

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Memorial Health System and Subsidiaries
Years Ended September 30, 2017 and 2016
With Report of Independent Auditors

Ernst & Young LLP



Memorial Health System and Subsidiaries
Consolidated Financial Statements and Supplementary Information
Years Ended September 30, 2017 and 2016

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Report of Independent Auditors

The Board of Directors
Memorial Health System

We have audited the accompanying consolidated financial statements of Memorial Health System and Subsidiaries (MHS), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Memorial Health System and Subsidiaries at September 30, 2017 and 2016, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

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

Ernst + Young LLP

December 15, 2017

Memorial Health System and Subsidiaries

Consolidated Balance Sheets (In Thousands)

	September 30	
	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 166,851	\$ 116,377
Short-term investments	157,943	142,365
Assets whose use is limited	4,422	8,134
Receivables:		
Patient accounts receivable, net of allowance for uncollectible accounts of \$26,134 and \$25,269 as of September 30, 2017 and 2016, respectively	156,461	148,692
Receivables from third-party payors	15,438	14,535
Receivables held for sale	30,353	56,767
Other receivables	23,543	29,729
Inventories	13,320	14,267
Prepaid expenses	14,415	14,244
Total current assets	582,746	545,110
Long-term investments:		
Unrestricted investments	348,611	309,810
Assets whose use is limited	53,867	56,303
Total long-term investments	402,478	366,113
Property, plant, and equipment, net	585,139	611,557
Other assets:		
Investments in partnerships	9,275	8,843
Beneficial interest in trusts	49,012	55,139
Other	40,062	27,442
Total other assets	98,349	91,424
Total assets	\$ 1,668,712	\$ 1,614,204

Memorial Health System and Subsidiaries

Consolidated Balance Sheets (continued)

(In Thousands)

	September 30	
	2017	2016
Liabilities and net assets		
Current liabilities:		
Long-term debt	\$ 13,731	\$ 11,631
Accounts payable	51,506	54,592
Accrued payroll	41,028	36,789
Interest payable	5,258	4,947
Payables to third-party payors	40,186	40,602
Other	15,372	15,735
Total current liabilities	<u>167,081</u>	<u>164,296</u>
Noncurrent liabilities:		
Long-term debt obligations, net	423,529	450,709
Deferred compensation and benefits	25,098	22,175
Self-insurance accrued expenses	18,069	24,554
Accrued employee benefits	17,952	17,337
Pension obligations	14,685	34,660
Other	23,645	25,823
Total noncurrent liabilities	<u>522,978</u>	<u>575,258</u>
Total liabilities	690,059	739,554
Net assets:		
Unrestricted	910,582	801,309
Temporarily restricted	41,952	47,402
Permanently restricted	26,119	25,939
Total net assets	<u>978,653</u>	<u>874,650</u>
Total liabilities and net assets	<u>\$ 1,668,712</u>	<u>\$ 1,614,204</u>

See accompanying notes.

Memorial Health System and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (In Thousands)

	Years Ended September 30	
	2017	2016
Revenues:		
Patient service revenues	\$ 870,505	\$ 883,170
Provision for uncollectible accounts	(18,388)	(16,622)
Net patient service revenues	852,117	866,548
Hospital access improvement payments	54,032	50,595
Capitation revenues	56,856	54,771
Other revenues	32,751	34,506
Total revenues	995,756	1,006,420
Expenses:		
Salaries and wages	367,439	355,035
Employee benefits	103,620	113,823
Physician fees	95,732	87,453
Utilities	13,549	13,383
Pharmaceutical supplies	38,645	37,104
Patient service supplies	98,846	99,609
Purchased services and other	111,160	126,536
Hospital provider assessment	22,469	20,406
Purchased medical services	30,843	32,928
Depreciation and amortization	69,186	68,654
Interest expense and other financing costs	16,893	15,428
Total expenses	968,382	970,359
Income from operations	27,374	36,061
Nonoperating gains (losses):		
Interest and dividends	7,936	9,858
Realized gain (loss) on investments, net	20,797	8,589
Unrealized gain (loss) on investments, net	32,603	15,356
Gain (loss) on derivatives	594	(1,465)
Contributions	1,983	3,274
Net periodic benefit cost	(11,513)	(10,129)
Other revenue (expense), net	(5,114)	(7,438)
Total nonoperating gains (losses), net	47,286	18,045
Excess of revenues over expenses	\$ 74,660	\$ 54,106

Memorial Health System and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued) (In Thousands)

	Years Ended September 30	
	2017	2016
Unrestricted net assets:		
Excess of revenues over expenses	\$ 74,660	\$ 54,106
Pension and other postretirement liability adjustments	34,537	(26,976)
Other	76	288
Increase (decrease) in unrestricted net assets	109,273	27,418
Temporarily restricted net assets:		
Contributions	1,671	1,344
Change in fair value of split interest agreements	(3,714)	(43)
Net investment gain (loss)	1,357	683
Net assets released from restrictions and other	(4,764)	(4,570)
Increase (decrease) in temporarily restricted net assets	(5,450)	(2,586)
Permanently restricted net assets:		
Contributions	18	18
Net investment gain (loss) and other	162	(2,379)
Increase (decrease) in permanently restricted net assets	180	(2,361)
Increase (decrease) in net assets	104,003	22,471
Net assets, beginning of year	874,650	852,179
Net assets, end of year	\$ 978,653	\$ 874,650

See accompanying notes.

Memorial Health System and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Years Ended September 30	
	2017	2016
Operating activities		
Change in net assets	\$ 104,003	\$ 22,471
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
(Gain) loss on derivatives	(594)	1,465
Realized (gain) loss on investments, net	(21,308)	(6,420)
Unrealized (gain) loss on investments, net	(33,611)	(15,909)
Restricted contributions and other	(1,689)	(1,362)
Unrealized (gain) loss on beneficial interest in trusts	2,934	1,736
Depreciation and amortization	69,186	68,654
Amortization of debt issuance costs	614	591
(Gain) loss on disposal of assets	551	95
Provision for uncollectible accounts	18,388	16,622
Pension obligations	(34,537)	26,976
Changes in assets and liabilities:		
Accounts receivable	(26,157)	(17,188)
Inventory and other assets	20,258	(63,610)
Estimated third-party payor settlements	(1,319)	(4,372)
Accounts payable and other current liabilities	(694)	(14,027)
Self-insurance and other long-term liabilities	11,553	(58,162)
Net cash provided by (used in) operating activities	107,578	(42,440)
Investing activities		
Acquisition of property and equipment	(42,593)	(81,741)
Proceeds on sale of property	71	224
Investments classified as trading, net	8,406	12,841
Change in investment in partnerships	(432)	(937)
Net change in other assets	838	864
Net cash provided by (used in) investing activities	\$ (33,710)	\$ (68,749)

Memorial Health System and Subsidiaries

Consolidated Statements of Cash Flows (continued)

(In Thousands)

	Years Ended September 30	
	2017	2016
Financing activities		
Restricted contributions and other	\$ 1,689	\$ 1,362
Repayment of long-term debt	(25,633)	(37,385)
Issuance of long-term debt	–	99,548
Payment of debt issuance costs, net of premium	–	(559)
Distributions from beneficial interest in trusts	550	1,056
Net cash provided by (used in) financing activities	<u>(23,394)</u>	<u>64,022</u>
Net increase (decrease) in cash and cash equivalents	50,474	(47,167)
Cash and cash equivalents, beginning of year	116,377	163,544
Cash and cash equivalents, end of year	<u>\$ 166,851</u>	<u>\$ 116,377</u>
Supplemental disclosure of cash flow information		
Cash paid for interest	<u>\$ 15,689</u>	<u>\$ 14,495</u>
Non-cash investing activity		
Contributions of land	<u>\$ 2,643</u>	<u>\$ 1,106</u>

See accompanying notes.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars in Thousands)

September 30, 2017 and 2016

1. Organization

Memorial Health System (Parent) is incorporated as a not-for-profit corporation under the laws of the State of Illinois and is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code). Memorial Health System and Subsidiaries (MHS) comprise the following corporations and their subsidiaries:

Memorial Health System

Sole corporate member of:

- Memorial Medical Center (MMC)
 - Memorial Medical Center Foundation (MMCF)
- Memorial Physician Services (MPS)
- Memorial Home Services NFP (MHSvc)
 - Memorial Home Services of Central Illinois, Inc. (MHSCI)
- MHS QALICB, LLC (QALICB)
- McDEKK, LLC (McDEKK)
- The Abraham Lincoln Memorial Hospital (ALMH)
- Abraham Lincoln Healthcare Foundation (ALHF)
- Mental Health Centers of Central Illinois d/b/a Memorial Behavioral Health (MBH)
 - Springfield Residential Services (SRS)
- Memorial Health Ventures (MHV)
 - Memorial ExpressCare, LLC (MEC)
- Memorial Health Partners, LLC (MHP)
- Taylorville Memorial Hospital (TMH)
- Taylorville Memorial Hospital Foundation, Inc. (TMHF)
- The Passavant Memorial Area Hospital Association (PAH)
 - Passavant Physician Association (PPA)
 - Jacksonville CRNA's, Inc. (CRNA)
 - Passavant Area Hospital Foundation (PAHF)

All significant intercompany transactions and balances have been eliminated in the consolidated financial statements.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board designation or other arrangements under trust agreements. MHS places its cash and cash equivalents with institutions with high credit quality. However, at certain times, such cash and cash equivalents are in excess of government-provided insurance limits. MHS routinely invests in money market mutual funds. These funds generally invest in highly liquid U.S. government and agency obligations. MHS's cash and cash equivalents are invested in financial instruments that potentially subject MHS to concentrations of credit risk.

Short-Term Investments

Short-term investments primarily include cash and cash equivalents, corporate obligations, government obligations, certificates of deposit, mutual funds, and corporate equity securities that are classified as current assets because such amounts are available to meet MHS's operating cash requirements.

Inventories

Inventories, consisting primarily of medical supplies and drugs, are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Long-term Investments

Long-term investments primarily include unrestricted investments and assets whose use is limited. Assets whose use is limited include amounts set aside under revocable self-insurance trust agreements, assets held by trustees under indenture agreements, assets restricted as to use by donors, cash restricted as to withdrawal or use, and deferred compensation investments. Amounts designated to help meet the current liabilities of MHS have been classified as the current portion of assets whose use is limited in the consolidated balance sheets.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Investment securities are recorded at fair value, based on the valuation methodologies used in the Fair Value Measurement and Disclosures Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). The cost of securities sold is based on the specific identification method. MHS classifies its investment portfolio as trading, with unrealized gains and losses included in excess of revenues over expenses.

Realized and unrealized gains and losses on investments, interest, and dividends from all other investments are reported as nonoperating gains (losses) unless the income is restricted by donor or law.

MHS has elected the fair value option in accordance with U.S. generally accepted accounting principles (GAAP) when valuing investments in farmland, which are included in unrestricted investments on the consolidated balance sheets.

Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost or, if donated, at fair value at the date of receipt. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets as follows:

Land improvements	5–25 years
Buildings and improvements	10–40 years
Equipment	3–10 years

Leasehold improvements and equipment under capital leases are depreciated or amortized over the corresponding lease term and included in depreciation and amortization expense.

Beneficial Interest in Trusts

MMC and PAH are the beneficiaries of several irrevocable trusts held and administered by third-party trustees. The income from these trusts is distributed annually. The proceeds from the trust are classified as unrestricted or restricted net assets based on the terms of the applicable trust agreement. Beneficial interest in the trusts totaled \$49,012 and \$55,139 as of September 30, 2017

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

and 2016, respectively, and is equal to the estimated fair value of the underlying trust assets (primarily Illinois farmland). Trust distributions were \$3,193 and \$2,162 in 2017 and 2016, respectively, and are included in other revenue in the nonoperating section of the consolidated statements of operations and changes in net assets.

Other Assets

Other assets primarily consist of cash surrender value of life insurance policies, non-compete agreement clauses in physician acquisition contracts, beneficial interests in the MHI Illinois Receivables Grantor Trust described in Note 5, notes receivables and reinsurance recoveries. Under the terms of the physician employment agreements, vesting to the physicians in the cash surrender values occurs over various terms.

Deferred Compensation Investments

MHS has non-qualified deferred compensation plans available to select employees. Contributions to the plans are invested in mutual funds and are payable to the employees upon vesting, retirement, or resignation. Deferred compensation investments, which are recorded at fair value, and deferred compensation liabilities have been recorded in the accompanying consolidated balance sheets.

Accrued Employee Benefits

Accrued employee benefits consist of the accrual for the paid sick time program and the accrual for post-employment benefits, which consists of three liabilities: the continuation of medical benefits to employees on long-term disability, postretirement health care benefits for certain employee groups that meet special qualifications, and sick time paid at retirement. MHS accrues these benefits based on actuarial estimates.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Net Assets

MHS's net assets are classified as restricted and unrestricted based on the existence or absence of donor-imposed restrictions. Restricted net assets comprise temporarily restricted net assets, whose use by MHS has been limited by donors to a specific time period or for a particular purpose, and permanently restricted net assets, which must be maintained by MHS in perpetuity with the related investment income expendable to support the donor-designated purpose. The general nature of the donor restrictions is to support MHS's mission and health education programs and to assist in capital purchasing.

For both September 30, 2017 and 2016, MHS's endowments consist of 56 individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

MHS has a policy of appropriating for distribution each year 5% of its endowment funds' average fair value of investments over the prior 36 months as of September 30 of the preceding fiscal year in which the distribution is planned. In establishing this policy, MHS considers the long-term expected return on its endowments. Accordingly, over the long term, MHS expects the current spending policy to allow its endowment to grow at the average long-term rate of inflation. This is consistent with MHS's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specific term, as well as to provide additional real growth through new gifts and investment return.

Net Patient Service Revenues and Accounts Receivable Valuation

MHS provides health care services through inpatient and outpatient care facilities located in central Illinois and grants credit to patients, substantially all of whom are local residents. MHS generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies, including, but not limited to, Medicare, Medicaid, health maintenance organizations, and commercial insurance policies.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Patient service revenue is reported net of contractual allowances and discounts at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive adjustments due to future audits, reviews, investigations, and significant regulatory actions. MHS recognizes patient service revenue at the time services are rendered, even though the patient's ability to pay may not be completely assessed at that time.

MHS has agreements with third-party payors that provide for payments at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and these amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, or investigations. MHS's patient service revenue increased by \$2,136 and \$8,934 in 2017 and 2016, respectively, as the result of these retroactive adjustments.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Noncompliance with Medicare and Medicaid laws and regulations can make MHS subject to significant regulatory action, including substantial fines and penalties, as well as exclusion from the Medicare and Medicaid programs.

The provision for uncollectible accounts is based upon management's judgmental assessment of historical and expected net collections considering business and general economic conditions in its service area, trends in health care coverage, and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectible accounts, taking into consideration recent write-off experience by payor category, including those not covered by insurance. The results of these assessments are used to make modifications to the provision for uncollectible accounts and to establish an appropriate allowance for uncollectible accounts receivable. For third-party payors, the provision is determined by analyzing the anticipated residual patient balances and contractually due amounts from payors who are known to be having financial difficulties. For uninsured patients, the provision is based on an analysis of past experience related to patients unwilling to pay the discounted patient balances. The difference between patient service revenues and the amount actually collected after the reasonable collection efforts have been exhausted is charged against the allowance for uncollectible accounts.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

MHS has included certain accounts totaling \$30,353 and \$56,767 as of September 30, 2017 and 2016, respectively, which are owed by the State of Illinois for health care services provided to its employees as held for sale and are included in the Receivables held for sale line in the accompanying consolidated balance sheet. Receivable amounts classified as held for sale are valued based on the adjudicated claim value assigned by the insurance provider. During the year ended September 30, 2017, MHS completed a sale of a portion of the receivables held for sale, which is discussed in Note 5.

