



Consolidated Financial Statements as of and  
for the Years Ended June 30, 2017 and 2016,  
Consolidating Schedules as of and  
for the Year Ended June 30, 2017, and  
Independent Auditors' Report

# MIDMICHIGAN HEALTH

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## **INDEPENDENT AUDITORS' REPORT**

To the Audit Committee and the Board of Directors of  
MidMichigan Health  
Midland, Michigan

We have audited the accompanying consolidated financial statements of MidMichigan Health and its subsidiaries, which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditors' Responsibility**

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

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

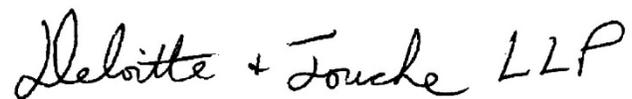
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MidMichigan Health as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Report on Supplementary Consolidating Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating information listed in the table of contents on pages 44-46 is presented for the purpose of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies, and is not a required part of the consolidated financial statements. This supplementary information is the responsibility of MidMichigan Health's management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our 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 consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

The image shows a handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

October 11, 2017

**MIDMICHIGAN HEALTH**  
**CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

	<b>As of June 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 20,488	\$ 23,747
Investments — trading securities	-	11,537
Accounts receivable for patient services — net of allowance for doubtful accounts of \$25,406 and \$13,889 as of June 30, 2017 and 2016, respectively	87,247	73,865
Estimated receivables from third-party payors	8,985	7,874
Inventories	8,387	9,131
Prepaid expenses and other current assets	8,458	9,183
Assets limited or restricted as to use — current portion	<u>18,259</u>	<u>11,581</u>
Total current assets	<u>151,824</u>	<u>146,918</u>
<b>ASSETS LIMITED AS TO USE AND INVESTMENTS:</b>		
Investments — less current portion	150,989	183,195
Limited as to use by Board for capital acquisitions	455,033	410,362
Self-insurance, deferred compensation, and other	48,193	39,282
Limited as to use by donor or time restriction	<u>40,262</u>	<u>39,967</u>
Total assets limited as to use and investments	<u>694,477</u>	<u>672,806</u>
PROPERTY AND EQUIPMENT — net of accumulated depreciation of \$388,433 and \$400,446 as of June 30, 2017 and 2016, respectively	<u>388,750</u>	<u>349,376</u>
INVESTMENTS IN JOINT VENTURES	<u>8,265</u>	<u>10,220</u>
GOODWILL	<u>-</u>	<u>56,215</u>
OTHER ASSETS	<u>21,186</u>	<u>17,338</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 1,264,502</u></b>	<b><u>\$ 1,252,873</u></b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$ 31,076	\$ 32,309
Salaries, wages, and payroll-related liabilities	43,717	43,569
Estimated third-party settlements payable	20,792	21,672
Current portion of long-term debt	5,663	3,890
Current portion of self-insurance, deferred compensation, and other liabilities	<u>5,081</u>	<u>2,623</u>
Total current liabilities	<u>106,329</u>	<u>104,063</u>
<b>LONG-TERM LIABILITIES:</b>		
Self-insurance, deferred compensation, and other liabilities — less current portion	74,730	67,481
Accrued pension and postretirement benefits	152,871	251,662
Long-term debt — less current portion	<u>206,742</u>	<u>188,809</u>
Total long-term liabilities	<u>434,343</u>	<u>507,952</u>
Total liabilities	<u>540,672</u>	<u>612,015</u>
<b>NET ASSETS:</b>		
Unrestricted	683,568	600,891
Temporarily restricted	25,609	25,711
Permanently restricted	<u>14,653</u>	<u>14,256</u>
Total net assets	<u>723,830</u>	<u>640,858</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 1,264,502</u></b>	<b><u>\$ 1,252,873</u></b>

See notes to consolidated financial statements.

**MIDMICHIGAN HEALTH**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
*(Dollars in thousands)*

	<b>For the Years Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>REVENUE:</b>		
Patient service revenue (net of contractual allowances and discounts)	\$ 801,530	\$ 676,091
Provision for uncollectible accounts	<u>(39,165)</u>	<u>(26,396)</u>
Net patient service revenue, less provision for uncollectible accounts	762,365	649,695
Other revenue	<u>34,470</u>	<u>28,272</u>
Total revenue	<u>796,835</u>	<u>677,967</u>
<b>EXPENSES:</b>		
Salaries and wages	339,762	288,853
Employee benefits	88,222	76,475
Supplies	140,912	115,767
Purchased services and other	80,782	68,551
Fees	62,970	52,256
Depreciation and amortization	45,677	41,624
Utilities	10,196	9,898
Interest	7,499	8,220
Insurance	<u>5,221</u>	<u>3,394</u>
Total expenses	<u>781,241</u>	<u>665,038</u>
OPERATING INCOME — BEFORE OTHER ITEMS	<u>15,594</u>	<u>12,929</u>
<b>OTHER ITEMS</b>		
Impairment of goodwill	(56,215)	-
Asset charges for electronic health record legacy costs	(14,017)	-
Gain on sale of long-term care	-	3,498
Pension settlement loss	<u>-</u>	<u>(6,646)</u>
Total other items	<u>(70,232)</u>	<u>(3,148)</u>
OPERATING (LOSS) INCOME	<u>(54,638)</u>	<u>9,781</u>
<b>NONOPERATING INCOME:</b>		
Investment income	<u>15,675</u>	<u>15,852</u>
Total nonoperating income	<u>15,675</u>	<u>15,852</u>
(DEFICIENCY) EXCESS OF REVENUE OVER EXPENSES	<u>\$ (38,963)</u>	<u>\$ 25,633</u>

*(Continued)*

**MIDMICHIGAN HEALTH**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
*(Dollars in thousands)*

	<b>For the Years Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>UNRESTRICTED NET ASSETS</b>		
(Deficiency) excess of revenue over expenses	\$ (38,963)	\$ 25,633
Net assets released from restrictions used for purchase of property and equipment	2,942	5,713
Change in unrealized investment return	44,995	(15,046)
Postretirement-related changes other than net periodic postretirement cost	<u>73,703</u>	<u>(44,333)</u>
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	<u>82,677</u>	<u>(28,033)</u>
<b>RESTRICTED NET ASSETS</b>		
TEMPORARILY RESTRICTED NET ASSETS:		
Acquisition of Alpena		6,191
Pledges, contributions, grants, and interest income	12,899	5,996
Net assets released from restrictions	<u>(13,001)</u>	<u>(10,607)</u>
(DECREASE) INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	<u>(102)</u>	<u>1,580</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Pledges, contributions, grants, and interest income	277	264
Investment gains (losses) on trustee-held investments	<u>120</u>	<u>(13)</u>
INCREASE IN PERMANENTLY RESTRICTED NET ASSETS	<u>397</u>	<u>251</u>
INCREASE (DECREASE) IN NET ASSETS	82,972	(26,202)
NET ASSETS — Beginning of year	<u>640,858</u>	<u>667,060</u>
NET ASSETS — End of year	<u>\$ 723,830</u>	<u>\$ 640,858</u>

See notes to consolidated financial statements.

*(Concluded)*

**MIDMICHIGAN HEALTH**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	For the Years Ended June 30,	
	2017	2016
<b>OPERATING ACTIVITIES:</b>		
Increase (decrease) in net assets	\$ 82,972	\$ (26,202)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	45,677	41,624
Postretirement-related changes other than net periodic postretirement cost	(73,703)	44,333
Impairment charge	56,215	-
Provision for uncollectible accounts	39,165	26,396
Change in unrealized investment return	(44,995)	15,046
Realized gains on investments	(7,633)	(2,267)
Net unrealized gains on investments accounted for using the fair value option and the equity method	(3,475)	(2,344)
Restricted contributions and restricted investment income received	(13,176)	(6,260)
Loss on disposal of property, plant, and equipment	9,632	327
Gain on sale of long-term care	-	(3,498)
Equity earnings in joint ventures	(528)	(577)
Distributions received from investments in joint ventures	2,482	1,545
Changes in operating assets and liabilities:		
Trading securities	11,537	(177)
Accounts receivable for patient services	(52,548)	(23,248)
Accounts payable and accrued expenses	296	5,698
Estimated third-party settlements payable	(1,991)	1,163
Prepaid expenses, other current assets, and inventories	1,471	(1,424)
Self-insurance, deferred compensation, and other liabilities	(15,753)	8,523
Other changes in operating assets and liabilities	(3,382)	(604)
Net cash provided by operating activities	<u>32,263</u>	<u>78,054</u>
<b>INVESTING ACTIVITIES:</b>		
Additions to property and equipment	(96,158)	(39,520)
Acquisition of hospital	-	9,484
Purchase of investments	(22,993)	(73,301)
Sale of investments	50,748	45,927
Proceeds from sale of long-term care	-	9,481
Contributions to joint ventures	-	(1,527)
Net cash used in investing activities	<u>(68,403)</u>	<u>(49,456)</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of long-term debt	25,467	-
Refunding of long-term debt	-	(17,869)
Debt issuance costs	(66)	-
Restricted contributions and restricted investment income received	13,176	6,260
Payment of long-term debt	(5,696)	(4,573)
Net cash provided by (used in) financing activities	<u>32,881</u>	<u>(16,182)</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(3,259)</b>	<b>12,416</b>
<b>CASH AND CASH EQUIVALENTS — Beginning of year</b>	<b><u>23,747</u></b>	<b><u>11,331</u></b>
<b>CASH AND CASH EQUIVALENTS — End of year</b>	<b><u>\$ 20,488</u></b>	<b><u>\$ 23,747</u></b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for interest	\$ 8,227	\$ 8,216
Noncash additions to property and equipment	\$ 1,633	\$ 3,015

See notes to consolidated financial statements.

