000, respectively. The 2013 Bonds were purchased by a single financial institution in a direct, private placement transaction and will bear interest at variable rates of interest calculated monthly pursuant to a floating rate at a percentage of one month LIBOR plus a spread. The spread is based on the rating of the long-term debt of the Obligated Group. The 2013A Bonds are subject to a mandatory tender by the holder of the bonds at the end of seven years and the 2013B Bonds are subject to a mandatory tender by the holder of the bonds at the end of eight years, unless the holding period is renewed and extended by the bondholder. During 2018, the 2013A and 2013B mandatory tenders were extended to 2027 and 2028, respectively. Upon a mandatory tender the Obligated Group will have the ability to convert to another interest rate mode (daily, weekly, term rate, flexible rate, or fixed rate) and remarket the 2013 Bonds. The

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

2013A and 2013B bonds are classified in the accompanying consolidated balance sheet and the maturity table below in accordance with the mandatory tender provisions in place with the holder of the bonds.

During 1999, INTEGRIS *Health* entered into agreements whereby INTEGRIS *Health* agrees to receive variable market-indexed payments in exchange for fixed rate interest payments. The notional principal amount underlying these interest rate swaps at June 30, 2017 was \$101,800,000. The variable payment rates approximate 67% of the one-month USD-LIBOR-BBA. The fixed payment rate is 3.52%. During 2018, these swaps were novated and replaced with a swap related to the 2017A bonds. Under the new agreement, INTEGRIS *Health* agrees to receive variable market-indexed payments in exchange for fixed rate interest payments. The notional principal amount underlying these interest rate swaps at June 30, 2018 was \$100,000,000. The interest rate swaps mature in August 2047. The variable payment rates approximate 70% of the one-month USD-LIBOR-BBA. The fixed payment rate is 2.65%.

During 2005, INTEGRIS *Health* entered into agreements whereby INTEGRIS *Health* agrees to receive variable market-indexed payments in exchange for fixed rate interest payments. The notional principal amount underlying these interest rate swaps at June 30, 2018 and 2017 was \$84,250,000 and \$87,650,000, respectively. The interest rate swaps mature in August 2035. The variable payment rates approximate 67% of the one-month USD-LIBOR-BBA, which approximates the variable rates of the Series 2013A and 2013B bonds. The fixed payment rate is 3.57%.

During fiscal year 2008, INTEGRIS *Health* entered into agreements whereby INTEGRIS *Health* agrees to receive variable market-indexed payments in exchange for fixed rate interest payments. The notional principal amount underlying these interest rate swaps at June 30, 2018 and 2017 was \$127,775,000 and \$131,175,000, respectively. The interest rate swaps mature in August 2033. The variable payment rates approximate 67% of three-month USD-LIBOR-BBA, which approximates the variable rates of the Series 2015B and 2015C bonds. The fixed payment rate is 3.62%.

In the event all of the bonds were tendered and the remarketing agent was unable to remarket the bonds, INTEGRIS *Health*'s required repayment of principal as compared to scheduled principal repayments are as follows (in thousands):

	<u>Scheduled principal payments</u>	<u>Including mandatory tendered bonds</u>
Year ending June 30:		
2019	\$ 14,860	58,190
2020	15,525	13,995
2021	16,080	14,525
2022	16,760	15,135
2023	17,510	15,860
Thereafter	<u>414,665</u>	<u>377,695</u>
Total	<u>\$ 495,400</u>	<u>495,400</u>

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

During 2015, INTEGRIS *Health* entered into a line of credit with Bank of Oklahoma, N.A. in the amount of \$75,000 that expires on July 1, 2018. This line of credit was renewed in 2018. There were no amounts outstanding under the line of credit as of June 30, 2018 and 2017.

Quality Alliance had a Standby Letter of Credit with Commerce Bank for \$11,000,000 in fiscal years 2018 and 2017. The Letter of Credit secures Quality Alliance's insurance obligations for the employed physicians. The line of credit expired on September 2, 2017 and was not renewed.

**(5) Investments in Affiliates**

INTEGRIS *Health* owns interests of less than or equal to 50% in Two Corporate Plaza, L.L.C. (Plaza), a real estate limited liability company; Medical Plaza Imaging Center LLC (MPIC), a healthcare limited liability company; Advanced Imaging LLC (Advanced Imaging) a healthcare limited liability company; Southwest Ambulatory Surgery Center, LLC (SW Ortho), a surgery center limited liability company; IntelliStaf, a medical personnel agency; Diagnostic Lab of Oklahoma (DLO), a comprehensive medical laboratory; and LifeCare Health Services, LLC, a healthcare collaborative. These investments are accounted for using the equity method and are recorded in other assets, net.

