McLaren Health Care Corporation and Subsidiaries

Consolidated Financial Report
with Additional Information
September 30, 2019

Contents

Independent Auditor's Report

To the Board of Directors
McLaren Health Care Corporation
and Subsidiaries

We have audited the accompanying consolidated financial statements of McLaren Health Care Corporation and Subsidiaries (the "Corporation"), which comprise the consolidated balance sheet as of September 30, 2019 and 2018 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 audits 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 auditor's 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 McLaren Health Care Corporation and Subsidiaries as of September 30, 2019 and 2018 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
McLaren Health Care Corporation
and Subsidiaries

Emphasis of Matter

As described in Note 2 to the consolidated financial statements, on October 1, 2018, the Corporation adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, using the modified (or full) retrospective adoption method and adopted ASC Topic 958, *Presentation of Financial Statements of Not-for-Profit Entities*, using the retrospective adoption method for the year ended September 30, 2019. Our opinion is not modified with respect to these matters.

Plante & Moran, PLLC

January 7, 2020

Consolidated Balance Sheet

September 30, 2019 and 2018
(in thousands)

	2019	2018
Assets		
Current Assets		
Cash and cash equivalents	$ 1,053,456	$ 824,687
Collateral from securities lending (Note 7)	-	2,208
Accounts receivable - Net (Note 3)	313,576	277,990
Healthcare insurance receivables	183,305	250,261
Assets limited as to use (Note 7)	1,207	1,807
Other current assets	105,638	134,750
Total current assets	1,657,182	1,491,703
Investments - Including internally designated (Note 7)	1,243,402	1,141,112
Other Assets (Note 7)	1,028,517	550,700
Property and Equipment - Net (Note 6)	1,314,576	1,224,009
Total assets	**$ 5,243,677**	**$ 4,407,524**
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 358,212	$ 327,421
Medical claims payable (Note 9)	275,643	177,130
Current portion of long-term debt (Note 10)	37,984	23,500
Third-party payor settlements payable (Note 4)	18,458	19,889
Accrued and other liabilities (Note 12)	423,126	400,140
Total current liabilities	1,113,423	948,080
Long-term Debt - Net of current portion (Note 10)	1,645,665	1,036,337
Fair Value of Interest Rate Swap Agreements (Note 10)	28,043	5,973
Other Liabilities		
Accrued defined benefit pension cost (Note 14)	270,102	90,234
Accrued postretirement benefit cost (Note 14)	7,620	10,561
Accrued professional liability claims (Note 15)	88,368	97,467
Other long-term liabilities	61,442	75,746
Total liabilities	3,214,663	2,264,398
Net Assets		
Without donor restrictions	1,884,802	1,995,094
With donor restrictions	144,212	148,032
Total net assets	2,029,014	2,143,126
Total liabilities and net assets	**$ 5,243,677**	**$ 4,407,524**

See notes to consolidated financial statements.

Consolidated Statement of Operations

Years Ended September 30, 2019 and 2018
(in thousands)

	2019	2018
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue		$ 2,885,990
Provision for bad debts		(95,490)
Net patient service revenue less provision for bad debts	$ 2,851,246	2,790,500
Premium revenue	2,099,724	1,751,675
Other	166,761	148,834
Net assets released from restrictions used for operations	7,786	10,734
Total unrestricted revenue, gains, and other support	5,125,517	4,701,743
Expenses		
Salaries and wages	1,236,329	1,188,290
Employee benefits and payroll taxes	240,140	220,983
Supplies	611,782	599,410
Purchased services and other	1,071,349	1,223,223
Medical claims expense (Note 9)	1,671,402	1,213,229
Depreciation and amortization	131,124	116,602
Interest expense	34,578	21,716
Total expenses (Note 17)	4,996,704	4,583,453
Operating Income - Before nonrecurring impairment loss	128,813	118,290
Nonrecurring Impairment Loss (Note 2)	55,612	-
Total operating income	73,201	118,290
Nonoperating Income (Loss)		
Investment income (Note 7)	83,760	40,276
Change in interest rate swap agreements (Note 10)	(22,070)	(315)
Change in unrealized gains and losses on investments (Note 7)	(41,899)	34,841
Inherent contribution (Note 19)	-	19,584
Other	1	11,170
Total nonoperating income	19,792	105,556
Excess of Revenue Over Expenses	92,993	223,846
Other Changes in Net Assets	3,839	(386)
Pension-related Changes Other than Net Periodic Benefit Cost	(221,445)	90,143
Net Assets Released from Restrictions	14,321	6,900
(Decrease) Increase in Net Assets without Donor Restrictions	**$ (110,292)**	**$ 320,503**

See notes to consolidated financial statements.

Consolidated Statement of Changes in Net Assets

Years Ended September 30, 2019 and 2018
(in thousands)

	Without Donor Restrictions	With Donor Restrictions	Total
Net Assets - October 1, 2017	$ 1,674,591	$ 131,887	$ 1,806,478
Excess of revenue over expenses	223,846	-	223,846
Restricted contributions	-	30,507	30,507
Inherent contribution from acquisition	-	376	376
Change in unrealized gains and losses on investments	-	699	699
Increase in fair value of perpetual trust	-	605	605
Pension-related changes other than net periodic benefit cost	90,143	-	90,143
Other changes in net assets	(386)	(21)	(407)
Net assets released from restrictions	6,900	(17,634)	(10,734)
Restricted investment income	-	1,613	1,613
Increase in net assets	320,503	16,145	336,648
Net Assets - September 30, 2018	1,995,094	148,032	2,143,126
Excess of revenue over expenses	92,993	-	92,993
Restricted contributions	-	18,155	18,155
Change in unrealized gains and losses on investments	-	(754)	(754)
Decrease in fair value of perpetual trust	-	(1,020)	(1,020)
Pension-related changes other than net periodic benefit cost	(221,445)	-	(221,445)
Other changes in net assets	3,839	343	4,182
Net assets released from restrictions	14,321	(22,107)	(7,786)
Restricted investment income	-	1,563	1,563
Decrease in net assets	(110,292)	(3,820)	(114,112)
Net Assets - September 30, 2019	**$ 1,884,802**	**$ 144,212**	**$ 2,029,014**

See notes to consolidated financial statements.

Consolidated Statement of Cash Flows

Years Ended September 30, 2019 and 2018
(in thousands)

	2019	2018
Cash Flows from Operating Activities		
(Decrease) increase in net assets	$ (114,112)	$ 336,648
Adjustments to reconcile (decrease) increase in net assets to net cash and cash equivalents from operating activities:		
Depreciation	131,124	116,602
Impairment of property and equipment	55,612	-
Loss on disposal of equipment	1,690	486
Net change in unrealized gains and losses on investments	42,653	(35,540)
Realized gains on investments	(85,323)	(55,382)
(Income) loss from unconsolidated subsidiaries	(5,048)	1,023
Pension-related changes other than periodic benefit costs	221,445	(90,143)
Decrease (increase) in fair value of perpetual trusts	1,020	(605)
Change in fair value of interest rate swap agreements	22,070	315
Donor-restricted contributions	(18,155)	(30,507)
Amortization of bond premium	(2,837)	(2,318)
Inherent contribution	-	(19,958)
Changes in operating assets and liabilities that (used) provided cash and cash equivalents - Net of assets acquired and liabilities assumed in connection with acquisitions:		
Accounts receivable	(35,586)	(53,965)
Other current assets	31,320	(2,872)
Third-party payor settlements	(1,431)	(9,223)
Other assets	(12,217)	8,602
Accounts payable	16,918	27,578
Medical claims payable	98,513	(7,910)
Accrued and other liabilities	22,986	(28,523)
Healthcare insurance receivables	66,956	(7,542)
Other liabilities	(67,921)	(23,348)
Net cash and cash equivalents provided by operating activities	369,677	123,418
Cash Flows from Investing Activities		
Purchase of property and equipment	(257,076)	(223,834)
Proceeds from disposition of property and equipment	353	317
Purchases of investments	(312,911)	(132,517)
Proceeds from sales and maturities of investments	285,021	145,840
Cash received as part of the acquisition of MDwise, Caro, and Thumb	-	103,311
Cash paid for the acquisition of MDwise	-	(169,000)
Cash paid for intangible assets	(242)	-
Cash paid to joint ventures	(696)	(150)
Cash received from joint ventures	782	966
Net cash and cash equivalents used in investing activities	(284,769)	(275,067)
Cash Flows from Financing Activities		
Change in funds held by trustee under bond indenture	(500,384)	57,161
Proceeds from issuance of debt obligations	654,570	300,000
Principal payments on long-term debt	(24,530)	(23,782)
Debt issuance costs	(3,950)	(2,784)
Donor-restricted contributions	18,155	30,507
Net cash and cash equivalents provided by financing activities	143,861	361,102
Net Increase in Cash and Cash Equivalents	228,769	209,453
Cash and Cash Equivalents - Beginning of year	824,687	615,234
Cash and Cash Equivalents - End of year	**$ 1,053,456**	**$ 824,687**
Supplemental Cash Flow Information - Cash paid for interest	$ 38,260	$ 18,780
Significant Noncash Transactions - Noncash purchases of property and equipment	13,873	7,487

See notes to consolidated financial statements.