**MIDMICHIGAN HEALTH**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF AND FOR THE YEARS ENDED JUNE 30, 2017 AND 2016**  
**(Dollars in thousands)**

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**1. ORGANIZATION AND MISSION**

**Organization**

MidMichigan Health, a Michigan not-for-profit corporation, and its subsidiaries are collectively referred to as “MidMichigan Health.” MidMichigan Health operates a network of health services, including inpatient and outpatient services, physician services, home health care, long-term care, and rehabilitation services primarily in Midland, Alpena, Alma, Clare, and Gladwin counties.

The following entities are collectively referred to as “Subsidiaries”:

Sole corporate member organizations:

- MidMichigan Medical Center — Midland (Midland)
- MidMichigan Medical Center — Alpena (Alpena)
- MidMichigan Medical Center — Gratiot (Gratiot)
- MidMichigan Medical Center — Clare (Clare)
- MidMichigan Medical Center — Gladwin (Gladwin)
- MidMichigan Physicians Group (MPG)
- MidMichigan Visiting Nurse Association dba MidMichigan Home Care (MHC)
- MidMichigan Collaborative Care Organization (MCCO)
- MidMichigan Health Foundation (Foundation)

100% of capital stock owned:

- MidMichigan Health Development Associates (MHDA)

Effective April 1, 2017, MidMichigan Assurance Group (MAG) was dissolved and liquidated and as a result, MidMichigan Health no longer holds trading securities.

Effective July 1, 2016, MidMichigan Health Foundation was formed to enhance the mission of MidMichigan Health by raising funds and public support and funding MidMichigan Health’s services, programs, projects, and initiatives to further its exempt purposes.

Effective May 1, 2016, MidMichigan Health completed the divestiture of its two long-term care facilities, MidMichigan Stratford Village and MidMichigan Gladwin Pines. The assets sold consisted primarily of building and building improvements. The sale resulted in a gain of \$3,498 recorded in other items in the consolidated statements of operations and changes in net assets.

Effective April 1, 2016, MidMichigan Health and Alpena Regional Medical Center (ARMC) entered into an agreement whereby MidMichigan Health became the sole corporate member of ARMC and ARMC changed its name to MidMichigan Medical Center – Alpena (see Note 3).

## **Mission**

MidMichigan Health's vision, "We celebrate the power of health throughout life – with you," promotes health throughout each person's lifetime by providing seamless care, including inpatient, outpatient, physician, home health care, psychiatric, and rehabilitation services. The mission statement for MidMichigan Health provides the purpose for its existence. The mission statement is as follows:

*Our mission is to provide excellent health services to improve the quality of life for people in our communities. Our patients remain the focus of everything we do.*

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Presentation**

The consolidated financial statements have been presented in conformity with accounting principles generally accepted in the United States of America (GAAP).

### **Basis of Consolidation**

Included in MidMichigan Health's consolidated financial statements are all of its wholly owned or controlled subsidiaries. All intercompany transactions have been eliminated in consolidation.

### **Use of Estimates**

The preparation of consolidated financial statements in conformity with GAAP requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. MidMichigan Health considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including recognition of net patient service revenue, which includes contractual allowances and discounts, recorded values of investments, provisions for uncompensated services, reserves for losses and expenses related to health care professional and general liabilities, and risks and assumptions for measurement of pension and postretirement health care liabilities. Management relies on historical experience and other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ materially from those estimates.

### **Cash and Cash Equivalents**

Cash and investments having an original maturity of 90 days or less when purchased are considered to be cash and cash equivalents. These securities are so near maturity that they present insignificant risk of changes in value.

### **Trading Securities**

Investments are held principally for sale in the near term and have been classified by management as trading securities. These investments include equity securities with readily determinable fair values and debt securities, which are also measured at fair value. Unrealized gains and losses on these investments are included in other revenue in the consolidated statements of operations and changes in net assets. As of June 30, 2017, with the dissolution of MAG, MidMichigan Health no longer holds trading securities.

## **Net Patient Service Revenue, Accounts Receivable for Patient Services, and Allowance for Doubtful Accounts**

Net patient service revenue is reported at the estimated net realizable amounts from third-party payors, patients, and others for services rendered. MidMichigan Health has agreements with third-party payors that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, per diem payments, and discounted charges, including estimated retroactive settlements under payment agreements with third-party payors.

MidMichigan Health recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. Provisions for adjustments to net patient service revenue are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. For uninsured patients that do not qualify for charity care, MidMichigan Health recognizes revenue based on its discounted rates. On the basis of historical experience, a significant portion of MidMichigan Health's uninsured patients will be unable or unwilling to pay for the services provided. Thus, MidMichigan Health records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided.

Patient accounts receivable are based on gross charges and stated at net realizable value. Accounts receivable are reduced by an allowance for contractual adjustments, based on expected payment rates from payors under current reimbursement methodologies, and also by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, MidMichigan Health analyzes historical trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for contractual adjustments and allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, MidMichigan Health analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for uncollectible accounts (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), MidMichigan Health records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

MidMichigan Health administers a patient financial assistance policy designed to provide financial assistance for uninsured patients, as well as for insured patients with limited resources. For uninsured patients who meet the qualifications stipulated in MidMichigan Health's patient financial assistance policy, emergency and other medically necessary inpatient and outpatient services are provided at no cost. For uninsured patients that do not qualify for full financial assistance, MidMichigan Health offers a discount off standard rates for services provided that result in net charges that do not exceed Medicare payment rates. MidMichigan Health offers a 40% discount for all uninsured patients that do not qualify for financial assistance. The discount is offered regardless of the patient's ability to pay. The accounts receivable from self-pay patients represented 38.1% and 31.2% of total accounts receivable at June 30, 2017 and 2016, respectively. Insured patients with limited financial resources may qualify for a discount on self-pay balances. MidMichigan Health's allowance for doubtful accounts, which is primarily related to self-pay patients, was \$25,406 and \$13,889. The significant increase in the allowances is due to several factors, including the acquisition of Alpena and shifts by patients to high deductible insurance plans. The difference between the discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is written off against the allowance for doubtful accounts in the period they are determined uncollectible.

## **Charity Care**

It is an inherent part of MidMichigan Health's mission to provide necessary medical care free of charge, or at a discount, to individuals without insurance or other means of paying for such care. As the amounts determined to qualify for charity care are not pursued for collection, they are not reported as net patient service revenue.

## **Inventory**

Inventories consist primarily of medical supplies and pharmaceuticals and are stated at the lower of cost or market. The cost of inventories is determined principally by the weighted-average cost method.

## **Fair Value of Financial Instruments**

Financial instruments consist of cash and cash equivalents, investments, accounts receivable, accounts payable, accrued expenses, estimated third-party settlements, and debt. The fair value of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and estimated third-party settlements approximated their financial statement carrying amount as of June 30, 2017 and 2016, because of their short-term maturity. The fair value of the other instruments is disclosed in Notes 7, 10, and 12.

## **Assets Limited as to Use, Investments, and Investment Income**

Assets limited as to use consist primarily of investments limited as to use by donors, unconditional promises to contribute, assets held by trustees under debt or other agreements (including deferred compensation arrangements) and for self-insurance, and board-designated assets set aside for a specified future use. The current portion of cash and investments limited as to use primarily represents the assets that are required for current liabilities, debt service, and professional liability as of June 30, 2017 and 2016.

Investments, inclusive of assets limited as to use, include marketable debt and equity securities. Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices or model-driven valuations. Investments also include investments in commingled funds structured as limited liability corporations or partnerships. These investments are measured at net asset value (NAV) (see Note 7).

Investments also include alternatives. Alternative investments consist of limited partnerships that invest primarily in real estate and hedge funds. These investments are generally not marketable and may be divested only at specified times.

Investments in real estate funds and hedge funds are measured at fair value based on MidMichigan Health's interest in the NAV of the respective fund. The estimated valuations of hedge fund and real estate investments are subject to uncertainty and could differ had a ready market existed for these investments. Such differences could be material.