INTEGRIS *Health* purchased an interest in VADovations, Inc. in 2011. VADovations is a research and development company. INTEGRIS *Health* owns 75% of the stock and controls 40% of the representation on the board of directors. Based upon the level of control maintained, this investment is also accounted for using the equity method and is recorded in other assets, net. In addition, INTEGRIS *Health* has a note receivable due from VADovations. The balance, including accrued interest, was approximately \$13,917,000 and \$10,436,000 as of June 30, 2018 and 2017, respectively and is included in other assets, net, in the accompanying consolidated balance sheet.

Following is a summary of the ownership interests, carrying values, and equity in earnings (losses) of investments in affiliates at June 30, 2018 and 2017 (in thousands):

	Ownership interest		Carrying value		Equity in earnings (losses)	
	2018	2017	2018	2017	2018	2017
Plaza	33.33 %	33.33 %	\$ 387	424	(37)	(36)
MPIC	50.00	50.00	271	324	(50)	(48)
Advanced imaging	50.00	50.00	15	15	—	(8)
SW Ortho	19.52	19.86	6,463	6,456	2,728	3,045
IntelliStaf	32.00	32.00	453	487	1,247	1,069
DLO	49.00	49.00	12,240	12,140	14,800	15,088
LifeCare Health Services	19.77	—	1,354	—	1,354	—
VADovations, Inc.	75.00	75.00	(5,233)	(2,426)	(2,807)	(1,817)
			\$ 15,950	17,420	17,235	17,293

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(6) Noncontrolling Interests**

INTEGRIS *Health* controls and, therefore, consolidates certain investees in its partnerships and joint ventures with physicians and nonphysicians to operate hospitals and other health-related ventures. The activity for noncontrolling interest for the years ended June 30, 2018 and 2017 is summarized below (in thousands):

	<b>2018</b>	<b>2017</b>
Noncontrolling ownership interest in equity of consolidated affiliates, beginning of year	\$ 7,334	6,484
Revenue and gains in excess of expenses and losses attributable to noncontrolling interest	1,914	1,426
Distributions to noncontrolling interest holders	(2,013)	(576)
Noncontrolling ownership interest in equity of consolidated affiliates, end of year	\$ 7,235	7,334

**(7) Malpractice and Liability Costs**

INTEGRIS *Health* is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against INTEGRIS *Health* and are currently in various stages of litigation. Currently, there are varying insurance programs and arrangements in place.

Effective July 1, 1995, INTEGRIS *Health* formed Quality Alliance, a captive insurance company formed for the purpose of providing coverage to INTEGRIS *Health* and all of its controlled entities for medical malpractice and other liability risks. Quality Alliance charges premiums to the respective entities for coverage and accrues losses based on estimates that incorporate past experience as well as other considerations, which are based on actuarial estimates from an independent third-party actuary. Adjustments to the liability based on subsequent developments or other changes in the estimate are reflected in the consolidated statements of operations and changes in net assets in the period in which such adjustments become known. Quality Alliance maintains reinsurance coverage to reduce exposure from significant individual and aggregate losses. INTEGRIS *Health* has an undiscounted accrued liability for estimated claims incurred of approximately \$84,282,000 and \$84,795,000 as of June 30, 2018 and 2017, respectively, recorded in accounts payable, accrued expenses, and other and in other long term liabilities.

Claims arising from services provided to patients through June 30, 2018 and 2017 have been filed requesting damages in excess of insurance and the amount accrued for estimated malpractice costs. It is the opinion of management, however, after consulting with its legal counsel, insurance carrier, and actuary, that estimated costs to be incurred will be covered by professional liability insurance and the amount accrued for estimated malpractice costs. Due to the inherent uncertainties and subjectivity involved in accounting for contingencies, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(8) Pension and Postretirement Benefit Plans**

INTEGRIS *Health* has a defined-benefit pension plan (the Pension Plan) covering certain eligible employees and employees of controlled entities and affiliates. Eligible employees include those over 21 years of age who have attained at least 1,000 hours of service. The benefits are based on the employee's years of service and compensation. Employees newly hired or rehired after July 1, 2009 were no longer able to access this plan. As of January 1, 2013, the Pension Plan was frozen.

INTEGRIS *Health's* funding policy for the Pension Plan is to contribute at least the minimum amount necessary to satisfy the funding standards of the Employee Retirement Income Security Act of 1974, as amended. The minimum contributions were approximately \$14,754,000 and \$12,478,000 in 2018 and 2017, respectively. Contributions of approximately \$15,859,000 and \$0 were made in 2018 and 2017, respectively.

INTEGRIS *Health* also offers eligible employees of INTEGRIS *Health* and controlled entities and affiliates certain postretirement healthcare and life insurance benefits. INTEGRIS *Health's* funding policy is to pay the benefits as they are incurred.