Note 1 - Nature of Business

McLaren Health Care Corporation and Subsidiaries (the "Corporation"), a not-for-profit corporation, is a major provider of health care and insurance services to residents of southeast Michigan and the cities of Flint, Lansing, Bay City, Lapeer, Mt. Pleasant, Petoskey, Port Huron, Caro, and Bad Axe, Michigan and surrounding communities. A significant portion of the Corporation's revenue is derived through its insurance organizations in the states of Michigan and Indiana.

The consolidated financial statements include the corporations listed below, as well as their subsidiaries and related foundations, of which McLaren Health Care (MHC) is the sole member:

McLaren Flint (Flint)

McLaren Bay Region (Bay)

McLaren Lapeer Region (Lapeer)

McLaren Greater Lansing (Lansing)

McLaren Macomb (Macomb)

McLaren Oakland (Oakland)

McLaren Central Michigan (Central)

McLaren Northern Michigan (Northern)

McLaren Port Huron (Port Huron)

McLaren Caro (Caro)

McLaren Thumb Region (Thumb)

Barbara Ann Karmanos Cancer Institute and Karmanos Cancer Center (Karmanos)

McLaren Medical Group (MMG)

McLaren High Performance Network (ACO)

McLaren Health Management Group (MHMG)

McLaren Integrated HMO Group (MIG)

McLaren Health Plan (MHP)

MDwise

McLaren Bay Special Care (BSC)

McLaren Insurance Company, LTD (MICOL)

Note 2 - Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of McLaren Health Care Corporation and all of its subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use by board designation or other arrangements under trust agreements (see Note 7).

Note 2 - Significant Accounting Policies (Continued)

The Corporation routinely invests its surplus operating funds in money market mutual funds and in insured bank deposits. The money market mutual funds invest only in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies and instrumentalities. The bank deposits, backed by the full faith and credit of the U.S. government, utilize a series of insured deposit accounts that are electronically linked and aggregated. Both investments aim to preserve capital, maintain liquidity, and provide a competitive yield.

Accounts Receivable

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges, reduced by explicit price concessions provided to third-party payors, discounts provided to qualifying individuals as part of the Corporation's financial assistance policy, and implicit price concessions provided primarily to self-pay patients. Estimates for explicit price concessions are based on provider contracts, payment terms for relevant prospective payment systems, and historical experience adjusted for economic conditions and other trends affecting the Corporation's ability to collect outstanding amounts.

For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Corporation records significant implicit price concessions 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.

Healthcare Insurance Receivables

Healthcare insurance receivables include uncollected capitation and premiums due from the Michigan and Indiana departments of Medicaid and other amounts due from networks and delivery systems. Certain receivable balances are secured under an escrow account established as a result of the acquisition described in Note 19. Amounts due from Michigan and Indiana departments of Medicaid are unsecured and are estimated based on provisions of the contracts with Michigan and Indiana departments of Medicaid and capitation rates in effect throughout the year.

Investments

Investments include general investments held by the Corporation and assets set aside by the governing boards of various subsidiaries for future capital improvements, over which the boards retain control and may, at their discretion, subsequently use for other purposes, subject to the reserve powers of the Corporation's governing board. Investments in equity securities with readily determinable fair values and all investments in debt securities are stated at fair market value. Investment income or loss (including interest and dividend income, realized gains or losses, and changes in unrealized gains or losses on investments) is included in excess of revenue over expenses, unless the income or loss is restricted by the donor.

The Corporation's investments are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in the value of investments in the near term could materially affect the amounts reported in the consolidated balance sheet and the consolidated statements of operations and changes in net assets.

Securities Lending Arrangements

The Corporation engaged in transactions whereby certain securities in its portfolio are loaned to other institutions, generally for a short period of time. The Corporation recorded the fair value of the collateral received as a current asset and a current liability since the Corporation is obligated to return the collateral upon the return of the borrowed securities. During 2019, the Corporation ceased engaging in securities lending arrangements.

Note 2 - Significant Accounting Policies (Continued)

Pooled Funds

The Corporation has authorized investment pools for flexibility in investing its assets and maximizing its rate of return. Realized and unrealized gains or losses and income on unallocated investments are allocated to the net assets without donor restrictions and net assets with donor restrictions participating in the pool based upon the average balance of the respective net assets.

Assets Limited as to Use

Assets limited as to use include assets held by trustees under indenture agreements, funds held in trust by foundations, funds restricted by donors for specific purposes, funds held in trust for payment of employee benefits, and funds held under self-insurance trust arrangements (see Note 7).

Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated property and equipment are recorded at the estimated fair market value at the time of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

Impairment of Long-lived Assets

The Corporation evaluates the recoverability of long-lived assets and the related estimated remaining lives when indicators of impairment are present. For the purpose of impairment analysis, assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The Corporation records an impairment charge or changes the useful life if events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed. An impairment loss of approximately $55,612,000 was recognized in 2019. No impairment loss was recognized in 2018.

Goodwill

The recorded amounts of goodwill from prior business combinations are based on management's best estimates of the fair values of assets acquired and liabilities assumed at the date of acquisition. Goodwill is not amortized, but rather is assessed on an annual basis for impairment.

Intangible Assets

The recorded amount of intangible assets results primarily from the acquisition of plan members and provider networks by MHP and MDwise, and the acquisition of various physician practices. Intangible assets are based on management's best estimates of the fair value of assets acquired at the date of acquisition. As described in Note 7, certain components of the intangible assets are being amortized. The remainder is assessed for impairment on an annual basis. No impairment charge related to intangible assets was recognized during the years ended September 30, 2019 or 2018.

Medical Claims Payable and Medical Claims Expense

Medical claims expense includes claim payments made to a variety of healthcare providers for the provision of medical care related to its members, pharmacy costs net of rebates, and other costs incurred to provide health insurance coverage to members, as well as estimates of future claims payments to healthcare providers for medical care provided prior to the consolidated balance sheet date.

Note 2 - Significant Accounting Policies (Continued)

Medical claims payable is estimated in aggregate, employing actuarial methods that are commonly used by health insurance actuaries and meet actuarial standards of practice. Claims incurred but not reported are based primarily on past experience, including claim payment patterns, enrollment data, historical utilization of services, emerging healthcare cost trends, seasonality, and other relevant information and determined by actuarial calculations. Healthcare cost trends are primarily impacted by service utilization and unit costs that are affected by changes in the level and mix of healthcare benefits offered, in addition to the impact of copayments and deductibles, changes in provider practices, and changes in consumer demographics. Under this process, historical paid claims data is formatted into claim triangles, which compare claim incurred dates to the dates of claim payments. This information is analyzed to create completion factors that represent the average percentage of total incurred claims that have been paid through a given date. Completion factors are applied to claims paid through the period end date to estimate the ultimate claim expense incurred for the period. Actuarial estimates of incurred but not paid claim liabilities are then determined by subtracting the actual paid claims from the estimate of the ultimate incurred claims. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are reflected in current operations. There were no significant changes in estimates or assumptions during 2019 or 2018.

Capitation payments represent contractual fees disbursed to healthcare providers who are responsible for providing medical care to members and are recorded in purchased services and other in the consolidated statement of operations.

Interest Rate Swaps

The Corporation has entered into interest rate swap agreements to manage its investments and capitalization, including risks associated with changes in interest rates. The Corporation records its interest rate swaps at fair value in the accompanying consolidated balance sheet as either assets or liabilities. None of the Corporation's current swaps are designated as a hedge. Accordingly, both the unrealized and realized gains or losses related to the interest rate swaps are included in nonoperating income (loss) on the consolidated statement of operations (see Note 10).

Classification of Net Assets

Net assets of the Corporation are classified based on the presence or absence of donor-imposed restrictions.

Net assets without donor restrictions: Net assets that are not subject to donor-imposed restrictions or for which the donor-imposed restrictions have expired or been fulfilled. Net assets in this category may be expended for any purpose in performing the primary objectives of the Corporation.

Net assets with donor restrictions: Net assets subject to stipulations imposed by donors and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Corporation or by the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity.

Earnings, gains, and losses on net assets with donor restrictions are classified as net assets without donor restrictions unless specifically restricted by the donor or by applicable state law.

Excess of Revenue Over Expenses

The consolidated statement of operations includes excess of revenue over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenue over expenses, consistent with industry practice, include net assets transferred (to) from affiliates, other changes in net assets, pension-related changes other than net periodic benefit cost, and net assets released from restrictions for the acquisition of long-lived assets.

Note 2 - Significant Accounting Policies (Continued)

Revenue Recognition - Patient Service Revenue

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

Performance obligations are determined based on the nature of the services provided by the Corporation. Revenue for performance obligations satisfied over time are recognized based on actual charges incurred in relation to total expected (or actual) charges. The Corporation believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients of the Corporation receiving inpatient acute care services or patients receiving services in outpatient centers or other clinical settings. The Corporation measures performance obligations from admission into the Corporation, or the commencement of an outpatient service or other visit, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of outpatient services or other visits.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Corporation has elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) ASC 606-10-50-14 (a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

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

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

Contributions

The Corporation reports gifts of cash and other assets as 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, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statement of operations and the consolidated statement of changes in net assets as net assets released from restrictions.

Note 2 - Significant Accounting Policies (Continued)

The Corporation reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports the expiration of donor restrictions when the assets are placed in service.

Premium Revenue

Premiums and capitated premiums are recognized in the period members are entitled to healthcare services. Additional premium revenue received from the Michigan and Indiana departments of Medicaid for maternity cases is recognized in the period maternity services are provided. Premiums billed and collected in advance are recorded as unearned premiums. The majority of premiums are received from the Michigan and Indiana departments of Medicaid.

