

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Memorial Health System and Subsidiaries
Years Ended September 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Memorial Health System and Subsidiaries
Consolidated Financial Statements and Supplementary Information
Years Ended September 30, 2018 and 2017

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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, 2018 and 2017, and the related consolidated statements of operations and changes in nets 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, 2018 and 2017, 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 consolidated financial statements as a whole. The accompanying Consolidating Balance Sheet, Consolidated Statement of Operations and Changes in Net assets, and Consolidating Statement of Cash Flows 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 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst + Young LLP

December 17, 2018

Memorial Health System and Subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands)

	September 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 79,397	\$ 166,851
Short-term investments	116,064	157,943
Assets whose use is limited	3,033	4,422
Receivables:		
Patient accounts receivable, net of allowance for uncollectible accounts of \$21,733 and \$26,134 as of September 30, 2018 and 2017, respectively	137,366	156,461
Receivables from third-party payors	13,620	15,438
Receivables held for sale	6,636	30,353
Other receivables	22,551	23,543
Inventories	14,558	13,320
Prepaid expenses	13,380	14,415
Total current assets	406,605	582,746
Long-term investments:		
Unrestricted investments	579,903	348,611
Assets whose use is limited	43,847	53,867
Total long-term investments	623,750	402,478
Property, plant, and equipment, net	573,422	585,139
Other assets:		
Investments in partnerships	7,577	9,275
Beneficial interest in trusts	46,111	49,012
Other	40,714	40,062
Total other assets	94,402	98,349
Total assets	\$ 1,698,179	\$ 1,668,712

Memorial Health System and Subsidiaries

Consolidated Balance Sheets (continued)

(Dollars in Thousands)

	September 30	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Long-term debt	\$ 12,945	\$ 13,731
Accounts payable	58,650	51,506
Accrued payroll	44,104	41,028
Interest payable	5,093	5,258
Payables to third-party payors	43,816	40,186
Other	16,268	15,372
Total current liabilities	180,876	167,081
Noncurrent liabilities:		
Long-term debt obligations, net	371,059	423,529
Deferred compensation and benefits	17,268	25,098
Self-insurance accrued expenses	18,243	18,069
Accrued employee benefits	17,772	17,952
Pension obligations	6,027	14,685
Other	25,003	23,645
Total noncurrent liabilities	455,372	522,978
Total liabilities	636,248	690,059
Net assets:		
Without donor restrictions	996,921	910,582
With donor restrictions	65,010	68,071
Total net assets	1,061,931	978,653
Total liabilities and net assets	\$ 1,698,179	\$ 1,668,712

See accompanying notes.

Memorial Health System and Subsidiaries

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

	Years Ended September 30	
	2018	2017
Revenues:		
Patient service revenues	\$ 890,975	\$ 870,505
Provision for uncollectible accounts	(12,589)	(18,388)
Net patient service revenues	878,386	852,117
Hospital access improvement payments	51,651	54,032
Capitation revenues	60,043	56,856
Other revenues	30,232	32,751
Total revenues	1,020,312	995,756
Expenses:		
Salaries and wages	371,796	367,439
Employee benefits	107,388	103,620
Physician fees	91,966	95,732
Utilities	13,442	13,549
Pharmaceutical supplies	38,793	38,645
Patient service supplies	98,003	98,846
Purchased services and other	117,945	111,160
Hospital provider assessment	24,640	22,469
Purchased medical services	36,375	30,843
Depreciation and amortization	68,381	69,186
Interest expense and other financing costs	17,149	16,893
Total expenses	985,878	968,382
Income from operations	34,434	27,374
Nonoperating gains (losses):		
Interest and dividends	10,481	7,936
Realized gain (loss) on investments, net	60,201	20,797
Unrealized gain (loss) on investments, net	(29,133)	32,603
Gain (loss) on derivatives	796	594
Net periodic benefit cost	(7,947)	(11,513)
Other revenue (expense), net	(2,585)	(3,131)
Total nonoperating gains (losses), net	31,813	47,286
Excess of revenues over expenses	\$ 66,247	\$ 74,660

Memorial Health System and Subsidiaries

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

	Years Ended September 30	
	2018	2017
Net assets without donor restrictions:		
Excess of revenues over expenses	\$ 66,247	\$ 74,660
Pension and other postretirement liability adjustments	19,920	34,537
Other	172	76
Increase (decrease) in net assets without donor restrictions	86,339	109,273
Net assets with donor restrictions:		
Contributions	979	1,689
Net investment gain (loss)	1,110	1,519
Net assets released from restrictions	(4,772)	(4,452)
Change in fair value of split interest agreements	(111)	(3,714)
Other	(267)	(312)
Increase (decrease) in net assets with donor restrictions	(3,061)	(5,270)
Increase (decrease) in net assets	83,278	104,003
Net assets, beginning of year	978,653	874,650
Net assets, end of year	\$ 1,061,931	\$ 978,653

See accompanying notes.

Memorial Health System and Subsidiaries

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	Years Ended September 30	
	2018	2017
Operating activities		
Change in net assets	\$ 83,278	\$ 104,003
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
(Gain) loss on derivatives	(796)	(594)
Realized (gain) loss on investments, net	(60,841)	(21,308)
Unrealized (gain) loss on investments, net	28,908	(33,611)
Restricted contributions and other	(979)	(1,689)
Unrealized (gain) loss on beneficial interest in trusts	(158)	2,934
Depreciation and amortization	68,381	69,186
Amortization of debt issuance costs	615	614
(Gain) loss on disposal of assets	865	551
Provision for uncollectible accounts	12,589	18,388
Pension obligations	(19,920)	(34,537)
Changes in assets and liabilities:		
Accounts receivable	6,506	(26,157)
Inventory and other assets	25,313	20,258
Estimated third-party payor settlements	5,448	(1,319)
Accounts payable and other current liabilities	11,317	(694)
Self-insurance and other long-term liabilities	(7,067)	11,553
Net cash provided by (used in) operating activities	153,459	107,578
Investing activities		
Acquisition of property and equipment	(59,406)	(42,593)
Proceeds on sale of property	1,341	71
Investments classified as trading, net	(133,646)	8,406
Change in investment in partnerships	1,698	(432)
Net change in other assets	1,082	838
Net cash provided by (used in) investing activities	\$ (188,931)	\$ (33,710)

Memorial Health System and Subsidiaries

Consolidated Statements of Cash Flows (continued)

(Dollars in Thousands)

	Years Ended September 30	
	2018	2017
Financing activities		
Restricted contributions and other	\$ 979	\$ 1,689
Repayment of long-term debt	(53,809)	(25,633)
Distributions from beneficial interest in trusts	848	550
Net cash provided by (used in) financing activities	<u>(51,982)</u>	<u>(23,394)</u>
Net increase (decrease) in cash and cash equivalents	(87,454)	50,474
Cash and cash equivalents, beginning of year	166,851	116,377
Cash and cash equivalents, end of year	<u>\$ 79,397</u>	<u>\$ 166,851</u>
Supplemental disclosure of cash flow information		
Cash paid for interest	<u>\$ 16,417</u>	<u>\$ 15,689</u>
Non-cash investing activity		
Contributions of land	<u>\$ 2,211</u>	<u>\$ 2,643</u>

See accompanying notes.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars in Thousands)

September 30, 2018 and 2017

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

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.

Available Resources and Liquidity

MHS considers all cash and cash equivalents, short-term investments, and unrestricted investments to be financial assets available and free from restriction to meet cash needs for operating activities of MHS within one year of September 30, 2018.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

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 net assets without donor restrictions or net assets with donor restrictions based on the terms of the applicable trust agreement. Beneficial interest in the trusts totaled \$46,111 and \$49,012 as of September 30, 2018 and 2017, respectively, and is equal to the estimated fair value of the underlying trust assets (primarily Illinois farmland). Trust distributions were \$3,059 and \$3,193 in 2018 and 2017, 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 with donor restrictions and without donor restrictions based on the existence or absence of donor-imposed restrictions. Net assets with donor restrictions consist of net assets whose use by MHS has been limited by donors to a specific time period or for a particular purpose or 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.

As of September 30, 2018 and 2017, MHS's endowments consist of 55 and 56, respectively, 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.

The endowment net asset composition by type of fund consisted of the following as of September 30, 2018:

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total
Donor-restricted endowment funds	\$ —	\$ 8,613	\$ 8,613
Board-designated endowments funds	1,326	—	1,326
Total endowment funds	<u>\$ 1,326</u>	<u>\$ 8,613</u>	<u>\$ 9,939</u>

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

The endowment net asset composition by type of fund consisted of the following as of September 30, 2017:

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total
Donor-restricted endowment funds	\$ —	\$ 8,647	\$ 8,647
Board-designated endowments funds	1,274	—	1,274
Total endowment funds	\$ 1,274	\$ 8,647	\$ 9,921

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.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

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 \$2,053 and \$2,136 in 2018 and 2017, 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.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

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. MHS had no asset impairment for the years ended September 30, 2018 or 2017.

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 \$9,355 and \$8,961 for the years ended September 30, 2018 and 2017, respectively. MHS calculates the unpaid cost of services by payor using an activity-based costing methodology.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

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 net assets with donor restrictions 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, net assets with donor restrictions are reclassified to net assets without donor restrictions 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 in the Other revenue (expense), net line item in the nonoperating gains (losses) section of the consolidated statements of operations and changes in net assets.

Performance Indicator

MHS's performance indicator excess of revenues over expenses includes all changes in net assets without donor restrictions other than net assets released from restrictions for property acquisitions and pension and other postretirement liability adjustments.

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, net periodic benefit cost, and other revenues and expenses not related to patient care.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Functional Classification of 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. However, there are certain costs not directly attributable to health care services, including certain salaries and benefits, depreciation, and other costs. These costs are allocated to Management, general and administrative on a reasonable basis that is consistently applied. Expenses by functional classification consist of the following:

	Years Ended September 30	
	2018	2017
Health care services	\$ 818,279	\$ 803,757
Management, general and administrative	167,599	164,625
Total	<u>\$ 985,878</u>	<u>\$ 968,382</u>

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, 2018 or 2017.