The following table sets forth the pension and postretirement benefit plan's benefit obligations, fair value of plan assets, and funded status as of June 30, 2018 and 2017 (in thousands):

	<b>Pension plan</b>		<b>Postretirement benefit plan</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Projected benefit obligation at June 30	\$ 658,591	695,917	2,648	2,272
Fair value of plan assets at June 30	402,459	399,411	—	—
Funded status	\$ <u>(256,132)</u>	<u>(296,506)</u>	<u>(2,648)</u>	<u>(2,272)</u>
Accrued benefit cost recognized in the balance sheet	\$ (256,132)	(296,506)	(2,648)	(2,272)

Net assets include approximately \$271,826,000 and \$300,966,000 related to the pension plan as of June 30, 2018 and 2017, respectively which is comprised fully of a net actuarial loss. The net loss as of June 30, 2018 that will be amortized from net assets into net periodic benefit cost over the next fiscal year is approximately \$6,337,000. The net loss amortized during the year ended June 30, 2018 was approximately \$7,417,000.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Actuarial assumptions utilized for the plans are as follows:

	<u>Pension plan</u>		<u>Postretirement benefit plan</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Weighted average assumptions as of June 30 used to determine net periodic benefit cost:				
Discount rate	3.87 %	3.81 %	3.87 %	3.81 %
Expected long-term rate of return on plan assets	7.49	7.51	—	—
Healthcare cost trend rate	—	—	7.00	7.50
Weighted average assumptions as of June 30 used to determine the benefit obligation:				
Discount rate	4.32	3.87	4.32	3.87
Healthcare cost trend rate	—	—	7.80	7.00

The accumulated benefit obligation for the Pension Plan was approximately \$658,591,000 and \$695,917,000 at June 30, 2018 and 2017, respectively. The mortality assumption was updated at June 30, 2018 to the RP-2014 Mortality Table with the MP-2017 improvement scale to reflect the most recent information published by the Society of Actuaries Retirement Plans Experience Committee.

For measurement purposes, medical claims in 2018 are assumed to be 7.8% greater than medical claims for 2017. The trend is graded down so that medical claims in 2035 and later are assumed to be 4.5% greater than claims in the prior year.

Summary information for the plans is as follows:

		<u>Pension plan</u>		<u>Postretirement benefit plan</u>	
		<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Net periodic benefit cost	\$	4,624,000	6,246,000	(45,000)	5,000
INTEGRIS Health contributions		15,859,000	—	214,000	179,000
Benefits paid		23,174,000	32,059,000	219,000	190,000

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The following tables present information about INTEGRIS Health's pension plan assets that are measured at fair value on a recurring basis as of June 30, 2018 and 2017 (in thousands). The table indicates the fair value hierarchy of the valuation techniques utilized to determine such fair values. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates, and yield curves. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018
Equity:				
Common stocks:				
Consumer discretionary	\$ 8,511	—	—	8,511
Consumer staples	2,481	—	—	2,481
Energy	13,935	—	—	13,935
Financials	19,400	—	—	19,400
Healthcare	8,465	—	—	8,465
Industrials	11,831	—	—	11,831
Information technology	16,192	—	—	16,192
Materials	1,090	—	—	1,090
Telecommunications services	1,559	—	—	1,559
Total common stocks	83,464	—	—	83,464
Publicly traded mutual funds – equity	89,198	—	—	89,198
Total equity	172,662	—	—	172,662
Fixed income:				
Treasury and federal agencies:				
Short (less than 5 years)	17,332	—	—	17,332
Intermediate (5–10 years)	9,873	—	—	9,873
Long (more than 10 years)	13,387	—	—	13,387
Total treasury and federal agencies	40,592	—	—	40,592

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018
Nongovernmental obligations:				
Short (less than 5 years)	\$ —	28,264	—	28,264
Intermediate (5–10 years)	—	9,593	—	9,593
Long (over 10 years)	—	5,192	—	5,192
Total nongovernmental obligations	—	43,049	—	43,049
Publicly traded mutual funds – fixed income	81,822	—	—	81,822
Total fixed income	122,414	43,049	—	165,463
Limited partnerships	28,219	—	—	28,219
Cash and cash equivalents	9,534	—	—	9,534
Investments measured at net asset value	—	—	—	26,581
Total assets	\$ 332,829	43,049	—	402,459

Investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy table above.

Plan assets also include \$825,000 of accrued interest at June 30, 2018.