Capitation Revenues

MHS has entered into risk-based contracts to provide medical services. Under these arrangements, MHS receives capitation payments based on the demographic characteristics of covered members in exchange for providing certain medical services to those members. MHS has engaged in stop-loss insurance contracts to protect against future significant losses for catastrophic cases.

Purchased medical services represent payments made to non-MHS and out-of-network providers for covered medical claims. MHS estimates its liability for covered medical claims, including claims incurred but not reported as of the balance sheet dates, based upon historical costs incurred and payment-processing experience. The liability for covered medical claims is included in other current liabilities in the accompanying consolidated balance sheets.

Asset Impairment

MHS considers whether indicators of impairment are present and, if present, performs the necessary tests to determine whether the carrying values of an asset are recoverable. Impairment write-downs are recognized in depreciation expense at the time the impairment is identified.

Charity Care

In support of its mission, MHS provides care to patients who lack financial resources and are deemed to be financially indigent. Traditional charity care includes cost of services provided to persons who MHS determines cannot afford health care because of inadequate resources. The charges for services provided to charity patients are not reported as net patient service revenue. The cost of traditional charity care was \$8,961 and \$6,359 for the years ended September 30, 2017 and 2016, respectively. MHS calculates the unpaid cost of services by payor using an activity-based costing methodology.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Derivative Financial Instruments

MHS uses interest rate swap instruments as part of a risk management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. All derivatives are recognized as either assets or liabilities and are measured at fair value. MHS does not account for any of its interest rate swap instruments as hedges, and accordingly, all realized and unrealized gains and losses resulting from changes in the fair value of derivatives are reflected in nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. The fair values of the interest rate swap instruments are determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved, and reflect a credit spread adjustment to the LIBOR discount curve in order to emulate the credit value adjustment for nonperformance risk.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to MHS are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or the condition is met. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. A donor restriction expires when a stipulated time restriction ends or the purpose restriction is accomplished. At that time, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Donor-restricted contributions whose restrictions are met within the same year as they are received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Performance Indicator

MHS's performance indicator (excess of revenues over expenses) includes all changes in unrestricted net assets other than net assets released from restrictions for property acquisitions and pension and other postretirement liability adjustments.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Operating and Nonoperating Gains (Losses)

MHS's primary mission is to improve the health of the people and communities it serves through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, and other health care services. Activities directly associated with the furtherance of this purpose are considered to be operating activities. Other activities that result in gains or losses peripheral to MHS's primary mission are considered to be nonoperating. Nonoperating activities include interest, dividends, realized and unrealized gains and losses on investments, gains and losses on derivatives, contributions, net periodic benefit cost and other revenues and expenses not related to patient care.

Income Taxes

Each of MHS's subsidiaries, excluding those described in the following paragraph, is a separately incorporated not-for-profit corporation as described under Section 501(c)(3) of the Code and is tax-exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Code. They do, however, operate certain programs that may result in unrelated business income. Upon review as required by ASC 740, *Income Taxes*, no tax provision was recorded for the years ended September 30, 2017 or 2016.

MHS is no longer subject to income tax examinations for years prior to 2014.

QALICB, McDEKK and MHP are considered disregarded entities for tax purposes and are exempt from income tax.

MHSCI is a taxable for-profit corporation and PPA is a taxable not-for-profit corporation. Both are subject to federal and state income taxes.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Accounting Policies

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. This ASU requires debt issuance costs to be directly deducted from the carrying amount of debt. ASU 2015-03 is effective for annual reporting periods beginning after December 15, 2015 and interim periods within annual reporting periods beginning after December 15, 2016 with early adoption permitted. Upon adoption, MHS is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements. MHS adopted the provisions of ASU 2015-03 in FY2017 and retrospectively applied the guidance to FY2016. The impact of the adoption of ASU 2015-03 for MHS when applied retrospectively to the year ended September 30, 2016 decreased long-term debt obligations, net on the consolidated balance sheet as presented herein by \$2,275, with a corresponding decrease to total other assets. The adoption of ASU 2015-03 had no impact on net assets.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statement of operations. ASU 2017-07 is effective for annual reporting periods beginning after December 15, 2018 and interim periods within annual reporting periods beginning after December 15, 2019 with early adoption permitted. Upon adoption, MHS is required to apply the new guidance retrospectively to all periods presented in the consolidated financial statements, except for the guidance limiting the capitalization of net periodic benefit costs in assets which is required to be applied prospectively. MHS elected to early adopt the provisions of ASU 2017-07 and retrospectively applied the guidance to FY2016. The impact of adoption ASU 2017-07 for MHS when applied retrospectively to the year ended September 30, 2016 decreased employee benefits on the consolidated statement of operations as presented herein by \$10,129, with a corresponding increase to income from operations and decrease to nonoperating gains and losses, net. The adoption of ASU 2017-07 had no impact on excess of revenues over expenses or net assets.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Functional Expenses

MHS's accounting policies conform to U.S. GAAP applicable to health care organizations. Substantially all expenses are related to providing health care services to the community.

Reclassifications

Certain amounts in the 2016 consolidated financial statements have been reclassified to conform to 2017 presentation. These reclassifications had no impact on net assets or the excess of revenues over expenses as of and for the year ended September 30, 2016, as previously reported.

3. Affiliation with Southern Illinois University School of Medicine

MHS has entered an affiliation agreement with Southern Illinois University School of Medicine (SIU) in an effort to enhance the quality, sophistication and access of health care in central and southern Illinois. The term of the agreement renewed on July 30, 2015 and automatically renews for successive five-year terms, until terminated by either party. The agreement requires an advance notice of either party's intent to terminate the affiliation agreement to be no less than three years prior to the expiration of the current five-year term. The affiliation agreement allows SIU to conduct both graduate and undergraduate medical educational programs at MHS facilities. In addition, the affiliation allows for both parties (including all of SIU's and MHS's subsidiaries) to execute separate agreements to provide the following: academic support, medical director and/or chairman contracts, administrative services, space leases, recruitment contracts, and/or clinical service contracts. MHS also provides other support and funding in the form of grants to SIU through MMCF.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

3. Affiliation with Southern Illinois University School of Medicine (continued)

The table below reports the extent to which MHS and SIU have partnered to strengthen their affiliation:

Agreement type	Years Ended September 30	
	2017	2016
Academic Support provided	\$ 33,021	\$ 33,187
Grants and contributions provided	2,263	3,920
Medical Director/Chairman contracts provided	3,215	3,726
Administrative, clinical, recruitment, and other services provided	272	368
Lease revenues earned	4,925	3,715
Administrative and clinical service revenues earned	537	1,537

All agreement types listed above are included in income from operations on the consolidated statements of operations and changes in net assets, except for grants and contributions provided.

4. Revenues

Net Patient Service Revenues

MHS provides health care services through inpatient, outpatient, and ambulatory care facilities. Certain patients receive services that are covered by governmental and third-party payments, including Medicare and Medicaid (65.6% and 64.7% of gross patient service charges in 2017 and 2016, respectively) at contractual rates generally below MHS's established rates.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Revenues (continued)

The following is the mix of patient service revenues before the provision for uncollectible accounts by major payor source:

	Years Ended September 30	
	2017	2016
Medicare	\$ 321,238	\$ 315,654
Medicaid	71,113	73,570
Managed care	196,838	210,552
BlueCross BlueShield	210,718	209,388
Other commercial payors	57,238	59,291
Patients	13,360	14,715
Total	<u>\$ 870,505</u>	<u>\$ 883,170</u>

MHS is paid for services rendered to Medicare program beneficiaries generally under prospectively determined rates. Those rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. MMC's and PAH's payment classification of patients receive reimbursement under the prospective payment system (PPS). TMH and ALMH are both designated as critical access hospitals and receive cost-based reimbursement for the majority of their Medicare services.

Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient and home health services rendered to Medicaid program beneficiaries are reimbursed upon a per visit, per diem rate or on a fee-for-service basis.

The MHS allowance for uncollectible accounts as a percentage of accounts receivable was 14.3% and 14.5% as of September 30, 2017 and 2016, respectively. MHS's combined allowance for uncollectible accounts and charity care cover 71% and 68% of self-pay and patient responsibility accounts receivable at September 30, 2017 and 2016, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Revenues (continued)

The following is the mix of net receivables by major payor source:

	September 30	
	2017	2016
Medicare	20.6%	24.3%
Medicaid	22.0	13.3
Managed care	32.4	34.6
BlueCross BlueShield	13.0	14.0
Other commercial payors	9.3	10.9
Patients	2.7	2.9
Total	100.0%	100.0%

Net receivables percentages included in the table above exclude \$30,353 and \$56,767 in State of Illinois receivables classified as held for sale as of September 30, 2017 and September 30, 2016, respectively, and described in Note 2. As in recent years, the State of Illinois has shown an inability to pay health insurance claims on a timely basis. This delay in payments continued throughout fiscal year 2017. As a result, Medicaid accounts receivable, on a percentage basis, increased from 13.3% to 22.0% of net patient accounts receivable. Subsequent to September 30, 2017, MHS received significant cash collections which materially reduced the Medicaid net receivables reported as of September 30, 2017.

Hospital Access Improvement Revenue

On November 21, 2006, the Centers for Medicare and Medicaid Services (CMS) approved the State of Illinois' Hospital Assessment Program (the Program). The Program was initially effective from July 1, 2005 through June 30, 2008 but through various extensions, the State of Illinois has approved the Program to June 30, 2018.

In addition to the original Program, the State of Illinois General Assembly approved a program to enhance the Program (Enhanced Program). CMS approved the Enhanced Program on September 30, 2013, to be retrospectively effective at June 10, 2013, with an initial termination date of December 31, 2014 that was extended through June 30, 2018.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Revenues (continued)

On January 9, 2015, CMS authorized the State of Illinois to expand the Enhanced Program to account for those persons that are newly eligible under the Affordable Care Act (ACA Expansion Program). The ACA Expansion Program was retrospectively effective at March 1, 2014 and terminates on June 30, 2018.

In connection with the Program, contributions were also made to the Illinois Hospital & Research Education Foundation (IHREF) for the Program, which was reflected as hospital provider assessment expense in the consolidated statements of operations and changes in net assets.

The following is a breakdown of the Illinois Hospital Assessment Program based on the components previously described:

	Years Ended September 30	
	2017	2016
Hospital Access Improvement Payments:		
Program	\$ 26,617	\$ 26,380
Enhanced Program	9,468	9,705
ACA Expansion Program	17,947	14,510
Subtotal	54,032	50,595
Hospital Provider Assessment:		
Program	13,133	13,137
Enhanced Program	6,195	6,196
ACA Expansion Program	2,992	919
IHREF Contributions	149	154
Subtotal	22,469	20,406
Net impact of Illinois Hospital Assessment Program	\$ 31,563	\$ 30,189

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Revenues (continued)

Capitation Revenues

MMC and Springfield Clinic, LLP formed a network on July 1, 1999. The purpose of the network is to collaborate with and assist Health Alliance Medical Plans (HAMP) to arrange for, develop, and maintain a network of participating providers and to provide covered services to plan members in the service area. MMC has an agreement with the network to provide medical services to more than 21,000 members of the network as of both September 30, 2017 and 2016. MMC receives a monthly capitation payment based on the number of members, regardless of services provided by MMC or other providers. As of September 30, 2017 and 2016, MHS has recognized a liability for covered medical claims of \$2,140 and \$2,240, respectively.

5. Sale of Receivables Held for Sale

In September 2017, MMC, PAH, ALMH, TMH, MPS, MEC, MHSvc, and MHSCI (Sellers) assigned its respective rights in \$63,833 of receivables held for sale as described in Note 2 to McDEKK. Subsequently, McDEKK completed the transfer of its newly assigned rights in those receivables to MHI Illinois Receivables Grantor Trust (Grantor Trust). The Grantor Trust is owned by an unrelated entity, Illinois Financing Partners (IFP) and was funded by an external lender to facilitate the purchase of the transferred assets. IFP will also act as the servicer of the transferred assets on behalf of the Grantor Trust.

Terms of the transaction resulted in MHS receiving ninety percent of its sold receivables, or \$57,450, in the form of cash consideration on the date of sale from the Grantor Trust. The remaining ten percent totaling \$6,383 (deferred purchase price), plus accrued timely pay penalties owed by the State of Illinois on the sold receivables totaling \$4,940, collectively the beneficial interest in the Grantor Trust, are to be received by MHS from the Grantor Trust upon payment of the sold receivables from the State of Illinois and satisfaction of all other obligations under the sale transaction agreements. MHS has reported the beneficial interest in the Grantor Trust at fair value in the Other assets line item on the consolidated balance sheet as of September 30, 2017.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Sale of Receivables Held for Sale (continued)

MHS has no other continuing involvement with the sold receivables, except the aforementioned beneficial interest in the Grantor Trust. The beneficial interest remaining represents the extent of MHS's maximum risk of loss in the transaction should one or more parties fail to perform under the sale transaction agreements, or should the State of Illinois fail to make payments on its obligations to the Grantor Trust. Management has determined the transfer to meet the criteria to qualify for sale accounting under ASC 860 and has accordingly reported the transaction as a sale as of September 30, 2017.

6. Community Benefits (Unaudited)

MHS is dedicated to delivering high quality, patient-centered care in support of its mission to improve the health of the people and communities it serves. MHS strives to be a national leader for excellence in patient care and provide quality health care to every patient who comes through its doors, regardless of their ability to pay. Community benefit represents the unpaid costs of public means tested programs, traditional charity care, and other forms of community support such as academic support to the SIU, community health improvement activities, and contributions to health-related community activities.

Charity care is provided to those who are eligible based on MHS's charity policy. In addition to the charity care responsibilities, MHS provides numerous other community benefits. These community benefits include medical education and research, community health education, screenings, support groups, counseling services, subsidized health services, research, and in-kind support. To address the need for health care providers, a number of programs are offered for young people who may be interested in a career in health care. Medicare provides reimbursement using a PPS that pays MHS as described in Note 4, regardless of the actual cost of care. MHS recognized this unpaid cost of providing care to Medicare patients as a part of its total service to the community.

MHS calculates the unpaid cost of services by payor using an activity-based costing methodology. Direct costs related to patient care are added to indirect costs, which have been allocated based upon relative value units of each procedure. The sum of direct and indirect costs is offset by any net revenues to determine the unpaid costs by payor. Services provided to Medicaid and charity care patients represent the most significant levels of uncompensated care. MHS calculates the cost of other community benefits by identifying specific expenditures incurred that directly benefited the community.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

6. Community Benefits (Unaudited) (continued)

The following is a summary of management's estimate of the costs of MHS's community benefit services:

	Years Ended September 30					2016	
	2017						
	MMC	PAH	ALMH	TMH	All Other Affiliates	Total	Total
Unpaid cost of Medicaid	\$ 46,754	\$ 9,541	\$ 7,553	\$ 5,330	\$ 7,572	\$ 76,750	\$ 74,661
Unpaid cost of charity care	5,753	1,697	663	399	449	8,961	6,359
Subsidized health services	16,437	3,850	2,345	191	–	22,823	18,341
Other community benefits	43,273	552	112	243	931	45,111	46,342
Community benefit	<u>112,217</u>	<u>15,640</u>	<u>10,673</u>	<u>6,163</u>	<u>8,952</u>	<u>153,645</u>	<u>145,703</u>
Unpaid cost of Medicare	50,443	10,153	513	–	7,893	69,002	67,990
Subtotal	<u>162,660</u>	<u>25,793</u>	<u>11,186</u>	<u>6,163</u>	<u>16,845</u>	<u>222,647</u>	<u>213,693</u>
Hospital provider assessment	(19,349)	(6,436)	(3,170)	(2,608)	–	(31,563)	(30,189)
Total service to the community	<u>\$ 143,311</u>	<u>\$ 19,357</u>	<u>\$ 8,016</u>	<u>\$ 3,555</u>	<u>\$ 16,845</u>	<u>\$ 191,084</u>	<u>\$ 183,504</u>

The Illinois hospital assessment payment is designed to improve access to hospital services for state residents by improving the overall adequacy of payments for all hospitals as well as providing more equity in payments among hospitals. The program also receives federal matching funds for the Medicaid program.