Investment earnings, except trading securities, are included as investment income, a part of nonoperating income, in calculating excess of revenue over expenses. Unrealized gains or losses on securities for which the fair value option has not been elected are included in the changes in net assets.

Investment income on assets deposited in trust funds by the captive insurance company for self-insurance purposes is included in other revenue in the consolidated statements of operations and changes in net assets. Investment income from all other unrestricted investments and board-designated funds are included in nonoperating income. Nonoperating income consists principally of investment income, realized gains and losses, unrealized gains and losses on commingled funds for which the fair value option has been elected, and other-than-temporary impairment of investments.

MidMichigan Health continually reviews investments for impairment conditions that indicate that an other-than-temporary decline in market value has occurred. Factors considered in determining whether a reduction of the carrying value is required for debt securities include the intent to sell the security and whether MidMichigan Health will more likely than not be required to sell the security before its anticipated recovery. For equity securities, these factors include the length of time and extent to which the market value is below the cost basis of the investment, the financial condition and near-term prospects of the individual security, and the ability and intent of MidMichigan Health to retain the investment for a period of time sufficient to allow for any anticipated recovery in the market value. If an other-than-temporary impairment of equity and/or debt securities is deemed to have occurred, it is recognized as a realized loss, a component of nonoperating income. There was no other-than-temporary impairment recorded in fiscal 2017 and 2016.

### **Investment Risks**

Investment securities are exposed to various risks, such as interest rate risk, market risk, and credit risk. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in values in the near term could materially affect the amounts reported in the accompanying consolidated financial statements (see Note 7).

### **Unconditional Promises to Contribute**

Unconditional promises to contribute (pledges receivable) are recorded at the net present value of their estimated future cash flows. Estimated future cash flows due after one year are discounted using interest rates commensurate with the time value of money concept. The discount rate utilized approximates the risk-free investment rate of MidMichigan Health. MidMichigan Health maintains an estimated allowance for uncollectible pledges based upon management's assessment of historical and expected net collections considering business and economic conditions and other collection indicators. Net unconditional promises to contribute are reported in assets limited as to use by donor or time restriction in the accompanying consolidated balance sheets and amounted to \$8,837 and \$1,268 as of June 30, 2017 and 2016, respectively.

### **Property and Equipment**

Property and equipment, including internal-use software, are recorded at cost or at fair value at the date of receipt, if donated. Expenditures that substantially increase the useful life of existing property and equipment are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation expense is recognized over the estimated useful lives of the assets using either the straight-line or accelerated method and includes capital lease and internal-use software amortization. The useful lives of these assets range from three to 40 years.

Costs of computer software developed or obtained for internal use, including external direct costs of materials and services, payroll, and payroll-related costs of employees directly associated with internal-use software development projects, and interest costs incurred during the development period are expensed or capitalized depending on whether the costs are incurred in the preliminary project stage, development stage, or operational stage.

### **Capitalized Interest**

Interest expense from bond proceeds, net of interest income, incurred during the construction of major projects is capitalized during the construction period. Such capitalized interest is amortized over the depreciable life of the related assets on a straight-line basis. Interest costs are not capitalized on assets established with donor-restricted assets. There was no interest expense capitalized during the years ended June 30, 2017 and 2016.

## Goodwill

Goodwill represents the future economic benefits arising from assets acquired in business combinations that are not individually identified and separately recognized.

## Asset Impairments

### Long-lived Assets and Impairment

MidMichigan Health continually evaluates the recoverability of the carrying value of long-lived assets by reviewing long-lived assets for impairment. Impairment testing is performed following a triggering event or whenever events or changes in circumstances indicate an asset's carrying value may not be recoverable. When circumstances indicate the remaining estimated useful life of long-lived assets may not be recoverable, MidMichigan Health adjusts the carrying value of a long-lived asset to fair value if an estimate of the undiscounted cash flows over the remaining life is less than the carrying value of the asset. During the years ended June 30, 2017 and 2016, no such impairment was considered necessary.

### Goodwill

Goodwill is evaluated for possible impairment at the reporting unit level at least annually or when an event or change in circumstance indicates that the carrying value of such assets may not be recoverable. If the carrying amount of a reporting unit exceeds its fair value an impairment loss is recognized in the amount equal to that excess, limited to the total goodwill allocated to the reporting unit. Estimates of fair value are based on appraisals, established market prices for comparable assets or internal estimates of future net cash flows. MidMichigan Health recorded \$56,215 of impairment of goodwill during fiscal year 2017, which is due primarily to the valuation of the Alpena pension obligation.

Information on changes in the carrying amounts of goodwill as of June 30, 2017 and 2016, is as follows:

	<b>2017</b>	<b>2016</b>
Balance-beginning of year	\$ 56,215	\$ -
Goodwill acquired during the year:		
Alpena	-	56,215
Impairment of Alpena goodwill	<u>(56,215)</u>	<u>-</u>
Balance-end of year	<u>\$ 112,430</u>	<u>\$ 56,215</u>

## Asset Retirement Obligations

MidMichigan Health recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, MidMichigan Health capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle an asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statements of operations and changes in net assets.

### **Ownership Interests in Other Health-Related Entities**

MidMichigan Health has affiliations with and interests in other organizations that are not consolidated. These organizations primarily provide outpatient health care and managed care contracting services. An ownership interest in another health-related entity of at least 20%, but not more than 50%, in which MidMichigan Health has the ability to exercise significant influence over the operating and financial decisions of the investee is accounted for on the equity basis (see Note 14), and the income (loss) is reflected in other revenue. An ownership interest in a health-related entity of less than 20%, in which MidMichigan Health does not have the ability to exercise significant influence over the operating and financial decisions of the investee, is carried at cost or estimated net realizable value, which is not material to the consolidated financial statements.

### **Other Assets**

Other assets include prepaid postretirement assets, long-term notes receivable, and definite-lived intangible assets. The net balances of definite-lived intangible assets include noncompete agreements, payor contracts, and other definite-lived intangible assets with finite lives amortized using the straight-line method over their estimated useful life which is estimated to be 10 years.

### **Net Assets**

Resources of MidMichigan Health are designated as permanent, temporary, or unrestricted. Permanently restricted net assets include the original value of contributions that are required by donors to be permanently retained, including any accumulations to the permanent endowment made in accordance with the donor's restrictions. Temporarily restricted net assets include contributions and accumulated investment returns whose use is limited by donors for a specified purpose or time period or by interpretations of law. Temporarily restricted net assets are available for capital and operational purchases, health education, and community needs. Unrestricted net assets include the remaining resources of MidMichigan Health that are not restricted and arise from the general operations of the organization.

During fiscal 2017 and 2016, net assets were released from donor restrictions for purchasing property and equipment of \$2,942 and \$5,713, respectively, and incurring expenses of \$10,059 and \$4,894, respectively, both of which satisfied the restricted purposes of the donors. Net assets released from restriction used in operations are included in other revenue in the accompanying consolidated statements of operations and changes in net assets.

### **Contributions**

Unconditional promises to contribute cash and other assets are reported at fair value at the date the promise is received. Conditional gifts are reported at fair value when the conditions have been substantially met. Contributions are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as other revenue (if time restricted or restricted for operating purposes) or reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions used for purchase of property and equipment (if restricted for capital acquisition). Donor-restricted contributions for operating purposes whose restrictions are met within the same year as received are reported as operating revenue in the accompanying consolidated statements of operations and changes in net assets.

## **Other Revenue**

Other revenue is primarily composed of assets released from restrictions, revenues from cafeteria sales, reimbursement of outside services, county emergency medical services subsidy, income on trading securities, electronic health record (EHR) incentive payments, performance incentives, and other miscellaneous sources.

## **Self-Insured Employee Benefits**

Most of the employees of MidMichigan Health are covered by the self-funded employee health insurance program. The provisions of this program permit employees and their dependents to elect to receive medical care at either subsidiaries of MidMichigan Health or other health care providers. MidMichigan Health pays the claims as incurred. Net patient service revenue includes \$16,377 and \$18,123 for fiscal 2017 and 2016, respectively, for medical services provided by MidMichigan Health to its employees and dependents in such years. Employee health claims under the self-insurance plan that are provided by MidMichigan Health are recognized as employee benefits expense and net patient service revenue in the consolidated statements of operations and changes in net assets. Included in accrued expenses is \$6,223 and \$6,154 for estimated unprocessed claims and claims incurred, but not reported as of June 30, 2017 and 2016, respectively.

## **Estimated Professional Liability Costs**

The provision for insurance includes estimated medical malpractice claims. These estimates include the ultimate costs for both reported claims and claims incurred, but not reported.