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2017
Equity:				
Common stocks:				
Consumer discretionary	\$ 9,070	—	—	9,070
Consumer staples	2,264	—	—	2,264
Energy	9,718	—	—	9,718
Financials	16,952	—	—	16,952
Healthcare	8,762	—	—	8,762
Industrials	11,135	—	—	11,135
Information technology	8,823	—	—	8,823

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2017
Materials	\$ 498	—	—	498
Telecommunications services	1,836	—	—	1,836
Utilities	2,089	—	—	2,089
Total common stocks	71,147	—	—	71,147
Publicly traded mutual funds – equity	74,043	—	—	74,043
Total equity	145,190	—	—	145,190
Fixed income:				
Treasury and federal agencies:				
Long (more than 10 years)	20,401	—	—	20,401
Total treasury and federal agencies	20,401	—	—	20,401
Nongovernmental obligations:				
Short (less than 5 years)	25,327	25,158	—	50,485
Intermediate (5–10 years)	—	16,460	—	16,460
Long (over 10 years)	—	7,874	—	7,874
Total nongovernmental obligations	25,327	49,492	—	74,819
Publicly traded mutual funds – fixed income	94,816	—	—	94,816
Total fixed income	140,544	49,492	—	190,036
Limited partnerships	25,640	—		25,640
Cash and cash equivalents	13,300	—		13,300
Investments measured at net asset values	—	—		24,370
Total assets	\$ 324,674	49,492	—	398,536

Investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have no categorized in the fair value hierarchy table above.

Plan assets also include \$876,000 of accrued interest at June 30, 2017.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The weighted average asset allocation of INTEGRIS Health's pension benefits at June 30, 2018 and 2017, by asset category are as follows:

Asset category:	<b>Plan assets at June 30</b>	
	<b>2018</b>	<b>2017</b>
Equity securities	43 %	36 %
Debt securities	41	48
Cash	2	3
Real estate	6	—
Master limited partnerships	8	13
	100 %	100 %

The Pension Plan is administered by a board appointed committee that maintains a well-developed investment policy stating the guidelines for the performance and allocation of plan assets, performance review procedures, and updating the policy itself. The committee adheres to traditional capital market pricing theory, recognizing that over the long run the risk of owning equities should be rewarded with a somewhat greater return than available from fixed income investments. However, the committee also recognizes that the avoidance of large risks is desirable and is willing to trade off certain higher return opportunities in order to preserve a lower risk investment profile. At least annually, the Pension Plan asset allocation guidelines are reviewed in respect to evolving risk and return expectations. Current guidelines permit the committee to manage the target allocation of funds between equities and debt securities at its discretion; however, based on evaluations conducted periodically, the committee has maintained a target allocation of assets in the range of 50%–70% equities and 30%–50% debt securities.

The long-term return forecasting methodology for both equity and fixed income securities is based on the capital asset pricing model using historical data supplied by Ibbotson Associates. Based on the historical range of target asset allocations and the historical rates of return for each asset class, the expected long-term rate of return of Pension Plan assets has ranged from 6.3%–8.6%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories.

INTEGRIS Health expects to contribute \$23,945,000 to the Plan during the upcoming year.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

The expected benefits to be paid are as follows:

	<u>Pension plan</u>	<u>Postretirement benefit plan</u>
2019	\$ 25,150,000	222,000
2020	26,698,000	228,000
2021	28,297,000	232,000
2022	29,715,000	234,000
2023	30,082,000	233,000
2024–2028	167,028,000	1,081,000

The expected benefits are estimated based on the same assumptions used to measure the benefit obligations of INTEGRIS *Health* at June 30, 2018 and include benefits attributable to estimated future employee service.

**(9) Other Employee Benefit Plans**

INTEGRIS *Health* is self-insured for the purpose of providing medical and dental benefits to all eligible employees of INTEGRIS *Health* and affiliates through several plans. Eligible employees are allowed to select coverage through an affiliated preferred provider organization or a health maintenance organization. Claims and premiums under this plan are paid with funds provided by the operations of INTEGRIS *Health* as well as employee contributions. INTEGRIS *Health* has an accrued liability for estimated claims incurred of approximately \$8,409,000 as of June 30, 2018 and 2017, recorded in other long-term liabilities.

INTEGRIS *Health* is self-insured for workers' compensation for substantially all employees of INTEGRIS *Health* and affiliates through several plans. The accrued liability for estimated claims incurred is approximately \$13,801,000 and \$14,373,000 as of June 30, 2018 and 2017, respectively, recorded in other long-term liabilities. INTEGRIS *Health* maintains a surety bond for this program. The bond is with Travelers Casualty and Surety Company of America in the amount of \$7,808,000.

INTEGRIS *Health* administers a retirement savings plan for its employees and employees of controlled entities and affiliates. Eligible employees may contribute pretax wages in accordance with the retirement savings plan. INTEGRIS *Health* and affiliates match certain contributions made by their employees. INTEGRIS *Health* also makes contributions on behalf of employees based on years of service (the INTEGRIS *Health* Basic Contributions). Contributions of approximately \$33,855,000 and \$26,039,000 were made by INTEGRIS *Health* in 2018 and 2017, respectively.