MHS is no longer subject to income tax examinations for years prior to 2015.

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 August 2016, the FASB issued ASU 2016-14, Not-for-Profit Entities (Topic 958)—Presentation of Financial Statements of Not-for-Profit Entities. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include presentation of two classes of net assets versus the previously required three, presentation of expenses by their natural (e.g., salaries, benefits, supplies, etc.) and functional (e.g., specific program services) classification, enhanced disclosures regarding the available resources and liquidity, presentation of investment returns net of external and direct internal investment expenses, and allowance to use either the direct or indirect method of reporting cash flows provided by or used in operating activities, but is not required to present a reconciliation of changes in net assets to net operating activities when the direct method is used. ASU 2016-14 is effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018, with early adoption permitted. MHS early adopted ASU 2016-14, which had no impact on net assets.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820) —*Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*. The guidance affects fair value measurement disclosures only. Investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient provisions of ASC 820, Fair Value Measurement, are no longer required to be included within the fair value hierarchy leveling tables. ASU 2015-07 is effective for annual financial statements issued for fiscal years beginning after December 15, 2016, and for interim periods with those fiscal years with early adoption permitted. The adoption of ASU 2015-07 had no impact on net assets.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

Reclassifications

Certain amounts in the 2017 consolidated financial statements have been reclassified to conform to 2018 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, 2017, 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.

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

	Years Ended September 30	
	2018	2017
Agreement type		
Academic support provided	\$ 31,862	\$ 33,021
Grants and contributions provided	2,736	2,263
Medical Director/Chairman contracts provided	2,449	3,215
Administrative, clinical, recruitment, and other services provided	356	272
Lease revenues	5,339	4,925
Administrative and clinical service revenues	854	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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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 (46.2% and 45.8% of net patient service revenues in 2018 and 2017, respectively) at contractual rates generally below MHS's established rates.

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

	Years Ended September 30	
	2018	2017
Medicare	\$ 328,850	\$ 321,238
Medicaid	78,322	71,113
Managed care	204,782	196,838
BlueCross BlueShield	214,143	210,718
Other commercial payors	54,274	57,238
Patients	10,604	13,360
Total	<u>\$ 890,975</u>	<u>\$ 870,505</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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Revenues (continued)

The MHS allowance for uncollectible accounts as a percentage of accounts receivable was 13.7% and 14.3% as of September 30, 2018 and 2017, respectively. MHS's combined allowance for uncollectible accounts and charity care covers 71% of self-pay and patient responsibility accounts receivable for both September 30, 2018 and 2017.

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

	September 30	
	2018	2017
Medicare	24.9%	20.6%
Medicaid	12.8	22.0
Managed care	24.3	32.4
BlueCross BlueShield	20.3	13.0
Other commercial payors	13.7	9.3
Patients	4.0	2.7
Total	100.0%	100.0%

Net receivables percentages included in the table above exclude \$6,636 and \$30,353 in State of Illinois receivables classified as held for sale as of September 30, 2018 and 2017, respectively, and described in Note 5.

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 had 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 terminated on June 30, 2018.

Effective July 1, 2018, CMS authorized the State of Illinois to reform and modernize the present Hospital Assessment Program with Federal Matching Funds. The revised Hospital Assessment Program (Redesign Program) replaced the previously existing assessment programs that collectively expired on June 30, 2018.

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

	Years Ended September 30	
	2018	2017
Hospital access improvement payments:		
Program	\$ 19,963	\$ 26,617
Enhanced Program	7,101	9,468
ACA Expansion Program	10,125	17,947
Redesign Program	14,462	–
Subtotal	51,651	54,032
Hospital provider assessment:		
Program	9,850	13,252
Enhanced Program	4,646	6,225
ACA Expansion Program	3,016	2,992
Redesign Program	7,128	–
Subtotal	24,640	22,469
Net impact of Illinois Hospital Assessment Program	\$ 27,011	\$ 31,563

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 20,000 members of the network as of both September 30, 2018 and 2017. 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, 2018 and 2017, MHS has recognized a liability for covered medical claims of \$2,740 and \$2,140, 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 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, was 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 during 2018. MHS 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, and no balance remains as of September 30, 2018. Immediately after all party obligations under this transaction were satisfied, the Grantor Trust was dissolved and ceases to exist as of September 30, 2018.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

5. Sale of Receivables Held for Sale (continued)

In June 2018, the Sellers assigned its respective rights in \$19,667 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 IFP. MHS remained servicer of the transferred assets on behalf of IFP.

Terms of the transaction resulted in MHS receiving one hundred percent of its sold receivables in the form of cash consideration on the date of sale from IFP. The deferred purchase price totaling \$400 for accrued timely pay penalties owed by the State of Illinois on the sold receivables is owed to MHS by IFP upon payment of the sold receivables and associated timely pay penalties from the State of Illinois and satisfaction of all other obligations under the sale transaction agreement.

Also beginning in June 2018, the Sellers entered into a revolving weekly agreement to assign their respective rights in receivables held for sale as described in Note 2 to McDEKK. Subsequently, McDEKK transfers its newly assigned rights in those receivables to IFP. MHS remains servicer of the transferred assets on behalf of IFP.

Terms of the transaction result in MHS receiving one hundred percent of its sold receivables in the form of cash consideration on the date of sale from IFP. In exchange, MHS has assigned all of its rights in the associated timely pay penalties on assigned receivables to IFP.

MHS has no other continuing involvement with the sold receivables except the aforementioned deferred purchase price from IFP and its role as servicer over the transferred assets to IFP. The deferred purchase price represents the extent of MHS's maximum risk of loss in the transaction and MHS is paid reasonable compensation by IFP in its role as servicer. Management has determined the transfers meet the criteria to qualify for sale accounting under ASC 860 and has accordingly reported the receivables as sold as of September 30, 2018.

MHS has included certain accounts totaling \$6,636 and \$30,353 as of September 30, 2018 and 2017, 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 sheets. Receivable amounts classified as held for sale are valued based on the adjudicated claim value assigned by the insurance provider.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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 and Medicaid provide 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 and Medicaid 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					2017	
	2018						
	MMC	PAH	ALMH	TMH	All Other Affiliates	Total	Total
Unpaid cost of Medicaid	\$ 35,776	\$ 13,042	\$ 6,004	\$ 4,070	\$ 7,292	\$ 66,184	\$ 76,750
Unpaid cost of charity care	6,049	1,736	724	636	210	9,355	8,961
Subsidized health services	16,591	3,823	2,185	151	–	22,750	22,823
Other community benefits	40,532	400	188	139	1,035	42,294	45,111
Community benefit	98,948	19,001	9,101	4,996	8,537	140,583	153,645
Unpaid cost of Medicare	49,136	18,771	450	–	6,415	74,772	69,002
Subtotal	148,084	37,772	9,551	4,996	14,952	215,355	222,647
Hospital provider assessment, net	(16,915)	(4,488)	(3,017)	(2,591)	–	(27,011)	(31,563)
Total service to the community	<u>\$ 131,169</u>	<u>\$ 33,284</u>	<u>\$ 6,534</u>	<u>\$ 2,405</u>	<u>\$ 14,952</u>	<u>\$ 188,344</u>	<u>\$ 191,084</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	
	2018	2017
Cash and cash equivalents	\$ 34,159	\$ 24,703
Certificates of deposit	24,381	1,337
U.S. Treasury obligations	69,311	34,807
Government obligations	5,689	26,760
Corporate obligations	96,571	71,371
Domestic equities	78,215	172,570
International equities	15,875	17,874
Investment in farmland	27,811	25,370
Mutual funds	191,622	130,441
Equity – commingled funds	198,013	58,310
Accrued interest receivable and other	1,200	1,300
Short-term and long-term investments	\$ 742,847	\$ 564,843

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.

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, 2018:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 34,159	\$ –	\$ –	\$ 34,159
Certificates of deposit	–	24,381	–	24,381
U.S. Treasury obligations	69,311	–	–	69,311
Government obligations	–	5,689	–	5,689
Corporate obligations	–	96,571	–	96,571
Domestic equities	78,215	–	–	78,215
International equities	5,989	9,886	–	15,875
Investments in farmland	–	–	27,811	27,811
Mutual funds equities	191,622	–	–	191,622
Subtotal	379,296	136,527	27,811	543,634
Assets not at fair value:				
Assets measured at net asset value: ¹				
Equity – commingled funds				198,013
Accrued interest and dividends receivable				1,200
Short-term and long-term investments	379,296	136,527	27,811	742,847
Beneficial interest in trusts	–	–	46,111	46,111
Total assets	<u>\$ 379,296</u>	<u>\$ 136,527</u>	<u>\$ 73,922</u>	<u>\$ 788,958</u>
Liabilities				
Interest rate swaps	\$ –	\$ 2,667	\$ –	\$ 2,667

¹ – In accordance with Subtopic 820-10, certain investments that are measured at fair value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to amounts presented on the consolidated balance sheets.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

The following table presents the category, fair value, redemption frequency, and redemption notice period for assets, the fair values which are estimated using net asset value per share as of September 30, 2018:

<u>Assets</u>	<u>Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity – commingled funds ^a	\$ 146,996	\$ –	Weekly	3 days
Equity – commingled funds ^b	51,017	–	Monthly	10 – 30 days

^a – Includes investments in domestic large cap equity securities. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

^b – Includes investments in emerging market equity securities. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

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	\$ 24,703	\$ –	\$ –	\$ 24,703
Certificates of deposit	–	1,337	–	1,337
U.S. Treasury obligations	34,807	–	–	34,807
Government obligations	–	26,760	–	26,760
Corporate obligations	–	71,371	–	71,371
Domestic equities	172,570	–	–	172,570
International equities	17,874	–	–	17,874
Investments in farmland	–	–	25,370	25,370
Mutual funds equities	130,441	–	–	130,441
Subtotal	380,395	99,468	25,370	505,233
Assets not at fair value:				
Assets measured at net asset value: ¹				
Equity – commingled funds				58,310
Accrued interest and dividends receivable				1,300
Short-term and long-term investments	380,395	99,468	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>\$ 380,395</u>	<u>\$ 110,791</u>	<u>\$ 74,382</u>	<u>\$ 625,178</u>
Liabilities				
Interest rate swaps	\$ –	\$ 4,587	\$ –	\$ 4,587

¹ – In accordance with Subtopic 820-10, certain investments that are measured at fair value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to amounts presented on the consolidated balance sheets.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

The following table presents the category, fair value, redemption frequency, and redemption notice period for assets, the fair values which are estimated using net asset value per share as of September 30, 2017:

<u>Assets</u>	<u>Fair Value</u>	<u>Unfunded Commitment</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Equity – commingled funds ^a	\$ 22,574	\$ –	Monthly	30 days
Equity – commingled funds ^b	35,736	–	Monthly	10 – 30 days

^a – Includes investments in opportunistic equity securities. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

^b – Includes investments in emerging market equity securities. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

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, 2016 to September 30, 2018.