## **Tax Status**

MidMichigan Health and all subsidiaries, except MHDA, MCCO, and MAG, have been recognized as exempt from federal income taxes under provisions of the Internal Revenue Code (IRC) Section 501(a) as organizations described in IRC Section 501(c)(3). All of these exempt organizations are classified as public charities. MHDA is exempt from federal income taxes under provisions of IRC Section 501(a) as an organization described in Section 501(c)(2). MCCO is a single-member limited liability company, and the majority of its activity is considered exempt from tax since it is conducted by MidMichigan Health. MidMichigan Health's wholly owned insurance captive, MAG, operated in the Cayman Islands and was currently not subject to US income taxes. MidMichigan Health does not have any material uncertain tax positions as of June 30, 2017 and 2016.

## **Other Items**

During 2017 MidMichigan Health recognized asset impairment charges of \$56,215 related to the write down of goodwill and \$14,017 related to the write down of legacy costs incurred for the prior EHR. Other items in the consolidated statement of operations and change in net assets also included \$3,498 for gain on sale of long-term care and \$6,646 for pension settlement loss in fiscal 2016.

## **Excess of Revenue over Expenses**

The consolidated statements of operations and changes in net assets include excess of revenue over expenses as the performance indicator. Excess of revenue over expenses includes all changes in unrestricted net assets, except for unrealized investment return for investments other than trading securities and those for which the fair value option has not been elected, permanent transfers of assets to and from subsidiaries for other than goods and services, contributions of (and assets released from donor restrictions related to) long-lived assets, and other items that are required by GAAP to be reported separately (such as the effect of discontinued operations, postretirement-related changes other than net periodic postretirement costs, and the cumulative effect of changes in accounting principles). Certain income and expenses that are included in the performance indicator are separately presented as other items.

## **Nonoperating Income**

Nonoperating income includes items not directly associated with patient care or other activities not relating to the core operations of MidMichigan Health. Nonoperating income consists primarily of investment income (including interest, dividends, and realized and unrealized gains and losses) on all other investments except trading securities and those for which the fair value option has not been elected, and unrestricted contributions.

## **Accounting Pronouncements Adopted**

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This guidance requires debt issuance costs to be presented as a direct deduction from the related debt rather than as an asset. This guidance was retrospectively adopted for 2017 and 2016, resulting in a reduction in other assets and long-term debt – less current portion of \$1,558 and \$1,581 as of June 30, 2017 and 2016, respectively.

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment*. This guidance simplifies the subsequent measurement of goodwill by eliminating Step 2 of the goodwill impairment test. If a reporting unit fails Step 1 of the goodwill impairment test, entities are no longer required to compute the implied fair value of goodwill following the same procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, the guidance requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and to recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. This guidance is effective for MidMichigan Health beginning July 1, 2022, with early adoption permitted for annual goodwill impairment tests performed after January 1, 2017. MidMichigan Health early adopted ASU No. 2017-04 performing a goodwill test for the Alpena reporting unit as of March 31, 2017, which resulted in an impairment charge of \$56,215 in other items in the consolidated statements of operations and changes in net assets for June 30, 2017.

## **Accounting Pronouncements Pending Adoption**

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This guidance requires the service cost component of net periodic benefit cost related to defined benefit pension and postretirement benefit plans to be reported in the same financial statement line as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented separately from service costs and outside of operating income in the statements of operations. Only the service cost component of net periodic benefit cost will be eligible for capitalization in assets. This guidance is effective for MidMichigan Health beginning July 1, 2019. MidMichigan Health is currently evaluating the impact on its consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows*. This guidance requires the statement of cash flow to explain the change in total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This guidance is effective for MidMichigan Health beginning July 1, 2019. MidMichigan is currently evaluating the impact on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. This guidance adds or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. This guidance is effective for MidMichigan Health beginning July 1, 2019. MidMichigan Health is currently evaluating the impact on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*. This guidance simplifies and improves how not-for-profit entities classify net assets, as well as the information presented in financial statements and notes about liquidity, financial performance, and cash flows. This guidance is effective for MidMichigan Health beginning July 1, 2018. MidMichigan Health is currently evaluating the impact on its consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*. This guidance amends certain aspects of the FASB's revenue standard, ASU No. 2014-09, *Revenue from Contracts with Customers*. In March 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers: Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*. This guidance amends the principal-versus-agent implementation guidance and illustrations in the FASB's revenue standard ASU No. 2014-09, *Revenue from Contracts with Customers*. In July 2015, the FASB issued ASU No. 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of the FASB's revenue standard, ASU No. 2014-09, *Revenue From Contracts With Customers*, by one year for all entities and permits early adoption on a limited basis. In May 2014, the FASB issued ASU No. 2014-09. This guidance outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. After the deferral, this guidance is now effective for MidMichigan Health beginning July 1, 2018. MidMichigan Health is currently evaluating the impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This guidance increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This guidance is effective for MidMichigan Health beginning July 1, 2019. MidMichigan Health is currently evaluating the impact on its consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*. This guidance requires an acquirer in a business combination to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The effect on earnings of changes in depreciation or amortization, or other income effects (if any) as a result of change to the provisional amounts, calculated as if the accounting had been completed as of the acquisition date, must be recorded in the reporting period in which the adjustment amounts are determined rather than retrospectively. Also, the acquirer must present separately on the face of the income statement, or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This guidance is effective for MidMichigan Health beginning July 1, 2017. MidMichigan Health does not expect this guidance to have a material impact on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*. This guidance requires entities to measure most inventories at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective for MidMichigan Health beginning July 1, 2017. MidMichigan Health does not expect this guidance to have a material impact on its consolidated financial statements.

### **3. BUSINESS ACQUISITION**

MidMichigan Health entered into the following significant acquisition activity during the year ended June 30, 2016.

#### *Alpena Regional Medical Center*

As part of the agreement between MidMichigan Health and ARMC, MidMichigan Health committed to make an investment of \$125,000 in Alpena, which includes defeasance of Alpena's long-term debt, the assumption of Alpena pension deficit and all remaining liabilities. In addition, MidMichigan Health committed to invest \$70,000 over the next 10 years for capital improvements in Alpena.

Alpena assets include a 139-bed hospital located in Alpena, Michigan that provides comprehensive inpatient and outpatient services and is federally designated as a rural referral center for all of northeast Michigan. Alpena has approximately 4,500 inpatient admissions, 160,000 outpatient visits, including 18,000 emergency department visits per year. The primary purpose of the acquisition is to further the missions of MidMichigan Health and Alpena, provide new opportunities and efficiencies, and further the health system's response to health reform, ensuring that the health care needs of the communities served will continue to be met.

Summarized balance sheet information for Alpena as of April 1, 2016, is shown below:

	<b>2016</b>
Cash and cash equivalents	\$ 9,484
Accounts receivable, net	13,145
Other current assets	6,896
Assets limited or restricted as to use	62,797
Property and equipment, net	67,545
Goodwill and intangible assets	56,945
Other assets	<u>3,818</u>
Total assets acquired	<u>\$ 220,630</u>
Accounts payable and accrued expenses	\$ 24,279
Salaries, wages, and related liabilities	4,884
Estimated third-party settlements payable	5,154
Other current liabilities	3,979
Accrued pension benefits	153,519
Other liabilities	7,618
Long-term debt	<u>15,006</u>
Total liabilities assumed	<u>\$ 214,439</u>
Temporarily restricted net assets	<u>\$ 6,191</u>

Operating results of Alpena, for the period from April 1, 2016, through June 30, 2016, included total operating revenues of \$33,609, operating losses of \$685, and expenses over revenues of \$578.

The pro forma amount of MidMichigan Health's revenue, earnings, and changes in net assets had the above acquisition occurred on July 1, 2015, are as follows:

	<b>2016</b>
Total operating revenues	\$ 777,802
Income from operations	9,063
Excess of revenues over expenses	25,085

#### 4. NET PATIENT SERVICE REVENUE

The mix of patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized during the years ended June 30, 2017 and 2016, by major payor source, was as follows:

	2017		2016	
Medicare	\$ 345,358	43.1 %	\$ 273,863	40.5 %
Blue Cross	158,602	11.9	133,222	19.7
Medicaid	95,483	19.8	88,352	13.1
Commercial, self-pay, and other	202,087	25.2	180,654	26.7
Total patient service revenue	\$ 801,530	100.0 %	\$ 676,091	100.0 %

A summary of the payment arrangements by major payor source is as follows:

*Medicare* — Acute inpatient and outpatient services rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain items are reimbursed at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractors.

*Medicaid* — Reimbursement for services rendered to Medicaid program beneficiaries includes prospectively determined rates per discharge, per diem payments, and discounts from established charges, statewide distribution pools, fee schedules, and cost reimbursement methodologies, with certain limitations. Cost reimbursable items are reimbursed at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare Administrative Contractor and state Medicaid administrators.