Premium Deficiency Reserve

A reserve for premium deficiency and related expense is recognized when it is probable that expected future healthcare costs, under a group of existing contracts, will exceed future premiums and stop-loss coverage recoveries anticipated over the remaining term of the contract. The Corporation determines whether a premium deficiency reserve is necessary, including investment income as a factor in the premium deficiency calculation. At September 30, 2019 and 2018, the Corporation did not have a premium deficiency reserve.

Professional Liability Insurance

Subsidiaries of the Corporation and qualifying medical staff are insured for professional liability on a claims-made basis by MICOL, a multiprovider offshore captive insurance company that is wholly owned by the Corporation. The Corporation and its subsidiaries accrue an estimate of the ultimate expense, including litigation and settlement expense, for professional service liability claims occurring during the year, as well as for those claims that have not been reported at year end, which is based on estimates provided by an independent actuary (see Note 15). The expected amount of insurance recoveries is recorded as a receivable, net of allowance for uncollectible receivables, if applicable.

Charity Care

Subsidiaries of the Corporation provide care to patients who meet certain criteria under charity care policies without charge or at amounts less than established rates. Because the Corporation and its subsidiaries do not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue (see Note 5).

Tax Status

The Corporation and substantially all of its subsidiaries are nonprofit, tax-exempt organizations. Some subsidiaries are for-profit corporations. Income tax provisions are not material to the consolidated financial statements.

Management believes the Corporation is not subject to federal tax examinations for years prior to September 30, 2016.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 - Significant Accounting Policies (Continued)

Recently Adopted Accounting Pronouncements

Effective October 1, 2018, the Corporation adopted Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using a modified retrospective method of application to all contracts existing as of October 1, 2018. The core principle of the guidance in ASU No. 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The adoption of ASU No. 2014-09 resulted in changes to the Corporation's presentation for disclosure of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU No. 2014-09, a significant portion of the Corporation's provision for uncollectible accounts related to self-pay patients, as well as copays, coinsurance, and deductibles owed by patients with insurance. Under ASU No. 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to operating revenue, with a corresponding material reduction in the amounts presented separately as provision for doubtful accounts. For the year ended September 30, 2019, the Corporation recorded approximately $124,394,000 of implicit price concessions as a direct reduction of patient service revenue that would have been recorded as provision for uncollectible accounts prior to the adoption of ASU No. 2014-09. At September 30, 2019, the Corporation recorded approximately $131,537,000 as a direct reduction of accounts receivable that would have been reflected as allowance for doubtful accounts prior to the adoption of ASU No. 2014-09.

For the year ended September 30, 2019, the Corporation adopted ASU No. 2016-14, *Not-for-Profit Entities.* This standard requires net assets to be classified in two categories, net assets without donor restrictions and net assets with donor restrictions, rather than the three previous classifications. This standard also requires changes in the way certain information is aggregated and reported by the Corporation, including disclosures of quantitative and qualitative information about the liquidity and availability of resources and the presentation of expenses by both functional and natural classification. The standard also clarifies the definition of management and general and prohibits certain expenses from being allocated out of management and general. As a result of the adoption of this standard, the financial information for the year ended September 30, 2018 has been restated to reclassify net assets of $71,455,000 previously reported as temporarily restricted net assets and net assets of $76,577,000 previously reported as permanently restricted net assets as net assets with donor restrictions. In addition, total healthcare service costs of $3,967,484,000 and total general and administrative costs of $694,229,000 previously reported for the year ended September 30, 2018 have been restated to $3,897,784,000 for healthcare service costs, $659,640,000 for general and administrative, $12,694,000 for fundraising, and $13,335,000 for research.

Upcoming Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Corporation's year ending September 30, 2020 and will be applied using a modified retrospective transition method. The new lease standard is expected to have a significant effect on the Corporation's consolidated balance sheet as a result of the leases disclosed in Note 18, which are currently classified as operating leases. The effects on the results of operations are not expected to be significant, as recognition and measurement of expenses and cash flows for leases will be substantially the same under the new standard.

Note 2 - Significant Accounting Policies (Continued)

In March 2017, the FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* This standard requires the presentation of the service cost component of net benefit cost to be in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. All other components of net benefit cost should be presented separately from the service cost component and outside of income from operations. The standard is effective for fiscal years beginning after September 30, 2019 and must be adopted retrospectively. Adoption of the new standard will reduce operating income and increase nonoperating income by approximately $16,300,000 and $15,100,000 for 2019 and 2018, respectively.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*, which primarily removes and modifies Level 3 fair value measurement disclosures. ASU No. 2018-13 is effective for fiscal years beginning after September 30, 2021. Early adoption is permitted for any removed or modified disclosures. Management does not expect the adoption of this ASU to have a significant impact on the Corporation's financial statements.

In August 2018, the FASB issued ASU No. 2018-14, *Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*, which removes, clarifies, and adds certain disclosure requirements for employers sponsoring defined benefit pension and other postretirement plans. ASU No. 2018-14 is effective for the Corporation for fiscal year ending September 30, 2022. Early adoption is permitted for all entities. Management does not expect the adoption of this ASU to have a significant impact on the Corporation's financial statements.

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including January 7, 2020, which is the date the consolidated financial statements were available to be issued.

Note 3 - Accounts Receivable

Accounts receivable are based on the estimated transaction price for completed contracts, which total $313,576,000 at September 30, 2019. Prior to the adoption of ASU No. 2014-09, patient accounts receivable at September 30, 2018 were composed of $1,293,390,000 less allowances for uncollectible accounts of $120,430,000 and allowances for contractual adjustments of $915,047,000 plus other accounts receivable of $20,077,000.

Subsidiaries of the Corporation grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	2019	2018
Medicare	37 %	39 %
Blue Cross/Blue Shield of Michigan	16	15
Medicaid	11	11
Commercial insurance and HMOs	33	32
Self-pay	3	3
Total	100 %	100 %

Note 4 - Patient Service Revenue

Medical centers of the Corporation have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Inpatient psychiatric and substance abuse services are reimbursed at cost subject to a per case limit. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care. Caro is reimbursed as a critical access hospital by the Medicare program. Critical access hospitals receive cost reimbursement for all acute-care inpatient and outpatient services.

- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Outpatient and physician services are reimbursed on an established fee-for-service methodology.

- **Blue Cross/Blue Shield** - Inpatient, acute-care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed on fee-for-service and percentage-of-charge basis.

- **Commercial and Health Maintenance Organizations** - Services rendered to commercial and HMO beneficiaries are paid at predetermined rates or at a percentage of hospital charges.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare, Medicaid, and Blue Cross/Blue Shield programs that are subject to audit by fiscal intermediaries.

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

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

Note 4 - Patient Service Revenue (Continued)

The Corporation has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected primarily by payor. The composition of net patient service revenue by primary payor for the years ended September 30 is as follows (in thousands):

	2019	2018
Medicare	$ 1,432,147	$ 1,403,435
Medicaid	456,418	441,388
Blue Cross	551,789	532,304
Commercial and managed care	379,857	382,174
Self-pay	31,035	31,199
Total	$ 2,851,246	$ 2,790,500

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

The Corporation recognized patient service revenue over time as patients simultaneously receive and consume benefits provided as care is administered. Total patient service revenue recognized over time was approximately $2,851,246,000 and $2,790,500,000 for the years ended September 30, 2019 and 2018, respectively.

Note 5 - Community Benefit

The Corporation and its subsidiaries accept all patients regardless of their ability to pay. The Corporation has established a formal policy whereby a patient may qualify as a charity patient if certain criteria are met. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Corporation utilizes multiples of the Federal Poverty Guideline consistent with industry practice, but also includes certain cases where incurred charges are significant compared to the patient's available resources. In addition to providing services to the financially disadvantaged, the medical centers participate in county, state, and federal programs designed for the indigent and elderly, whereby the medical centers may be reimbursed at less than the cost of providing those services, provide other community services at no or nominal cost, and subsidize graduate medical education in the community. The estimated cost of providing charity services is based on a calculation that applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Corporation’s total expenses divided by gross patient service revenue. The Corporation also provides price concessions to uninsured and underinsured individuals. The amount of these inherent price concessions to these patients is based on the Corporation's history. An estimate of charity and other uncompensated care for the medical centers is as follows (in thousands):

	2019	2018
Charity care cost	$ 13,042	$ 12,066
Cost in excess of reimbursement for county health plans (unaudited)	-	99
Cost in excess of reimbursement from government programs (unaudited)	219,188	194,079
Cost in excess of reimbursement for graduate medical education (unaudited)	24,047	22,519
Cost of community programs (unaudited)	20,129	19,419
Uninsured - Price concessions	39,856	30,425
Total	$ 316,262	$ 278,607

Note 6 - Property and Equipment

Property and equipment and depreciable lives are summarized as follows (in thousands):

	2019	2018	Depreciable Life - Years
Land	$ 86,073	$ 80,866	-
Land improvements	54,944	49,379	5-35
Buildings	1,242,920	1,050,646	20-40
Equipment	1,392,682	1,309,541	5-15
Construction in progress	234,778	337,321	-
Total cost	3,011,397	2,827,753	
Accumulated depreciation	1,696,821	1,603,744	
Net property and equipment	$ 1,314,576	$ 1,224,009	

Construction in progress consists primarily of an expansion of Northern, an expansion of Macomb, a replacement hospital at Lansing, various other new construction and renovation projects, and the implementation of information technology projects at the medical centers and MHC. At September 30, 2019, the Corporation had commitments of approximately $503,332,000 related to various construction projects and financial and clinical information technology applications. The Corporation had capitalized interest, net of investment earnings, of approximately $6,472,000 and $4,364,000 as of September 30, 2019 and 2018, respectively.