	<u>Beneficial Interest in Trusts</u>	<u>Investments in Farmland</u>	<u>Total</u>
Total as of October 1, 2016	\$ 55,139	\$ 23,213	\$ 78,352
Trust distribution	(3,193)	2,643	(550)
Contributions of farmland	–	198	198
Realized and unrealized gains (losses)	(2,934)	(684)	(3,618)
Total as of September 30, 2017	49,012	25,370	74,382
Trust distribution	(3,059)	2,211	(848)
Contributions of farmland	–	408	408
Realized and unrealized gains (losses)	158	(178)	(20)
Total as of September 30, 2018	<u>\$ 46,111</u>	<u>\$ 27,811</u>	<u>\$ 73,922</u>

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

	Years Ended September 30	
	2018	2017
Unrealized gains (losses) related to Level 3 financial instruments held	\$ (20)	\$ (3,618)

9. Property, Plant, and Equipment

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

	September 30	
	2018	2017
Land	\$ 35,301	\$ 36,344
Land improvements	57,804	56,996
Buildings	696,581	686,704
Equipment	366,845	359,596
Construction in progress	52,364	30,943
Subtotal	1,208,895	1,170,583
Less accumulated depreciation	635,473	585,444
Property, plant, and equipment, net	\$ 573,422	\$ 585,139

Capitalized interest was \$311 and \$47 for the years ended September 30, 2018 and 2017, respectively. Equipment under capital lease obligation was carried at \$1,056 and \$1,056, with accumulated depreciation of \$310 and \$239 as of September 30, 2018 and 2017, 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 (loss) from these investments in partnerships was (\$510) and \$387 for the years ended September 30, 2018 and 2017, 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:

	<u>Ownership</u>	Ownership at	September 30	
		September 30,	2018	2017
		2018	2018	2017
Rutledge Joint Ventures, LLC	MHV	50.0%	\$ 5,486	\$ 6,793
Orthopedic Surgery Center of Illinois, LLC	MHV	50.0	1,242	1,639
Mid-America Service Solutions, LLC	MHS	9.0	500	500
Lincoln Land Health Information Exchange	MHS	27.3	186	199
Memorial Employee Assistance Services	MBH	50.0	31	12
BJC Collaborative, LLC	MHS	25.0	105	105
WTA Laser, LLC	MHV	36.8	22	21
Midwest Healthcare Quality Alliance, LLC	MHS	55.2	5	6
Investments in partnerships			<u>\$ 7,577</u>	<u>\$ 9,275</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	
	2018	2017
Obligated Group:		
Tax-exempt Variable Rate Demand Revenue Bonds (Series 2003) at average annual variable interest rates of 1.20% and 0.68% for the years ended September 30, 2018 and 2017, respectively, secured by a letter of credit expiring on October 1, 2019.	\$ 15,080	\$ 17,470
Taxable Variable Rate Demand Revenue Bonds (Series 2004) at average annual variable interest rates of 1.66% and 0.92% for the years ended September 30, 2018 and 2017, respectively, secured by a letter of credit, expiring on October 1, 2019.	10,025	11,600
Tax-exempt Revenue Bonds (Series 2009) secured by pledged revenues of the MHS Obligated Group at an annual fixed interest rate of 5.00% as of September 30, 2018 and 2017.	85,208	85,948
Taxable Direct Note Obligation 2012C at a stated annual fixed interest rate of 4.3% as of September 30, 2018 and 2017.	49,557	51,860
Taxable Direct Note Obligation (Series 2013A) secured by pledged revenues of the MHS Obligated Group at an average variable interest rate of 1.92% for the year ended September 30, 2017, and retired in 2018.	–	26,225
Tax-exempt Revenue Bonds (Series 2014A) secured by pledged revenues of the MHS Obligated Group at an annual fixed interest rate of 5.00% as of September 30, 2018 and 2017.	57,805	58,930
Tax-Exempt Variable Rate Revenue Bonds (Series 2014B), privately placed, puttable starting in 2024, at an annual variable interest rate of 1.96% and 1.39% for the years ended September 30, 2018 and 2017, respectively.	57,565	58,805
Taxable Direct Note Obligation 2016 secured by pledged revenues of the MHS Obligated Group at an average variable rate of 2.13% and 1.82% for the years ended September 30, 2018 and 2017, respectively.	30,000	45,000
Obligated Group debt subtotal	\$ 305,240	\$ 355,838

Memorial Health System and Subsidiaries

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

11. Long-Term Debt Obligations (continued)

	September 30	
	2018	2017
Other Entities:		
Indenture issued to ALMH 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 5.00% as of September 30, 2018 and 2017.	\$ 41,530	\$ 41,890
Indenture issued to TMH 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 5.00% as of September 30, 2018 and 2017.	17,797	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 2.10% and 1.29% for the years ended September 30, 2018 and 2017, respectively.	20,224	21,511
Notes payable	—	1,409
Total long-term obligations	384,791	438,600
Less current installments of long-term obligations	12,945	13,731
Less unamortized debt issuance costs, discounts, and premiums	787	1,340
Long-term debt obligations, net	\$ 371,059	\$ 423,529

Of MHS's debt, 84.6% 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, 2018.

MHS maintains letters of credit with JP Morgan Chase Bank supporting the Series 2003 and Series 2004 bonds. As of September 30, 2018, the letters of credit are available up to \$30,482 and had related debt and interest outstanding against them of \$25,518. These letters of credit expire on October 1, 2019. 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, 2018, are as follows:

Year ending September 30	
2019	\$ 12,945
2020	13,447
2021	14,705
2022	13,438
2023	19,506
Thereafter	310,749
Total	<u>\$ 384,791</u>

Interest expense is \$16,085 and \$15,836 for the years ended September 30, 2018 and 2017, 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, 2018 and 2017, based on quoted market prices for the same or similar issues was \$390,791 and \$430,078, 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, which are long-term liabilities:

Expiration Date	MHS Pays	MHS Receives	Notional Amount	Fair Value		Gain (loss) on Derivatives	
				2018	2017	2018	2017
October 1, 2024	4.99%	100% of LIBOR	\$ 10,025	\$ 560	\$ 1,136	\$ 253	\$ 363
October 1, 2022	3.69%	70% of LIBOR	15,080	572	1,184	240	341
December 1, 2031	2.95%	67% of LIBOR	13,570	796	1,083	45	(447)
December 1, 2031	3.45%	67% of LIBOR	8,105	739	1,184	258	337
			<u>\$ 46,780</u>	<u>\$ 2,667</u>	<u>\$ 4,587</u>	<u>\$ 796</u>	<u>\$ 594</u>

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

12. Derivatives (continued)

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.

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 sheets. 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 sheets.

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 \$166 and \$164 for the years ended September 30, 2018 and 2017, respectively. Total interest income on the notes receivable totaled \$116 for both the years ended September 30, 2018 and 2017.

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.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

14. Liability Programs (continued)

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 2.73% and 2.67% at September 30, 2018 and 2017, respectively.

The general and professional liability was \$14,017 and \$13,960 at September 30, 2018 and 2017, respectively, including tail coverage on the claims-made policy. Insurance receivables related to excess coverage are \$2,861 and \$2,768 at September 30, 2018 and 2017, 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	
	2018	2017
Self-insurance	\$ 1,122	\$ (887)
Insured	2,206	2,721
Total	<u>\$ 3,328</u>	<u>\$ 1,834</u>

MHS maintains a revocable general and professional liability trust fund containing investments of \$9,592 and \$12,647 at September 30, 2018 and 2017, 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, 2018 and 2017, were \$287 and \$705, respectively, and are included in employee benefits in the consolidated statements of operations and changes in net assets. The workers' compensation liability was \$4,278 and \$4,944 at September 30, 2018 and 2017, respectively, discounted at the same rates as the self-insurance liability. The insurance receivable related to excess coverage is \$375 and \$451 at September 30, 2018 and 2017, respectively. MHS maintains a revocable workers' compensation liability trust fund containing investments of \$4,250 and \$5,265 at September 30, 2018 and 2017, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

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	
	2018	2017
Change in benefit obligation:		
Benefit obligation – beginning of year	\$ 466,903	\$ 462,987
Service cost	432	547
Interest cost	18,910	18,655
Actuarial (gain) loss	(20,886)	(870)
Benefits paid	(23,136)	(14,416)
Benefit obligation – end of year	442,223	466,903
Change in plan assets:		
Fair value of plan assets – beginning of year	458,360	429,642
Actual gain (loss) on plan assets	11,242	43,110
Employer contribution	6,905	24
Benefits paid	(23,136)	(14,416)
Fair value of plan assets – end of year	453,371	458,360
Over (under) funded status, net	\$ 11,148	\$ (8,543)

Funded status consists of a \$7,502 and \$13,485 unfunded pension obligation as of September 30, 2018 and 2017, respectively, and a net pension asset of \$18,650 and \$4,942 recorded in Other Assets on the consolidated balance sheets as of September 30, 2018 and 2017, respectively.