7. Investments

MHS's investments are exposed to various kinds and levels of risk. Fixed-income securities expose MHS to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Equity securities expose MHS to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets, both foreign and domestic. Performance risk is the risk associated with a company's operating performance. Liquidity risk, as previously defined, tends to be higher for foreign equities and equities related to small capitalization companies.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

7. Investments (continued)

The composition of short-term and long-term investments, all at fair market value, is set forth in the following table:

	September 30	
	2017	2016
Cash and cash equivalents	\$ 24,703	\$ 27,637
Certificates of deposit	1,337	2,278
U.S. Treasury obligations	34,807	28,541
Government obligations	26,760	25,484
Corporate obligations	71,371	70,991
Domestic equities	172,570	145,952
International equities	17,874	16,187
Investment in farmland	25,370	23,213
Mutual funds	188,751	175,158
Accrued interest receivable and other	1,300	1,171
Short-term and long-term investments	\$ 564,843	\$ 516,612

8. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value Measurements and Disclosures Topic of the FASB ASC establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Certain of MHS's financial assets and financial liabilities are measured at fair value on a recurring basis, including investments, beneficial interest in trusts, and interest rate swap agreements. The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Level 1 primarily consists of financial instruments such as money market securities and listed equities.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

Level 2 – Pricing inputs other than quoted prices included in Level 1, which are either directly observable or can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets and liabilities in non-active markets or pricing models whose inputs are observable for substantially the full term of the asset or liability. Instruments in this category include certificates of deposit, certain U.S. government agency and sponsored entity debt securities, certain mutual funds and interest rate swap agreements.

Level 3 – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial instruments categorized as Level 3 consist of investments in farmland and beneficial interest in trusts. Investments in farmland have been valued based on market value appraisals of the corresponding real estate. Beneficial interest in trusts are recorded at fair value based on MHS's interest in the value of the underlying trust assets. Real estate appraisals on land held within the trust are used as unobservable inputs to estimate MHS's allocable portion of trust assets.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at September 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 24,164	\$ 539	\$ –	\$ 24,703
Certificates of deposit	–	1,337	–	1,337
U.S. Treasury obligations	35,699	–	–	35,699
Government obligations	–	26,760	–	26,760
Corporate obligations	–	71,779	–	71,779
Domestic equities	172,570	–	–	172,570
International equities	17,874	–	–	17,874
Investments in farmland	–	–	25,370	25,370
Mutual funds	116,437	72,314	–	188,751
Short-term and long-term investments	366,744	172,729	25,370	564,843
Beneficial interest in trusts	–	–	49,012	49,012
Beneficial interest in MHI Illinois Receivables Grantor Trust	–	11,323	–	11,323
Total assets	<u>\$ 366,744</u>	<u>\$ 184,052</u>	<u>\$ 74,382</u>	<u>\$ 625,178</u>
Liabilities				
Interest rate swaps	\$ –	\$ 4,587	\$ –	\$ 4,587

The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at September 30, 2016:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 27,303	\$ 334	\$ –	\$ 27,637
Certificates of deposit	–	2,278	–	2,278
U.S. Treasury obligations	29,301	–	–	29,301
Government obligations	–	25,484	–	25,484
Corporate obligations	–	71,402	–	71,402
Domestic equities	145,952	–	–	145,952
International equities	16,187	–	–	16,187
Investments in farmland	–	–	23,213	23,213
Mutual funds	94,708	80,450	–	175,158
Short-term and long-term investments	313,451	179,948	23,213	516,612
Beneficial interest in trusts	–	–	55,139	55,139
Total assets	<u>\$ 313,451</u>	<u>\$ 179,948</u>	<u>\$ 78,352</u>	<u>\$ 571,751</u>
Liabilities				
Interest rate swaps	\$ –	\$ 6,640	\$ –	\$ 6,640

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

The table below sets forth a summary of changes in the fair value of MHS's Level 3 assets for the period from October 1, 2015 to September 30, 2017.

	Beneficial Interest in Trusts	Investments in Farmland	Total
Total as of October 1, 2015	\$ 59,037	\$ 24,385	\$ 83,422
Trust distribution	(2,162)	1,106	(1,056)
Contributions of farmland	–	214	214
Realized and unrealized gains (losses)	<u>(1,736)</u>	<u>(2,492)</u>	<u>(4,228)</u>
Total as of September 30, 2016	55,139	23,213	78,352
Trust distribution	(3,193)	2,643	(550)
Contributions of farmland	–	198	198
Realized and unrealized gains (losses)	<u>(2,934)</u>	<u>(684)</u>	<u>(3,618)</u>
Total as of September 30, 2017	<u>\$ 49,012</u>	<u>\$ 25,370</u>	<u>\$ 74,382</u>
		Years Ended September 30	
		2017	2016
Unrealized gains (losses) related to Level 3 financial instruments held		\$ (3,618)	\$ (3,619)

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

9. Property, Plant, and Equipment

The following is a summary of property, plant, and equipment:

	September 30	
	2017	2016
Land	\$ 36,344	\$ 34,380
Land improvements	56,996	56,467
Buildings	686,704	647,924
Equipment	359,596	341,526
Construction in progress	30,943	57,017
	1,170,583	1,137,314
Less accumulated depreciation	585,444	525,757
Property, plant, and equipment, net	\$ 585,139	\$ 611,557

Capitalized interest was \$47 and \$267 for the years ended September 30, 2017 and 2016, respectively. Equipment under capital lease obligation was carried at \$1,056 and \$1,056, with accumulated depreciation of \$239 and \$167 as of September 30, 2017 and 2016, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

10. Investments in Partnerships

Investments in partnerships are accounted for using the equity method when the ownership interest is 20% or greater. The cost method is used for other investments in partnerships. Income from these investments in partnerships was \$387 and \$1,428 for the years ended September 30, 2017 and 2016, respectively, and is reflected in other revenues in the consolidated statements of operations and changes in net assets. Investments in partnerships include the following entities:

	Ownership	Ownership at		
		September 30, 2017	September 30 2017	2016
Rutledge Joint Ventures, LLC	MHV	50.0%	\$ 6,793	\$ 6,431
Orthopaedic Surgery Center of Illinois, LLC	MHV	50.0	1,639	1,590
Mid-America Service Solutions, LLC	MHS	10.0	500	500
Lincoln Land Health Information Exchange,	MHS	27.3	199	180
Memorial Employee Assistance Services, LLC	MBH	50.0	12	29
BJC Collaborative, LLC	MHS	25.0	105	105
WTA Laser, LLC	MHV	31.8	21	6
Midwest Healthcare Quality Alliance, LLC	MHS	58.7	6	2
Investments in partnerships			<u>\$ 9,275</u>	<u>\$ 8,843</u>

Memorial Health System and Subsidiaries

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

11. Long-Term Debt Obligations

Long-term debt obligations are as follows:

	September 30	
	2017	2016
Obligated Group:		
Tax-exempt Variable Rate Demand Revenue Bonds (Series 2003) at average annual variable interest rates of 0.68% and 0.22% for the years ended September 30, 2017 and 2016, respectively, secured by a letter of credit expiring on July 15, 2018.	\$ 17,470	\$ 19,415
Taxable Variable Rate Demand Revenue Bonds (Series 2004) at average annual variable interest rates of 0.92% and 0.39% for the years ended September 30, 2017 and 2016, respectively, secured by a letter of credit, expiring on July 15, 2018.	11,600	13,095
Tax-exempt Revenue Bonds (Series 2009) secured by pledged revenues of the MHS Obligated Group at an annual fixed interest rate of 5.40% as of September 30, 2017 and 2016.	85,948	85,948
Taxable Direct Note Obligation 2012C at a stated annual fixed interest rate of 4.3% as of September 30, 2017 and 2016.	51,860	53,886
Taxable Direct Note Obligation (Series 2013A) secured by pledged revenues of the MHS Obligated Group at an average variable interest rate of 1.92% and 1.26% for the years ended September 30, 2017 and 2016, respectively.	26,225	27,615
Tax-exempt Revenue Bonds (Series 2014A) secured by pledged revenues of the MHS Obligated Group at an annual fixed interest rate of 4.97% as of September 30, 2017 and 2016.	58,930	60,000
Tax-Exempt Variable Rate Revenue Bonds (Series 2014B), privately placed, puttable starting in 2024, at an annual variable interest rate of 1.39% and 1.04% for the years ended September 30, 2017 and 2016, respectively.	58,805	60,000
Taxable Direct Note Obligation 2016 secured by pledged revenues of the MHS Obligated Group at an average variable rate of 1.82% and 1.24% for the years ended September 30, 2017 and 2016, respectively.	45,000	60,000
	\$ 355,838	\$ 379,959
Obligated Group debt subtotal		

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

11. Long-Term Debt Obligations (continued)

	September 30	
	2017	2016
Other Entities:		
Indenture issued to Abraham Lincoln Memorial Hospital as part of the tax-exempt revenue bonds (Series 2009) secured by pledged revenues of the MHS Obligated Group at an annual fixed rate of 5.40% as of September 30, 2017 and 2016.	\$ 41,890	\$ 41,890
Indenture issued to Taylorville Memorial Hospital as part of the tax-exempt revenue bonds (Series 2009) secured by pledged revenues of the MHS Obligated Group at an annual fixed rate of 5.40% as of September 30, 2017 and 2016.	17,952	17,952
Tax-Exempt Variable Rate Revenue Refunding Bonds (Series 2015), privately placed issued by PAH, puttable starting in 2025, at an annual variable interest rate of 1.29% and 0.80% for the years ended September 30, 2017 and 2016, respectively.	21,511	22,778
Capital lease obligations	–	92
Notes payable	1,409	1,561
Total long-term obligations	438,600	464,232
Less current installments of long-term obligations	13,731	11,631
Less unamortized debt issuance costs, discounts, and premiums	1,340	1,892
Long-term debt obligations, net	\$ 423,529	\$ 450,709

Of MHS's debt, 86.0% is under an amended and restated Master Trust Indenture (MTI) dated December 1, 2009. Currently, the Parent and MMC are the corporations that are Obligated Group members under the MTI. The MTI requires the Obligated Group to maintain debt covenants, including meeting a minimum debt service coverage ratio, minimum days cash on hand, and a minimum rating requirement, all as defined in the MTI. Management believes MHS is in compliance with these covenants and conditions as of September 30, 2017.

MHS maintains letters of credit with JP Morgan Chase Bank supporting the Series 2003 and Series 2004 bonds. As of September 30, 2017, the letters of credit are available up to \$48,047, and had related debt and interest outstanding against them of \$29,548. These letters of credit expire on July 15, 2018. If the bonds are not remarketed, the principal on the term loans generally would be payable 24 months after the failed remarketing.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

11. Long-Term Debt Obligations (continued)

Aggregate maturities of long-term obligations at September 30, 2017, are as follows:

Year Ending September 30	
2018	\$ 13,731
2019	14,507
2020	15,044
2021	16,322
2022	15,077
Thereafter	363,919
Total	<u>\$ 438,600</u>

Interest expense is \$15,836 and \$14,349 for the years ended September 30, 2017 and 2016, respectively.

The valuation for the estimated fair value of long-term debt is completed by a third-party service and takes into account a number of factors including, but not limited to, any one or more of the following: (i) general interest rate and market conditions; (ii) macroeconomic and/or deal-specific credit fundamentals; (iii) valuations of other financial instruments that may be comparable in terms of rating, structure, maturity, and/or covenant protection; (iv) investor opinions above the respective deal parties; (v) size of the transaction; (vi) cash flow projections, which in turn are based on assumptions about certain parameters that include, but are not limited to, default, recovery, prepayment, and reinvestment rates; (vii) administrator reports, asset manager estimates, broker quotations, and/or trustee reports; and (viii) comparable trades, where observable. Based on the inputs in determining the estimated fair value of debt, this liability is considered to be Level 2 measurement. The estimated fair value of long-term debt at September 30, 2017 and 2016, based on quoted market prices for the same or similar issues was \$430,078 and \$484,432, respectively, which includes consideration of third-party credit enhancements, of which there is no impact.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

12. Derivatives

MHS has interest rate-related derivative instruments to manage its exposure on its variable-rate debt instruments and does not enter into derivative instruments for any purpose other than risk management purposes. Interest rate swap contracts between MHS and a third party (counterparty) provide for the periodic exchange of payments between the parties based on changes in a defined index and a fixed rate, and expose MHS to market risk and credit risk. Credit risk is the risk that contractual obligations of the counterparties will not be fulfilled.

Concentrations of credit risk relate to groups of counterparties that have similar economic or industry characteristics, which could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Counterparty credit risk is managed by requiring high credit standards for MHS's counterparties. The counterparties to these contracts are financial institutions that carry investment-grade credit ratings. MHS does not anticipate nonperformance by its 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 changes is managed by established and monitoring parameters, which limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of MHS's derivative positions in the context of its blended cost of capital.

The following is a summary of the outstanding positions under these interest rate swap agreements at September 30, 2017:

<u>Expiration Date</u>	<u>MHS Pays</u>	<u>MHS Receives</u>	<u>Notional Amount</u>
October 1, 2024	4.99%	100% of LIBOR	\$ 11,600
October 1, 2022	3.69%	70% of LIBOR	17,470
December 1, 2031	2.95%	67% of LIBOR	14,270
December 1, 2031	3.45%	67% of LIBOR	8,565

The objective of these interest swaps is to mitigate interest rate fluctuations and synthetically fix the interest rate of the related bond series. The Parent, MMC, and PAH have entered into an interest rate swap agreement to convert the 2003, 2004, 2006A and 2006B series variable rate debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense. The 2006A and 2006B series debt were retired in fiscal year 2016, but the swaps remain outstanding until expiration in 2031.

Memorial Health System and Subsidiaries

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

12. Derivatives (continued)

The fair values of derivative instruments at September 30, 2017 and 2016 are as follows:

Derivatives Not Designated as Hedging Instruments	Balance Sheet Location	September 30	
		2017	2016
Interest rate swaps	Other long-term liabilities	\$ 4,587	\$ 6,640

The effect of derivative instruments on the consolidated statements of operations and changes in net assets for the years ended September 30, 2017 and 2016, are as follows:

Derivatives Not Designated as Hedging Instruments	Location of Loss on Derivatives Recognized in Excess of Revenues Over Expenses	Amount of Gain (Loss) on Derivatives Recognized in Excess of Revenues Over Expenses	
		Years Ended September 30 2017	2016
Interest rate swaps	Gain (loss) on derivatives	\$ 594	\$ (1,465)

13. New Markets Tax Credit Program

QALICB is party to a 35 year loan agreement for \$16,770 with a Direct Lender through the U.S. Department of the Treasury Community Development Financial Institution (CDFI) Fund New Markets Tax Credit (NMTC) Program for reimbursement of certain capital expenditures which qualify as a Qualified Low Income Community Investment (QLICI). The loan (QLICI notes payable) bears annual interest at a fixed rate of 0.98% and has a bilateral put/call option that becomes effective in December 2022. The QLICI notes payable are reported as Other non-current liabilities on the consolidated balance sheet. To facilitate the NMTC transaction, MMC concurrently loaned \$11,628 to a newly created special purpose entity (SPE). This note receivable owed from the SPE is reported in Other assets in the non-current section of the consolidated balance sheet.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

13. New Markets Tax Credit Program (continued)

Upon maintaining compliance under the NMTC program, management expects the bilateral put/call option to be exercised in 2022, which will trigger the transaction structure to unwind and result in immediate cancelation of the QLICI notes payable and note receivable balances. As a result, management anticipates recognizing a gain of \$5,142 on the consolidated statement of operations in 2022. Total interest expense on the QLICI notes payable totaled \$164 and \$99 for the years ended September 30, 2017 and 2016, respectively. Total interest income on the notes receivable totaled \$116 and \$88 for the years ended September 30, 2017 and 2016, respectively.