Note 7 - Other Assets

The detail of other assets is summarized in the following schedule (in thousands):

	2019	2018
Assets limited as to use and permanently or temporarily restricted assets:		
Funds held by trustees under bond indentures	$ 543,280	$ 42,896
Funds held in trust for payment of professional and other liability claims (Note 15)	51,658	89,639
Funds held in trust for the benefit of MHC and funds restricted by donors for specific purpose	125,896	126,603
Funds held in trust for payment of employee benefits	42,857	38,967
Amount for payment of current liabilities	(1,207)	(1,807)
Total assets limited as to use and permanently or temporarily restricted assets	762,484	296,298
Investment in joint ventures	15,413	18,640
Intangible assets	112,334	120,116
Goodwill	50,396	49,671
Pledges receivable - Net	17,732	19,670
Other	70,158	46,305
Total other assets	$ 1,028,517	$ 550,700

Note 7 - Other Assets (Continued)

Investments, included within other assets above, and investments, including internally designated amounts on the consolidated balance sheet, consist of the following (in thousands):

	2019	2018
Money market investments	$ 42,623	$ 69,784
Certificates of deposit and cash equivalents	540,204	20,343
Government securities	27,187	53,467
Mortgage-backed securities	174	5,983
Mutual funds	1,126,167	988,585
Corporate bonds	38,399	61,084
Common and preferred stocks	189,296	195,892
Due from trusts (Note 13)	41,791	42,811
Other investments	1,252	1,268
Total	$ 2,007,093	$ 1,439,217

Funds held by the trustee under bond indenture are held for the purpose of making future bond principal and interest payments and payments for certain construction projects. Investment income accrues to the funds as earned.

Investment income and gains and losses are composed of the following for the years ended September 30, 2019 and 2018 (in thousands):

	2019	2018
Unrestricted investment income	$ 83,760	$ 40,276
Investment income on donor restricted fund	1,563	1,613
Change in net unrealized gains and losses on unrestricted investments	(41,899)	34,841
Change in net unrealized gains and losses on restricted investments	(754)	699
Total investment income	$ 42,670	$ 77,429

Prior to 2019, the Corporation participated in the JPMorgan Chase Bank, N.A. Security Lending Program for its U.S. and non-U.S. securities held in custody at JPMorgan Chase Bank, N.A. (JPMorgan Chase). The Corporation stopped participating in this program during 2019. These securities were loaned to certain unrelated third-party brokers in exchange for collateral, usually in the form of cash. Both the collateral and the securities loaned are marked to market on a daily basis so that all loaned securities are more than fully collateralized at all times.

At September 30, 2018, the fair value of securities loaned in the portfolio was approximately $2,257,000, while the collateral held was approximately $2,208,000. Collateral received consists of cash and fixed-income securities. The value of the collateral held and a corresponding liability to return the collateral have been reported on the accompanying consolidated balance sheet. No securities were loaned as of September 30, 2019.

On January 1, 2018, the Corporation purchased MDwise for approximately $253 million, of which $169 million represents the purchase price, and the remainder was used to fund capital requirements and remained within the Corporation (see Note 19). As part of that transaction, the Corporation recorded $110 million of intangible assets for plan member relationships, state contracts, trade names, and provider networks that will be amortized at various rates between 7 and 20 years. In addition, the Corporation recognized approximately $26 million of goodwill, which is considered to have an indefinite useful life and, therefore, is not being amortized but is tested for impairment on an annual basis.

Note 7 - Other Assets (Continued)

The Corporation has recognized intangible assets of approximately $112,334,000 and $120,116,000 at September 30, 2019 and 2018, respectively. The Corporation has recorded approximately $109,029,000 and $116,866,000 of net intangible assets for plan members, state contracts, trade names, and provider networks that is being amortized over 7 to 20 years at September 30, 2019 and 2018, respectively. In addition, the Corporation recognized intangible assets related to Medicare Advantage contracts of approximately $3,250,000 at September 30, 2019 and 2018. These assets are considered to have an indefinite useful life and, therefore, are not being amortized but are tested for impairment on an annual basis.

Note 8 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Corporation’s assets and liabilities measured at fair value on a recurring basis at September 30, 2019 and 2018 and the valuation techniques used by the Corporation to determine those fair values.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability. These Level 3 fair value measurements are based primarily on management’s own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset or liability.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation’s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The Corporation's policy is to recognize transfers between levels of the fair value hierarchy as of the actual date of the event of change in circumstances that caused the transfer. There were no significant transfers between levels of the fair value hierarchy during 2019 and 2018.

Note 8 - Fair Value Measurements (Continued)

	Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2019 (in thousands)			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2019
Assets				
Mutual funds:				
Fixed-income investments	$ 176,057	$ 28,171	$ -	$ 204,228
Equity investments	821,862	50,200	-	872,062
Balanced investments	48,685	-	-	48,685
Short-term investments	1,192	-	-	1,192
Total mutual funds	1,047,796	78,371	-	1,126,167
Common stocks:				
U.S. securities	158,186	-	-	158,186
Foreign securities	31,110	-	-	31,110
Total common stocks	189,296	-	-	189,296
Debt securities:				
U.S. government and agencies	794	23,493	-	24,287
State government and agencies	-	2,900	-	2,900
Corporate bonds and notes	-	38,399	-	38,399
Residential mortgage-backed securities	-	174	-	174
Total debt securities	794	64,966	-	65,760
Money market investments:				
Short-term investments	27,439	6,662	-	34,101
Fixed-income investments	362	-	-	362
Equity investments	8,160	-	-	8,160
Total money market investments	35,961	6,662	-	42,623
Alternative strategies	886	-	-	886
Real assets	366	-	-	366
Due from trusts	-	41,791	-	41,791
Total assets	$ 1,275,099	$ 191,790	$ -	$ 1,466,889
Liabilities - Interest rate swap agreements	$ -	$ 28,043	$ -	$ 28,043

Note 8 - Fair Value Measurements (Continued)

	Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2018 (in thousands)			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2018
Assets				
Mutual funds:				
Fixed-income investments	$ 177,321	$ 22,548	$ -	$ 199,869
Equity investments	730,320	44,606	-	774,926
Balanced investments	13,757	-	-	13,757
Short-term investments	33	-	-	33
Total mutual funds	921,431	67,154	-	988,585
Common stocks:				
U.S. securities	153,956	27	-	153,983
Foreign securities	41,909	-	-	41,909
Total common stocks	195,865	27	-	195,892
Debt securities:				
U.S. government and agencies	789	52,678	-	53,467
Corporate bonds and notes	-	61,084	-	61,084
Residential mortgage-backed securities	-	1,534	-	1,534
Foreign government and agencies	-	4,449	-	4,449
Total debt securities	789	119,745	-	120,534
Money market investments:				
Short-term investments	57,972	4,538	-	62,510
Fixed-income investments	343	-	-	343
Equity investments	6,931	-	-	6,931
Total money market investments	65,246	4,538	-	69,784
Other	1,268	-	-	1,268
Collateral on securities lending arrangements	-	2,208	-	2,208
Due from trusts	-	42,811	-	42,811
Total assets	$ 1,184,599	$ 236,483	$ -	$ 1,421,082
Liabilities				
Obligations on secured lending arrangements	$ -	$ 2,257	$ -	$ 2,257
Interest rate swap agreements	-	5,973	-	5,973
Total liabilities	$ -	$ 8,230	$ -	$ 8,230

Assets whose use is limited or restricted, and investments on the consolidated balance sheet, as further discussed in Note 7, at September 30, 2019 and 2018 included cash and certificates of deposit of approximately $540,204,000 and $20,343,000, respectively.

Note 8 - Fair Value Measurements (Continued)

The Corporation holds fixed-income and equity mutual funds, common stocks, debt securities, money market investments, securities lending, due from trusts, and interest rate swap agreements at September 30, 2019 and 2018 for which the fair value was based on Level 2 inputs. The Corporation estimates the fair value of these investments using quoted prices for similar assets in active markets. The fair value of the assets was determined primarily based on quoted market prices from the investment custodians. The Level 2 inputs used in estimating the fair value of the swap agreements include the notional amount, effective interest rate, and maturity date.

Note 9 - Medical Claims Payable

The following summarizes activity in the liability for medical claims, including claim adjustment expenses, for the years ended September 30, 2019 and 2018 (in thousands):

	2019	2018
Balance - Beginning of year	$ 177,130	$ 82,416
Incurred related to:		
Current year	1,673,223	1,221,456
Prior years	(1,821)	(8,227)
Total incurred	1,671,402	1,213,229
Paid related to:		
Current year	(1,400,640)	(1,048,031)
Prior years	(172,249)	(173,108)
Total paid	(1,572,889)	(1,221,139)
Purchased through acquisitions	-	102,624
Balance - End of year	$ 275,643	$ 177,130

As a result of changes in estimates for medical claims expenses attributable to insured events in prior years, the provision of medical claims expenses changed during 2019 and 2018. Estimates are adjusted as changes in these factors occur, and such adjustments are reported in the period of determination.