Amounts recognized in net assets without donor restrictions consist of the following:

	September 30	
	2018	2017
Unrecognized actuarial (gain) loss	\$ 123,825	\$ 144,050

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 net assets without donor restrictions include the following:

	Years Ended September 30	
	2018	2017
Current actuarial (gain) loss	\$ (2,905)	\$ (14,988)
Amortization of gain (loss)	(13,706)	(18,789)
Settlement charge	(3,614)	—
	<u>\$ (20,225)</u>	<u>\$ (33,777)</u>

The actuarial loss included in net assets without donor restrictions expected to be recognized in net periodic pension cost during the year ending September 30, 2019, is \$11,361.

Components of net periodic benefit cost are as follows:

	Years Ended September 30	
	2018	2017
Service cost	\$ 432	\$ 547
Interest cost	18,910	18,655
Expected return on plan assets	(29,222)	(28,992)
Amortization of net loss and prior service cost	13,706	18,789
Settlement charge	3,614	—
Net periodic benefit cost	<u>\$ 7,440</u>	<u>\$ 8,999</u>

No plan assets are expected to be returned to MHS during the year ending September 30, 2019.

The accumulated benefit obligations were \$440,954 and \$464,769 at September 30, 2018 and 2017, 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	
	2018	2017
Discount rate	4.50%	4.16%
Expected long-term return on plan assets	5.80	6.50

The effects of the changes in actuarial assumptions from 2017 to 2018, which include a revision to the assumed mortality table, decreased the projected benefit obligation and the accumulated benefit obligation by \$23,649 and \$23,582, respectively, at September 30, 2018. The effects of the changes in actuarial assumptions from 2016 to 2017, which include a revision to the assumed mortality table, increased the projected benefit obligation and the accumulated benefit obligation by \$2,412 and \$2,399, respectively, at September 30, 2017.

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

	Years Ended September 30	
	2018	2017
Discount rate	4.16%	4.10%
Expected long-term return on plan assets	6.50	6.88

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 2018	September 30 2018	Target Asset Allocation 2017	September 30 2017
Equity securities	20.0%	19.4%	55.0%	53.9%
Debt securities	80.0	79.7	45.0	43.7
Cash and cash equivalents	–	0.9	–	2.4
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, 2018:

	Level 1	Level 2	Level 3	Total
Assets				
Money market funds	\$ 3,956	\$ –	\$ –	\$ 3,956
U.S. Treasury obligations	73,449	–	–	73,449
Government obligations	–	28,517	–	28,517
Corporate obligations	–	259,514	–	259,514
Domestic equities	53,272	–	–	53,272
Mutual funds	34,663	–	–	34,663
Total assets	\$ 165,340	\$ 288,031	\$ –	\$ 453,371

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, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
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	<u>\$ 359,580</u>	<u>\$ 98,780</u>	<u>\$ —</u>	<u>\$ 458,360</u>

At September 30, 2018 and 2017, 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 governed by management policy consisting of fixed income and equity securities. The fixed income portion of the total portfolio has been constructed to hedge the corresponding plans liabilities under a strategy referred to as liability driven investing. This strategy reduces risk of deterioration in the plan's overall funded status. Investment performance is monitored and compared against stated management policy investment objectives. The plan's structured portfolio also takes into consideration the cash flow requirements of the plan 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, 2019, 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:

Year ending September 30	
2019	\$ 20,179
2020	21,988
2021	22,796
2022	24,497
2023	23,639
2024–28	130,009

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%. 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 contributions for the Defined Contribution Plan calendar plan year are discretionary and subject to approval by the MHS Board of Directors. As of December 17, 2018, no approval of contribution has been made for plan calendar year 2018. PAH also sponsors two defined contribution plans with an employer match provision, the PAH Tax Deferred Annuity Plan and the PAH Employees' Pension Plan.

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). Through December 31, 2017, this plan excluded anyone eligible to receive a benefit under the MHS Restoration plan. The plan was amended and restated January 1, 2018, providing that no employer contributions will be made after December 31, 2017, an employee deferral option was added for all eligible employees and renamed the Memorial Health System 457(b) Deferral Plan.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Retirement Plans (continued)

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

	Years Ended September 30	
	2018	2017
MHS Defined Contribution Plan	\$ 20,741	\$ 21,259
MHS Defined Contribution Restoration Plan	513	503
PAH Tax Deferred Annuity and Employees' Pension Plans	2,018	1,939
Total retirement expense	<u>\$ 23,272</u>	<u>\$ 23,701</u>

16. Post-Employment and Other Benefits

MHS and PAH provide unfunded post-employment benefit plans to certain employees. The cost for these plans were \$869 and \$3,573 for the years ended September 30, 2018 and 2017, respectively. As of September 30, 2018 and 2017, the accumulated post-employment benefit obligation was \$11,989 and \$12,011, respectively. Annual discount rates ranged from 4.16% to 4.50%. The plans assume a medical plan trend rate of 7.00% in 2018 grading down to the ultimate rate of 4.03% in 2075.

A one-percentage-point increase in the assumed medical plan trend rates would have increased the accumulated post-employment benefit obligation by \$1,762 and \$1,679 at September 30, 2018 and 2017, respectively. A one-percentage-point decrease in the assumed medical plan trend rates would have decreased the accumulated post-employment benefit obligation by \$1,414 and \$1,347 at September 30, 2018 and 2017, respectively.

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

16. Post-Employment and Other Benefits (continued)

Included in net assets without donor restrictions are the following amounts that have not yet been recognized in net periodic post-employment benefit cost:

	September 30	
	2018	2017
Unrecognized actuarial losses	\$ 3,005	\$ 2,457

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 \$6,232 and \$6,407 at September 30, 2018 and 2017, respectively.

17. Operating Leases

Revenues

Rental revenues were \$15,152 and \$14,165 for the years ended September 30, 2018 and 2017, respectively, from non-MHS entities. As of September 30, 2018 and 2017, the cost of the buildings held for lease was \$155,737 and \$155,556, respectively, and the related accumulated depreciation was \$54,943 and \$49,010, respectively.

Future minimum rental revenue under noncancelable operating leases as of September 30, 2018, which have initial or remaining terms in excess of one year, is as follows:

Years ending September 30		
2019	\$	9,603
2020		8,189
2021		7,177
2022		6,817
2023		6,571
Thereafter		35,982
Total minimum lease revenue	\$	74,339

Memorial Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

17. Operating Leases (continued)

Expenses

Rental expense was \$2,996 and \$2,871 for the years ended September 30, 2018 and 2017, respectively.

Future minimum rental payments under noncancelable operating leases as of September 30, 2018, which have initial or remaining terms in excess of one year, are as follows:

Years ending September 30	
2019	\$ 1,245
2020	451
2021	258
2022	93
2023	41
Thereafter	92
Total minimum lease payment	<u>\$ 2,180</u>

18. Commitments and Contingencies

Firm commitments for construction in progress totaled \$46,563 as of September 30, 2018.

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, 2018 through December 17, 2018, the date the consolidated financial statements were issued.

MHS signed a non-binding Letter of Intent on November 14, 2018 with a regional health system (the "RHS"), which proposes that the RHS become an affiliated corporation of MHS. If the parties proceed with the transaction, the parties anticipate closing on or after October 1, 2019, subject to customary closing conditions and regulatory approvals. Pursuant to the Letter of Intent, MHS would become the sole corporate member of the RHS through a membership substitution. It is anticipated no cash consideration will be paid to the RHS to accomplish this membership substitution; however, MHS anticipates agreeing to certain operational and capital commitments to the RHS, the cost of which cannot be determined at this time. MHS anticipates that fulfilling these commitments will not require any additional borrowing. MHS does not presently intend to add the RHS to the Obligated Group.

As the due diligence process has only just begun and the affiliation negotiations are at a very early stage, the likelihood of MHS consummating the transaction and the final terms thereof cannot be assessed at this time. MHS is committed to completing this affiliation only if it will enhance MHS's ability to further its mission. Although the RHS is not expected to become a member of the Obligated Group, such affiliation could have a material adverse effect on the consolidated financial position and financial results of MHS.