**(10) Charity Care and Uncompensated Care**

The healthcare related controlled entities provide care to patients who lack financial resources and are deemed medically and financially indigent. Because the healthcare related entities do not pursue collection of amounts determined to qualify as charity care, these amounts are removed from net patient service revenue.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

INTEGRIS *Health* accepts patients regardless of their ability to pay. A patient is classified as a traditional charity patient by meeting the requirements of system approved policies. Essentially, these policies define traditional charity services as those services for which the ability to pay from existing patient resources is not reasonably expected. The amount of traditional charity care provided, determined on the basis of cost, was approximately \$19,100,000 and \$20,254,000 for the years ended June 30, 2018 and 2017, respectively. INTEGRIS *Health* estimated the cost of charity care based on a ratio of total operating expenses to gross charges. Additionally, INTEGRIS *Health* provides a private pay discount and considers the private pay discount and all Medicaid contractual adjustments to be a component of total charity care.

**(11) Concentration of Credit Risk**

INTEGRIS *Health* grants credit without collateral to patients, most of who are insured under third-party payor agreements. Gross outstanding Medicare and Medicaid payor receivables represented approximately 32% and 38% of total gross outstanding receivables at June 30, 2018 and 2017, respectively.

Through various legislative actions, Congress has mandated the Centers for Medicare and Medicaid Services (CMS) should phase out cost-based reimbursement in favor of prospective payment mechanisms. In the recent past this has been accomplished for most services that are provided by INTEGRIS *Health* facilities. Many of these changes had the effect of restraining net patient revenue growth. Reimbursement levels are often established for political rather than economic benefit. Based on previous trends, it is assumed that this situation should continue into the near future without major changes. This will continue to limit net patient revenue growth from these payor sources.

**(12) Federal Income Taxes**

INTEGRIS *Health* has certain subsidiaries and operations such as partnership interests, retail pharmacies, and outside laboratory services that are taxable for federal income tax purposes. The taxable activities of all includible entities have approximately \$4,909,000 and \$8,082,000 in net deferred tax assets, against which a 100% valuation allowance has been recorded, for the years ended June 30, 2018 and 2017, respectively.

**(13) Functional Expenses**

INTEGRIS *Health* and its controlled entities provide a variety of healthcare services. Expenses related to providing these services are as follows (in thousands) for the year ended June 30.

	<b>2018</b>	<b>2017</b>
Healthcare services	\$ 1,374,000	1,284,000
General and administrative	297,000	288,000
	\$ 1,671,000	1,572,000

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

**(14) Fair Value Disclosures**

The financial assets recorded at fair value on a recurring basis primarily relate to investments and assets limited as to use and derivatives. A fair value hierarchy is utilized that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

The following tables present information about INTEGRIS Health's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2018 and 2017 (in thousands), and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates, and yield curves. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018
Equity:				
Common stocks:				
Consumer discretionary	\$ 18,498	—	—	18,498
Consumer staples	5,191	—	—	5,191
Energy	29,801	—	—	29,801
Financials	40,787	—	—	40,787
Healthcare	17,702	—	—	17,702
Industrials	25,158	—	—	25,158
Information technology	33,578	—	—	33,578
Materials	2,766	—	—	2,766
Telecommunications services	3,328	—	—	3,328
Total common stocks	176,809	—	—	176,809
Publicly traded mutual funds – equity	265,807	—	—	265,807
Total equities	442,616	—	—	442,616

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018
Fixed income:				
Treasury and federal agencies:				
Short (less than 5 years)	\$ 57,352	—	—	57,352
Intermediate (5 to 10 years)	3,278	—	—	3,278
Long (more than 10 years)	4,710	—	—	4,710
Total treasury and federal agencies	65,340	—	—	65,340
Nongovernmental obligations:				
Short (less than 5 years)	20,207	92,386	—	112,593
Intermediate (5–10 years)	—	12,655	—	12,655
Long (over 10 years)	—	16,440	—	16,440
Total nongovernmental obligations	20,207	121,481	—	141,688
Publicly traded mutual funds – fixed income	230,351	—	—	230,351
Total fixed income	315,898	121,481	—	437,379
Limited partnerships	58,439	—	—	58,439
Cash and cash equivalents	158,197	—	—	158,197
Investments measured at net asset values	—	—	—	14,935
Total assets	975,150	121,481	—	1,111,566
Liabilities:				
Interest rate swap agreements	\$ —	40,086	—	40,086

Investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy table above.