The following presents information about incurred and paid claims development as of September 30, 2019, net of reinsurance, as well as IBNR and cumulative reported claims by loss year for MHP and MDwise. The information relates to incurred and paid claims development and is presented as supplementary information.

	Incurred Claims and Claims Adjustment Expenses, Net of Reinsurance for the Years Ended September 30 (in thousands)			As of September 30, 2019	
Incident Year	2017	2018	2019	Total IBNR and Bulk Reserves (in thousands)	Cumulative Number of Reported Claims (in thousands)
2017	$ 662,457	$ 659,498	$ 659,498	$ -	$ 2,855
2018	-	1,221,456	1,227,915	5,670	5,184
2019	-	-	1,673,223	269,973	6,156
Total	$ 662,457	$ 1,880,954	$ 3,560,636	$ 275,643	$ 14,195

Note 9 - Medical Claims Payable (Continued)

Incident Year	Cumulative Paid Claims and Allocated Claims Adjustment Expenses, Net of Reinsurance, for the Years Ended September 30 (in thousands) 2017	2018	2019
2017	$ 580,041	$ 659,498	$ 659,498
2018	-	1,048,032	1,222,245
2019	-	-	1,403,250
Total	$ 580,041	$ 1,707,530	$ 3,284,993

The total liability for medical claims and medical claim adjustment expense, net of reinsurance, is $275,643 at September 30, 2019.

Note 10 - Long-term Debt

The following is the detail of long-term debt (in thousands):

	2019	2018
McLaren Health Care Series 2019A	$ 600,000	$ -
McLaren Health Care Series 2018A	300,000	300,000
McLaren Health Care Series 2016A	154,140	154,140
McLaren Health Care Series 2015A	90,965	93,895
McLaren Health Care Series 2015B	64,749	65,605
McLaren Health Care Series 2015C	83,942	87,258
McLaren Health Care Series 2015D-1	70,255	72,497
McLaren Health Care Series 2015D-2	75,420	75,420
McLaren Health Care Series 2014A	17,916	21,539
McLaren Health Care Series 2012A	64,680	71,375
McLaren Health Care Series 2010	67,125	67,125
Promissory and other notes payable	30,602	35,826
Unamortized premium	73,453	21,461
Less bond issuance cost	(9,598)	(6,304)
Long-term debt and unamortized discount/premium less debt issuance costs	1,683,649	1,059,837
Less current portion	37,984	23,500
Long-term portion	$ 1,645,665	$ 1,036,337

The McLaren Health Care Series bonds are issued through MHC as credit group agent, on behalf of the credit group, which consists of the following medical centers: Bay, Flint, Karmanos, Lansing, Oakland, Lapeer, Macomb, Northern, Central, and Port Huron (the "Credit Group"), along with the following foundations: McLaren Foundation, McLaren Macomb Healthcare Foundation, and McLaren Lapeer Region Foundation. As credit group agent, MHC has the power to cause any member of the Credit Group to make required principal and interest payments on the bonds issued by the Credit Group.

During 2019, the Michigan Finance Authority issued Hospital Revenue Bonds, Series 2019A, totaling $600,000,000. The 2019A bonds consist of serial bonds and term bonds. The serial bonds bear interest at 5 percent and have annual maturities ranging from $960,000 to $26,470,000 beginning in 2025 through 2039. The term bonds have amounts and interest due of $12,000,000 and 3.125 percent due on February 15, 2044; $152,165,000 and 4 percent due on February 15, 2044; $12,000,000 and 3.25 percent due on February 15, 2047; $129,130,000 and 4 percent due on February 15, 2047; and $167,165,000 and 4 percent due on February 15, 2050. The bonds are secured by the gross revenue of the Credit Group. The proceeds of the bonds were used to finance a replacement hospital at Lansing, capital projects at certain of its affiliates, and to finance general corporate purposes of the Corporation and certain of its affiliates.

Note 10 - Long-term Debt (Continued)

During 2018, the Corporation issued Taxable Bonds, Series 2018A, totaling $300,000,000. The bonds have a balloon payment of $300,000,000 in 2048 with interest at 4.386 percent. The bonds are secured by the gross revenue of the Credit Group. The proceeds of the bonds were used to fund the acquisition of MDwise and to finance general corporate purposes of the Corporation and certain of its affiliates.

During 2016, the Michigan Finance Authority issued Hospital Revenue Bonds, Series 2016, totaling $154,140,000. The term bonds have annual redemption requirements ranging from $17,945,000 to $24,735,000 beginning in 2040 through 2046 with interest at 4.40 percent. The series 2016 bonds are secured by the gross revenue of the Credit Group.

During 2015, the Michigan Finance Authority issued Hospital Revenue Refunding Bonds, Series 2015A, 2015B, 2015C, 2015D-1, and 2015D-2, as described below. The proceeds of the bonds were used to refund the following outstanding bonds: Michigan Finance Authority Revenue and Refunding Bonds McLaren Health Care Series 2005C, 2008A, and 2008B. The series 2015 bonds are secured by the gross revenue of the Credit Group.

In May 2015, the Michigan Finance Authority issued Hospital Revenue Refunding Bonds, Series 2015A, totaling $101,995,000. The 2015A bonds consist of serial bonds with interest ranging from 4 percent to 5 percent and annual maturities ranging from $3,070,000 to $6,125,000 through May 15, 2035 and a term bond in the amount of $19,960,000, with interest at 5 percent and annual redemption requirements ranging from $6,370,000 to $6,940,000 through May 15, 2038.

In March 2015, the Michigan Finance Authority issued Hospital Revenue Refunding Bonds, Series 2015B, totaling $67,950,000. The 2015B bonds consist of serial bonds with interest ranging from 3 percent to 5 percent and annual maturities ranging from $910,000 to $14,095,000, through May 15, 2035.

In March 2015, Bank of New York Mellon issued McLaren Health Care Taxable Bonds, Series 2015C. The 2015C bonds consist of serial bonds with interest ranging from 2.74 percent to 4.23 percent and annual maturities ranging from $3,220,000 in 2020 to $4,805,000 in 2032 and a term bond in the amount of $41,495,000, due on May 15, 2038, with interest at 4.534 percent. The bonds also have mandatory sinking fund payments ranging from $4,070,000 in 2028 to $6,085,000 in 2038.

In May 2015, the Michigan Finance Authority issued Hospital Revenue Refunding Bonds, Series 2015D-1 and D-2 (collectively, the "2015D bonds"), totaling $154,160,000. The 2015D bonds consist of floating rate notes that bear interest at a floating rate that varies on a weekly basis, based on the one-month LIBOR (effective rates of 2.62 and 2.86 percent for bond 2015D-1 and 2.77 and 3.01 percent for bond 2015D-2 at September 30, 2019 and 2018, respectively). The bonds are secured by the gross revenue of the Credit Group. The 2015D-1 bonds have mandatory sinking fund payments ranging from $2,615,000 in October 2019 to $12,765,000 in 2030. The 2015D-2 bonds also have mandatory sinking fund payments ranging from $2,915,000 in 2035 to $20,295,000 in 2039. The 2015D-1 bonds were subject to a mandatory purchase date and were successfully repurchased during 2018. The 2015D-1 and 2015D-2 bonds shall be subject to a mandatory purchase date on October 15, 2021 and October 15, 2020, respectively. The Credit Group has entered into a remarketing agreement that requires the remarketing agent to utilize best efforts to offer for sale all of the 2015D bonds required to be purchased beginning on the mandatory purchase date. In the event the bonds cannot be remarketed, the Credit Group will be responsible for repurchasing the bonds.

In September 2014, the Michigan Finance Authority issued the Hospital Revenue Refunding Bonds, Series 2014A. The bonds bear interest at 1.99 percent with annual principal of $3,622,000 through 2024.

Note 10 - Long-term Debt (Continued)

In June 2012, the Michigan Finance Authority issued the Hospital Revenue Refunding Bonds, Series 2012A. The 2012A bonds consist of serial bonds with interest at 5.0 percent and annual maturities ranging from $7,035,000 to $7,385,000 through June 1, 2028, and term bonds in the amount of $10,285,000 and $660,000. The terms bonds have annual redemption requirements ranging from $100,000 to $2,655,000, due on June 1, 2035, with interest at 5.0 percent and 4.0 percent, respectively. The bonds are secured by the gross revenue of the Credit Group.

McLaren Health Care Series 2010 bonds consist of revenue bonds issued by the Michigan Finance Authority on behalf of the Credit Group. The bonds are secured by the gross revenue of the Credit Group and are payable in annual installments of $3,356,250 plus interest beginning on December 1, 2021. The remaining outstanding principal is due on December 1, 2040. The bonds bear interest at 3.25 percent per annum until the initial optional tender date on December 1, 2020.

Under the terms of the revenue bond indentures, the revenue bonds are subject to certain financial covenants calculated on a quarterly basis. As of September 30, 2019, management believes that the Corporation was in compliance with financial covenants.

Karmanos has various promissory notes that are due to a financial institution, of which a portion of the promissory notes is guaranteed by various donors. Donors have committed to support and guarantee various components of donor-collateralized debt. These pledges are reflected as other assets in the consolidated balance sheet and follow the maturity schedules of the debt instruments. Interest is payable quarterly at an interest rate of 0.95 percent over the LIBOR-based rate, for an effective rate of 3.05 percent as of September 30, 2019 and 2018. The promissory notes mature in July 2023.