14. Liability Programs

MHS is involved in litigation arising in the ordinary course of business. Claims alleging professional or general liability have been asserted against MHS and are currently in various stages of litigation. MHS is self-insured for claims of up to \$1,000 individually and \$6,000 in the aggregate and has commercial claims-made excess insurance coverage up to \$25,000 per claim and \$25,000 in the aggregate.

Accruals related to the estimated self-insurance liability and the corresponding charge to expense are actuarially determined for asserted and unasserted claims using historical claims experience and other relevant industry and hospital-specific factors and trends, discounted at an annual interest rate of 2.67% and 2.5% at September 30, 2017 and 2016, respectively.

The general and professional liability was \$13,960 and \$16,623 at September 30, 2017 and 2016, respectively, including tail coverage on the claims-made policy. Insurance receivables related to excess coverage are \$2,768 and \$3,435 at September 30, 2017 and 2016, respectively. Amounts charged to purchased services and other expense in the consolidated statements of operations and changes in net assets are as follows:

	Years Ended September 30	
	2017	2016
Self-insurance	\$ (887)	\$ 1,798
Insured	2,721	2,958
Total	<u>\$ 1,834</u>	<u>\$ 4,756</u>

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

14. Liability Programs (continued)

MHS maintains a revocable general and professional liability trust fund containing investments of \$12,647 and \$12,557 at September 30, 2017 and 2016, respectively.

MHS also provides for workers' compensation through a self-insurance trust or through insured programs. The funding level for this trust and estimation of the related liability are actuarially determined. Amounts charged to expense for this coverage for the years ended September 30, 2017 and 2016, were \$705 and \$1,362, respectively, and are included in employee benefits in the consolidated statements of operations and changes in net assets. The workers' compensation liability was \$4,944 and \$6,580, at September 30, 2017 and 2016, respectively discounted at the same rates as the self-insurance liability. The insurance receivable related to excess coverage is \$451 and \$811 at September 30, 2017 and 2016, respectively. MHS maintains a revocable workers' compensation liability trust fund containing investments of \$5,265 and \$5,822 at September 30, 2017 and 2016, respectively.

15. Retirement Plans

Defined Benefit Plans

The MHS defined benefit pension plan (MHS Pension) covers substantially all of the employees of MHS, MMC, MPS and MHSvc who began employment prior to January 1, 2012. The benefits are based on years of service and the employee's compensation during the highest five consecutive years of the last ten years of employment. Contributions are made to the plans to meet the target funding level established by management and have exceeded the net pension cost each year. On December 31, 2011, MHS Pension was frozen and no new participants were permitted after that date. Unvested participants on December 31, 2011, are still eligible to vest assuming service period requirements are met.

MHS also has a supplemental retirement defined benefit plan (MHS Restoration) covering MHS and MMC executives, which was frozen to new participants on December 31, 2009. Eligible participants in the MHS Restoration as of January 1, 2010, will continue to accrue benefits.

The MPS Pension Restoration Plan covered physicians and was frozen for both new participation and benefits accruals as of December 31, 2011. Both restoration plans were designed to cover participants whose annual compensation exceeds the Internal Revenue Service cap limits for pension plan contributions and are unfunded.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

The following table sets forth the benefit obligation and assets of MHS's defined benefit plans' funded status as recognized in MHS's consolidated balance sheets:

	September 30	
	2017	2016
Change in benefit obligation:		
Benefit obligation – beginning of year	\$ 462,987	\$ 424,143
Service cost	547	527
Interest cost	18,655	19,932
Actuarial (gain) loss	(870)	41,496
Benefits paid	(14,416)	(23,111)
Benefit obligation – end of year	<u>466,903</u>	<u>462,987</u>
Change in plan assets:		
Fair value of plan assets – beginning of year	429,642	357,060
Actual gain (loss) on plan assets	43,110	26,690
Employer contribution	24	69,003
Benefits paid	(14,416)	(23,111)
Fair value of plan assets – end of year	<u>458,360</u>	<u>429,642</u>
Funded status	<u>\$ (8,543)</u>	<u>\$ (33,345)</u>

A special lump sum payout offered to eligible participants in September 2016 resulted in additional benefit payments of \$10,017. Funded status includes liability of an unfunded liability and a net pension asset of \$4,942 recorded in Other Assets on the consolidated balance sheet as of September 30, 2017.

Amounts recognized in unrestricted net assets consist of the following:

	September 30	
	2017	2016
Unrecognized actuarial (gain) loss	\$ 144,050	\$ 177,827

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

Changes in plan assets and benefit obligations recognized in unrestricted net assets include the following:

	Years Ended September 30	
	2017	2016
Current actuarial (gain) loss	\$ (14,988)	\$ 40,779
Amortization of gain (loss)	(18,789)	(15,772)
	\$ (33,777)	\$ 25,007

The actuarial loss included in unrestricted net assets expected to be recognized in net periodic pension cost during the year ending September 30, 2018 is \$13,838.

Components of net periodic benefit cost are as follows:

	Years Ended September 30	
	2017	2016
Service cost	\$ 547	\$ 527
Interest cost	18,655	19,932
Expected return on plan assets	(28,992)	(25,973)
Amortization of net loss and prior service cost	18,789	15,772
Net periodic benefit cost	\$ 8,999	\$ 10,258

No plan assets are expected to be returned to MHS during the year ending September 30, 2018.

The accumulated benefit obligations were \$464,769 and \$460,155 at September 30, 2017 and 2016, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

Assumptions

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

	September 30	
	2017	2016
Discount rate	4.16%	4.10%
Expected long-term return on plan assets	6.50	6.88

The effects of the changes in actuarial assumptions from 2016 to 2017, which include a revision to the assumed mortality table, decreased the projected benefit obligation and the accumulated benefit obligation by \$2,412 and \$2,399, respectively, at September 30, 2017. The effects of the changes in actuarial assumptions from 2015 to 2016, which include a revision to the assumed mortality table, increased the projected benefit obligation and the accumulated benefit obligation by \$40,994 and \$40,699, respectively, at September 30, 2016.

Weighted-average assumptions used to determine net periodic benefit costs are as follows:

	Years Ended September 30	
	2017	2016
Discount rate	4.10%	4.78%
Expected long-term return on plan assets	6.88	7.25

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

The weighted-average asset allocation by asset category is as follows:

	Target Asset Allocation 2017	September 30 2017	Target Asset Allocation 2016	September 30 2016
Equity securities	55.0%	53.9%	58.0%	54.3%
Debt securities	45.0	43.7	32.0	34.5
Opportunistic	–	–	10.0	9.0
Cash and cash equivalents	–	2.4	–	2.2
Total	100.0%	100.0%	100.0%	100.0%

The fair value of plan assets measured at fair value was determined using the following inputs at September 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets				
Money market funds	\$ 11,079	\$ –	\$ –	\$ 11,079
U.S. Treasury obligations	101,339	–	–	101,339
Government obligations	–	9,063	–	9,063
Corporate obligations	–	89,717	–	89,717
Domestic equities	128,792	–	–	128,792
International equities	9,363	–	–	9,363
Mutual funds	109,007	–	–	109,007
Total assets	\$ 359,580	\$ 98,780	\$ –	\$ 458,360

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

The fair value of plan assets measured at fair value was determined using the following inputs at September 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets				
Money market funds	\$ 9,396	\$ –	\$ –	\$ 9,396
U.S. Treasury obligations	55,646	–	–	55,646
Government obligations	–	37,029	–	37,029
Corporate obligations	–	55,447	–	55,447
Domestic equities	125,695	–	–	125,695
International equities	10,918	–	–	10,918
Mutual funds	96,638	38,873	–	135,511
Total assets	<u>\$ 298,293</u>	<u>\$ 131,349</u>	<u>\$ –</u>	<u>\$ 429,642</u>

At September 30, 2017 and 2016, fair value methodologies for Level 1 and Level 2 assets are consistent with the inputs described in Note 8. There are no Level 3 assets.

Investment managers are employed to invest pension fund assets in a structured portfolio of equity and fixed income. All manager performance is reviewed by management to monitor that market performance has been calculated accurately, to monitor performance among peers and benchmarking, and to evaluate portfolio structure considering current and future needs based on economic forecasts and actuarial projections. MHS believes that a diversified portfolio will limit the degree of risk to the plans and stabilize the long-term results. The plans' diversified blend of marketable securities also takes into consideration the cash flow requirements of the plans to provide for the monthly payout of benefits required.

Projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of the category.

During the year ending September 30, 2018, MHS does not anticipate making any material contributions to the plan.

Memorial Health System and Subsidiaries

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

15. Retirement Plans (continued)

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

Years Ending September 30

2018	\$	18,048
2019		20,062
2020		22,382
2021		22,241
2022		23,309
2023–2027		129,698

Defined Contribution Plans

The Defined Contribution Plan is intended to qualify as a profit-sharing plan under Code Section 401(a), and includes a cash or deferred arrangement that is approved to qualify under Code Section 401(k). The plan allows employee contributions and an employer matching contribution of up to 3% of eligible pay, and provides a discretionary service-based employer contribution of between 3% and 7%. MHS is also providing a discretionary transition contribution to long-term employees who are closer to retirement. The amount of the discretionary transition contribution, which may be paid for a maximum of five years, will not exceed a percentage of eligible pay, based on age and service requirements as of January 1, 2012. All eligible employees of MHS, MMC, MPS, MHSvc, MBH, ALMH and TMH are included in the Defined Contribution Plan.

MHS contributes the employer match throughout the year, as the employee contributes to the plan through payroll deduction. The services based and transition contributions for the Defined Contribution Plan calendar plan year are discretionary and subject to approval by the MHS Board of Directors. As of December 15, 2017, no approval of contribution has been made for plan calendar year 2017.

MHS also has a Defined Contribution Restoration Plan. This plan is intended to qualify as an eligible deferred compensation plan under code Section 457(b). This plan excludes anyone eligible to receive a benefit under the MHS Restoration plan.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

Prior to December 31, 2015, MBH sponsored a separate defined contribution plan. On December 31, 2015, MBH's defined contribution plan merged into the Defined Contribution Plan and the Plan was amended to include MBH as a participating employer effective January 1, 2016. PAH also sponsors a defined contribution plan with an employer match provision.

Defined Contribution retirement expense for the plans previously mentioned is as follows:

	Years Ended September 30	
	2017	2016
MHS Defined Contribution Plan	\$ 21,259	\$ 20,976
MHS Defined Contribution Restoration Plan	503	479
MBH	–	514
PAH	1,939	1,951
Total retirement expense	\$ 23,701	\$ 23,920

16. Post-Employment and Other Benefits

MHS and PAH provide unfunded post-employment benefit plans to certain employees. The cost for these plans were \$3,573 and \$809 for the years ended September 30, 2017 and 2016, respectively. As of September 30, 2017 and 2016, the accumulated post-employment benefit obligation was \$12,011 and \$10,001, respectively. Annual discount rates ranged from 4.10% to 4.16%. The plans assume a medical plan trend rate of 6.25% in 2017, decreasing by 0.25% annually to 5.0% thereafter.

A one-percentage-point increase in the assumed medical plan trend rates would have increased the accumulated post-employment benefit obligation by \$1,679 and \$1,595, at September 30, 2017 and 2016, respectively. A one-percentage-point decrease in the assumed medical plan trend rates would have decreased the accumulated post-employment benefit obligation by \$1,347 and \$1,273, at September 30, 2017 and 2016, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

16. Post-Employment and Other Benefits (continued)

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic post-employment benefit cost:

	September 30	
	2017	2016
Unrecognized actuarial losses	\$ 2,457	\$ 3,215

Other post-employment and other benefit plans liabilities include continuation of medical benefits to employees on long-term disability, sick time paid to employees upon retirement, and the paid sick time program to current active employees, which were \$6,407 and \$7,395 at September 30, 2017 and 2016, respectively.

17. Operating Leases

Revenues

Rental revenues were \$14,165 and \$14,325 for the years ended September 30, 2017 and 2016, respectively, from non-MHS entities. As of September 30, 2017 and 2016, the cost of the buildings held for lease was \$155,556 and \$161,830, respectively, and the related accumulated depreciation was \$67,098 and \$47,354, respectively.

Future minimum rental revenue under noncancelable operating leases as of September 30, 2017, which have initial or remaining terms in excess of one year, is as follows:

Years Ending September 30		
2018	\$	9,709
2019		9,674
2020		8,852
2021		7,948
2022		7,788
Thereafter		22,780
Total minimum lease revenue	\$	66,751

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

17. Operating Leases (continued)

Expenses

Rental expense was \$2,871 and \$2,462 for the years ended September 30, 2017 and 2016, respectively.

Future minimum rental payments under noncancelable operating leases as of September 30, 2017, which have initial or remaining terms in excess of one year, are as follows:

Years Ending September 30	
2018	\$ 1,391
2019	927
2020	111
2021	78
2022	48
Thereafter	—
Total minimum lease payment	<u>\$ 2,555</u>

18. Commitments and Contingencies

Firm commitments for construction in progress totaled \$11,999 as of September 30, 2017.

Regulatory Compliance

The U.S. Department of Justice and other federal and state agencies are increasing resources dedicated to regulatory investigations and compliance audits of health care providers. MHS is not exempt from these regulatory efforts and has received inquiries from federal and state agencies with regard to such initiatives. In consultation with legal counsel, management estimates these matters will be resolved without material adverse effect on MHS's consolidated balance sheets or consolidated statements of operations and changes in net assets. MHS has a formal corporate compliance function, which management believes will help monitor MHS's compliance with applicable laws and regulations.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

18. Commitments and Contingencies (continued)

Litigation

MHS is involved in litigation arising in the normal course of business. After consultation with legal counsel, it is management's opinion that these matters will be resolved without a material adverse effect on MHS's consolidated balance sheets or consolidated statements of operations and changes in net assets.

19. Subsequent Events

MHS evaluated events and transactions occurring subsequent to September 30, 2017 through December 15, 2017, the date the consolidated financial statements were issued.