Total invested assets also included approximately \$1,843,000 of accrued income at June 30, 2018.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018
Equity:				
Common stocks:				
Consumer discretionary	\$ 21,157	—	—	21,157
Consumer staples	5,258	—	—	5,258
Energy	22,888	—	—	22,888
Financials	40,713	—	—	40,713
Healthcare	21,025	—	—	21,025
Industrials	24,432	—	—	24,432
Information technology	18,926	—	—	18,926
Materials	981	—	—	981
Telecommunications services	4,189	—	—	4,189
Utilities	5,311	—	—	5,311
Total common stocks	<u>164,880</u>	<u>—</u>	<u>—</u>	<u>164,880</u>
Publicly traded mutual funds – equity	261,378	—	—	261,378
Fixed income:				
Treasury and federal agencies:				
Short (less than 5 years)	33,224	—	—	33,224
Long (more than 10 years)	7,160	—	—	7,160
Total treasury and federal agencies	<u>40,384</u>	<u>—</u>	<u>—</u>	<u>40,384</u>
Nongovernmental obligations:				
Short (less than 5 years)	26,967	103,614	—	130,581
Intermediate (5–10 years)	—	15,147	—	15,147
Long (over 10 years)	—	24,819	—	24,819
Total nongovernmental obligations	26,967	143,580	—	170,547
Publicly traded mutual funds – fixed income	<u>254,035</u>	<u>—</u>	<u>—</u>	<u>254,035</u>
Total fixed income	321,386	143,580	—	464,966
Limited partnerships	60,489	—	—	60,489
Cash and cash equivalents	79,352	—	—	79,352
Investments measured at net asset values	—	—	—	11,911
Total assets	<u>\$ 887,485</u>	<u>143,580</u>	<u>—</u>	<u>1,042,976</u>
Liabilities:				
Interest rate swap agreements	\$ —	53,570	—	53,570

Investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy table above.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Total invested assets also included approximately \$1,586,000 of accrued income at June 30, 2017.

**(15) CMS Settlement**

On April 7, 2009, INTEGRIS *Health* was notified by its Medicare Administrative Contractor (MAC) of a proposed reduction in its Medicare Disproportionate Share Program (DSH) payment for 2007, because of their objection to the inclusion of certain Medicaid days for acute adolescent psychiatric treatment services in the calculation of its DSH payment. A final determination was deferred until CMS had ruled on a similar adjustment for an unrelated healthcare system in Oklahoma. If determined adversely, a portion of the DSH payments for 2005-2015 would be recoupable by CMS and, based on an average adjustment of \$13-15 million per year over the ten-year period, would result in a settlement payment and adjustment to the Obligated Group's earnings in the year of determination of approximately \$140,000,000. On March 20, 2015, INTEGRIS *Health* was informed by its MAC that a Notice of Program Reimbursement (NPR) would be issued (i) on April 17, 2015, relating to INTEGRIS Bass Baptist *Health* Center-Enid (INTEGRIS Bass) for the fiscal year ended June 30, 2007, and (ii) on May 15, 2015, relating to INTEGRIS Baptist Medical Center for the fiscal year ended June 30, 2007.

On May 15, 2015, INTEGRIS *Health* received a NPR, informing it that the audit of the Medicare Cost Report for INTEGRIS Bass for the period ending June 30, 2007 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$2,300,000 (the Disputed Amount).

On May 29, 2015, INTEGRIS *Health* received a NPR, informing it that the audit of the Medicare Cost Report for INTEGRIS Baptist for the period ending June 30, 2007 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$11,000,000 (the Disputed Amount).

On April 17, 2017, INTEGRIS *Health* received an amended NPR, informing it that the reopening of the Medicare Cost Report for INTEGRIS Baptist for the period ending June 30, 2005 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$11,100,000 (the Disputed Amount).

On June 2, 2017, INTEGRIS *Health* received a NPR, informing it that the audit of the Medicare Cost Report for INTEGRIS Bass for the period ending June 30, 2008 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$3,000,000 (the Disputed Amount).

On March 9, 2018, INTEGRIS *Health* received a NPR, informing it that the audit of the Medicare Cost Report for INTEGRIS Baptist for the period ending June 30, 2008 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$11,500,000 (the Disputed Amount).

On June 21, 2018, INTEGRIS *Health* received a NPR, informing it that the audit of the Medicare Cost Report for INTEGRIS Bass for the period ending June 30, 2009 had been completed, resulting in an adjustment to the cost report in a net amount due the program of approximately \$3,100,000 (the Disputed Amount).

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

INTEGRIS *Health* remains steadfast in its belief that the inclusion of such patient days in its cost reports is justified. To preserve its appeal rights, INTEGRIS *Health* has paid the Disputed Amount for which it has received an NPR and is pursuing all available administrative and legal remedies.