Scheduled minimum principal payments on long-term debt to maturity as of September 30, 2019 are as follows (in thousands):

Years Ending	Amount
2020	$ 37,984
2021	22,129
2022	23,373
2023	30,744
2024	24,835
Thereafter	1,480,729
Bond issue costs	(9,598)
Unamortized premium	73,453
Total	$ 1,683,649

Derivatives

The derivative instruments used by the Corporation are interest rate swap agreements that are used to manage variability in interest rates.

Objectives and Strategies

The Corporation's objectives with respect to its use of derivative instruments include managing the risk of increased debt service resulting from rising market interest rates, the risk of decreased surplus returns resulting from falling interest rates, and the management of the risk of an increase in the fair value of outstanding fixed rate obligations resulting from declining market interest rates.

Debt obligations expose the Corporation to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of a portion of its interest payments. To meet this objective, management enters into interest rate swap agreements to manage fluctuations resulting from interest rate risk.

Note 10 - Long-term Debt (Continued)

By using derivative financial instruments to hedge exposure to changes in interest rates, the Corporation 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 the Corporation, which creates credit risk for the Corporation. When the fair value of a derivative contract is negative, the Corporation owes the counterparty, and, therefore, it does not pose credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Market risk is the adverse effect on the value of a financial 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.

Risk Management Policies

The Corporation assesses interest rate risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Corporation maintains risk management control systems to monitor interest rate risk attributable to both the Corporation's outstanding or forecasted debt obligations and the Corporation's offsetting hedge positions. The risk management control system involves the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on the Corporation's future cash flows.

The Corporation does not use derivative instruments for speculative investment purposes.

Transactions

MHC has entered into five interest rate swap agreements to manage the overall variability in interest rates.

Under the terms of the ISDA master agreement, the Corporation is required to maintain collateral posted within the counterparty to secure a portion of the estimated value of the derivative instruments when said instruments are valued in favor of the counterparty, as periodically determined by the counterparty. The Corporation was not required to post collateral at September 30, 2019 or 2018. The Corporation’s accounting policy is to not offset collateral amounts against fair value amounts recognized for derivative instrument obligations. Accordingly, any posted collateral would be included in cash and cash equivalents in the accompanying consolidated balance sheet.

The first swap agreement is for a notional amount of $225,000,000. Under the terms of the agreement, MHC pays the counterparty a rate equal to the USD-SIFMA Municipal Swap Index rate and receives in exchange 61.3 percent of LIBOR plus 0.776 percent.

The second swap agreement is for a notional amount of $67,020,000 and $70,020,000 at September 30, 2019 and 2018, respectively. Under the terms of the agreement, MHC pays the counterparty a fixed rate of 3.355 percent and receives in exchange 65 percent of LIBOR plus 0.12 percent.

The third swap agreement is for a notional amount of $75,000,000. Under the terms of the agreement, MHC pays the counterparty a fixed rate of 3.64 percent and receives in exchange 65 percent of LIBOR plus 0.12 percent.

The fourth swap agreement is for a notional amount of $154,140,000. Under the terms of the agreement, MHC pays the counterparty a fixed rate of 1.996 percent and receives in exchange the USD SIFMA Municipal Swap Index rate through August 15, 2021. MHC will receive 68 percent of LIBOR beginning on September 15, 2021.

The fifth swap agreement is for a notional amount of $154,140,000. Under the terms of the agreement, MHC pays the counterparty a variable rate of the USD SIFMA Municipal Swap Index plus 0.55 percent and receives in exchange a fixed rate of 4.40 percent.

Note 10 - Long-term Debt (Continued)

During 2018, as part of the preparation for the 2018A bond issue, the Corporation entered into an interest rate swap agreement to protect itself from rising interest rates during the bond issuance period. Interest rates subsequently declined to a rate lower than the swap agreement. The Corporation terminated the swap and paid a fee of approximately $16 million to take advantage of the lower interest rates.

These swap agreements are recorded on the consolidated balance sheet at their fair value. Changes in the fair value of the swap agreements are reported as a component of excess of revenue over expenses, as well as any settlements on the interest rate swaps. There were no settlements in 2019 or 2018, other than the swap termination described in the preceding paragraph.

The Corporation's interest rate swap liability was approximately $28,043,000 and $5,973,000 at September 30, 2019 and 2018, respectively. The amount of loss recognized in the consolidated statement of operations attributable to derivative instruments as changes in fair market value of interest rate swap agreements was approximately $(22,070,000) and $(315,000) for the years ended September 30, 2019 and 2018, respectively.

Note 11 - Notes Payable

MHC negotiated, on behalf of the Corporation, a revolving line of credit agreement, secured by the gross revenue of the Credit Group, with a bank in the amount of $250,000,000. The line of credit agreement expires on May 31, 2021.

There was no outstanding balance on the line of credit as of September 30, 2019 and 2018.

Note 12 - Accrued and Other Liabilities

The following is the detail of accrued liabilities (in thousands):

	2019	2018
Payroll and related items	$ 102,589	$ 91,104
Compensated absences	59,603	57,509
Professional liability claims - Current portion (Note 15)	6,766	5,152
Interest	13,348	8,964
Obligations under securities lending (Note 7)	-	2,257
Amounts due to others	23,103	15,702
Insurance payables to delivery systems and the State of Indiana	100,641	127,390
Deferred revenue and other	117,076	92,062
Total accrued liabilities	$ 423,126	$ 400,140

Other accrued liabilities consist of various amounts owed by the Corporation, including certain liabilities for MDwise relating to escrow balances and amounts due to providers and networks for funds related to capitation receipts.

Note 13 - Due from Trusts

McLaren Foundation is the sole beneficiary of the income from the Minnie I. Ballenger Trust and the William S. Ballenger Trust (collectively, the "Trusts"). The amount due from these Trusts (see Note 7) represents the fair value of the assets held in the Trusts. Since McLaren Foundation receives only the net interest and dividend income of the Trusts, this income is recorded as an increase in net assets without donor restrictions. Changes in the fair value of the investments in the Trusts are recorded as changes in net assets with donor restrictions by the McLaren Foundation.

The amounts receivable, representing the fair value of the trust assets, are as follows (in thousands):

	2019	2018
Minnie I. Ballenger Trust	$ 40,788	$ 41,784
William S. Ballenger Trust	1,003	1,027
Total	$ 41,791	$ 42,811

Note 14 - Pension and Other Postretirement Benefit Obligation

MHC, Flint, MHP, MHMG, MMG, Bay, Lansing, Lapeer, Macomb, Oakland, Port Huron, and Northern participate in a single defined benefit pension plan. The Corporation intends to annually contribute amounts deemed necessary, if any, to maintain the plans on a sound actuarial basis.

The defined benefit pension plans have taken steps to freeze accrual of future benefits or participation in the plans by new hires. Essentially all the defined benefit plans have been frozen for future benefit accruals.

Substantially all employees of the Corporation also participate in defined contribution pension plans that provide benefits to eligible participants, as determined according to the provisions of the plan agreements.

MHC, Flint, Lansing, Macomb, and Bay also sponsor defined benefit postretirement plans that provide postretirement medical benefits summarized as follows:

MHC and Flint

The plan includes substantially all employees who have a minimum of 10 years of service after the age of 45. Employees who elect for early retirement can purchase benefits at the group rate through the plan. MHC and Flint currently fund the cost of these benefits as they are incurred. The retiree healthcare plan requires participant contributions and deductibles.

Lansing

The plan allows retirees to purchase health insurance coverage at group rates through Lansing. Individuals who retired before December 31, 1993 also receive a maximum monthly contribution for the purchase of health insurance coverage. Individuals who retire after January 1, 1994 and have attained the age of 65 do not receive postretirement medical benefits under this plan. Lansing does not prefund the plan and has the right to modify or terminate the plan in the future.

Bay

The plan provides certain health care and prescription drugs for employees who retired prior to October 1994. Bay funds the cost of these benefits as they are incurred. Benefits have been frozen for certain employee groups under this plan. As a result of collective bargaining during 2018, certain employees are no longer eligible for coverage upon retirement.

Note 14 - Pension and Other Postretirement Benefit Obligation (Continued)

Macomb

The plan provides medical savings account plan benefits to substantially all employees who are subject to certain collective bargaining unit agreements.

Obligations and Funded Status (in thousands)

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 1,184,610	$ 1,317,903	$ 10,561	$ 14,622
Service cost	2,003	2,067	144	192
Interest cost	51,904	51,455	455	565
Plan participants' contributions	-	-	277	327
Amendments	-	-	(1,599)	(818)
Actuarial loss (gain)	177,832	(92,577)	(1,574)	(3,383)
Benefits and expenses	(64,369)	(94,238)	(644)	(944)
Benefit obligation at end of year	1,351,980	1,184,610	7,620	10,561
Change in plan assets:				
Fair value of plan assets at beginning of year	1,094,376	1,098,058	-	-
Actual return on plan assets	21,793	60,481	-	-
Employer contributions	30,078	30,075	367	617
Plan participants' contributions	-	-	277	327
Benefits paid	(64,369)	(94,238)	(644)	(944)
Fair value of plan assets at end of year	1,081,878	1,094,376	-	-
Funded status and accrued benefit obligation at end of year	$ (270,102)	$ (90,234)	$ (7,620)	$ (10,561)

The accumulated benefit obligation for all defined benefit pension plans was approximately $1,347,358,000 and $1,180,839,000 at September 30, 2019 and 2018, respectively.