In December 2003, the Centers for Medicare and Medicaid Services approved the Michigan Hospital Assessment Program (the “Program”) to improve Medicaid reimbursement for Michigan hospitals. The Program increased net patient service revenue in the form of additional Medicaid payments and increased fees through a tax assessment from the State of Michigan. The net benefit to MidMichigan Health from the Program was \$18,784 and \$15,049 during the years ended June 30, 2017 and 2016, respectively. For the years ended June 30, 2017 and 2016, the Medicaid payment of \$34,369 and \$30,412, respectively, was included in net patient service revenue, representing 4.3% and 4.9%, respectively, of the net patient service revenue, and the tax assessment of \$15,585 and \$15,363, respectively, was included in fees in the consolidated statements of operations and changes in net assets. The Program is subject to federal acceptance of the assessments for federal matching funding and may be limited or eliminated in the future.

*Blue Cross Blue Shield of Michigan* — Reimbursement for services to subscriber patients include prospectively set, clinically adjusted per discharge rates, per diem rates, fee schedule rates, and discounts from established charges.

*Commercial, Self-Pay, and Other* — Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, preferred provider organizations, and directly from patients. The basis for reimbursement includes prospectively determined rates per discharge, per diem payments, and discounts from established charges. Michigan law limits amounts collectable from uninsured patients.

Changes in estimates relating to prior periods increased net patient service revenue by \$1,049 and \$2,981 in fiscal 2017 and 2016, respectively. Laws and regulations governing government and other payment programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated third-party settlements could change by a material amount.

As of June 30, 2017, letters of final settlements have not been received from Medicare for fiscal 2014 through fiscal 2017, Blue Cross for fiscal 2017, and Medicaid for fiscal 2014 through 2017. The estimated receivables from or payables to third-party payors related to settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as needed until final settlements are determined. In addition, MidMichigan Health filed formal appeals relating to the settlement of certain prior-year Medicare cost reports dating back to fiscal 2002. During fiscal 2017, MidMichigan Health received and recognized \$2,954 of Recovery Audit Contracts (RAC) settlement, representing 66% of the claims filed, as an increase to net patient service revenue in the consolidated statements of operations and changes in net assets.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity continues with respect to investigations and allegations concerning possible violations of regulations by health care providers, which could result in the imposition of significant fines and penalties, as well as significant repayment of previously billed and collected revenues from patient services. Management believes that MidMichigan Health is in compliance with current laws and regulations.

## **5. CHARITY CARE AND COMMUNITY BENEFIT**

As part of its mission, MidMichigan Health provides services to patients without regard to their ability to pay for these services. For some of its patient services, MidMichigan Health receives no payment or payment that is less than the full cost of providing the services.

MidMichigan Health has an established charity care policy and maintains records to identify and monitor the level of charity care it provides. MidMichigan Health voluntarily provides free care to all patients who are unable to pay for all or part of their health care expenses as determined by MidMichigan Health's criteria for financial assistance. Because MidMichigan Health does not pursue the collection of amounts determined to qualify as charity care, they are not reported as patient service revenues. In some cases, MidMichigan Health does not receive the amount billed for patient services even though it did not receive the information necessary to determine if the patients met the criteria for financial assistance in accordance with its charity care and financial assistance policies.

Additionally, MidMichigan Health demonstrates its exempt purpose to benefit the communities it serves by operating emergency rooms and other clinical services open to the public 24 hours a day, seven days a week; providing facilities for the education and training of health care professionals; and conducting research for the study of new drugs that offer the promise of improving health care.

MidMichigan Health’s quantifiable costs of charity care and unreimbursed Medicaid, community benefits, and other uncompensated care provided for the years ended June 30, 2017 and 2016, are as follows:

	<b>2017</b>	<b>2016</b>
Charity care and unreimbursed Medicaid— at cost:		
Charity care	\$ 1,728	\$ 804
Unreimbursed Medicaid	<u>30,176</u>	<u>24,035</u>
Total charity care and unreimbursed Medicaid — at cost	<u>31,904</u>	<u>24,839</u>
Community benefits — at cost:		
Medical education	6,547	6,679
Community services, including community building activities of \$470 and \$457 for the years ended June 30, 2017 and 2016, respectively	<u>2,013</u>	<u>2,257</u>
Total community benefits — at cost	<u>8,560</u>	<u>8,936</u>
<b>Total charity care and unreimbursed Medicaid and community benefits — at cost</b>	<b><u>40,464</u></b>	<b><u>33,775</u></b>
Other uncompensated care — at cost:		
Uncompensated services	15,277	10,395
Unreimbursed Medicare	<u>34,335</u>	<u>39,716</u>
<b>Total other uncompensated care — at cost</b>	<b><u>49,612</u></b>	<b><u>50,111</u></b>
Total community benefit — at cost	<u>\$ 90,076</u>	<u>\$ 83,886</u>

The costs of charity care and unreimbursed Medicaid, community benefits, and other uncompensated care are primarily determined using the Michigan Health and Hospital Association’s methodology, which utilizes a cost-to-charge ratio. The full cost incurred by MidMichigan Health is assigned to all patient care and other operating revenues and is then reduced by the amount expected to be collected for each reported group.

*Charity Care* represents the financial commitment to provide health care services to all patients regardless of their ability to pay. Services are offered with the understanding that health care is a basic human right, and all deserve access in accordance with MidMichigan Health’s mission. The categories included as programs and services related to charity care are as follows:

*Charity Care — at Cost* represents the costs of services provided to patients who cannot afford health care services due to inadequate resources and/or who are uninsured or underinsured. Such patients are classified as charity patients, in accordance with MidMichigan Health’s established policies, and no payment for such services is anticipated. Services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets.

*Unreimbursed Medicaid* represents the cost of providing services to beneficiaries of public programs, including state Medicaid and indigent care programs, in excess of any payments received from government agencies, managed care contracts, or any other source. MidMichigan Health received approximately \$77 and \$94 of stimulus funds related to its achieving meaningful use for its EHR for the years ended June 30, 2017 and 2016, respectively. This reduced its unreimbursed Medicaid.

*Community Benefits* represent the cost of services provided for the benefit of the entire community. The majority of these expenditures are for graduate medical education programs. Other benefits for the broader community include health promotion and wellness programs, health screenings, newsletters, and radio or television programs intended for health education. These programs are not intended to be financially self-supporting. MidMichigan Health actively collaborates with community groups and agencies to assist those in need in providing such services.

*Medical Education* includes the direct costs associated with training health professionals, such as medical residents, nursing students, technicians, and students in allied health professions.

*Community Services* represent community health education and clinical services, such as health screenings and immunizations, health care support services, and donations to organizations for community support and economic development.

*Other Uncompensated Care* represents the cost of services provided for which payment is expected at the time service is provided, but payment is not received or is less than the cost incurred to provide the service. The categories included as programs and services related to other uncompensated care are as follows:

*Uncompensated Services — at Cost* represent the cost of services provided for which a fee has been assessed, but not collected, or only a portion of the cost of the rendered service has been recovered.

*Unreimbursed Medicare* represents the cost of providing services, primarily to elderly beneficiaries of the Medicare program, in excess of government and managed care contract payments. MidMichigan Health received approximately \$581 and \$2,259 of stimulus funds related to its achieving meaningful use for its EHR for the years ended June 30, 2017 and 2016, respectively. This reduced its unreimbursed Medicare.

## 6. ASSETS LIMITED AS TO USE AND INVESTMENTS

Assets limited as to use and investments consist primarily of marketable equity and debt securities, which are held in investment pools to satisfy the investment objectives for which the assets are held or to satisfy donor restrictions. MidMichigan Health also holds certain investments in alternative securities consisting of hedge funds and real estate investments (see Note 2). Assets limited as to use by donor or time restriction also include unconditional promises to contribute.

A summary of the composition of assets limited as to use and investments as of June 30, 2017 and 2016, is as follows:

	<b>2017</b>	<b>2016</b>
Marketable securities and short-term investment funds	\$ 8,189	\$ 24,480
Fixed-income securities, including commingled funds	242,812	274,277
Equity securities, including commingled funds	350,781	300,021
Hedge fund of funds	31,096	28,904
Real estate	<u>70,465</u>	<u>66,236</u>
Total assets limited as to use and investments — excluding pledges receivable	703,343	693,918
Student loan receivables and net pledges	<u>9,393</u>	<u>2,006</u>
Total assets limited as to use and investments	712,736	695,924
Less amount reported as current assets	<u>(18,259)</u>	<u>(23,118)</u>
Assets limited as to use and investments — noncurrent	<u>\$ 694,477</u>	<u>\$ 672,806</u>

The table above comprises all of MidMichigan Health's investments, including those measured at fair value as well as certain alternative investments in hedge funds or real estate measured using NAV.