Supplementary Information

**MEMORIAL HEALTH SYSTEM
CONSOLIDATING BALANCE SHEET
SEPTEMBER 30, 2018**

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES					PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL	
	MHS	MMC	PAH	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF			
Assets																			
Current assets:																			
Cash and cash equivalents	\$ 9,138	18,588	4,958	15,064	12,197	4,064	98	1,260	451	9,389	677	767	1,467	441	49	789	-	-	79,397
Short-term investments	-	46,339	3,726	23,971	38,609	-	-	1,511	-	-	-	-	1,528	204	176	-	-	-	116,064
Assets whose use is limited	-	2,600	-	-	-	-	-	113	204	116	-	-	-	-	-	-	-	-	3,033
Receivables:																			
Patient accounts receivable	-	110,001	20,492	9,378	6,356	7,414	727	1,430	-	3,301	-	-	-	-	-	-	-	-	159,099
Allowance for uncollectible accounts	-	(13,068)	(2,544)	(2,489)	(1,516)	(1,441)	(230)	(286)	-	(159)	-	-	-	-	-	-	-	-	(21,733)
Net patient accounts receivable	-	96,933	17,948	6,889	4,840	5,973	497	1,144	-	3,142	-	-	-	-	-	-	-	-	137,366
Receivables from third-party payors	-	13,197	-	-	423	-	-	-	-	-	-	-	-	-	-	-	-	-	13,620
Due from affiliates	802	177	112	194	266	829	4	90	-	83	-	1	6	-	-	-	-	(2,564)	-
Receivables held for sale	-	5,089	611	299	125	389	-	-	-	123	-	-	-	-	-	-	-	-	6,636
Other receivables	1,796	14,635	360	143	42	1,746	91	670	5	633	1	2,472	227	176	24	-	-	(470)	22,551
Inventories	-	10,415	1,715	603	449	947	-	-	-	429	-	-	-	-	-	-	-	-	14,558
Prepaid expenses	5,437	5,345	996	253	732	291	-	141	-	88	1	17	79	-	-	-	-	-	13,380
Total current assets	17,173	213,318	30,426	47,416	57,683	14,239	690	4,929	660	14,003	679	3,257	3,307	821	249	789	(3,034)	-	406,605
Long-term investments:																			
Unrestricted investments	15,350	355,547	78,907	66,498	1,186	-	-	10,209	-	201	-	-	17,724	25,885	4,744	3,652	-	-	579,903
Assets whose use is limited:																			
Self-insurance trusts	-	11,242	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	11,242
Donor restricted assets and other	-	1,049	3,388	-	-	-	-	105	315	83	-	-	10,517	331	281	414	-	-	16,483
Deferred compensation assets	5,821	1,575	747	-	-	7,979	-	-	-	-	-	-	-	-	-	-	-	-	16,122
Total assets whose use is limited	5,821	13,866	4,135	-	-	7,979	-	105	315	83	-	-	10,517	331	281	414	-	-	43,847
Total long-term investments	21,171	369,413	83,042	66,498	1,186	-	-	10,314	315	284	-	-	28,241	26,216	5,025	4,066	-	-	623,750
Net property, plant, and equipment	178,449	269,677	38,674	31,495	23,246	6,434	189	3,947	18,880	2,005	-	-	-	426	-	-	-	-	573,422
Other assets:																			
Investments in partnerships	796	28,904	4,781	-	-	-	-	31	-	-	9,281	-	-	-	-	-	-	(36,216)	7,577
Beneficial interest in trusts	-	28,297	17,814	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	46,111
Other	4,651	32,751	1,405	127	31	-	-	-	-	104	-	-	1,651	-	-	-	-	(6)	40,714
Total other assets	5,447	89,952	24,000	127	31	-	-	31	-	104	9,281	-	1,651	-	-	-	-	-	94,402
TOTAL ASSETS	\$ 222,240	942,360	176,142	145,536	82,146	28,652	879	19,221	19,855	16,396	9,960	3,257	33,199	27,463	5,274	4,855	(39,256)	-	1,698,179
Liabilities and net assets																			
Current liabilities:																			
Long-term debt	\$ 4,755	6,225	1,308	460	197	-	-	-	-	-	-	-	-	-	-	-	-	-	12,945
Accounts payable	5,220	38,823	3,145	853	3,695	4,190	41	67	-	1,535	1	1,031	16	33	-	-	-	-	58,650
Accrued payroll	5,040	24,033	5,331	2,322	2,875	2,546	71	947	-	907	-	32	-	-	-	-	-	-	44,104
Interest payable	439	3,011	43	1,120	480	-	-	-	-	-	-	-	-	-	-	-	-	-	5,093
Due to affiliates	32	1,243	83	4	-	794	-	336	105	174	-	-	-	43	1	-	-	(2,815)	-
Payables to third-party payors	-	35,434	5,364	2,406	612	-	-	-	-	-	-	-	-	-	-	-	-	-	43,816
Other	5,488	6,395	431	85	23	2,648	1	124	-	68	-	275	950	-	5	-	-	(225)	16,268
Total current liabilities	20,974	115,164	15,705	7,250	7,882	10,178	113	1,474	105	2,684	1	1,338	966	76	6	-	-	(3,040)	180,876
Noncurrent liabilities:																			
Principal amount long-term debt obligations	66,410	227,850	18,916	41,070	17,600	-	-	-	-	-	-	-	-	-	-	-	-	-	371,846
Less unamortized debt issuance costs	(315)	(330)	(46)	(67)	(29)	-	-	-	-	-	-	-	-	-	-	-	-	-	(787)
Long-term debt obligations, net	66,095	227,520	18,870	41,003	17,571	-	-	-	-	-	-	-	-	-	-	-	-	-	371,059
Deferred compensation and benefits	6,725	1,575	747	-	-	8,221	-	-	-	-	-	-	-	-	-	-	-	-	17,268
Self-insurance accrued expenses	246	13,051	3,411	518	141	505	175	-	-	196	-	-	-	-	-	-	-	-	18,243
Accrued employee benefits	3,872	5,591	2,133	-	-	5,844	-	119	-	213	-	-	-	-	-	-	-	-	17,772
Pension obligations	2,771	862	-	-	-	2,198	-	196	-	-	-	-	-	-	-	-	-	-	6,027
Other	2,933	3,361	1,636	-	446	-	-	-	16,510	-	-	-	117	-	-	-	-	-	25,003
Total noncurrent liabilities	82,642	251,960	26,797	41,521	18,158	16,768	175	315	16,510	409	-	-	117	-	-	-	-	-	455,372
Total liabilities	103,616	367,124	42,502	48,771	26,040	26,946	288	1,789	16,615	3,093	1	1,338	1,083	76	6	-	-	(3,040)	636,248
Net assets:																			
Without donor restrictions	118,624	516,986	111,793	96,765	56,106	1,706	591	16,477	3,240	13,104	9,959	1,919	20,139	27,056	4,987	3,988	(6,519)	-	996,921
With donor restrictions	-	58,250	21,847	-	-	-	-	955	-	199	-	-	11,977	331	281	867	(29,697)	-	65,010
Total net assets	118,624	575,236	133,640	96,765	56,106	1,706	591	17,432	3,240	13,303	9,959	1,919	32,116	27,387	5,268	4,855	(36,216)	-	1,061,931
TOTAL LIABILITIES AND NET ASSETS	\$ 222,240	942,360	176,142	145,536	82,146	28,652	879	19,221	19,855	16,396	9,960	3,257	33,199	27,463	5,274	4,855	(39,256)	-	1,698,179

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2018

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES					PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL			
	MHS	MMC	PAH	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF					
Gross patient service charges:																					
Inpatient charges	\$ -	1,188,294	124,281	19,445	17,707	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,349,727	
Outpatient charges	-	1,135,514	285,872	113,233	90,721	126,133	6,895	15,240	-	30,497	-	-	-	-	-	-	-	-	(352)	1,803,753	
Total gross patient service charges	-	2,323,808	410,153	132,678	108,428	126,133	6,895	15,240	-	30,497	-	-	-	-	-	-	-	-	(352)	3,153,480	
Less charity	-	8,198	2,751	496	421	21	1	186	-	21	-	-	-	-	-	-	-	-	-	12,095	
Less contractual allowances	-	1,706,098	301,465	82,094	64,895	77,247	4,310	1,914	-	12,003	-	-	-	-	-	-	-	-	384	2,250,410	
Patient service revenues	-	609,512	105,937	50,088	43,112	48,865	2,584	13,140	-	18,473	-	-	-	-	-	-	-	-	(736)	890,975	
Provision for uncollectible accounts	-	6,831	1,228	2,064	1,031	2,062	14	20	-	(661)	-	-	-	-	-	-	-	-	-	12,589	
Net patient service revenues	-	602,681	104,709	48,024	42,081	46,803	2,570	13,120	-	19,134	-	-	-	-	-	-	-	-	(736)	878,386	
Hospital access improvement payments	-	36,724	7,235	4,160	3,532	-	-	-	-	-	-	-	-	-	-	-	-	-	-	51,651	
Capitation revenues	-	60,043	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	60,043	
Other revenues:																					
Management fees	56,639	-	-	17	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(56,656)	-
Other	21,011	11,869	1,619	266	153	1,213	50	634	1,885	241	(497)	3,373	-	-	-	-	-	-	-	(11,585)	30,232
Total other revenues	77,650	11,869	1,619	283	153	1,213	50	634	1,885	241	(497)	3,373	-	-	-	-	-	-	-	(68,241)	30,232
Total revenues	77,650	711,317	113,563	52,467	45,766	48,016	2,620	13,754	1,885	19,375	(497)	3,373	-	-	-	-	-	-	(68,977)	1,020,312	
Expenses:																					
Salaries and wages	27,367	214,982	47,186	16,955	15,612	26,350	2,943	8,420	114	10,275	15	1,577	-	-	-	-	-	-	-	-	371,796
Employee benefits	6,997	59,707	16,202	5,081	5,206	7,621	537	2,643	32	3,309	6	413	-	-	-	-	-	-	(366)	-	107,388
Physician fees	-	52,021	8,236	4,174	3,010	24,073	10	14	-	69	-	359	-	-	-	-	-	-	-	-	91,966
Utilities	3,762	7,839	1,280	491	644	248	25	339	148	113	-	18	-	-	-	-	-	-	-	(1,465)	13,442
Pharmaceutical supplies	-	28,274	4,568	1,300	992	3,360	30	1	-	268	-	-	-	-	-	-	-	-	-	-	38,793
Food	39	4,751	1,192	387	256	27	-	72	-	5	-	-	-	-	-	-	-	-	-	-	6,729
Patient service supplies	-	85,216	7,495	1,978	1,692	1,048	232	-	-	342	-	-	-	-	-	-	-	-	-	-	98,003
System management fee	-	45,476	2,013	1,283	1,202	3,313	84	669	-	827	39	269	-	-	-	-	-	-	-	(55,175)	-
Purchased services and other	19,508	66,096	11,717	4,748	4,969	9,506	1,130	1,009	61	2,865	1	1,413	-	-	-	-	-	-	-	(11,807)	111,216
Hospital provider assessment	-	19,809	2,747	1,143	941	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	24,640
Purchased medical services	-	36,375	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	36,375
Depreciation and amortization	16,376	36,323	4,373	4,367	3,450	634	60	417	1,425	956	-	-	-	-	-	-	-	-	-	-	68,381
Amortization of debt issuance expenses	57	297	7	134	58	-	-	-	-	62	-	-	-	-	-	-	-	-	-	-	615
Interest expense and other financing costs	3,544	9,109	470	2,248	954	-	-	-	209	-	-	-	-	-	-	-	-	-	-	-	16,534
Total expenses	77,650	666,275	107,486	44,289	38,986	76,180	5,051	13,584	2,051	19,029	61	4,049	-	-	-	-	-	-	(68,813)	985,878	
Income (loss) from operations	-	45,042	6,077	8,178	6,780	(28,164)	(2,431)	170	(166)	346	(558)	(676)	-	-	-	-	-	-	(164)	34,434	
<i>% of total operating revenue</i>	<i>0.0%</i>	<i>6.3%</i>	<i>5.4%</i>	<i>15.6%</i>	<i>14.8%</i>	<i>(58.7%)</i>	<i>(92.8%)</i>	<i>1.2%</i>	<i>(8.8%)</i>	<i>1.8%</i>	<i>(112.3%)</i>	<i>(20.0%)</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>3.4%</i>	
Nonoperating gains (losses):																					
Interest and dividends	773	5,566	1,018	1,208	421	591	-	172	1	46	7	-	207	385	75	11	-	-	-	-	10,481
Realized gain (loss) on investments, net	5,179	35,260	9,676	4,967	1,200	-	-	1,168	-	26	-	-	875	1,595	229	26	-	-	-	-	60,201
Unrealized gain (loss) on investments, net	(2,741)	(17,362)	(6,819)	(1,317)	(894)	65	-	(1,018)	-	(10)	-	-	349	571	(6)	49	-	-	-	-	(29,133)
Gain (loss) on derivatives	310	183	303	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	796
Equity in income of affiliate	-	-	74	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(74)	-
Provision for income taxes	-	-	-	-	-	-	-	-	-	(749)	-	-	-	-	-	-	-	-	-	-	(749)
Net periodic benefit cost	(4,547)	(2,306)	(347)	-	-	(627)	-	-	-	(120)	-	-	-	-	-	-	-	-	-	-	(7,947)
Other revenue (expense), net	(1,211)	152	(20)	(504)	66	(673)	-	-	-	8	-	-	506	(225)	(3)	(96)	164	-	-	-	(1,836)
Total nonoperating gains (losses), net	(2,237)	21,493	3,885	4,354	793	(644)	-	322	1	(799)	7	-	1,937	2,326	295	(10)	90	-	-	-	31,813
Excess (deficiency) of revenues over expenses	\$ (2,237)	66,535	9,962	12,532	7,573	(28,808)	(2,431)	492	(165)	(453)	(551)	(676)	1,937	2,326	295	(10)	(74)	-	-	66,247	
<i>Excess margin %</i>	<i>(3.0%)</i>	<i>9.1%</i>	<i>8.5%</i>	<i>22.1%</i>	<i>16.3%</i>	<i>(60.8%)</i>	<i>(92.8%)</i>	<i>3.5%</i>	<i>(8.7%)</i>	<i>(2.4%)</i>	<i>112.4%</i>	<i>(20.0%)</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>0.1%</i>	-	-	-	<i>6.3%</i>

MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE PERIOD ENDED SEPTEMBER 30, 2018

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES					PHYSICIANS		AMBULATORY & OTHER					FOUNDATIONS				ELIMIN- ATIONS	TOTAL
	MHS	MMC	PAH	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF		
Net assets without donor restrictions:																		
Excess of revenues over expenses	\$ (2,237)	66,535	9,962	12,532	7,573	(28,808)	(2,431)	492	(165)	(453)	(551)	(676)	1,937	2,326	295	(10)	(74)	66,247
Pension and other postretirement liability adjustments	3,315	16,991	-	-	-	(386)	-	-	-	-	-	-	-	-	-	-	-	19,920
Amortization of ineffective portion of derivatives	8	55	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	63
Other	-	-	48	-	-	-	-	-	-	-	-	-	129	-	-	(68)	-	109
Transfers (to) related organizations	(21,885)	(24,545)	(2,659)	-	-	-	(81)	-	(1,101)	-	(2,718)	(763)	-	-	-	-	-	53,752
Transfers from related organizations	26,795	1,046	-	-	205	20,119	2,507	225	-	-	-	2,703	-	-	-	-	152	(53,752)
Increase (decrease) in net assets without donor restrictions	5,996	60,082	7,351	12,532	7,778	(9,075)	(5)	717	(1,266)	(453)	(3,269)	1,264	2,066	2,326	295	74	(74)	86,339
Net assets with donor restrictions:																		
Contributions	-	264	-	-	-	-	-	-	-	35	-	-	325	47	84	224	-	979
Net investment gain (loss)	-	-	136	-	-	-	-	-	-	-	-	-	973	-	1	-	-	1,110
Net assets released from restrictions (non-operating)	-	(2,911)	-	-	-	-	-	-	-	-	-	-	(1,238)	-	-	(229)	-	(4,378)
Net assets released from restrictions (operating)	-	(242)	-	-	-	-	-	-	-	(30)	-	-	-	-	(122)	-	-	(394)
Change in fair value of split interest agreements	-	(134)	5	-	-	-	-	-	-	-	-	-	18	-	-	-	-	(111)
Transfers (to) related organizations	-	-	(83)	-	-	-	-	-	(83)	-	-	-	-	-	-	-	83	-
Transfers from related organizations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	83	(83)	-
Gain (loss) on interest in net assets of foundation	-	1,746	154	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,900)
Other	-	-	(47)	-	-	-	-	-	-	-	-	-	(203)	(85)	-	68	-	(267)
Increase (decrease) in net assets with donor restrictions	-	(1,277)	165	-	-	-	-	-	-	5	-	-	(125)	(38)	(37)	146	(1,900)	(3,061)
Increase (decrease) in net assets	5,996	58,805	7,516	12,532	7,778	(9,075)	(5)	717	(1,266)	(448)	(3,269)	1,264	1,941	2,288	258	220	(1,974)	83,278
Net assets, beginning of period	112,628	516,431	126,124	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
Net assets, end of period	\$ 118,624	575,236	133,640	96,765	56,106	1,706	591	17,432	3,240	13,303	9,959	1,919	32,116	27,387	5,268	4,855	(36,216)	1,061,931

**MEMORIAL HEALTH SYSTEM
CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED SEPTEMBER 30, 2018**

(dollars in thousands)

	CORPORATE & HOSPITAL SERVICES					PHYSICIANS		AMBULATORY & OTHER				FOUNDATIONS				ELIMIN- ATIONS	TOTAL	
	MHS	MMC	PAH	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF			PAHF
Cash flows from operating activities:																		
Changes in net assets	\$ 5,996	58,805	7,516	12,532	7,778	(9,075)	(5)	717	(1,266)	(448)	(3,269)	1,264	1,941	2,288	258	220	(1,974)	83,278
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities																		
Non cash contributions	-	(2,211)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,211)
(Gain) loss on derivatives	(310)	(183)	(303)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(796)
Realized (gain) loss on investments, net	(5,179)	(35,260)	(9,676)	(4,967)	(1,200)	-	-	(1,168)	-	(26)	-	-	(1,515)	(1,595)	(229)	(26)	-	(60,841)
Unrealized (gain) loss on investments, net	2,741	17,362	6,819	1,317	894	(65)	-	1,018	-	10	-	-	(574)	(571)	6	(49)	-	28,908
Restricted contributions and other	-	(264)	-	-	-	-	-	-	-	(35)	-	-	(325)	(47)	(84)	(224)	-	(979)
(Increase) decrease in beneficial interest in trusts	-	2,345	(292)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,053
Depreciation and amortization	16,376	36,323	4,373	4,367	3,450	634	60	417	1,425	956	-	-	-	-	-	-	-	68,381
Amortization of debt issuance costs	57	297	7	134	58	-	-	-	62	-	-	-	-	-	-	-	-	615
(Gain) loss on disposal of assets	602	323	6	-	-	6	(5)	(61)	-	(6)	-	-	-	-	-	-	-	865
Provision for uncollectible accounts	-	6,831	1,228	2,064	1,031	2,062	14	20	-	(661)	-	-	-	-	-	-	-	12,589
Pension obligations	(3,315)	(16,991)	-	-	-	386	-	-	-	-	-	-	-	-	-	-	-	(19,920)
Changes in assets and liabilities:																		
Accounts receivable	-	6,487	(688)	(1,137)	1,576	(1,371)	4	(73)	-	1,658	50	-	-	-	-	-	-	6,506
Inventory and other assets	1,261	18,442	3,375	1,049	266	251	4	993	65	991	265	(1,795)	(8)	207	(17)	-	(36)	25,313
Estimated third-party payor settlements	-	5,982	380	1,115	(2,029)	-	-	-	-	-	-	-	-	-	-	-	-	5,448
Accounts payable and other current liabilities	1,605	4,092	(7)	349	2,967	2,308	(71)	(433)	(136)	(325)	(45)	1,299	(201)	-	(8)	(7)	(70)	11,317
Self-insurance and other long-term liabilities	(5,864)	1,495	(882)	92	(3)	(2,164)	(13)	315	-	(68)	-	-	25	-	-	-	-	(7,067)
Amount due to (from) affiliates	58	1,430	(125)	(326)	(291)	(235)	5	(145)	(195)	90	(431)	(1)	1	31	5	-	129	-
Equity in unconsolidated affiliates and foundation	-	(1,746)	(228)	-	-	-	-	-	-	-	-	-	-	-	-	-	1,974	-
Transfers to (from) related organizations	(4,910)	23,499	2,659	-	(205)	(20,119)	(2,426)	(225)	1,101	-	2,718	(1,940)	-	-	-	(152)	-	-
Net cash provided by (used in) operating activities	9,118	127,058	14,162	16,589	14,292	(27,382)	(2,433)	1,375	1,056	2,136	(712)	(1,173)	(656)	313	(69)	(238)	23	153,459
Cash flows from investing activities:																		
Acquisition of property and equipment	(11,279)	(33,002)	(5,859)	(1,329)	(6,486)	(116)	-	(315)	(72)	(837)	-	-	-	(111)	-	-	-	(59,406)
Proceeds on sale of property	1,110	60	3	-	-	2	33	126	-	7	-	-	-	-	-	-	-	1,341
(Deposits) withdrawals in investments, net	24,825	(99,443)	(3,700)	(26,478)	(33,999)	-	-	(2,000)	-	-	-	-	(225)	-	75	-	-	(140,945)
Other investment activity, net	3,095	4,730	(625)	(744)	213	2,734	-	(2,117)	305	242	107	-	(558)	(114)	(58)	89	-	7,299
Change in investment in partnerships	14	-	-	-	-	-	-	(19)	-	-	1,703	-	-	-	-	-	-	1,698
Net change in other assets	465	-	-	-	-	-	-	-	-	-	-	-	640	-	-	-	(23)	1,082
Net cash provided by (used in) investing activities	18,230	(127,655)	(10,181)	(28,551)	(40,272)	2,620	33	(4,325)	233	(588)	1,810	-	(143)	(225)	17	89	(23)	(188,931)
Cash flows from financing activities:																		
Restricted contributions and other	-	264	-	-	-	-	-	-	-	35	-	-	325	47	84	224	-	979
Repayment of long-term debt	(30,745)	(19,852)	(2,697)	(360)	(155)	-	-	-	-	-	-	-	-	-	-	-	-	(53,809)
Distributions from beneficial interest in trusts	-	700	148	-	-	-	-	-	-	-	-	-	-	-	-	-	-	848
Transfers (to) from related organizations	5,115	(23,499)	(2,659)	-	-	19,579	2,426	225	(1,101)	-	(2,178)	1,940	-	-	-	152	-	-
Net cash flows provided by (used in) financing activities	(25,630)	(42,387)	(5,208)	(360)	(155)	19,579	2,426	225	(1,101)	35	(2,178)	1,940	325	47	84	376	-	(51,982)
Net increase (decrease) in cash and cash equivalents	1,718	(42,984)	(1,227)	(12,322)	(26,135)	(5,183)	26	(2,725)	188	1,583	(1,080)	767	(474)	135	32	227	-	(87,454)
Cash and cash equivalents, beginning of period	7,420	61,572	6,185	27,386	38,332	9,247	72	3,985	263	7,806	1,757	-	1,941	306	17	562	-	166,851
Cash and cash equivalents, end of period	\$ 9,138	18,588	4,958	15,064	12,197	4,064	98	1,260	451	9,389	677	767	1,467	441	49	789	-	79,397