Note 14 - Pension and Other Postretirement Benefit Obligation (Continued)

Components of net periodic benefit cost (benefit) and other changes in plan assets and benefit obligations are as follows (in thousands):

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Net Periodic Benefit Cost				
Service cost	$ 2,003	$ 2,067	$ 144	$ 192
Interest cost	51,904	51,455	456	565
Expected return on plan assets	(79,083)	(79,240)	-	-
Amortization of prior service cost (credits)	13,058	15,384	(2,655)	(3,235)
Total net periodic benefit cost	$ (12,118)	$ (10,334)	$ (2,055)	$ (2,478)
Other Changes in Plan Assets and Benefit Obligations				
Net loss (gain)	$ 690,543	$ 468,479	$ (15,396)	$ (15,600)
Amortization of transition asset	(1)	(1)	-	-
Prior service credit	-	-	(11,481)	(10,659)
Total other changes in plan assets and benefit obligations	$ 690,542	$ 468,478	$ (26,877)	$ (26,259)

Weighted-average assumptions used to determine benefit obligations at September 30 are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Discount rate	3.40%	4.50%	3.40%	4.00%

Weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30 are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Discount rate	4.50%	4.00%	4.50%	4.00%
Expected long-term return on plan assets	7.25%	7.25%	-	-

The actuarial assumption for rate of compensation increase is age graded for the benefit obligation and net periodic benefit cost at September 30, 2019 and 2018.

The overall expected rate of return on plan assets represents a weighted-average composite rate based on the historical rates of returns of the respective asset classes. Adjustments to historical returns have been made to reflect anticipated market movements. The determination is influenced by the asset allocation, as well as the Corporation's investment policy. The Corporation's investment strategy is of a long-term nature and is intended to ensure that funds are available to pay benefits as they become due and to maximize the trust's total return at an appropriate level of investment risk.

Note 14 - Pension and Other Postretirement Benefit Obligation (Continued)

Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the Corporation, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and ensures timely payment of retirement benefits.

The target allocation asset categories are 60 percent global equity, 30 percent global fixed income, 5 percent real assets, and 5 percent diversifying strategies.

The fair values of the Corporation's pension plan assets by major asset classes are as follows (in thousands):

	Fair Value Measurements at September 30, 2019			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Asset Classes				
Mutual funds:				
Equity investments	$ 653,321	$ 35,036	$ -	$ 688,357
Fixed-income investments	142,932	107,132	-	250,064
Equity investments:				
Common stock	136,121	-	-	136,121
Foreign	1,198	-	-	1,198
Other - Money market fund	-	6,138	-	6,138
Total	$ 933,572	$ 148,306	$ -	$ 1,081,878

	Fair Value Measurements at September 30, 2018			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Asset Classes				
Mutual funds:				
Equity investments	$ 695,433	$ 34,817	$ -	$ 730,250
Fixed-income investments	117,003	78,331	-	195,334
Equity investments:				
Common stock	156,735	-	-	156,735
Preferred stock	2,539	-	-	2,539
Other:				
Money market fund	-	9,107	-	9,107
Fund of funds	411	-	-	411
Total	$ 972,121	$ 122,255	$ -	$ 1,094,376

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

The Corporation's policy is to recognize transfers between levels of the fair value hierarchy as of the actual date of the event of change in circumstances that caused the transfer. There were no significant transfers between levels of the fair value hierarchy during 2019 and 2018.

Note 14 - Pension and Other Postretirement Benefit Obligation (Continued)

Cash Flow

Contributions

The Corporation expects to contribute approximately $29,850,000 to its pension plan and approximately $500,000 to its other postretirement benefit plan in 2020.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

Year	Pension Benefits	Postretirement Benefits
2020	$ 66,898	$ 613
2021	67,409	596
2022	69,172	580
2023	71,494	586
2024	107,582	584
Thereafter	370,038	2,670

Note 15 - Professional Liability Insurance

The Corporation has professional malpractice liability coverage provided by a multiprovider offshore captive insurance company (MICOL) on a retrospectively rated claims-made policy.

MICOL has agreements with various reinsurers. MICOL has coverage of $5 million per claim in excess of $30 million.

The Corporation records an estimate of the present value of the ultimate settlement cost of settling and defending professional liability claims based on projections from a consulting actuary. The estimate of losses is based on the covered entities' own past experience along with industry experience. This estimate includes a reserve for known claims and unreported incidents. A discount rate of 4 percent was used in determining the present value of the claims. Claims expected to be settled within one year and the related assets are recorded as a current liability and current asset, respectively, in the accompanying consolidated balance sheet.

The detail of accrued professional liability for the self-insurance plans and the MICOL claims is as follows (in thousands):

	2019	2018
Total professional liability claims	$ 95,134	$ 102,619
Less current portion (Note 12)	6,766	5,152
Long-term portion	$ 88,368	$ 97,467

Note 16 - Contingent Liabilities

The U.S. Drug Enforcement Administration (the "DEA") investigated the policies and processes of certain subsidiaries of the Corporation relating to improper actions involving controlled substances by two pharmacists at certain retail pharmacies.

The DEA expanded its inquiries into the operations of various subsidiaries, such as inpatient hospitals. These inquiries have not resulted in any discoveries that have caused the DEA to be alarmed about the policies and processes at these subsidiaries. Management expects that there is likely to be a fine resulting from the actions of the pharmacists, but does not anticipate that any such fine will have a material adverse effect on the financial position of the Corporation.

Note 16 - Contingent Liabilities (Continued)

Unrelated to the DEA investigation, the Corporation divested of its retail pharmacy operations during 2019.

Note 17 - Functional Expenses

The Corporation fulfills the healthcare requirements of residents in the communities it serves by providing, as its principal function, a complete array of necessary healthcare services. The financial statements report certain expense categories that are attributable to more than one healthcare service or support function; therefore, these expenses required an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation and amortization, are based on total square footage, and interest is allocated based total square footage of buildings funded by debt.

Expenses related to providing these services, classified by function, are as follows for the year ended September 30, 2019 (in thousands):

	Healthcare Services			Support Services			
	Hospital/ Physician	Insurance	Post Acute/Other	MG&A	Fundraising	Research	Total
Salaries and wages	$ 849,590	$ 16,446	$ 122,032	$ 234,043	$ 3,050	$ 11,168	$ 1,236,329
Employee benefits and payroll taxes	170,969	4,501	25,651	36,138	569	2,312	240,140
Supplies	529,703	-	75,321	6,143	298	317	611,782
Purchased services and other	611,820	55,830	53,161	341,811	8,727	-	1,071,349
Medical claims expense	-	1,671,402	-	-	-	-	1,671,402
Depreciation and amortization	66,628	-	1,484	61,919	418	675	131,124
Interest expense	9,290	-	119	25,000	169	-	34,578
Total	$ 2,238,000	$ 1,748,179	$ 277,768	$ 705,054	$ 13,231	$ 14,472	$ 4,996,704

Expenses related to providing these services, classified by function, are as follows for the year ended September 30, 2018 (in thousands):

	Healthcare Services			Support Services			
	Hospital/ Physician	Insurance	Post Acute/Other	MG&A	Fundraising	Research	Total
Salaries and wages	$ 826,117	$ 18,674	$ 119,759	$ 211,304	$ 2,321	$ 10,115	$ 1,188,290
Employee benefits and payroll taxes	164,673	-	20,932	32,898	472	2,008	220,983
Supplies	501,298	-	90,756	6,697	342	317	599,410
Purchased services and other	760,897	52,240	56,521	344,511	9,054	-	1,223,223
Medical claims expense	-	1,213,229	-	-	-	-	1,213,229
Depreciation and amortization	62,558	-	1,163	51,481	505	895	116,602
Interest expense	8,844	-	123	12,749	-	-	21,716
Total	$ 2,324,387	$ 1,284,143	$ 289,254	$ 659,640	$ 12,694	$ 13,335	$ 4,583,453

Note 18 - Operating Leases

The Corporation is obligated under certain operating leases, primarily for facilities and medical equipment. Total rent expense under these leases was approximately $28,634,000 and $25,405,000 for 2019 and 2018, respectively.

Note 18 - Operating Leases (Continued)

Future minimum annual commitments under operating leases that have initial or remaining lease terms in excess of one year are as follows (in thousands):

Years Ending September 30	Amount
2020	$ 25,458
2021	20,748
2022	17,464
2023	15,987
2024	13,965
Thereafter	61,701
Total	$ 155,323

Note 19 - Acquisitions

Caro Community Hospital and Huron Medical Center

On January 1, 2018, the Corporation acquired Caro Community Hospital. At the time of acquisition, the Caro Community Hospital name was changed to McLaren Caro (Caro). The Corporation's board of directors provides governance oversight of Caro's assets and operations. The accompanying consolidated financial statements represent the result of operations for the nine-month period as of the acquisition date of January 1, 2018 and ending on September 30, 2018, the Corporation's fiscal year end.

On May 1, 2018, the Corporation acquired Huron Medical Center. At the time of acquisition, the Huron Medical Center name was changed to McLaren Thumb Region (Thumb). The Corporation's board of directors provides governance oversight of Thumb's assets and operations. The accompanying consolidated financial statements represent the result of operations for the five-month period as of the acquisition date of May 1, 2018 and ending on September 30, 2018, the Corporation's fiscal year end.