All pledges are deemed collectible and consist of the following amounts as of June 30, 2017:

**Years Ending June 30**

2018	\$ 2,759
2019	2,743
2020	2,742
2021	2,268
2022	<u>250</u>
Total expected collections	10,762
Unamortized discount	<u>(1,369)</u>
Total student loan receivables and net pledges	<u>\$ 9,393</u>

The composition and presentation of investment income and the realized and unrealized gains and losses on all investments, including trading securities, for the years ended June 30, 2017 and 2016, are as follows:

	2017	2016
Interest and dividends — net	\$ 4,836	\$ 11,478
Realized gains — net	8,265	2,330
Unrealized gains from investments accounted for using the fair value option	2,920	2,346
Unrealized investment return	<u>44,995</u>	<u>(15,046)</u>
Total investment return	<u>\$ 61,016</u>	<u>\$ 1,108</u>
Reported as:		
Other revenue	\$ 346	\$ 302
Nonoperating income	15,675	15,852
Changes in unrestricted net assets	<u>44,995</u>	<u>(15,046)</u>
Total investment return	<u>\$ 61,016</u>	<u>\$ 1,108</u>

**7. FAIR VALUE MEASUREMENTS**

As of June 30, 2017 and 2016, MidMichigan Health’s consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets and liabilities measured at fair value on a recurring basis in MidMichigan Health’s consolidated financial statements include cash, cash equivalents, trading securities, investment funds, commingled funds, and pension and postretirement assets. Liabilities measured at fair value on a recurring basis for disclosure only include debt.

**Valuation Principles**

Under accounting guidance on fair value measurements, fair value is defined as an exit price, representing 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 valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs generally reflect market data from independent sources and are supported by market activity, while unobservable inputs are generally unsupported by market activity. The three-level valuation hierarchy, which prioritizes the inputs used in measuring fair value of an asset or liability at the measurement date, includes:

*Level 1 Inputs* — Quoted prices (unadjusted) for identical assets or liabilities in active markets. Securities typically priced using Level 1 inputs include listed equities and exchange-traded mutual funds.

*Level 2 Inputs* — Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets and liabilities in nonactive markets, and model-driven valuations whose inputs are observable for the asset or liability, either directly or indirectly. Securities typically priced using Level 2 inputs include government bonds (including US treasuries and agencies), corporate and municipal bonds, collateralized obligations, interest rate swaps, commercial paper and currency options, and commingled funds where NAV is corroborated with observable data.

*Level 3 Inputs* — Unobservable inputs for which there is little or no market data available and are based on the reporting entity's own judgment or estimation of the assumptions that market participants would use in pricing the asset or liability. The fair values for securities typically priced using Level 3 inputs are determined using model-driven techniques, which include option-pricing models, discounted cash flow models, and similar methods.

### Fair Value Measurements at the Consolidated Balance Sheet Date

The following tables present MidMichigan Health's fair value hierarchy for its financial assets measured at fair value on a recurring basis as of June 30, 2017 and 2016:

Fair Value Measurements as of June 30, 2017	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Cash equivalents	\$ 22,631	\$ 6,045	\$ -	\$ 28,676
Mutual funds:				
Fixed-income funds	132,718	-	-	132,718
US equity funds	42,215	-	-	42,215
Non-US equity funds	29,772	-	-	29,772
Equity securities:				
Common stock	2,144	-	-	2,144
Other	8,840	1,344	-	10,184
	<u>\$ 238,320</u>	<u>\$ 7,389</u>	<u>\$ -</u>	<u>245,709</u>
Total — assets at fair value				
<b>Investments measured at net asset value:</b>				
Equity securities:				
Collective funds — US Fixed income				108,748
Collective funds — US equity				132,281
Collective funds — Non-US equity				144,369
Alternatives:				
Real estate				70,465
Hedge fund of funds				<u>31,096</u>
Total — assets				<u>\$ 732,668</u>

Fair Value Measurements as of June 30, 2016	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Cash equivalents	\$ 47,979	\$ 946	\$ -	\$ 48,925
Trading securities:				
Fixed-income securities	-	9,223	-	9,223
Equity securities:				
US equity securities	1,571	-	-	1,571
Non-US equity securities	722	-	-	722
Other	-	21	-	21
Mutual funds:				
Fixed-income funds	130,408	-	-	130,408
US equity funds	30,554	-	-	30,554
Non-US equity funds	28,831	-	-	28,831
Equity securities:				
Common stock	1,690	-	-	1,690
Fixed income	-	24,585	-	24,585
Other	1,269	1,237	-	2,506
Total — assets at fair value	<u>\$ 243,024</u>	<u>\$ 36,012</u>	<u>\$ -</u>	<u>\$ 279,036</u>

**Investments measured at net asset value:**

Equity securities:		
Collective funds — US Fixed income		108,105
Collective funds — US equity		118,104
Collective funds — Non-US equity		118,549
Alternatives:		
Real estate		66,236
Hedge fund of funds		<u>28,904</u>
Total — assets		<u>\$ 718,934</u>

There were no security transfers between Levels 1, 2, and 3 during the years ended June 30, 2017 and 2016.

The following table reconciles the information about the fair value of MidMichigan Health's financial instruments measured at fair value on a recurring basis presented in the table above to the amounts presented in the consolidated balance sheets for the years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
<b>Assets:</b>		
Cash and cash equivalents	\$ 20,488	\$ 23,747
Investments — trading securities	-	11,537
Assets limited or restricted as to use — current portion	18,259	11,581
Assets limited as to use and investments:		
Investments	150,989	183,195
Limited as to use by Board for capital acquisitions	455,033	410,362
Self-insurance, deferred compensation, and other	48,193	39,282
Limited as to use by donor or time restriction	40,262	39,967
<b>Less items not recorded at fair value:</b>		
Loan receivable	<u>(556)</u>	<u>(737)</u>
Total assets	<u>\$ 732,668</u>	<u>\$ 718,934</u>

## Valuation Methodologies

The instruments listed in the preceding fair value tables use the following valuation techniques and inputs as of the valuation date:

*Cash and Cash Equivalents* — The carrying amounts reported in the consolidated balance sheets approximate their fair value. Certain cash and cash equivalents are included in investments and assets limited or restricted as to use in the consolidated balance sheets.

*Fixed-Income Securities* — Debt securities are valued using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models, and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve, as well as other relevant economic measures.

*Equity Securities* — Equity securities are valued at the closing price reported on the applicable exchange on which the security is traded or are estimated using quoted market prices for similar securities.

*Exchange Traded/Mutual Funds* — Exchange traded funds are valued at the closing price reported on the applicable exchange on which the fund is traded, or estimated using quoted market prices for similar securities. Mutual funds are valued using the NAV based on the value of the underlying assets owned by the fund, minus liabilities, divided by the number of shares outstanding, and multiplied by the number of shares owned.

*Collective Funds* — Collective funds are developed for investment by institutional investors only and therefore do not require registration with the Securities and Exchange Commission. Collective funds are recorded at fair value based on either the underlying investments that have a readily determinable market value or based on NAV, which is calculated using the most recent fund financial statements.

*Real Estate* — MidMichigan Health invests in various commingled real estate funds that are included in investments and assets limited or restricted as to use in the consolidated balance sheets. Real estate funds are recorded based on NAV, which is calculated using the most recent financial statement.

*Hedge Fund of Funds* — This class includes diversified investments in hedge fund of funds with diverse strategies, including equity long/short, credit long/short, event-driven, relative value, global opportunities, and other multistrategy funds. Hedge fund of funds investments are valued based on MidMichigan Health's ownership interest in the NAV of the respective fund as estimated by the general partner, which approximates fair value. The values for underlying investments are estimated either internally or by an external fund manager based on many factors, including operating performance, balance sheet indicators, growth, and other market and business fundamentals.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while MidMichigan Health believes that its methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

## Investments in Entities That Report Fair Value using NAV

Included within the fair value table above are investments in certain entities that report fair value using a calculated NAV or its equivalent. The following table summarizes the attributes relating to the nature and risk of such investments as of June 30, 2017:

Entities That Report Fair Value Using NAV	Fair Value 2017 (In Thousands)	Fair Value 2016 (In Thousands)	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Equity funds	\$ 276,650	\$ 236,653	None	Daily	5-6 days
Fixed-income funds	108,748	108,105	None	Daily	6 days
Real estate investment funds	70,465	66,236	None	Quarterly	30–60 days
Hedge fund of funds	31,096	28,904	None	Semiannual	95 days

## 8. ENDOWMENTS

MidMichigan Health's endowments consist of various funds established for specific purposes. Its endowments include only donor-restricted endowment funds. Net assets associated with endowment funds are classified and reported based on the existence of donor-imposed restrictions. MidMichigan Health considers various factors in making a determination to appropriate or accumulate donor-restricted endowment funds.

The assets are managed in investment pools. The pools use a targeted asset allocation of 40% equity securities, 10% global balanced funds, 35% fixed income, 10% real estate, and 5% hedge funds. In general, MidMichigan Health uses a long-term rate of return, which is evaluated periodically, to allocate investment earnings to its endowment funds, thus eliminating investment risk on its endowments. The endowment corpus is maintained in perpetuity. MidMichigan Health's spending policy is used as a guideline, in the absence of explicit donor restrictions, to allocate a portion of annual earnings to be maintained in perpetuity along with the corpus. Only amounts exceeding the amounts required to be maintained in perpetuity are expended.