Supplementary Information

**MEMORIAL HEALTH SYSTEM
CONSOLIDATING BALANCE SHEET
SEPTEMBER 30, 2017**

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF		
Assets																			
Current assets:																			
Cash and cash equivalents	\$ 7,420	\$ 61,572	\$ 6,179	\$ 6	\$ 27,386	\$ 38,332	\$ 9,247	\$ 72	\$ 3,985	\$ 263	\$ 7,806	\$ 1,757	\$ -	\$ 1,941	\$ 306	\$ 17	\$ 562	\$ -	\$ 166,851
Short-term investments	37,293	86,862	2	-	18,111	1,680	-	-	7,354	-	264	-	-	1,500	200	4,677	-	-	157,943
Assets whose use is limited	-	4,218	-	-	-	-	-	-	-	204	-	-	-	-	-	-	-	-	4,422
Receivables:																			
Patient accounts receivable	-	123,442	23,154	882	9,770	9,130	7,940	967	1,311	-	5,599	400	-	-	-	-	-	-	182,595
Allowance for uncollectible accounts	-	(13,191)	(5,092)	(456)	(1,954)	(1,683)	(1,394)	(452)	(220)	-	(1,460)	(232)	-	-	-	-	-	-	(26,134)
Net patient accounts receivable	-	110,251	18,062	426	7,816	7,447	6,546	515	1,091	-	4,139	168	-	-	-	-	-	-	156,461
Receivables from third-party payors	-	15,176	177	-	-	85	-	-	-	-	-	-	-	-	-	-	-	-	15,438
Due from affiliates	854	502	1	-	12	5	8	10	69	-	12	93	-	9	-	4	-	(1,579)	-
Receivables held for sale	-	24,336	2,636	-	913	469	947	-	-	-	962	90	-	-	-	-	-	-	30,353
Other receivables	2,077	14,349	1,456	-	530	373	1,397	95	1,615	70	795	164	694	187	240	7	-	(506)	23,543
Inventories	-	9,283	1,585	-	620	521	897	-	-	-	414	-	-	-	-	-	-	-	13,320
Prepaid expenses	6,205	5,983	953	-	277	254	348	-	176	-	94	14	-	111	-	-	-	-	14,415
Total current assets	53,849	332,532	31,051	432	55,665	49,166	19,390	692	14,290	537	14,486	2,286	694	3,748	746	4,705	562	(2,085)	582,746
Long-term investments:																			
Unrestricted investments	-	185,658	75,132	-	41,197	3,695	-	-	-	-	-	-	-	15,405	23,940	-	3,584	-	348,611
Assets whose use is limited:																			
Self-insurance trusts	-	13,694	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	13,694
Donor restricted assets and other	-	1,027	3,527	-	-	-	-	-	317	620	-	-	-	9,992	-	318	496	-	16,297
Deferred compensation assets	9,773	3,384	718	-	-	-	10,001	-	-	-	-	-	-	-	-	-	-	-	23,876
Total assets whose use is limited	9,773	18,105	4,245	-	-	-	10,001	-	317	620	-	-	-	9,992	-	318	496	-	53,867
Total long-term investments	9,773	203,763	79,377	-	41,197	3,695	10,001	-	317	620	-	-	-	25,397	23,940	318	4,080	-	402,478
Net property, plant, and equipment	185,036	274,098	37,197	-	34,533	20,005	6,960	277	4,217	20,233	2,125	-	-	-	458	-	-	-	585,139
Other assets:																			
Investments in partnerships	810	27,158	4,553	-	-	-	-	-	12	-	-	10,984	-	-	-	-	-	(34,242)	9,275
Beneficial interest in trusts	-	31,342	17,670	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	49,012
Other	16,624	27,987	2,467	-	423	356	652	-	13	-	465	136	-	2,291	-	-	-	(11,352)	40,062
Total other assets	17,434	86,487	24,690	-	423	356	652	-	25	-	465	11,120	-	2,291	-	-	-	(45,594)	98,349
TOTAL ASSETS	\$ 266,092	\$ 896,880	\$ 172,315	\$ 432	\$ 131,818	\$ 73,222	\$ 37,003	\$ 969	\$ 18,849	\$ 21,390	\$ 17,076	\$ 13,406	\$ 694	\$ 31,436	\$ 25,144	\$ 5,023	\$ 4,642	\$ (47,679)	\$ 1,668,712
Liabilities and net assets																			
Current liabilities:																			
Long-term debt	\$ 5,920	\$ 5,852	\$ 1,444	\$ -	\$ 360	\$ 155	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 13,731
Accounts payable	3,995	37,621	3,279	24	1,122	1,350	2,022	44	209	-	1,507	178	-	115	33	-	7	-	51,506
Accrued payroll	4,781	22,352	5,044	-	1,710	2,248	2,315	140	1,254	-	1,145	-	39	-	-	-	-	-	41,028
Interest payable	598	3,020	27	-	1,129	484	-	-	-	-	-	-	-	-	-	-	-	-	5,258
Due to affiliates	26	138	97	-	148	30	732	1	460	300	13	-	-	2	12	-	-	(1,959)	-
Payables to third-party payors	-	31,431	5,161	-	1,291	2,303	-	-	-	-	-	-	-	-	-	-	-	-	40,186
Other	4,754	5,894	583	-	70	24	2,607	-	211	136	183	-	-	1,052	-	13	-	(155)	15,372
Total current liabilities	20,074	106,308	15,635	24	5,830	6,594	7,676	185	2,134	436	2,848	178	39	1,169	45	13	7	(2,114)	167,081
Noncurrent liabilities:																			
Long-term debt obligations, net	95,618	247,448	21,424	-	41,329	17,710	-	-	-	-	-	-	-	-	-	-	-	-	423,529
Deferred compensation and benefits	10,689	3,384	718	-	-	-	10,307	-	-	-	-	-	-	-	-	-	-	-	25,098
Self-insurance accrued expenses	218	12,581	3,489	-	426	144	771	188	-	-	252	-	-	-	-	-	-	-	18,069
Accrued employee benefits	3,862	5,738	2,963	-	-	-	5,164	-	-	-	225	-	-	-	-	-	-	-	17,952
Pension obligations	10,009	2,372	-	-	-	-	2,304	-	-	-	-	-	-	-	-	-	-	-	14,685
Other	12,994	2,618	2,370	-	-	446	-	-	-	16,448	-	-	-	92	-	-	-	(11,323)	23,645
Total noncurrent liabilities	133,390	274,141	30,964	-	41,755	18,300	18,546	188	-	16,448	477	-	-	92	-	-	-	(11,323)	522,978
Total liabilities	153,464	380,449	46,599	24	47,585	24,894	26,222	373	2,134	16,884	3,325	178	39	1,261	45	13	7	(13,437)	690,059
Net assets:																			
Unrestricted	112,628	456,904	104,034	408	84,233	48,328	10,781	596	15,760	4,506	13,557	13,228	655	18,073	24,730	4,692	3,914	(6,445)	910,582
Temporarily restricted	-	59,527	793	-	-	-	-	-	955	-	111	-	-	7,005	369	268	307	(27,383)	41,952
Permanently restricted	-	-	20,889	-	-	-	-	-	-	-	83	-	-	5,097	-	50	414	(414)	26,119
Total net assets	112,628	516,431	125,716	408	84,233	48,328	10,781	596	16,715	4,506	13,751	13,228	655	30,175	25,099	5,010	4,635	(34,242)	978,653
TOTAL LIABILITIES AND NET ASSETS	\$ 266,092	\$ 896,880	\$ 172,315	\$ 432	\$ 131,818	\$ 73,222	\$ 37,003	\$ 969	\$ 18,849	\$ 21,390	\$ 17,076	\$ 13,406	\$ 694	\$ 31,436	\$ 25,144	\$ 5,023	\$ 4,642	\$ (47,679)	\$ 1,668,712

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2017

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL	
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF			
Gross patient service charges:																				
Inpatient charges	\$ -	\$ 1,151,958	\$ 122,595	\$ 2,567	\$ 16,099	\$ 18,050	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,311,269
Outpatient charges	-	1,072,983	252,702	8,886	109,093	89,946	109,972	9,257	15,224	-	35,244	18,357	-	-	-	-	-	-	(350)	1,721,314
Total gross patient service charges	-	2,224,941	375,297	11,453	125,192	107,996	109,972	9,257	15,224	-	35,244	18,357	-	-	-	-	-	-	(350)	3,032,583
Less charity	-	7,946	2,738	40	671	210	23	4	289	-	85	11	-	-	-	-	-	-	-	12,017
Less contractual allowances	-	1,635,606	266,241	8,510	78,072	65,326	64,509	5,695	1,446	-	12,091	12,565	-	-	-	-	-	-	-	2,150,061
Patient service revenues	-	581,389	106,318	2,903	46,449	42,460	45,440	3,558	13,489	-	23,068	5,781	-	-	-	-	-	-	(350)	870,505
Provision for uncollectible accounts	-	8,597	4,475	108	989	907	1,537	153	66	-	892	664	-	-	-	-	-	-	-	18,388
Net patient service revenues	-	572,792	101,843	2,795	45,460	41,553	43,903	3,405	13,423	-	22,176	5,117	-	-	-	-	-	-	(350)	852,117
Hospital access improvement payments	-	37,587	8,872	-	4,158	3,415	-	-	-	-	-	-	-	-	-	-	-	-	-	54,032
Capitation revenues	-	56,856	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	56,856
Other revenues:																				
Management fees	62,487	-	-	-	16	-	-	-	-	-	-	-	-	-	-	-	-	-	(62,503)	-
Other	17,507	15,012	1,759	-	372	523	5,295	41	589	1,533	608	538	960	-	-	-	-	-	(11,986)	32,751
Total other revenues	79,994	15,012	1,759	-	388	523	5,295	41	589	1,533	608	538	960	-	-	-	-	-	(74,489)	32,751
Total revenues	79,994	682,247	112,474	2,795	50,006	45,491	49,198	3,446	14,012	1,533	22,784	5,655	960	-	-	-	-	-	(74,839)	995,756
Expenses:																				
Salaries and wages	30,165	212,047	41,229	2,810	15,891	14,964	21,253	4,607	9,158	102	12,519	1,448	1,246	-	-	-	-	-	-	367,439
Employee benefits	7,385	56,213	14,458	422	4,880	5,166	6,776	708	2,915	37	3,872	368	420	-	-	-	-	-	-	103,620
Physician fees	1,498	51,182	7,104	1,300	3,549	2,898	24,314	2	29	-	73	3,432	351	-	-	-	-	-	-	95,732
Utilities	3,045	7,856	1,329	-	548	657	993	29	344	149	203	5	8	-	-	-	-	-	(1,617)	13,549
Pharmaceutical supplies	-	28,270	4,150	-	1,358	1,160	3,261	44	7	-	319	76	-	-	-	-	-	-	-	38,645
Food	36	4,494	1,095	-	370	283	18	-	72	-	7	4	-	-	-	-	-	-	-	6,379
Patient service supplies	-	84,497	8,975	-	1,986	1,721	1,011	238	-	-	352	66	-	-	-	-	-	-	-	98,846
System management fee	-	47,226	2,159	28	1,973	1,715	6,143	71	667	-	724	146	4	-	-	-	-	-	(60,856)	-
Purchased services and other	17,526	62,230	11,302	152	4,626	5,409	8,862	1,400	1,455	(47)	3,008	957	26	-	-	-	-	-	(12,125)	104,781
Hospital provider assessment	-	18,238	2,436	-	988	807	-	-	-	-	-	-	-	-	-	-	-	-	-	22,469
Purchased medical services	-	30,843	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	30,843
Depreciation and amortization	16,845	37,360	3,866	-	4,273	2,469	1,442	68	400	1,384	1,076	3	-	-	-	-	-	-	-	69,186
Amortization of debt issuance expenses	57	297	7	-	134	58	-	-	-	61	-	-	-	-	-	-	-	-	-	614
Interest expense and other financing costs	3,437	9,086	325	-	2,257	967	-	-	-	207	-	-	-	-	-	-	-	-	-	16,279
Total expenses	79,994	649,839	98,435	4,712	42,833	38,274	74,073	7,167	15,047	1,893	22,153	6,505	2,055	-	-	-	-	-	(74,598)	968,382
Income (loss) from operations	-	32,408	14,039	(1,917)	7,173	7,217	(24,875)	(3,721)	(1,035)	(360)	631	(850)	(1,095)	-	-	-	-	-	(241)	27,374
% of total operating revenue	0%	5%	13%	-69%	14%	16%	-51%	-108%	-7%	-24%	3%	-15%	-114%	NA	NA	NA	NA	NA	NA	3%
Nonoperating gains (losses):																				
Interest and dividends	673	2,975	1,340	-	1,203	216	355	-	253	7	39	10	-	235	531	91	8	-	-	7,936
Realized gain (loss) on investments, net	1,779	16,356	963	-	1,215	48	-	-	50	-	-	-	-	249	114	19	4	-	-	20,797
Unrealized gain (loss) on investments, net	1,781	17,933	3,506	-	3,875	377	710	-	(67)	-	17	-	-	1,157	2,752	444	118	-	-	32,603
Gain (loss) on derivatives	367	337	(110)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	594
Contributions	-	33	32	-	17	19	-	-	-	-	3	-	-	1,119	633	60	67	-	-	1,983
Equity in income of affiliate	-	-	190	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(190)	-
Provision for income taxes	-	-	-	-	-	-	-	-	-	-	(679)	-	-	-	-	-	-	-	-	(679)
Net periodic benefit cost	(1,620)	(6,138)	(2,405)	-	-	-	(1,027)	-	-	-	(323)	-	-	-	-	-	-	-	-	(11,513)
Other revenue (expense), net	(1,496)	(198)	129	-	(500)	-	(1,051)	-	-	-	-	-	-	(473)	(751)	(97)	(239)	241	(4,435)	
Total nonoperating gains (losses), net	1,484	31,298	3,645	-	5,810	660	(1,013)	-	236	7	(943)	10	-	2,287	3,279	517	(42)	51	47,286	
Excess (deficiency) of revenues over expenses	\$ 1,484	\$ 63,706	\$ 17,684	\$ (1,917)	\$ 12,983	\$ 7,877	\$ (25,888)	\$ (3,721)	\$ (799)	\$ (353)	\$ (312)	\$ (840)	\$ (1,095)	\$ 2,287	\$ 3,279	\$ 517	\$ (42)	\$ (190)	\$ 74,660	
Excess margin %	1.8%	8.9%	15.2%	-68.6%	23.3%	17.1%	-53.7%	-108.0%	-5.6%	-22.9%	-1.4%	-14.8%	-114.1%	NA	NA	NA	NA	NA	NA	7.2%

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2017

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL	
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF			
Unrestricted net assets:																				
Excess (deficiency) of revenues over expenses	\$ 1,484	\$ 63,706	\$ 17,684	\$ (1,917)	\$ 12,983	\$ 7,877	\$ (25,888)	\$ (3,721)	\$ (799)	\$ (353)	\$ (312)	\$ (840)	\$ (1,095)	\$ 2,287	\$ 3,279	\$ 517	\$ (42)	\$ (190)	\$ 74,660	
Pension and other postretirement liability adjustments	1,098	32,897	-	-	-	-	542	-	-	-	-	-	-	-	-	-	-	-	34,537	
Amortization of ineffective portion of derivatives	9	(69)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(60)	
Other	(135)	-	-	-	-	-	-	-	-	-	-	-	-	180	-	-	(44)	-	136	
Transfers (to) related organizations	(30,268)	(28,573)	(8,736)	(2,475)	-	-	(13,586)	(179)	-	(940)	-	(2,000)	(113)	-	-	-	(25)	86,895	-	
Transfers from related organizations	42,433	2,140	2,475	4,565	-	-	28,372	3,895	450	-	-	676	1,589	-	-	-	300	(86,895)	-	
Increase (decrease) in unrestricted net assets	14,621	70,101	11,423	173	12,983	7,877	(10,560)	(5)	(349)	(1,158)	(312)	(2,164)	381	2,467	3,279	517	189	(190)	109,273	
Temporarily restricted net assets:																				
Contributions	-	503	-	-	-	-	-	-	-	-	38	-	-	737	79	126	188	-	1,671	
Net investment income gain (loss)	-	-	6	-	-	-	-	-	-	-	-	-	-	1,350	-	-	1	-	1,357	
Net assets released from restrictions (non-operating)	-	(2,547)	-	-	-	-	-	-	-	-	-	-	-	(1,272)	-	-	(44)	-	(3,863)	
Net assets released from restrictions (operating)	-	(465)	-	-	-	-	-	-	-	-	(32)	-	-	-	(54)	(38)	-	-	(589)	
Change in value of split-interest agreements	-	(3,742)	1	-	-	-	-	-	-	-	-	-	-	27	-	-	-	-	(3,714)	
Gain (loss) on interest in net assets of foundation	-	2,690	196	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,886)	-	
Other	-	-	(19)	-	-	-	-	-	-	-	-	-	-	(337)	-	-	44	-	(312)	
Increase (decrease) in temporarily restricted net assets	-	(3,561)	184	-	-	-	-	-	-	-	6	-	-	505	25	88	189	(2,886)	(5,450)	
Permanently restricted net assets:																				
Contributions	-	-	-	-	-	-	-	-	-	-	-	-	-	16	-	-	2	-	18	
Net investment income gain (loss)	-	-	162	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	162	
Gain (loss) on interest in net assets of foundation	-	-	2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2)	-	
Increase (decrease) in permanently restricted net assets	-	-	164	-	-	-	-	-	-	-	-	-	-	16	-	-	2	-	180	
Increase (decrease) in net assets	14,621	66,540	11,771	173	12,983	7,877	(10,560)	(5)	(349)	(1,158)	(306)	(2,164)	381	2,988	3,304	605	380	(3,078)	104,003	
Net assets, beginning of period	98,007	449,891	113,945	235	71,250	40,451	21,341	601	17,064	5,664	14,057	15,392	274	27,187	21,795	4,405	4,255	(31,164)	874,650	
Net assets, end of period	\$ 112,628	\$ 516,431	\$ 125,716	\$ 408	\$ 84,233	\$ 48,328	\$ 10,781	\$ 596	\$ 16,715	\$ 4,506	\$ 13,751	\$ 13,228	\$ 655	\$ 30,175	\$ 25,099	\$ 5,010	\$ 4,635	\$ (34,242)	\$ 978,653	