**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	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF			PAHF
Assets																		
Current assets:																		
Cash and cash equivalents	\$ 7,420	61,572	6,185	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	24,036	9,770	9,130	7,940	967	1,311	-	5,599	400	-	-	-	-	-	-	182,595
Allowance for uncollectible accounts	-	(13,191)	(5,548)	(1,954)	(1,683)	(1,394)	(452)	(220)	-	(1,460)	(232)	-	-	-	-	-	-	(26,134)
Net patient accounts receivable	-	110,251	18,488	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	31,483	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	-	53,866
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	172,747	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	3,303	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	15,659	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	46,623	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:																		
Without donor restrictions	112,628	456,904	104,442	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
With donor restrictions	-	59,527	21,682	-	-	-	-	955	-	194	-	-	12,102	369	318	721	(27,797)	68,071
Total net assets	112,628	516,431	126,124	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	172,747	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	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF					
Gross patient service charges:																					
Inpatient charges	\$ -	1,151,958	125,162	16,099	18,050	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,311,269	
Outpatient charges	-	1,072,983	261,588	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	386,750	125,192	107,996	109,972	9,257	15,224	-	35,244	18,357	-	-	-	-	-	-	-	(350)	3,032,583	
Less charity	-	7,946	2,778	671	210	23	4	289	-	85	11	-	-	-	-	-	-	-	-	12,017	
Less contractual allowances	-	1,635,606	274,751	78,072	65,326	64,509	5,695	1,446	-	12,091	12,565	-	-	-	-	-	-	-	-	2,150,061	
Patient service revenues	-	581,389	109,221	46,449	42,460	45,440	3,558	13,489	-	23,068	5,781	-	-	-	-	-	-	-	(350)	870,505	
Provision for uncollectible accounts	-	8,597	4,583	989	907	1,537	153	66	-	892	664	-	-	-	-	-	-	-	-	18,388	
Net patient service revenues	-	572,792	104,638	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	115,269	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	44,039	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	14,880	4,880	5,166	6,776	708	2,915	37	3,872	368	420	-	-	-	-	-	-	-	-	103,620
Physician fees	1,498	51,182	8,404	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	2,187	1,973	1,715	6,143	71	667	-	724	146	4	-	-	-	-	-	-	-	(60,856)	-
Purchased services and other	17,526	62,230	11,454	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	103,147	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	12,122	7,173	7,217	(24,875)	(3,721)	(1,035)	(360)	631	(850)	(1,095)	-	-	-	-	-	-	(241)	27,374	
<i>% of total operating revenue</i>	<i>0.0%</i>	<i>4.8%</i>	<i>10.5%</i>	<i>14.3%</i>	<i>15.9%</i>	<i>-50.6%</i>	<i>-108.0%</i>	<i>-7.4%</i>	<i>-23.5%</i>	<i>2.8%</i>	<i>-15.0%</i>	<i>-114.1%</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>2.7%</i>	
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
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)	(165)	161	(483)	19	(1,051)	-	-	-	3	-	-	646	(118)	(37)	(172)	241	-	-	(2,452)	
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	15,767	12,983	7,877	(25,888)	(3,721)	(799)	(353)	(312)	(840)	(1,095)	2,287	3,279	517	(42)	(190)	-	-	74,660	
<i>Excess margin %</i>	<i>1.8%</i>	<i>8.9%</i>	<i>13.3%</i>	<i>23.3%</i>	<i>17.1%</i>	<i>-53.7%</i>	<i>-108.0%</i>	<i>-5.6%</i>	<i>-22.9%</i>	<i>-1.4%</i>	<i>-14.8%</i>	<i>-114.1%</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>NA</i>	<i>7.2%</i>	

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	ALMH	TMH	MPS	PPA	MBH	QALICB	MHSvc	MHV	MHP	MMCF	ALHF	TMHF	PAHF		
Net assets without donor restrictions:																		
Excess of revenues over expenses	\$ 1,484	63,706	15,767	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)	-	-	-	-	-	-	-	135	-	-	-	180	-	-	(44)	-	136
Transfers (to) related organizations	(30,268)	(28,573)	(4,171)	-	-	(13,586)	(179)	-	(940)	-	(2,000)	(113)	-	-	-	(25)	79,855	-
Transfers from related organizations	42,433	2,140	-	-	-	28,372	3,895	450	-	-	676	1,589	-	-	-	300	(79,855)	-
Increase (decrease) in net assets without donor restrictions	14,621	70,101	11,596	12,983	7,877	(10,560)	(5)	(349)	(1,158)	(312)	(2,164)	381	2,467	3,279	517	189	(190)	109,273
Net assets with donor restrictions:																		
Contributions	-	503	-	-	-	-	-	-	-	38	-	-	753	79	126	190	-	1,689
Net investment gain (loss)	-	-	168	-	-	-	-	-	-	-	-	-	1,350	-	-	1	-	1,519
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 fair value of split interest agreements	-	(3,742)	1	-	-	-	-	-	-	-	-	-	27	-	-	-	-	(3,714)
Gain (loss) on interest in net assets of foundation	-	2,690	198	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,888)	-
Other	-	-	(19)	-	-	-	-	-	-	-	-	-	(337)	-	-	44	-	(312)
Increase (decrease) in net assets with donor restrictions	-	(3,561)	348	-	-	-	-	-	-	6	-	-	521	25	88	191	(2,888)	(5,270)
Increase (decrease) in net assets	14,621	66,540	11,944	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	114,180	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	126,124	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				ELIMIN- ATIONS	TOTAL		
	MHS	MMC	PAH	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	11,944	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	4,583	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)	(7,457)	(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)	918	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	4,171	-	-	(14,786)	(3,716)	(450)	805	-	1,324	(1,476)	-	-	-	(275)	-	-	-	
Net cash provided by (used in) operating activities	15,730	77,351	15,196	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)	(4,171)	-	-	27,279	3,716	450	(940)	-	(1,475)	1,476	-	-	-	275	-	-	-	
Net cash provided by (used in) financing activities	(5,556)	(44,273)	(5,532)	-	-	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	2,976	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	3,209	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	6,185	27,386	38,332	9,247	72	3,985	263	7,806	1,757	-	1,941	306	17	562	-	-	166,851	

MEMORIAL HEALTH SYSTEM
BALANCE SHEET
SEPTEMBER 30, 2018
(dollars in thousands)

Assets	MHS	MMC	Eliminations	OBLIGATED GROUP TOTAL	NON- OBLIGATED GROUP TOTAL	CONSOLIDATED TOTAL
Current assets:						
Cash and cash equivalents	\$ 9,138	18,588	-	27,726	51,671	79,397
Short-term investments	-	46,339	-	46,339	69,725	116,064
Assets whose use is limited-current portion	-	2,600	-	2,600	433	3,033
Patient accounts receivable	-	110,001	-	110,001	49,098	159,099
Allowance for uncollectible accounts	-	(13,068)	-	(13,068)	(8,665)	(21,733)
Net patient accounts receivable	-	96,933	-	96,933	40,433	137,366
Receivables from third-party payors	-	13,197	-	13,197	423	13,620
Due from affiliates	802	177	-	979	(979)	-
Receivables held for sale	-	5,089	-	5,089	1,547	6,636
Other receivables	1,796	14,635	(320)	16,111	6,440	22,551
Inventories	-	10,415	-	10,415	4,143	14,558
Prepaid expenses	5,437	5,345	-	10,782	2,598	13,380
Total current assets	17,173	213,318	(320)	230,171	176,434	406,605
Long-term investments:						
Unrestricted investments	15,350	355,547	-	370,897	209,006	579,903
Assets whose use is limited:						
Self-insurance trusts	-	11,242	-	11,242	-	11,242
Donor restricted assets and other	-	1,049	-	1,049	15,434	16,483
Deferred compensation assets	5,821	1,575	-	7,396	8,726	16,122
Total assets whose use is limited	5,821	13,866	-	19,687	24,160	43,847
Total long-term investments	21,171	369,413	-	390,584	233,166	623,750
Net property, plant, and equipment	178,449	269,677	-	448,126	125,296	573,422
Other assets:						
Investments in partnerships	796	28,904	-	29,700	(22,123)	7,577
Beneficial interest in trusts	-	28,297	-	28,297	17,814	46,111
Other	4,651	32,751	-	37,402	3,312	40,714
Total other assets	5,447	89,952	-	95,399	(997)	94,402
TOTAL ASSETS	222,240	942,360	(320)	1,164,280	533,899	1,698,179
Liabilities and net assets						
Current liabilities:						
Long-term debt	\$ 4,755	6,225	-	10,980	1,965	12,945
Accounts payable	5,220	38,823	-	44,043	14,607	58,650
Accrued payroll	5,040	24,033	-	29,073	15,031	44,104
Interest payable	439	3,011	-	3,450	1,643	5,093
Due to affiliates	32	1,243	-	1,275	(1,275)	-
Payables to third-party payors	-	35,434	-	35,434	8,382	43,816
Other	5,488	6,395	(320)	11,563	4,705	16,268
Total current liabilities	20,974	115,164	(320)	135,818	45,058	180,876
Noncurrent liabilities:						
Long-term debt obligations, net	66,095	227,520	-	293,615	77,444	371,059
Deferred compensation and benefits	6,725	1,575	-	8,300	8,968	17,268
Self-insurance accrued expenses	246	13,051	-	13,297	4,946	18,243
Accrued employee benefits	3,872	5,591	-	9,463	8,309	17,772
Pension obligations	2,771	862	-	3,633	2,394	6,027
Other	2,933	3,361	-	6,294	18,709	25,003
Total noncurrent liabilities	82,642	251,960	-	334,602	120,770	455,372
Total liabilities	103,616	367,124	(320)	470,420	165,828	636,248
Net assets:						
Without donor restrictions	118,624	516,986	-	635,610	361,311	996,921
With donor restrictions	-	58,250	-	58,250	6,760	65,010
Total net assets	118,624	575,236	-	693,860	368,071	1,061,931
TOTAL LIABILITIES AND NET ASSETS	\$ 222,240	942,360	(320)	1,164,280	533,899	1,698,179