The June 30, 2007 cost reports for both INTEGRIS Baptist and INTEGRIS Bass have been appealed to the Provider Reimbursement Review Board (PRRB.) The providers were granted an expedited hearing by the PRRB which took place June 21, 2016. A decision by the PRRB has not yet been rendered. The current trend is for PRRB to render a decision in two to three years from the date of the hearing.

The June 30, 2005 cost report for INTEGRIS Baptist and the June 30, 2008 cost report for INTEGRIS Bass have also been appealed to the Provider Reimbursement Review Board (PRRB.)

INTEGRIS *Health* continues to believe that its position will be sustained.

As a result of the issuance of the above NPRs, INTEGRIS *Health* recorded an estimate of \$140,000,000 for the exposure associated with this dispute in fiscal year 2015. The liability is approximately \$95,700,000 and \$112,450,000 on June 30, 2018 and 2017, respectively. Management does not believe that this decision will have a material impact on future operations or the financial profile of INTEGRIS *Health*.

**(16) Commitments and Contingencies**

As discussed in note 7, INTEGRIS *Health* and its controlled entities are involved in litigation associated with alleged malpractice and general liability claims, which arise out in the ordinary course of business. It is the opinion of management, upon consultation with legal counsel, that self-insurance reserves are sufficient to cover the related exposure, and that the outcome of these matters will not have a material adverse effect on INTEGRIS *Health*'s consolidated financial position or results of operations.

In the normal course of operations, INTEGRIS *Health* receives grants and other funding from the federal government. These activities are subject to audit by agents of the funding authority, the purpose of which is to ensure compliance with conditions precedent to providing of such funds. Management believes that the liability, if any, for any reimbursement that may arise as the result of grant audits, would not be material to the consolidated financial statements.

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. INTEGRIS *Health* is subject to these regulatory efforts. In consultation with legal counsel, management does not expect that the resolution of regulatory compliance matters will have a material adverse effect on INTEGRIS *Health*'s consolidated financial position or results of operations.

Certain controlled entities have projects to construct and expand facilities and purchase medical equipment, which are in various stages of completion. As of June 30, 2018, the estimated remaining costs to complete these projects totaled approximately \$46,471,000.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Future minimum lease payments for all noncancelable leases with terms greater than one year are as follows (in thousands):

2019	\$	8,284
2020		2,329
2021		975
2022		497
2023		391
Thereafter		<u>422</u>
Total	\$	<u><u>12,898</u></u>

Operating lease expense approximated \$24,593,000 and \$22,963,000 in 2018 and 2017, respectively.

**(17) Subsequent Events**

Management of INTEGRIS *Health* has evaluated subsequent events through September 26, 2018, the date on which the consolidated financial statements were issued.

On June 28, 2018, INTEGRIS *Health* entered into an asset purchase agreement with Community Health System to purchase the AllianceHealth Deaconess Hospital and its associated clinics located in Oklahoma City for approximately \$6,500,000. The transaction is anticipated to close on September 30, 2018.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidating Schedule – Balance Sheet Information

June 30, 2018

(In thousands)

Assets	INTEGRIS Baptist Medical Center, Inc.	INTEGRIS South Oklahoma City Hospital Corporation	INTEGRIS Rural Health, Inc.	INTEGRIS Health Edmond	Obligated group combined total	All others	Reclassifications and eliminations	Consolidated total
Current assets:								
Cash and cash equivalents	\$ 339,234	51,305	30,975	9,092	430,606	205,932	(559,893)	76,645
Short-term investments	74,558	30,276	25,361	—	130,195	46,981	—	177,176
Patient accounts receivable, net	105,298	27,677	24,084	7,764	164,822	47,078	—	211,900
Inventories	21,217	3,152	6,623	1,165	32,157	6,077	—	38,234
Prepaid expenses and other current assets	584	185	30,474	6,137	37,381	19,874	(40,079)	17,176
Total current assets	540,891	112,595	117,517	24,158	795,161	325,942	(599,972)	521,131
Assets whose use is limited	503,460	91,438	60,539	—	655,437	280,796	—	936,233
Property and equipment, net	163,960	55,312	149,091	95,716	464,079	251,233	—	715,312
Other assets, net	43,266	4,404	4,328	—	51,998	1,372,851	(1,343,893)	80,956
Total assets	\$ 1,251,577	263,749	331,475	119,874	1,966,675	2,230,822	(1,943,865)	2,253,632
<b>Liabilities and Net Assets</b>								
Current liabilities:								
Accounts payable, accrued expenses and other	\$ 121,592	5,145	77,112	3,347	207,196	555,258	(559,893)	202,561
Employee compensation and related liabilities	15,648	5,450	6,274	1,212	28,584	30,727	—	59,311
Current portion of long-term debt	58,190	—	—	—	58,190	—	—	58,190
Current portion of capital lease obligations	—	—	—	—	—	212	—	212
Due to affiliates	2,081	—	—	—	2,081	42,960	(40,079)	4,962
Total current liabilities	197,511	10,595	83,386	4,559	296,051	629,157	(599,972)	325,236
Long-term debt, less current portion	456,220	—	—	—	456,220	229	(229)	456,220
Long-term pension liability	—	—	—	—	—	256,132	—	256,132
Other long-term liabilities	43,172	282	462	—	43,916	116,618	—	160,534
Total liabilities	696,903	10,877	83,848	4,559	796,187	1,002,136	(600,201)	1,198,122
Net assets of INTEGRIS Health	554,996	252,872	247,627	115,315	1,170,810	1,221,129	(1,343,664)	1,048,275
Noncontrolling ownership interest in equity of consolidated affiliates – unrestricted	(322)	—	—	—	(322)	7,557	—	7,235
Total net assets	554,674	252,872	247,627	115,315	1,170,488	1,228,686	(1,343,664)	1,055,510
Total liabilities and net assets	\$ 1,251,577	263,749	331,475	119,874	1,966,675	2,230,822	(1,943,865)	2,253,632