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED SEPTEMBER 30, 2017

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMINATIONS	TOTAL	
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF			
Cash flows from operating activities:																				
Changes in net assets	\$ 14,621	\$ 66,540	\$ 11,771	\$ 173	\$ 12,983	\$ 7,877	\$ (10,560)	\$ (5)	\$ (349)	\$ (1,158)	\$ (306)	\$ (2,164)	\$ 381	\$ 2,988	\$ 3,304	\$ 605	\$ 380	\$ (3,078)	\$ 104,003	
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:																				
Non cash contributions	-	(2,147)	(496)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,643)
(Gain) loss on derivatives	(367)	(337)	110	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(594)
Realized (gain) loss on investments, net	(1,779)	(16,356)	(1,131)	-	(1,215)	(48)	-	-	(50)	-	-	-	-	(591)	(114)	(19)	(5)	-	(21,308)	
Unrealized (gain) loss on investments, net	(1,781)	(17,933)	(3,506)	-	(3,875)	(377)	(710)	-	67	-	(17)	-	-	(2,165)	(2,752)	(444)	(118)	-	(33,611)	
Restricted contributions and other	-	(503)	-	-	-	-	-	-	-	-	(38)	-	-	(753)	(79)	(126)	(190)	-	(1,689)	
(Increase) decrease in beneficial interest in trusts	-	5,889	(312)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5,577
Depreciation and amortization	16,845	37,360	3,866	-	4,273	2,469	1,442	68	400	1,384	1,076	3	-	-	-	-	-	-	-	69,186
Amortization of debt issuance costs	57	297	7	-	134	58	-	-	-	61	-	-	-	-	-	-	-	-	-	614
(Gain) loss on disposal of assets	(38)	370	(15)	-	-	-	-	-	-	134	20	-	-	80	-	-	-	-	-	551
Provision for uncollectible accounts	-	8,597	4,475	108	989	907	1,537	153	66	-	892	664	-	-	-	-	-	-	-	18,388
Pension obligations	(1,098)	(32,897)	-	-	-	-	(542)	-	-	-	-	-	-	-	-	-	-	-	-	(34,537)
Changes in assets and liabilities:																				
Accounts receivable	-	(12,338)	(7,139)	(318)	(1,282)	(1,722)	(2,171)	(125)	(691)	-	(832)	461	-	-	-	-	-	-	-	(26,157)
Inventory and other assets	138	12,702	2,876	-	443	1,229	1,273	36	700	321	365	519	(394)	(9)	53	(7)	-	13	20,258	
Estimated third-party payor settlements	-	(2,718)	587	-	32	780	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,319)
Accounts payable and other current liabilities	1,138	(3,944)	917	1	382	622	458	(83)	(136)	70	(528)	(21)	13	248	(13)	8	7	167	(694)	
Self-insurance and other long-term liabilities	1,956	8,935	(509)	-	99	(104)	1,447	(61)	-	-	(219)	19	-	(10)	-	-	-	-	-	11,553
Amount due to (from) affiliates	(1,932)	2,091	(52)	-	394	(62)	400	(13)	150	(285)	(135)	(57)	-	(2)	(334)	(6)	-	(157)	-	
Equity in unconsolidated affiliates and foundation	-	(2,690)	(388)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,078	-	
Transfers to (from) related organizations	(12,030)	26,433	6,261	(2,090)	-	-	(14,786)	(3,716)	(450)	805	-	1,324	(1,476)	-	-	-	(275)	-	-	
Net cash provided by (used in) operating activities	15,730	77,351	17,322	(2,126)	13,357	11,629	(22,212)	(3,746)	(293)	1,332	278	748	(1,476)	(214)	65	11	(201)	23	107,578	
Cash flows from investing activities:																				
Acquisition of property and equipment	(4,123)	(18,086)	(9,713)	-	(1,387)	(1,125)	(1,148)	(35)	(234)	(5,989)	(679)	-	-	-	(74)	-	-	-	-	(42,593)
Proceeds on sale of property	-	23	48	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	71
(Deposits) withdrawals in investments, net	1,441	11,164	4,264	-	(9,000)	-	-	-	(284)	5,105	-	-	-	(2,197)	226	(50)	-	-	-	10,669
Other investment activity, net	(1,359)	509	(1,287)	-	158	446	(207)	-	237	132	(2)	-	-	(313)	(506)	(86)	15	-	-	(2,263)
Change in investment in partnerships	(23)	-	-	-	-	-	-	-	17	-	-	(426)	-	-	-	-	-	-	-	(432)
Net change in other assets	(58)	-	-	-	-	-	-	-	-	-	-	(1)	-	920	-	-	-	(23)	-	838
Net cash provided by (used in) investing activities	(4,122)	(6,390)	(6,688)	-	(10,229)	(679)	(1,355)	(35)	(264)	(752)	(681)	(427)	-	(1,590)	(354)	(136)	15	(23)	(33,710)	
Cash flows from financing activities:																				
Restricted contributions and other	-	503	-	-	-	-	-	-	-	-	38	-	-	753	79	126	190	-	-	1,689
Repayment of long-term debt	(5,379)	(18,743)	(1,511)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(25,633)
Distributions from beneficial interest in trusts	-	400	150	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	550
Transfers (to) from related organizations	(177)	(26,433)	(6,261)	2,090	-	-	27,279	3,716	450	(940)	-	(1,475)	1,476	-	-	-	275	-	-	-
Net cash provided by (used in) financing activities	(5,556)	(44,273)	(7,622)	2,090	-	-	27,279	3,716	450	(940)	38	(1,475)	1,476	753	79	126	465	-	-	(23,394)
Net increase (decrease) in cash and cash equivalents	6,052	26,688	3,012	(36)	3,128	10,950	3,712	(65)	(107)	(360)	(365)	(1,154)	-	(1,051)	(210)	1	279	-	-	50,474
Cash and cash equivalents, beginning of period	1,368	34,884	3,167	42	24,258	27,382	5,535	137	4,092	623	8,171	2,911	-	2,992	516	16	283	-	-	116,377
Cash and cash equivalents, end of period	\$ 7,420	\$ 61,572	\$ 6,179	\$ 6	\$ 27,386	\$ 38,332	\$ 9,247	\$ 72	\$ 3,985	\$ 263	\$ 7,806	\$ 1,757	\$ -	\$ 1,941	\$ 306	\$ 17	\$ 562	\$ -	\$ -	\$ 166,851

**MEMORIAL HEALTH SYSTEM
CONSOLIDATING BALANCE SHEET
SEPTEMBER 30, 2016**

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS*	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF		
Assets																			
Current assets:																			
Cash and cash equivalents	\$ 1,368	\$ 34,884	\$ 3,167	\$ 42	\$ 24,258	\$ 27,382	\$ 5,535	\$ 137	\$ 4,092	\$ 623	\$ 8,171	\$ 2,911	\$ -	\$ 2,992	\$ 516	\$ 16	\$ 283	\$ -	\$ 116,377
Short-term investments	34,798	78,235	4,266	-	11,890	1,628	-	-	7,137	-	245	-	-	-	-	4,166	-	-	142,365
Assets whose use is limited	216	6,056	-	-	1,129	484	-	-	-	249	-	-	-	-	-	-	-	-	8,134
Patient accounts receivable	-	118,881	19,790	630	9,807	8,592	7,034	879	672	-	5,660	2,016	-	-	-	-	-	-	173,961
Allowance for uncollectible accounts	-	(12,371)	(4,392)	(414)	(2,284)	(1,960)	(1,122)	(336)	(206)	-	(1,461)	(723)	-	-	-	-	-	-	(25,269)
Net patient accounts receivable	-	106,510	15,398	216	7,523	6,632	5,912	543	466	-	4,199	1,293	-	-	-	-	-	-	148,692
Receivables from third-party payors	-	14,018	432	-	-	85	-	-	-	-	-	-	-	-	-	-	-	-	14,535
Due from affiliates	1,195	2,607	-	-	346	3	158	-	53	-	3	11	-	5	-	-	-	(4,381)	-
Receivables held for sale	-	44,849	2,849	-	1,603	1,908	3,060	-	-	-	1,833	665	-	-	-	-	-	-	56,767
Other receivables	2,632	19,256	2,129	-	583	409	779	131	2,264	391	697	198	300	181	272	-	-	(493)	29,729
Inventories	-	10,216	1,611	-	612	503	969	-	-	-	356	-	-	-	-	-	-	-	14,267
Prepaid expenses	5,681	5,294	1,481	-	255	327	733	-	204	-	101	60	-	108	-	-	-	-	14,244
Total current assets	45,890	321,925	31,333	258	48,199	39,361	17,146	811	14,216	1,263	15,605	5,138	300	3,286	788	4,182	283	(4,874)	545,110
Long-term investments:																			
Unrestricted investments	-	167,796	69,483	-	32,357	3,284	-	-	-	-	-	-	-	12,425	20,994	-	3,471	-	309,810
Assets whose use is limited:																			
Self-insurance trusts	-	14,423	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	14,423
Donor restricted assets and other	-	990	3,540	-	-	-	-	-	504	5,812	-	-	-	9,206	-	230	501	-	20,783
Deferred compensation assets	8,500	2,984	529	-	-	-	9,084	-	-	-	-	-	-	-	-	-	-	-	21,097
Total assets whose use is limited	8,500	18,397	4,069	-	-	-	9,084	-	504	5,812	-	-	-	9,206	-	230	501	-	56,303
Total long-term investments	8,500	186,193	73,552	-	32,357	3,284	9,084	-	504	5,812	-	-	-	21,631	20,994	230	3,972	-	366,113
Net property, plant, and equipment	184,982	290,932	31,367	-	37,419	21,349	19,899	310	4,280	18,013	2,542	59	-	-	405	-	-	-	611,557
Other assets:																			
Investments in partnerships	787	24,468	4,165	-	-	-	-	-	29	-	-	10,558	-	-	-	-	-	(31,164)	8,843
Beneficial interest in trusts	-	37,631	17,508	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	55,139
Other	4,884	15,025	3,903	-	153	55	-	-	36	-	108	39	-	3,291	-	-	-	(52)	27,442
Total other assets	5,671	77,124	25,576	-	153	55	-	-	65	-	108	10,597	-	3,291	-	-	-	(31,216)	91,424
TOTAL ASSETS	\$ 245,043	\$ 876,174	\$ 161,828	\$ 258	\$ 118,128	\$ 64,049	\$ 46,129	\$ 1,121	\$ 19,065	\$ 25,088	\$ 18,255	\$ 15,794	\$ 300	\$ 28,208	\$ 22,187	\$ 4,412	\$ 4,255	\$ (36,090)	\$ 1,614,204
Liabilities and net assets																			
Current liabilities:																			
Long-term debt	\$ 5,378	\$ 4,743	\$ 1,510	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,631
Accounts payable	3,970	38,255	2,604	23	1,253	925	2,476	124	406	2,386	1,868	188	26	42	46	-	-	-	54,592
Accrued payroll	3,081	21,830	4,768	-	1,172	1,999	1,562	143	976	-	1,258	-	-	-	-	-	-	-	36,789
Interest payable	360	2,956	19	-	1,128	484	-	-	-	-	-	-	-	-	-	-	-	-	4,947
Due to affiliates	2,334	152	148	-	88	90	417	4	294	585	139	5	-	346	2	-	-	(4,604)	-
Payables to third-party payors	-	32,991	4,829	-	1,259	1,523	-	-	-	-	-	-	-	-	-	-	-	-	40,602
Other	3,873	6,957	625	-	96	76	2,891	-	325	66	237	29	-	877	-	5	-	(322)	15,735
Total current liabilities	18,996	107,884	14,503	23	4,996	5,097	7,346	271	2,001	3,037	3,502	222	26	919	392	7	-	(4,926)	164,296
Noncurrent liabilities:																			
Long-term debt obligations, net	101,482	267,003	22,862	-	41,555	17,807	-	-	-	-	-	-	-	-	-	-	-	-	450,709
Deferred compensation and benefits	9,272	2,984	529	-	-	-	9,390	-	-	-	-	-	-	-	-	-	-	-	22,175
Self-insurance accrued expenses	288	15,910	6,262	-	327	248	676	249	-	-	414	180	-	-	-	-	-	-	24,554
Accrued employee benefits	4,119	6,702	886	-	-	-	5,348	-	-	-	282	-	-	-	-	-	-	-	17,337
Pension obligations	9,991	22,641	-	-	-	-	2,028	-	-	-	-	-	-	-	-	-	-	-	34,660
Other	2,888	3,159	2,841	-	446	-	-	-	-	16,387	-	-	-	102	-	-	-	-	25,823
Total noncurrent liabilities	128,040	318,399	33,380	-	41,882	18,501	17,442	249	-	16,387	696	180	-	102	-	-	-	-	575,258
Total liabilities	147,036	426,283	47,883	23	46,878	23,598	24,788	520	2,001	19,424	4,198	402	26	1,021	392	7	-	(4,926)	739,554
Net assets:																			
Unrestricted	98,007	386,803	92,611	235	71,250	40,451	21,341	601	16,109	5,664	13,869	15,392	274	15,606	21,451	4,175	3,725	(6,255)	801,309
Temporarily restricted	-	63,088	609	-	-	-	-	-	955	-	105	-	-	6,500	344	180	118	(24,497)	47,402
Permanently restricted	-	-	20,725	-	-	-	-	-	-	-	83	-	-	5,081	-	50	412	(412)	25,939
Total net assets	98,007	449,891	113,945	235	71,250	40,451	21,341	601	17,064	5,664	14,057	15,392	274	27,187	21,795	4,405	4,255	(31,164)	874,650
TOTAL LIABILITIES AND NET ASSETS	\$ 245,043	\$ 876,174	\$ 161,828	\$ 258	\$ 118,128	\$ 64,049	\$ 46,129	\$ 1,121	\$ 19,065	\$ 25,088	\$ 18,255	\$ 15,794	\$ 300	\$ 28,208	\$ 22,187	\$ 4,412	\$ 4,255	\$ (36,090)	\$ 1,614,204