Endowment amounts classified as permanently restricted net assets as of June 30, 2017 and 2016, are described below:

	2017	2016
Permanently restricted net assets:		
Hospital capital support	\$ 7,275	\$ 7,056
Hospital operations support	2,265	2,127
Scholarship funds	3,730	3,729
Community service funds	<u>1,383</u>	<u>1,344</u>
Total endowment funds	<u>\$ 14,653</u>	<u>\$ 14,256</u>

No endowment funds have been classified as temporarily restricted.

Changes in endowment net assets for the fiscal years ended June 30, 2017 and 2016, include:

	<b>2017</b>	<b>2016</b>
Endowment net assets — July 1	\$ 14,256	\$ 14,005
Investment return:		
Investment income - net of annual spending appropriation	265	264
Change in net realized and unrealized gains and losses	120	(13)
Total investment return	385	251
Contributions	12	-
Endowment net assets — June 30	<u>\$ 14,653</u>	<u>\$ 14,256</u>

### Funds with Deficiencies

Periodically, the fair value of assets associated with the individual donor-restricted endowment funds may fall below the level that the donor requires MidMichigan Health to retain as a fund of perpetual duration. Deficiencies of this nature are reported in unrestricted net assets. These deficiencies result from unfavorable market fluctuations or continued appropriation for certain programs that continue to be considered necessary by MidMichigan Health. There were no such deficiencies as of June 30, 2017 and 2016.

## 9. PROPERTY AND EQUIPMENT

Property and equipment as of June 30, 2017 and 2016, consisted of the following:

	<b>2017</b>	<b>2016</b>
Land and improvements	\$ 38,153	\$ 34,641
Building and improvements	424,131	389,543
Equipment	305,951	302,883
Construction in progress	8,948	22,755
Total	777,183	749,822
Less accumulated depreciation	(388,433)	(400,446)
Property and equipment, net	<u>\$ 388,750</u>	<u>\$ 349,376</u>

Internal-use software is included above in equipment and construction in progress. The net book value was \$39,461 and \$15,476 as of June 30, 2017 and 2016, respectively. Approximately \$8,896 related to internal-use software was written off in fiscal 2017 as a result of the implementation of a different EHR. This amount has been included in "Other items – Asset charges for electronic health record legacy costs" in the consolidated statements of operations and change in net assets.

Construction in progress as of June 30, 2017, includes \$2,400 for the new Cardiovascular Regional Referral Center in Midland (including related relocations), \$1,400 for Alpena integration including the EHR, as well as various smaller capital projects. As of June 30, 2017, significant commitments include \$1,200 related to the Cardiovascular Regional Referral Center.

## 10. LONG-TERM DEBT

MidMichigan Health currently has debt outstanding under a master indenture dated December 1, 2014 (the "Master Indenture"), which established an obligated group composed of MidMichigan Health and Midland. The

Master Indenture, as supplemented thereto, permits MidMichigan Health to issue obligations to finance certain capital acquisitions and improvements. The MidMichigan Health Credit Group, under the Master Indenture, consists of the obligated group members and all of MidMichigan Health's active controlled subsidiaries, with the exception of MCCO and MAG. Under the Master Indenture, debt is generally issued as unsecured direct obligations of MidMichigan Health and any future members of the MidMichigan Obligated Group. Proceeds from the tax-exempt revenue and refunding bonds are to be used to finance the construction, acquisition, and equipping of capital improvements. All members of the MidMichigan Obligated Group are jointly and severally liable for debt outstanding of \$207,017 carrying value and \$209,159 fair value as of June 30, 2017.

A summary of MidMichigan Health's long-term debt as of June 30, 2017 and 2016, is as follows:

	Interest Rates	Final Maturity Date	Amount Outstanding at June 30,	
			2017	2016
Fixed-rate revenue bonds:				
Michigan Finance Authority Revenue Bonds:				
Series 2014	4.00%–5.00%	June 1, 2034	\$ 167,235	\$ 168,950
Gratiot Community Hospital Finance Authority Revenue Bonds:				
Series 1998	5.34%	December 1, 2018	<u>351</u>	<u>573</u>
Total fixed-rate debt			<u>167,586</u>	<u>169,523</u>
Variable-rate revenue bonds:				
Michigan Finance Authority Revenue Bonds:				
Series 2016	1.27%–1.48%	October 1, 2031	24,466	-
Hospital Equipment Loan Program Bonds: Series D	0.5%–1.00%	September 15, 2020	<u>4,930</u>	<u>6,447</u>
Total variable-rate debt			<u>29,396</u>	<u>6,447</u>
Other debt:				
Capital lease obligations collateralized by equipment	2.27%–4.78%	November 1, 2017	<u>132</u>	<u>568</u>
Total other debt			<u>132</u>	<u>568</u>
Total debt			197,114	176,538
Less current portion of long-term debt			(5,663)	(3,890)
Unamortized debt issue costs on bonds			(1,558)	(1,581)
Unamortized premium on bonds			<u>16,849</u>	<u>17,742</u>
Long-term debt - net			<u>\$ 206,742</u>	<u>\$ 188,809</u>
Estimated fair value based on quoted market prices and other relevant information (Level 2 classification)			<u>\$ 214,547</u>	<u>\$ 208,513</u>

The fair value of MidMichigan Health’s fixed-rate long-term debt is estimated by an independent third party using a pricing scale based on spreads to municipal market data of comparable transactions that price in the market, as well as secondary market trades for comparable credits. As MidMichigan Health is responsible for the determination of fair value, it performs quarterly analyses on the prices received from independent third parties to determine whether the prices are reasonable estimates of fair value. As a result of these reviews, MidMichigan Health has not historically adjusted the prices obtained from third parties. Since such amounts are estimated based on limited available market information and do not acknowledge certain restrictions that may exist, the actual fair value market values for these obligations may differ significantly from what is provided herein or upon settlement of the obligation. The carrying value of MidMichigan Health’s variable rate bonds and other obligations approximates the fair value.

Under its various indebtedness agreements, the MidMichigan Health Credit Group is subject to certain financial covenants, including maintaining a minimum historical debt service coverage and maximum annual debt service coverage ratios; limitations on selling, leasing, or otherwise disposing of MidMichigan Obligated Group property; and certain other nonfinancial covenants. MidMichigan Health has no knowledge of any default in the performance of the terms, covenants, provisions, or conditions of the Master Indenture. Long-term obligations outstanding as of June 30, 2017 and 2016, excluding amounts issued under the Master Indenture, are generally collateralized by certain property and equipment and secured by a letter of credit with a third-party institution. As of June 30, 2017 and 2016, there were no outstanding draws against the letter of credit related to the Series D Hospital Equipment Loan Program Bonds, which are not subject to remarketing. This letter of credit expires in June 2019. As of June 30, 2017 and 2016, the outstanding obligation was \$4,930 and \$6,447, respectively, which approximated the net book value of property and equipment collateralized. Annual principal payments on long-term debt as of June 30, 2017, are due as follows:

**Years Ending June 30**

2018	\$ 5,663
2019	5,469
2020	6,707
2021	5,699
2022	5,485
Thereafter	<u>168,091</u>
Total	<u>\$ 197,114</u>

**Financing Activity**

On December 15, 2016, MidMichigan Health issued \$30,000 of tax-exempt variable-rate Michigan Finance Authority Revenue Bonds Series 2016. The debt was issued as a direct purchase. As of June 30, 2017, \$25,467 of the debt had been drawn down. MidMichigan Health expects to draw down the remaining \$4,533 of debt during the next fiscal year.

On April 1, 2016, MidMichigan Health, as part of the agreement with ARMC, fully advance refunded through net defeasance \$16,275 of ARMC Series 2013 and Series 2012 bonds, plus accrued interest. MidMichigan Health advance refunded the bonds by depositing funds in trustee-held escrow accounts exclusively for the payment of principal and interest. The trustees/escrow agents are solely responsible for the subsequent extinguishment of the bonds. The trustee held escrow accounts are invested in US government securities.

## 11. OTHER LONG-TERM LIABILITIES

The composition of other long-term liabilities as of June 30, 2017 and 2016, is as follows:

	2017	2016
Self-insurance liabilities	\$ 19,431	\$ 19,803
Estimated payables to third-party payors, long-term	10,704	10,749
Deferred compensation plan liabilities	25,774	21,533
Asset retirement obligations	8,859	9,857
Long-term accrued fees	9,442	365
Equity option	3,000	3,000
Other	<u>2,601</u>	<u>4,797</u>
Total self-insurance, deferred compensation, and other liabilities	79,811	70,104
Less current portion	<u>(5,081)</u>	<u>(2,623)</u>
Total	<u>\$ 74,730</u>	<u>\$ 67,481</u>

### Asset Retirement Obligation

Asset retirement obligations represent legal or contractual obligations associated with the retirement of tangible long-lived assets that are incurred upon the acquisition, construction, development, or normal operation of that long-lived asset. Asset retirement obligations are required to be recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. The asset retirement obligations are accreted to their present value at the end of each reporting period. The associated estimated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over its useful life. MidMichigan Health annually evaluates its leased and owned properties for potential asset retirement obligations. Based on these reviews, MidMichigan Health identified obligations primarily related to the removal of certain materials previously utilized in the construction process.