The transactions have been accounted for as acquisitions in accordance with FASB Accounting Standards Codification Topic 958-805, *Not-for-Profit Entities: Mergers and Acquisitions*. The assets and liabilities of Caro were adjusted to fair value as of January 1, 2018. The fair value of the net assets without donor restrictions on January 1, 2018 acquired from Caro Community Hospital was approximately $2,567,000, which is reflected as inherent contribution due to the acquisition in the consolidated statement of operations and changes in net assets at January 1, 2018 as a result of a lack of financial contributions in the acquisition. The assets and liabilities of Thumb were adjusted to fair value as of May 1, 2018. The fair value of the net assets without donor restrictions on May 1, 2018 acquired from Huron Medical Center was approximately $16,408,000, which is reflected as inherent contribution from acquisition in the consolidated statements of operations and changes in net assets at May 1, 2018 as a result of a lack of financial contributions in the acquisition.

The amount of Caro patient revenue and excess of revenue over expenses for the nine-month period ended September 30, 2018 that is included in the Corporation's financial statements is approximately $11,700,000 and $(32,000), excluding the inherent contribution recognized. The amount of Thumb revenue and excess of revenue over expenses for the five-month period ended September 30, 2018 that is included in the Corporation's financial statements is approximately $20,200,000 and $(160,000), excluding the inherent contribution recognized.

Note 19 - Acquisitions (Continued)

The Corporation acquired the following assets and liabilities at January 1, 2018 (Caro) and May 1, 2018 (Thumb) (in thousands):

	Caro	Thumb
Cash and cash equivalents	$ 1,430	$ 3,560
Other current assets	2,842	7,426
Property and equipment	5,770	12,571
Investments and other assets	-	11,382
Accounts payable	(853)	(2,228)
Other accruals	(3,584)	(6,944)
Long-term debt	(2,053)	(9,359)
Total	$ 3,552	$ 16,408

MDwise

Effective January 1, 2018, the Corporation purchased 100 percent of MDwise, Inc. (MDW) and MDwise Medicaid Network, Inc. d/b/a MDwise Excel (Excel) for total consideration of approximately $253,000,000, of which $169,000,000 represents the purchase price, and the remainder was used to fund capital requirements and remained with the Corporation in a business combination accounted for as an acquisition. MDW is a licensed Indiana domestic health maintenance organization and administers risk-based managed care programs for certain Indiana Medicaid enrollees. Excel is a delivery system network that manages risk-based managed care contracts of MDW. The mission of Excel is to improve the health of its members and community through innovation and excellence in care, education, research, and service. Total assets acquired were approximately $528,000,000, including cash and investments of approximately $241,000,000, goodwill of approximately $27,000,000 and other intangibles of approximately $110,000,000. Total liabilities assumed approximated $408,000,000.

The amount of revenue for the nine-month period ended September 30, 2018 that is included in the consolidated financial statements is $1.01 billion. The amount of MDwise's excess of revenue over expenses for the nine-month period ended September 30, 2018 that is included in the consolidated financial statements is a loss of $8.5 million. It is impractical to determine the amount of MDwise's excess of revenue over expenses for the 12-month period ended September 30, 2018.

Note 20 - Liquidity and Availability of Resources

The following reflects the Corporation's financial assets as of September 30, 2019, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the consolidated balance sheet date (amounts in thousands):

Cash and cash equivalents	$ 1,053,456
Accounts receivable	313,576
Healthcare insurance receivable	183,305
Investments and assets limited as to use	1,244,609
Other assets	895,616
Financial assets - At year end	3,690,562
Less those unavailable for general expenditures within one year due to contractual or donor-imposed restrictions:	
Funds held by trustees under bond indentures	543,280
Funds held in trust for payment of professional and other liability claims	55,791
Funds held in trust for benefit of MHC and funds restricted by donors for specific purposes	125,763
Funds held in trust for payment of employee benefits	42,139
Funds held for payment of current liabilities	1,207
Pledges receivable - Net	17,732
Financial assets available to meet cash needs for general expenditures within one year	$ 2,904,650

The Corporation has certain donor-restricted assets limited as to use, which are more fully described in Note 7. These amounts are not available for general expenditure within the next year. However, the board-designated amounts could be made available, if necessary.

The Corporation has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet at least 30 days of normal operating expenses. The Corporation has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, the Corporation invests cash in excess of daily requirements in various short-term investments, including certificates of deposit and short-term treasury instruments.

The Corporation also realizes there could be unanticipated liquidity needs.

Note 21 - Subsequent Events

Subsequent to the year ended September 30, 2019, the Corporation signed a definitive agreement to acquire St. Luke’s Hospital, which is an acute care hospital in Maumee, Ohio serving residents in the surrounding communities.

Additional Information

Independent Auditor's Report on Additional Information

To the Board of Directors
McLaren Health Care Corporation
and Subsidiaries

We have audited the consolidated financial statements of McLaren Health Care Corporation and Subsidiaries as of and for the years ended September 30, 2019 and 2018 and have issued our report thereon dated January 7, 2020, which contained an unmodified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for the purpose of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies 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.

Plante & Moran, PLLC

January 7, 2020

Consolidating Balance Sheet - Credit Group

September 30, 2019
(in thousands)

	McLaren Credit Group	Non-Credit Group Members	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	$ 386,718	$ 666,738	$ -	$ 1,053,456
Accounts receivable	264,433	49,143	-	313,576
Healthcare insurance receivables	-	183,305	-	183,305
Third-party payor settlements receivable	13,888	-	(13,888)	-
Assets limited as to use	1,133	74	-	1,207
Other current assets	345,982	22,206	(262,550)	105,638
Total current assets	1,012,154	921,466	(276,438)	1,657,182
Investments	1,028,485	214,917	-	1,243,402
Other Assets	768,691	287,992	(28,166)	1,028,517
Property and Equipment - Net	1,236,226	78,350	-	1,314,576
Total assets	**$ 4,045,556**	**$ 1,502,725**	**$ (304,604)**	**$ 5,243,677**
Liabilities and Net Assets				
Current Liabilities				
Accounts payable	$ 201,962	$ 156,250	$ -	$ 358,212
Medical claims payable	-	275,643	-	275,643
Current portion of long-term debt	27,990	9,994	-	37,984
Third-party payor settlements payable	29,814	2,532	(13,888)	18,458
Accrued and other liabilities	172,644	504,759	(254,277)	423,126
Total current liabilities	432,410	949,178	(268,165)	1,113,423
Long-term Debt - Net of current portion	1,644,224	1,441	-	1,645,665
Fair Value of Interest Rate Swap Agreements	28,043	-	-	28,043
Other Liabilities - Other long-term liabilities	343,562	102,871	(18,901)	427,532
Total liabilities	2,448,239	1,053,490	(287,066)	3,214,663
Net Assets				
Without donor restrictions	1,505,054	397,286	(17,538)	1,884,802
With donor restrictions	92,263	51,949	-	144,212
Total net assets	1,597,317	449,235	(17,538)	2,029,014
Total liabilities and net assets	**$ 4,045,556**	**$ 1,502,725**	**$ (304,604)**	**$ 5,243,677**

Consolidating Statement of Operations - Credit Group

Year Ended September 30, 2019
(in thousands)

	McLaren Credit Group	Non-Credit Group Members	Eliminating Entries	Total
Unrestricted Revenue, Gains, and Other Support				
Net patient service revenue	$ 2,642,557	$ 265,876	$ (57,187)	$ 2,851,246
Premium revenue	-	2,100,754	(1,030)	2,099,724
Other	346,574	90,470	(270,283)	166,761
Net assets released from restrictions used for operations	4,788	2,998	-	7,786
Total unrestricted revenue, gains, and other support	2,993,919	2,460,098	(328,500)	5,125,517
Expenses				
Salaries and wages	1,083,297	202,948	(49,916)	1,236,329
Employee benefits and payroll taxes	224,967	44,525	(29,352)	240,140
Supplies	566,368	46,207	(793)	611,782
Purchased services and other	841,323	403,396	(173,370)	1,071,349
Medical claims expense	-	1,726,415	(55,013)	1,671,402
Depreciation and amortization	129,161	19,681	(17,718)	131,124
Interest expense	25,020	12,551	(2,993)	34,578
Total expenses	2,870,136	2,455,723	(329,155)	4,996,704
Operating Income - Before nonrecurring impairment loss	123,783	4,375	655	128,813
Nonrecurring Impairment Loss	55,612	-	-	55,612
Total operating income	68,171	4,375	655	73,201
Other Income (Expense)				
Investment income	40,017	43,743	-	83,760
Change in interest rate swap agreements	(22,070)	-	-	(22,070)
Change in unrealized gains and losses on investments	(14,549)	(27,350)	-	(41,899)
Other	(24)	25	-	1
Total other income	3,374	16,418	-	19,792
Excess of Revenue Over Expenses	71,545	20,793	655	92,993
Net Assets Transferred (to) from Affiliate	(3,860)	3,860	-	-
Other Changes in Net Assets	197	3,642	-	3,839
Pension-related Changes Other Than Net Periodic Benefit Cost	(211,868)	(9,577)	-	(221,445)
Net Assets Released from Restrictions	6,193	8,128	-	14,321
(Decrease) Increase in Unrestricted Net Assets	**$ (137,793)**	**$ 26,846**	**$ 655**	**$ (110,292)**