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2016

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER				FOUNDATIONS				ELIMIN- ATIONS	TOTAL		
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS*	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF			PAHF	
Gross patient service charges:																				
Inpatient charges	\$ -	\$ 1,133,362	\$ 105,052	\$ 2,764	\$ 16,137	\$ 17,622	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,274,937
Outpatient charges	-	1,080,213	232,591	7,390	103,429	83,715	98,175	10,041	15,616	-	36,501	25,136	-	-	-	-	-	-	(344)	1,692,463
Total gross patient service charges	-	2,213,575	337,643	10,154	119,566	101,337	98,175	10,041	15,616	-	36,501	25,136	-	-	-	-	-	-	(344)	2,967,400
Less charity	-	5,254	1,465	60	548	621	54	13	300	-	40	13	-	-	-	-	-	-	-	8,368
Less contractual allowances	-	1,608,366	241,310	7,515	71,101	57,079	54,967	5,939	1,760	-	11,264	16,561	-	-	-	-	-	-	-	2,075,862
Patient service revenues	-	599,955	94,868	2,579	47,917	43,637	43,154	4,089	13,556	-	25,197	8,562	-	-	-	-	-	-	(344)	883,170
Provision for uncollectible accounts	-	6,923	4,090	159	1,169	1,195	1,139	236	76	-	659	976	-	-	-	-	-	-	-	16,622
Net patient service revenues	-	593,032	90,778	2,420	46,748	42,442	42,015	3,853	13,480	-	24,538	7,586	-	-	-	-	-	-	(344)	866,548
Hospital access improvement payments	-	35,289	8,239	-	3,881	3,186	-	-	-	-	-	-	-	-	-	-	-	-	-	50,595
Capitation revenues	-	54,771	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	54,771
Other revenues:																				
Management fees	64,466	-	-	-	16	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(64,482)
Other	18,106	16,166	2,332	-	389	266	5,408	77	379	759	512	1,426	453	-	-	-	-	-	-	(11,767)
Total other revenues	82,572	16,166	2,332	-	405	266	5,408	77	379	759	512	1,426	453	-	-	-	-	-	-	(76,249)
Total revenues	82,572	699,258	101,349	2,420	51,034	45,894	47,423	3,930	13,859	759	25,050	9,012	453	-	-	-	-	-	(76,593)	1,006,420
Expenses:																				
Salaries and wages	29,083	208,024	37,100	2,569	15,126	14,500	17,932	5,124	9,578	67	12,686	2,228	1,018	-	-	-	-	-	-	355,035
Employee benefits	7,883	64,331	16,361	642	4,852	5,345	5,954	712	2,540	24	4,266	566	347	-	-	-	-	-	-	113,823
Physician fees	1,362	51,263	1,495	-	2,880	2,629	22,367	-	122	-	124	5,117	94	-	-	-	-	-	-	87,453
Utilities	3,074	7,821	1,188	-	564	651	922	44	352	84	214	21	11	-	-	-	-	-	(1,563)	13,383
Pharmaceutical supplies	-	27,530	3,500	-	1,225	1,077	3,250	53	21	-	309	139	-	-	-	-	-	-	-	37,104
Food	25	4,909	996	-	354	325	13	-	91	-	10	6	-	-	-	-	-	-	-	6,729
Patient service supplies	-	86,744	7,835	-	1,833	1,620	856	193	-	-	421	107	-	-	-	-	-	-	-	99,609
System management fee	-	52,174	877	-	1,621	1,503	5,177	-	602	-	647	268	1	-	-	-	-	-	(62,870)	-
Purchased services and other	21,861	68,900	13,626	1,462	4,254	4,480	8,497	1,340	1,928	436	3,559	1,460	148	-	-	-	-	-	(12,144)	119,807
Hospital provider assessment	-	16,516	2,236	-	904	750	-	-	-	-	-	-	-	-	-	-	-	-	-	20,406
Purchased medical services	-	32,928	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	32,928
Depreciation and amortization	15,925	39,456	2,913	-	4,362	2,823	1,313	61	381	250	1,166	4	-	-	-	-	-	-	-	68,654
Amortization of debt issuance expenses	57	290	6	-	134	58	-	-	-	46	-	-	-	-	-	-	-	-	-	591
Interest expense and other financing costs	3,302	7,776	385	-	2,260	968	14	-	-	132	-	-	-	-	-	-	-	-	-	14,837
Total expenses	82,572	668,662	88,518	4,673	40,369	36,729	66,295	7,527	15,615	1,039	23,402	9,916	1,619	-	-	-	-	-	(76,577)	970,359
Income (loss) from operations	-	30,596	12,831	(2,253)	10,665	9,165	(18,872)	(3,597)	(1,756)	(280)	1,648	(904)	(1,166)	-	-	-	-	-	(16)	36,061
% of total operating revenue	0%	4%	13%	-93%	21%	20%	-40%	-92%	-13%	-37%	7%	-10%	-257%	NA	NA	NA	NA	NA	NA	4%
Nonoperating gains (losses):																				
Interest and dividends	889	4,871	1,282	-	1,019	200	444	-	256	12	44	10	-	205	542	77	7	-	-	9,858
Realized gain (loss) on investments, net	918	7,511	553	-	43	60	-	-	7	-	-	-	-	(25)	(148)	(340)	10	-	-	8,589
Unrealized gains (loss) on investments, net	1,202	8,535	1,287	-	1,820	10	775	-	27	-	16	-	-	419	1,379	211	(325)	-	-	15,356
Gain (loss) on derivatives	(421)	(238)	(806)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,465)
Contributions	-	3	1,390	-	46	-	-	-	-	-	3	-	-	1,397	118	157	160	-	-	3,274
Equity in income of affiliate	-	-	(48)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	48	-
Provision for income taxes	-	-	-	-	-	-	-	-	-	-	(1,179)	-	-	-	-	-	-	-	-	(1,179)
Net periodic benefit cost	(1,564)	(7,226)	-	-	-	-	(960)	-	-	-	(379)	-	-	-	-	-	-	-	-	(10,129)
Other revenue (expense), net	(1,276)	(2,487)	500	-	-	-	(1,210)	-	-	-	-	-	-	(791)	(663)	(84)	(264)	16	-	(6,259)
Total nonoperating gains (losses), net	(252)	10,969	4,158	-	2,928	270	(951)	-	290	12	(1,495)	10	-	1,205	1,228	21	(412)	64	-	18,045
Excess (deficiency) of revenues over expenses	\$ (252)	\$ 41,565	\$ 16,989	\$ (2,253)	\$ 13,593	\$ 9,435	\$ (19,823)	\$ (3,597)	\$ (1,466)	\$ (268)	\$ 153	\$ (894)	\$ (1,166)	\$ 1,205	\$ 1,228	\$ 21	\$ (412)	\$ 48	\$ 48	\$ 54,106
Excess margin %	-0.3%	5.9%	16.1%	-93.1%	25.2%	20.4%	-42.7%	-91.5%	-10.4%	-34.8%	0.6%	-9.9%	-257.4%	NA	NA	NA	NA	NA	NA	5.3%

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2016

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL	
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS*	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF			
Unrestricted net assets:																				
Excess (deficiency) of revenues over expenses	\$ (252)	\$ 41,565	\$ 16,989	\$ (2,253)	\$ 13,593	\$ 9,435	\$ (19,823)	\$ (3,597)	\$ (1,466)	\$ (268)	\$ 153	\$ (894)	\$ (1,166)	\$ 1,205	\$ 1,228	\$ 21	\$ (412)	\$ 48	\$ 54,106	
Pension and other postretirement liability adjustments	(1,141)	(24,873)	-	-	-	-	(962)	-	-	-	-	-	-	-	-	-	-	-	(26,976)	
Amortization of ineffective portion of derivatives	9	189	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	198	
Other	471	-	-	-	-	-	-	-	(471)	-	-	-	90	-	-	-	-	-	90	
Transfers (to) related organizations	(59,538)	(29,794)	(8,579)	(2,390)	-	-	-	-	(2,030)	-	-	-	-	-	-	-	(12)	102,343	-	
Transfers from related organizations	29,197	28,642	2,402	4,621	-	-	20,525	3,581	675	8,433	-	2,320	1,445	125	-	-	377	(102,343)	-	
Increase (decrease) in unrestricted net assets	(31,254)	15,729	10,812	(22)	13,593	9,435	(260)	(16)	(791)	5,664	153	1,426	279	1,420	1,228	21	(47)	48	27,418	
Temporarily restricted net assets:																				
Contributions	-	467	-	-	-	-	-	-	-	-	54	-	-	404	109	73	237	-	1,344	
Net investment income gain (loss)	-	-	-	-	-	-	-	-	-	-	-	-	-	675	-	-	8	-	683	
Net assets released from restrictions (non-operating)	-	(1,549)	-	-	-	-	-	-	-	-	-	-	-	(1,196)	(126)	(20)	-	-	(2,891)	
Net assets released from restrictions (operating)	-	(446)	-	-	-	-	-	-	-	(48)	-	-	-	-	-	-	(1,100)	-	(1,594)	
Change in value of split-interest agreements	-	(81)	27	-	-	-	-	-	-	-	-	-	11	-	-	-	-	-	(43)	
Gain (loss) on interest in net assets of foundation	-	1,045	(864)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(181)	-	
Other	-	-	-	-	-	-	-	-	-	-	-	-	(165)	-	-	-	80	-	(85)	
Increase (decrease) in temporarily restricted net assets	-	(564)	(837)	-	-	-	-	-	-	-	6	-	-	(271)	(17)	53	(775)	(181)	(2,586)	
Permanently restricted net assets:																				
Contributions	-	-	-	-	-	-	-	-	-	-	-	-	-	13	-	-	5	-	18	
Net investment income gain (loss)	-	-	(2,299)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,299)	
Gain (loss) on interest in net assets of foundation	-	-	5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(5)	-	
Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(80)	-	(80)	
Increase (decrease) in permanently restricted net assets	-	-	(2,294)	-	-	-	-	-	-	-	-	-	-	13	-	-	(75)	(5)	(2,361)	
Increase (decrease) in net assets	(31,254)	15,165	7,681	(22)	13,593	9,435	(260)	(16)	(791)	5,664	159	1,426	279	1,162	1,211	74	(897)	(138)	22,471	
Net assets, beginning of period	129,261	434,726	106,264	257	57,657	31,016	21,601	617	17,855	-	13,898	13,966	(5)	26,025	20,584	4,331	5,152	(31,026)	852,179	
Net assets, end of period	\$ 98,007	\$ 449,891	\$ 113,945	\$ 235	\$ 71,250	\$ 40,451	\$ 21,341	\$ 601	\$ 17,064	\$ 5,664	\$ 14,057	\$ 15,392	\$ 274	\$ 27,187	\$ 21,795	\$ 4,405	\$ 4,255	\$ (31,164)	\$ 874,650	

**MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED SEPTEMBER 30, 2016**

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES						PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL
	MHS	MMC	PAH	CRNA	ALMH	TMH	MPS*	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF		
Cash flows from operating activities:																			
Changes in net assets	\$ (31,254)	\$ 15,165	\$ 7,681	\$ (22)	\$ 13,593	\$ 9,435	\$ (260)	\$ (16)	\$ (791)	\$ 5,664	\$ 159	\$ 1,426	\$ 279	\$ 1,162	\$ 1,211	\$ 74	\$ (897)	\$ (138)	\$ 22,471
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:																			
Non cash contributions	-	(686)	(420)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,106)
(Gain) loss on derivatives	421	238	806	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,465
Realized (gain) loss on investments, net	(918)	(7,511)	1,746	-	(43)	(60)	-	-	(7)	-	-	-	(97)	148	340	(18)	-	-	(6,420)
Unrealized (gain) loss on investments, net	(1,202)	(8,535)	(1,287)	-	(1,820)	(10)	(775)	-	(27)	-	(16)	-	(972)	(1,379)	(211)	325	-	-	(15,909)
Restricted contributions and other (Increase) decrease in beneficial interest in trusts	-	(467)	-	-	-	-	-	-	-	(54)	-	-	(417)	(109)	(73)	(242)	-	-	(1,362)
Depreciation and amortization	15,925	39,456	2,913	-	4,362	2,823	1,313	61	381	250	1,166	4	-	-	-	-	-	-	68,654
Amortization of debt issuance costs	57	290	6	-	134	58	-	-	-	46	-	-	-	-	-	-	-	-	591
(Gain) loss on disposal of assets	-	155	24	-	(91)	-	7	-	-	-	-	-	-	-	-	-	-	-	95
Provision for uncollectible accounts	-	6,923	4,090	159	1,169	1,195	1,139	236	76	-	659	976	-	-	-	-	-	-	16,622
Pension obligations	1,141	24,873	-	-	-	-	962	-	-	-	-	-	-	-	-	-	-	-	26,976
Changes in assets and liabilities:																			
Accounts receivable	-	(667)	(8,267)	(108)	(3,275)	(2,977)	(779)	(234)	(686)	-	490	(689)	-	-	-	2	2	-	(17,188)
Inventory and other assets	(630)	(50,003)	(2,932)	-	(1,751)	(1,971)	(3,147)	(27)	(16)	(391)	(1,974)	(611)	(300)	118	51	-	-	(26)	(63,610)
Estimated third-party payor settlements	-	(1,298)	729	-	(3,193)	(610)	-	-	-	-	-	-	-	-	-	-	-	-	(4,372)
Accounts payable and other current liabilities	(2,039)	(10,450)	(1,992)	10	(229)	(337)	374	(31)	524	68	(161)	(84)	21	45	(10)	-	(45)	309	(14,027)
Self-insurance and other long-term liabilities	220	(61,372)	1,377	-	(29)	(18)	1,483	57	-	-	51	74	-	(5)	-	-	-	-	(58,162)
Amount due to (from) affiliates	1,252	(2,693)	126	-	(229)	89	381	4	241	585	167	60	-	(9)	294	(6)	-	(262)	-
Equity in unconsolidated affiliates and foundation	-	(1,045)	907	-	-	-	-	-	-	-	-	-	-	-	-	-	-	138	-
Transfers to (from) related organizations	29,871	1,152	6,177	(2,231)	-	-	(20,525)	(3,581)	(675)	(5,932)	-	(2,320)	(1,445)	(125)	-	-	(366)	-	-
Net cash provided by (used in) operating activities	12,844	(55,708)	13,759	(2,192)	8,598	7,617	(19,827)	(3,531)	(980)	290	487	(1,164)	(1,445)	(300)	206	126	(1,241)	21	(42,440)
Cash flows from investing activities:																			
Acquisition of property and equipment	(21,686)	(35,507)	(9,516)	-	(2,432)	(1,222)	(1,861)	(87)	(358)	(7,916)	(759)	-	-	(405)	-	-	-	8	(81,741)
Proceeds on sale of property	-	45	-	-	175	-	4	-	-	-	-	-	8	-	-	-	-	(8)	224
(Deposits) withdrawals in investments, net	4,920	38,078	-	-	(9,000)	-	-	-	(244)	(6,205)	-	-	-	649	(484)	-	-	-	27,714
Other investment activity, net	(398)	(16,432)	661	-	(796)	(52)	1,949	-	(11)	144	(2)	-	(204)	(559)	155	672	-	-	(14,873)
Change in investment in partnerships	27	-	-	-	-	-	-	-	12	-	-	(976)	-	-	-	-	-	-	(937)
Net change in other assets	241	-	-	-	-	-	-	-	-	-	-	-	644	-	-	-	-	(21)	864
Net cash provided by (used in) investing activities	(16,896)	(13,816)	(8,855)	-	(12,053)	(1,274)	92	(87)	(601)	(13,977)	(761)	(976)	-	448	(315)	(329)	672	(21)	(68,749)
Cash flows from financing activities:																			
Restricted contributions and other	-	467	-	-	-	-	-	-	-	-	54	-	-	417	109	73	242	-	1,362
Repayment of long-term debt	(5,369)	(4,648)	(22,940)	-	(128)	(55)	(4,245)	-	-	-	-	-	-	-	-	-	-	-	(37,385)
Issuance of long-term debt	-	60,000	22,778	-	-	-	-	-	-	16,770	-	-	-	-	-	-	-	-	99,548
Payment of debt issuance costs, net of premium	-	(65)	(65)	-	-	-	-	-	-	(429)	-	-	-	-	-	-	-	-	(559)
Distributions from beneficial interest in trusts	-	863	193	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,056
Transfers (to) from related organizations	(21,908)	(1,152)	(6,177)	2,231	-	-	20,525	3,581	675	(2,031)	-	2,320	1,445	125	-	-	366	-	-
Net cash provided by (used in) financing activities	(27,277)	55,465	(6,211)	2,231	(128)	(55)	16,280	3,581	675	14,310	54	2,320	1,445	542	109	73	608	-	64,022
Net increase (decrease) in cash and cash equivalents	(31,329)	(14,059)	(1,307)	39	(3,583)	6,288	(3,455)	(37)	(906)	623	(220)	180	-	690	-	(130)	39	-	(47,167)
Cash and cash equivalents, beginning of period	32,697	48,943	4,474	3	27,841	21,094	8,990	174	4,998	-	8,391	2,731	-	2,302	516	146	244	-	163,544
Cash and cash equivalents, end of period	\$ 1,368	\$ 34,884	\$ 3,167	\$ 42	\$ 24,258	\$ 27,382	\$ 5,535	\$ 137	\$ 4,092	\$ 623	\$ 8,171	\$ 2,911	\$ -	\$ 2,992	\$ 516	\$ 16	\$ 283	\$ -	\$ 116,377