MEMORIAL HEALTH SYSTEM
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED
SEPTEMBER 30, 2018

(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>
Gross patient service charges:						
Inpatient charges	\$ -	1,188,294	-	1,188,294	161,433	1,349,727
Outpatient charges	-	1,135,514	-	1,135,514	668,239	1,803,753
Total gross patient service charges	-	2,323,808	-	2,323,808	829,672	3,153,480
Less charity	-	8,198	-	8,198	3,897	12,095
Less contractual allowances	-	1,706,098	-	1,706,098	544,312	2,250,410
Patient service revenues	-	609,512	-	609,512	281,463	890,975
Provision for uncollectible accounts	-	6,831	-	6,831	5,758	12,589
Net patient service revenues	-	602,681	-	602,681	275,705	878,386
Hospital access improvement payments	-	36,724	-	36,724	14,927	51,651
Capitation revenues	-	60,043	-	60,043	-	60,043
Other revenues:						
Management fees	56,639	-	(46,738)	9,901	(9,901)	-
Other	21,011	11,869	(4,828)	28,052	2,180	30,232
Total other revenues	77,650	11,869	(51,566)	37,953	(7,721)	30,232
Total revenues	77,650	711,317	(51,566)	737,401	282,911	1,020,312
Expenses:						
Salaries and wages	27,367	214,982	-	242,349	129,447	371,796
Employee benefits	6,997	59,707	-	66,704	40,684	107,388
Physician fees	-	52,021	-	52,021	39,945	91,966
Utilities	3,762	7,839	(1,262)	10,339	3,103	13,442
Pharmaceutical supplies	-	28,274	-	28,274	10,519	38,793
Food	39	4,751	-	4,790	1,939	6,729
Patient service supplies	-	85,216	-	85,216	12,787	98,003
System management fee	-	45,476	(45,476)	-	-	-
Purchased services and other	19,508	66,096	(4,828)	80,776	30,440	111,216
Hospital provider assessment	-	19,809	-	19,809	4,831	24,640
Purchased medical services	-	36,375	-	36,375	-	36,375
Depreciation and amortization	16,376	36,323	-	52,699	15,682	68,381
Amortization of bond issuance expenses	57	297	-	354	261	615
Interest expense and other financing costs	3,544	9,109	-	12,653	3,881	16,534
Total expenses	77,650	666,275	(51,566)	692,359	293,519	985,878
Income (loss) from operations	-	45,042	-	45,042	(10,608)	34,434
Nonoperating gains (losses):						
Interest and dividends	773	5,566	-	6,339	4,142	10,481
Realized gain (loss) on investments, net	5,179	35,260	-	40,439	19,762	60,201
Unrealized gain (loss) on investments, net	(2,741)	(17,362)	-	(20,103)	(9,030)	(29,133)
Gain (loss) on derivatives	310	183	-	493	303	796
Provision for income taxes	-	-	-	-	(749)	(749)
Net periodic benefit cost	(4,547)	(2,306)	-	(6,853)	(1,094)	(7,947)
Other revenue (expense), net	(1,211)	152	-	(1,059)	(777)	(1,836)
Total nonoperating gains (losses), net	(2,237)	21,493	-	19,256	12,557	31,813
Excess of revenues over expenses	\$ (2,237)	66,535	-	64,298	1,949	66,247

MEMORIAL HEALTH SYSTEM
CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED
SEPTEMBER 30, 2018
(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>
Net assets without donor restrictions:						
Excess of revenues over expenses	\$ (2,237)	66,535	-	64,298	1,949	66,247
Pension and other postretirement liability adjustments	3,315	16,991	-	20,306	(386)	19,920
Amortization of ineffective portion of derivatives	8	55	-	63	-	63
Other	-	-	-	-	109	109
Transfers (to) related organizations	(21,885)	(24,545)	24,492	(21,938)	21,938	-
Transfers from related organizations	26,795	1,046	(24,492)	3,349	(3,349)	-
Increase (decrease) in unrestricted net assets	5,996	60,082	-	66,078	20,261	86,339
Net assets with donor restrictions:						
Contributions	-	264	-	264	715	979
Net investment income gain (loss)	-	-	-	-	1,110	1,110
Net assets released from restrictions (non-operating)	-	(2,911)	-	(2,911)	(1,467)	(4,378)
Net assets released from restrictions (operating)	-	(242)	-	(242)	(152)	(394)
Change in value of split-interest agreements	-	(134)	-	(134)	23	(111)
Gain (loss) on interest in net assets of foundation	-	1,746	-	1,746	(1,746)	-
Other	-	-	-	-	(267)	(267)
Increase (decrease) in temporarily restricted net assets	-	(1,277)	-	(1,277)	(1,784)	(3,061)
Increase (decrease) in net assets	5,996	58,805	-	64,801	18,477	83,278
Net assets, beginning of period	112,628	516,431	-	629,059	349,594	978,653
Net assets, end of period	\$ 118,624	575,236	-	693,860	368,071	1,061,931

**MEMORIAL HEALTH SYSTEM
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED
SEPTEMBER 30, 2018**

(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	\$ 5,996	58,805	64,801	18,477	83,278
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:					
Non cash contribution	-	(2,211)	(2,211)	-	(2,211)
(Gain) loss on derivatives	(310)	(183)	(493)	(303)	(796)
Realized (gain) loss on investments, net	(5,179)	(35,260)	(40,439)	(20,402)	(60,841)
Unrealized (gain) loss on investments, net	2,741	17,362	20,103	8,805	28,908
Restricted contributions and other	-	(264)	(264)	(715)	(979)
(Increase) decrease in beneficial interest in trusts	-	2,345	2,345	(292)	2,053
Depreciation and amortization	16,376	36,323	52,699	15,682	68,381
Amortization of debt issuance costs	57	297	354	261	615
(Gain) loss on disposal of assets	602	323	925	(60)	865
Provision for uncollectible accounts	-	6,831	6,831	5,758	12,589
Pension obligations	(3,315)	(16,991)	(20,306)	386	(19,920)
Changes in assets and liabilities:					
Accounts receivable	-	6,487	6,487	19	6,506
Inventory and other assets	1,261	18,442	19,703	5,610	25,313
Estimated third-party payor settlements	-	5,982	5,982	(534)	5,448
Accounts payable and other current liabilities	1,605	4,092	5,697	5,620	11,317
Self-insurance and other long-term liabilities	(5,864)	1,495	(4,369)	(2,698)	(7,067)
Amount due to (from) affiliates	58	1,430	1,488	(1,488)	-
Equity in unconsolidated affiliates and foundation	-	(1,746)	(1,746)	1,746	-
Transfers to (from) related organizations	(4,910)	23,499	18,589	(18,589)	-
Net cash provided by (used in) operating activities	<u>9,118</u>	<u>127,058</u>	<u>136,176</u>	<u>17,283</u>	<u>153,459</u>
Cash flows from investing activities:					
Acquisition of property and equipment	(11,279)	(33,002)	(44,281)	(15,125)	(59,406)
Proceeds on sale of property	1,110	60	1,170	171	1,341
(Deposits) withdrawals in investments, net	24,825	(99,443)	(74,618)	(66,327)	(140,945)
Other investment activity, net	3,095	4,730	7,825	(526)	7,299
Change in investment in partnerships	14	-	14	1,684	1,698
Net change in other assets	465	-	465	617	1,082
Net cash provided by (used in) investing activities	<u>18,230</u>	<u>(127,655)</u>	<u>(109,425)</u>	<u>(79,506)</u>	<u>(188,931)</u>
Cash flows from financing activities:					
Restricted contributions and other	-	264	264	715	979
Repayment of long-term debt	(30,745)	(19,852)	(50,597)	(3,212)	(53,809)
Distributions from beneficial interest in trusts	-	700	700	148	848
Transfers (to) from related organizations	5,115	(23,499)	(18,384)	18,384	-
Net cash provided by (used in) financing activities	<u>(25,630)</u>	<u>(42,387)</u>	<u>(68,017)</u>	<u>16,035</u>	<u>(51,982)</u>
Net increase (decrease) in cash and cash equivalents	1,718	(42,984)	(41,266)	(46,188)	(87,454)
Cash and cash equivalents, beginning of period	7,420	61,572	68,992	97,859	166,851
Cash and cash equivalents, end of period	<u>\$ 9,138</u>	<u>18,588</u>	<u>27,726</u>	<u>51,671</u>	<u>79,397</u>

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