See accompanying independent auditors' report.

**INTEGRIS HEALTH, INC.  
AND CONTROLLED ENTITIES**

Consolidating Schedule – Statement of Operations and Changes in Net Assets Information

Year ended June 30, 2018

(In thousands)

	INTEGRIS Baptist Medical Center, Inc.	INTEGRIS South Oklahoma City Hospital Corporation	INTEGRIS Rural Health, Inc.	INTEGRIS Health Edmond	Obligated group combined total	All others	Reclassifications and eliminations	Consolidated total
Operating revenues:								
Patient service revenue (net of contractual allowances and discounts)	\$ 851,560	268,629	269,523	70,463	1,460,175	212,119	(14,492)	1,657,802
Provision for bad debts	(63,248)	(38,602)	(27,722)	(6,630)	(136,202)	(12,144)	—	(148,346)
Net patient service revenue	788,312	230,027	241,801	63,833	1,323,973	199,975	(14,492)	1,509,456
Premium revenue	194	—	—	—	194	7,722	—	7,916
Other operating revenue	25,579	12,357	8,532	1,914	48,382	515,549	(407,842)	156,089
Total operating revenues	814,085	242,384	250,333	65,747	1,372,549	723,246	(422,334)	1,673,461
Operating expenses:								
Salaries and related expenses	271,833	95,086	100,347	22,475	489,741	367,075	(1,297)	855,519
Supplies and other expenses	340,958	84,880	92,645	18,515	536,998	253,949	(132,360)	658,587
Professional services	129,990	50,424	38,648	12,875	231,937	42,804	(228,401)	46,340
Depreciation and amortization	23,124	9,543	13,305	5,066	51,038	39,026	—	90,064
Interest expense	8,283	2,152	5,295	3,193	18,923	1,286	(18)	20,191
Total operating expenses	774,188	242,085	250,240	62,124	1,328,637	704,140	(362,076)	1,670,701
Income from operations	39,897	299	93	3,623	43,912	19,106	(60,258)	2,760
Nonoperating revenue (expense):								
Net investment income	30,166	3,778	2,524	—	36,468	18,587	—	55,055
Net equity in loss of affiliates	(2,807)	—	—	—	(2,807)	—	—	(2,807)
Other, net	487	—	(6)	—	481	(1,893)	(18)	(1,430)
Total nonoperating revenue, net	27,846	3,778	2,518	—	34,142	16,694	(18)	50,818
Net income	67,743	4,077	2,611	3,623	78,054	35,800	(60,276)	53,578
Net loss attributable to noncontrolling interest	—	—	—	—	—	1,914	—	1,914
Net income attributable to INTEGRIS Health	67,743	4,077	2,611	3,623	78,054	37,714	(60,276)	55,492
Other changes in net assets:								
Pension liability adjustment	—	—	—	—	—	27,688	—	27,688
Other, net	(35,168)	907	30,334	13,022	9,095	8,170	(11,083)	6,182
Change in net assets	32,575	4,984	32,945	16,645	87,149	73,572	(71,359)	89,362
Net assets of INTEGRIS Health, beginning of year	522,421	247,888	214,682	98,670	1,083,661	1,147,557	(1,272,305)	958,913
Net assets of INTEGRIS Health, end of year	\$ 554,996	252,872	247,627	115,315	1,170,810	1,221,129	(1,343,664)	1,048,275

See accompanying independent auditors' report.