MEMORIAL HEALTH SYSTEM
BALANCE SHEET
SEPTEMBER 30, 2017
(dollars in thousands)

Assets	MHS	MMC	Eliminations	OBLIGATED GROUP TOTAL	NON- OBLIGATED GROUP TOTAL	CONSOLIDATED TOTAL
Current assets:						
Cash and cash equivalents	\$ 7,420	\$ 61,572	\$ –	\$ 68,992	\$ 97,859	\$ 166,851
Short-term investments	37,293	86,862	–	124,155	33,788	157,943
Assets whose use is limited-current portion	–	4,218	–	4,218	204	4,422
Patient accounts receivable	–	123,442	–	123,442	59,153	182,595
Allowance for uncollectible accounts	–	(13,191)	–	(13,191)	(12,943)	(26,134)
Net patient accounts receivable	–	110,251	–	110,251	46,210	156,461
Receivables from third-party payors	–	15,176	–	15,176	262	15,438
Due from affiliates	854	502	(129)	1,227	(1,227)	–
Receivables held for sale	–	24,336	–	24,336	6,017	30,353
Other receivables	2,077	14,349	–	16,426	7,117	23,543
Inventories	–	9,283	–	9,283	4,037	13,320
Prepaid expenses	6,205	5,983	–	12,188	2,227	14,415
Total current assets	53,849	332,532	(129)	386,252	196,494	582,746
Long-term investments:						
Unrestricted investments	–	185,658	–	185,658	162,953	348,611
Assets whose use is limited:						
Self-insurance trusts	–	13,694	–	13,694	–	13,694
Donor restricted assets and other	–	1,027	–	1,027	15,270	16,297
Deferred compensation assets	9,773	3,384	–	13,157	10,719	23,876
Total assets whose use is limited	9,773	18,105	–	27,878	25,989	53,867
Total long-term investments	9,773	203,763	–	213,536	188,942	402,478
Net property, plant, and equipment	185,036	274,098	–	459,134	126,005	585,139
Other assets:						
Investments in partnerships	810	27,158	–	27,968	(18,693)	9,275
Beneficial interest in trusts	–	31,342	–	31,342	17,670	49,012
Other	16,624	27,987	(8,969)	35,642	4,420	40,062
Total other assets	17,434	86,487	(8,969)	94,952	3,397	98,349
TOTAL ASSETS	\$ 266,092	\$ 896,880	\$ (9,098)	\$ 1,153,874	\$ 514,838	\$ 1,668,712
Liabilities and net assets						
Current liabilities:						
Long-term debt	\$ 5,920	\$ 5,852	\$ –	\$ 11,772	\$ 1,959	\$ 13,731
Accounts payable	3,995	37,621	–	41,616	9,890	51,506
Accrued payroll	4,781	22,352	–	27,133	13,895	41,028
Interest payable	598	3,020	–	3,618	1,640	5,258
Due to affiliates	26	138	(129)	35	(35)	–
Payables to third-party payors	–	31,431	–	31,431	8,755	40,186
Other	4,754	5,894	–	10,648	4,724	15,372
Total current liabilities	20,074	106,308	(129)	126,253	40,828	167,081
Noncurrent liabilities:						
Long-term debt obligations, net	95,618	247,448	–	343,066	80,463	423,529
Deferred compensation and benefits	10,689	3,384	–	14,073	11,025	25,098
Self-insurance accrued expenses	218	12,581	–	12,799	5,270	18,069
Accrued employee benefits	3,862	5,738	–	9,600	8,352	17,952
Pension obligations	10,009	2,372	–	12,381	2,304	14,685
Other	12,994	2,618	(8,969)	6,643	17,002	23,645
Total noncurrent liabilities	133,390	274,141	(8,969)	398,562	124,416	522,978
Total liabilities	153,464	380,449	(9,098)	524,815	165,244	690,059
Net assets:						
Unrestricted	112,628	456,904	–	569,532	341,050	910,582
Temporarily restricted	–	59,527	–	59,527	(17,575)	41,952
Permanently restricted	–	–	–	–	26,119	26,119
Total net assets	112,628	516,431	–	629,059	349,594	978,653
TOTAL LIABILITIES AND NET ASSETS	\$ 266,092	\$ 896,880	\$ (9,098)	\$ 1,153,874	\$ 514,838	\$ 1,668,712

MEMORIAL HEALTH SYSTEM
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED
SEPTEMBER 30, 2017

(dollars in thousands)

	MHS	MMC	Eliminations	OBLIGATED GROUP TOTAL	NON- OBLIGATED GROUP TOTAL	CONSOLIDATED TOTAL
Gross patient service charges:						
Inpatient charges	\$ -	\$ 1,151,958	\$ -	\$ 1,151,958	\$ 159,311	\$ 1,311,269
Outpatient charges	-	1,072,983	-	1,072,983	648,331	1,721,314
Total gross patient service charges	-	2,224,941	-	2,224,941	807,642	3,032,583
Less charity	-	7,946	-	7,946	4,071	12,017
Less contractual allowances	-	1,635,606	-	1,635,606	514,455	2,150,061
Patient service revenues	-	581,389	-	581,389	289,116	870,505
Provision for uncollectible accounts	-	8,597	-	8,597	9,791	18,388
Net patient service revenues	-	572,792	-	572,792	279,325	852,117
Hospital access improvement payments	-	37,587	-	37,587	16,445	54,032
Capitation revenues	-	56,856	-	56,856	-	56,856
Other revenues:						
Management fees	62,487	-	(48,602)	13,885	(13,885)	-
Other	17,507	15,012	(2,888)	29,631	3,120	32,751
Total other revenues	79,994	15,012	(51,490)	43,516	(10,765)	32,751
Total revenues	79,994	682,247	(51,490)	710,751	285,005	995,756
Expenses:						
Salaries and wages	30,165	212,047	-	242,212	125,227	367,439
Employee benefits	7,385	56,213	-	63,598	40,022	103,620
Physician fees	1,498	51,182	-	52,680	43,052	95,732
Utilities	3,045	7,856	(1,376)	9,525	4,024	13,549
Pharmaceutical supplies	-	28,270	-	28,270	10,375	38,645
Food	36	4,494	-	4,530	1,849	6,379
Patient service supplies	-	84,497	-	84,497	14,349	98,846
System management fee	-	47,226	(47,226)	-	-	-
Purchased services and other	17,526	62,230	(2,888)	76,868	27,913	104,781
Hospital provider assessment	-	18,238	-	18,238	4,231	22,469
Purchased medical services	-	30,843	-	30,843	-	30,843
Depreciation and amortization	16,845	37,360	-	54,205	14,981	69,186
Amortization of bond issuance expenses	57	297	-	354	260	614
Interest expense and other financing costs	3,437	9,086	-	12,523	3,756	16,279
Total expenses	79,994	649,839	(51,490)	678,343	290,039	968,382
Income (loss) from operations	-	32,408	-	32,408	(5,034)	27,374
Nonoperating gains (losses):						
Interest and dividends	673	2,975	-	3,648	4,288	7,936
Realized gain (loss) on investments, net	1,779	16,356	-	18,135	2,662	20,797
Unrealized gain (loss) on investments, net	1,781	17,933	-	19,714	12,889	32,603
Gain (loss) on derivatives	367	337	-	704	(110)	594
Contributions	-	33	-	33	1,950	1,983
Provision for income taxes	-	-	-	-	(679)	(679)
Net periodic benefit cost	(1,620)	(6,138)	-	(7,758)	(3,755)	(11,513)
Other revenue (expense), net	(1,496)	(198)	-	(1,694)	(2,741)	(4,435)
Total nonoperating gains (losses), net	1,484	31,298	-	32,782	14,504	47,286
Excess of revenues over expenses	\$ 1,484	\$ 63,706	\$ -	\$ 65,190	\$ 9,470	\$ 74,660

MEMORIAL HEALTH SYSTEM
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED
SEPTEMBER 30, 2017

(dollars in thousands)

	<u>MHS</u>	<u>MMC</u>	<u>Eliminations</u>	<u>OBLIGATED GROUP TOTAL</u>	<u>NON- OBLIGATED GROUP TOTAL</u>	<u>CONSOLIDATED TOTAL</u>
Unrestricted net assets:						
Excess of revenues over expenses	\$ 1,484	\$ 63,706	\$ –	\$ 65,190	\$ 9,470	\$ 74,660
Pension and other postretirement liability adjustments	1,098	32,897	–	33,995	542	34,537
Amortization of ineffective portion of derivatives	9	(69)	–	(60)	–	(60)
Other	(135)	–	–	(135)	271	136
Transfers (to) related organizations	(30,268)	(28,573)	28,048	(30,793)	30,793	–
Transfers from related organizations	42,433	2,140	(28,048)	16,525	(16,525)	–
Increase (decrease) in unrestricted net assets	<u>14,621</u>	<u>70,101</u>	<u>–</u>	<u>84,722</u>	<u>24,551</u>	<u>109,273</u>
Temporarily restricted net assets:						
Contributions	–	503	–	503	1,168	1,671
Net investment income gain (loss)	–	–	–	–	1,357	1,357
Net assets released from restrictions (non-operating)	–	(2,547)	–	(2,547)	(1,316)	(3,863)
Net assets released from restrictions (operating)	–	(465)	–	(465)	(124)	(589)
Change in value of split-interest agreements	–	(3,742)	–	(3,742)	28	(3,714)
Gain (loss) on interest in net assets of foundation	–	2,690	–	2,690	(2,690)	–
Other	–	–	–	–	(312)	(312)
Increase (decrease) in temporarily restricted net assets	<u>–</u>	<u>(3,561)</u>	<u>–</u>	<u>(3,561)</u>	<u>(1,889)</u>	<u>(5,450)</u>
Permanently restricted net assets:						
Contributions	–	–	–	–	18	18
Net investment income gain (loss)	–	–	–	–	162	162
Increase (decrease) in permanently restricted net assets	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>180</u>	<u>180</u>
Increase (decrease) in net assets	14,621	66,540	–	81,161	22,842	104,003
Net assets, beginning of period	98,007	449,891	–	547,898	326,752	874,650
Net assets, end of period	<u>\$ 112,628</u>	<u>\$ 516,431</u>	<u>\$ –</u>	<u>\$ 629,059</u>	<u>\$ 349,594</u>	<u>\$ 978,653</u>

MEMORIAL HEALTH SYSTEM
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED
SEPTEMBER 30, 2017

(dollars in thousands)

	<u>MHS</u>	<u>MMC</u>	<u>OBLIGATED GROUP TOTAL</u>	<u>NON- OBLIGATED GROUP TOTAL</u>	<u>CONSOLIDATED TOTAL</u>
Cash flows from operating activities:					
Changes in net assets	\$ 14,621	\$ 66,540	\$ 81,161	\$ 22,842	\$ 104,003
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:					
Non cash contribution	–	(2,147)	(2,147)	(496)	(2,643)
(Gain) loss on derivatives	(367)	(337)	(704)	110	(594)
Realized (gain) loss on investments, net	(1,779)	(16,356)	(18,135)	(3,173)	(21,308)
Unrealized (gain) loss on investments, net	(1,781)	(17,933)	(19,714)	(13,897)	(33,611)
Restricted contributions and other	–	(503)	(503)	(1,186)	(1,689)
(Increase) decrease in beneficial interest in trusts	–	5,889	5,889	(312)	5,577
Depreciation and amortization	16,845	37,360	54,205	14,981	69,186
Amortization of debt issuance costs	57	297	354	260	614
(Gain) loss on disposal of assets	(38)	370	332	219	551
Provision for uncollectible accounts	–	8,597	8,597	9,791	18,388
Pension obligations	(1,098)	(32,897)	(33,995)	(542)	(34,537)
Changes in assets and liabilities:					
Accounts receivable	–	(12,338)	(12,338)	(13,819)	(26,157)
Inventory and other assets	138	12,702	12,840	7,418	20,258
Estimated third-party payor settlements	–	(2,718)	(2,718)	1,399	(1,319)
Accounts payable and other current liabilities	1,138	(3,944)	(2,806)	2,112	(694)
Self-insurance and other long-term liabilities	1,956	8,935	10,891	662	11,553
Amount due to (from) affiliates	(1,932)	2,091	159	(159)	–
Equity in unconsolidated affiliates and foundation	–	(2,690)	(2,690)	2,690	–
Transfers to (from) related organizations	(12,030)	26,433	14,403	(14,403)	–
Net cash provided by (used in) operating activities	<u>15,730</u>	<u>77,351</u>	<u>93,081</u>	<u>14,497</u>	<u>107,578</u>
Cash flows from investing activities:					
Acquisition of property and equipment	(4,123)	(18,086)	(22,209)	(20,384)	(42,593)
Proceeds on sale of property	–	23	23	48	71
(Deposits) withdrawals in investments, net	1,441	11,164	12,605	(1,936)	10,669
Other investment activity, net	(1,359)	509	(850)	(1,413)	(2,263)
Change in investment in partnerships	(23)	–	(23)	(409)	(432)
Net change in other assets	(58)	–	(58)	896	838
Net cash provided by (used in) investing activities	<u>(4,122)</u>	<u>(6,390)</u>	<u>(10,512)</u>	<u>(23,198)</u>	<u>(33,710)</u>
Cash flows from financing activities:					
Restricted contributions and other	–	503	503	1,186	1,689
Repayment of long-term debt	(5,379)	(18,743)	(24,122)	(1,511)	(25,633)
Distributions from beneficial interest in trusts	–	400	400	150	550
Transfers (to) from related organizations	(177)	(26,433)	(26,610)	26,610	–
Net cash provided by (used in) financing activities	<u>(5,556)</u>	<u>(44,273)</u>	<u>(49,829)</u>	<u>26,435</u>	<u>(23,394)</u>
Net increase (decrease) in cash and cash equivalents	6,052	26,688	32,740	17,734	50,474
Cash and cash equivalents, beginning of period	1,368	34,884	36,252	80,125	116,377
Cash and cash equivalents, end of period	<u>\$ 7,420</u>	<u>\$ 61,572</u>	<u>\$ 68,992</u>	<u>\$ 97,859</u>	<u>\$ 166,851</u>

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