The following table summarizes changes in the total liability for asset retirement obligations as of June 30, 2017 and 2016:

	2017	2016
Asset retirement obligation — beginning of the year	\$ 9,857	\$ 7,049
Accretion	541	404
Liabilities settled	(986)	(512)
Liabilities incurred (future remediation assumption changes)	<u>(553)</u>	<u>2,916</u>
Asset retirement obligation — end of the year	<u>\$ 8,859</u>	<u>\$ 9,857</u>

## 12. PENSION, POSTRETIREMENT, AND OTHER EMPLOYEE BENEFIT PLANS

MidMichigan Health maintains a defined benefit/cash balance pension plan (the "Pension Plan"), a defined benefit pension plan (the "Alpena Pension Plan"), defined contribution plans, and other postretirement benefit plans that together cover substantially all of MidMichigan Health's employees.

Effective April 1, 2016, MidMichigan Health established a new defined benefit pension plan for Alpena employees. This plan is a spinoff of the Municipal Employees Retirement System (MERS) plan that was in place for Alpena employees prior to the acquisition. On the effective date, \$260,719 of benefit obligations and \$108,700 of assets were transferred from the MERS plan into the new Alpena Pension Plan.

Effective January 1, 2008, the Pension Plan was amended and changed to a cash balance plan. Substantially, all of MidMichigan Health's employees participate in the qualified noncontributory Pension Plan. Benefits for the Pension Plan are based on pay credits and interest credits; at the end of each calendar year, participant accounts are credited with a percentage of the participant's annual salary. The minimum amounts required to meet the provisions of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 (ERISA), as amended, are funded on an annual basis, plus any additional amounts that MidMichigan Health may determine to be appropriate. Plan assets and obligations are measured as of June 30 (the "Measurement Date") each year. The Pension Plan can be terminated by the board subject to certain notification requirements. MidMichigan Health, at this time, does not intend to terminate the Pension Plan.

In addition to the pension programs, MidMichigan Health (primarily, Midland) also provides postretirement health care benefits (the "Postretirement Healthcare Plan") to certain retirees. Further benefits under the Postretirement Healthcare Plan have been curtailed. Contributions are intended to provide not only for benefits attributed to service to date, but also for the related interest cost associated with the Postretirement Healthcare Plan. Retirees who have the Postretirement Healthcare Plan are required to make contributions toward the cost of their benefits based on their years of service at retirement. For retirements on or after January 1, 1994, retirees are required to contribute, in addition to a percentage of the premium based on years of service, the difference between actual cost for a particular year and four times the 1994 cost. Midland reserves the right to amend, modify, or terminate these benefits at any time.

Effective April 1, 2016, MidMichigan Health assumed a \$1,463 postretirement obligation for the Alpena employees Medicare Part B Reimbursement Program. This plan is unfunded. The plan provides a closed group of retirees' quarterly Medicare Part B premium reimbursement. The reimbursement amounts were fixed at retirement and do not increase.

The table below sets forth the accumulated benefit obligation, the change in the projected benefit obligation, and the change in the plan assets of the Pension Plan, Alpena Pension Plan, Postretirement Healthcare Plan, and the Medicare Part B Reimbursement Program (collectively, the "Plans"). The table also reflects the funded status of the Plans as of the Measurement Date and amounts recognized in MidMichigan Health's consolidated balance sheets as of June 30, 2017 and 2016.

<b>Obligations and Funded Status</b>	<b>Pension Plans</b>		<b>Postretirement Healthcare Plans</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Change in benefit obligations:				
Benefit obligation — beginning of measurement period	\$ 629,011	\$ 328,345	\$ 5,297	\$ 4,546
Service cost	10,932	7,694	-	-
Interest cost	21,822	16,567	138	156
Acquisition of ARMC	-	260,719	-	1,463
Plan settlements	-	(21,024)	-	-
Actuarial (gains) losses	(42,204)	49,813	(304)	(463)
Plan participants' contributions	177	51	-	-
Benefits paid	<u>(24,885)</u>	<u>(13,154)</u>	<u>(489)</u>	<u>(405)</u>
Projected benefit obligation — end of measurement period	<u>\$ 594,853</u>	<u>\$ 629,011</u>	<u>\$ 4,642</u>	<u>\$ 5,297</u>
Change in plan assets:				
Fair value of plan assets — beginning of measurement period	\$ 378,833	\$ 282,982	\$ 14,942	\$ 14,720
Actual return on plan assets	46,399	9,278	1,749	605
Acquisition of ARMC	-	108,700	-	-
Plan participants' contributions	177	51	-	-
Employer contributions	42,750	12,000	112	51
Plan settlements	-	(21,024)	-	-
Administrative expenses paid	-	-	(26)	(29)
Benefits paid	<u>(24,885)</u>	<u>(13,154)</u>	<u>(489)</u>	<u>(405)</u>
Fair value of plan assets — end of measurement period	<u>\$ 443,274</u>	<u>\$ 378,833</u>	<u>\$ 16,288</u>	<u>\$ 14,942</u>
Accrued liability (asset)	<u>\$ 151,579</u>	<u>\$ 250,178</u>	<u>\$ (11,646)</u>	<u>\$ (9,645)</u>
Recognized in the consolidated balance sheets as follows:				
Noncurrent asset	\$ -	\$ -	\$ (12,938)	\$ (11,129)
Noncurrent liability	<u>151,579</u>	<u>250,178</u>	<u>1,292</u>	<u>1,484</u>
	<u>\$ 151,579</u>	<u>\$ 250,178</u>	<u>\$ (11,646)</u>	<u>\$ (9,645)</u>

The actuarial cost method used to compute the Pension Plan liabilities and expenses is the projected unit credit method.

MidMichigan Health offered a limited-term voluntary lump-sum option to the Pension Plan's terminated vested participants in fiscal 2016. Lump-sum settlements of \$21,024 were made during the year ended June 30, 2016. As a result of total lump-sum settlements exceeding the sum of service costs and interest costs, MidMichigan Health recognized a settlement loss of \$6,646 during fiscal 2016. The components of net periodic pension cost for the Plans were as follows:

Components of Net Periodic Pension Cost Years Ended June 30	Pension Plans		Postretirement Healthcare Plans	
	2017	2016	2017	2016
	Net periodic pension cost comprised the following:			
Service cost	\$ 10,932	\$ 7,694	\$ -	\$ -
Interest cost	21,822	16,567	138	156
Expected return on plan assets	(24,552)	(16,798)	(940)	(815)
Amortization of prior service cost and other actuarial amounts	217	223	(14)	(14)
Amortization of unrecognized net loss (gain)	8,050	5,729	(32)	(22)
Settlement cost	-	6,646	-	-
Net periodic pension cost (credit)	<u>\$ 16,469</u>	<u>\$ 20,061</u>	<u>\$ (848)</u>	<u>\$ (695)</u>

In accordance with FASB guidance regarding accounting for defined benefit pension and other postretirement plans, all previously unrecognized actuarial losses and prior service costs are reflected in the consolidated balance sheets. The postretirement-related charges other than net periodic benefit cost related to the pension and postretirement health care plans are included as a separate increase (decrease) to unrestricted net assets and total \$73,360 and \$(44,547) for fiscal 2017 and 2016, respectively. For fiscal 2017, this amount includes actuarial gains arising during fiscal 2017 of \$65,140 and a reclassification adjustment for losses and prior service cost reflected in periodic expense in fiscal 2017 of \$8,220. For fiscal 2016, this amount includes actuarial losses arising during fiscal 2016 of \$(57,108) and a reclassification adjustment for losses and prior service cost reflected in periodic expense in fiscal 2016 of \$12,561.

In accordance with FASB Accounting Standards Codification Topic 715, Compensation — Retirement Benefits, all previously unrecognized actuarial losses are reflected in the consolidated balance sheets. The pension plan and postretirement benefit plan items not yet recognized as a component of periodic pension and postretirement medical plan expense, but included within unrestricted net assets, as of and for the years ended June 30, 2017 and 2016, are as follows:

	Pension Plans		Postretirement Healthcare Plans	
	2017	2016	2017	2016
Unrecognized prior service (cost) credit	\$ (418)	\$ (635)	\$ 275	\$ 290
Unrecognized net actuarial (loss) gain	<u>(81,311)</u>	<u>(124,900)</u>	<u>3,185</u>	<u>2,129</u>
Total	<u>\$ (81,729)</u>	<u>\$ (125,535)</u>	<u>\$ 3,460</u>	<u>\$ 2,419</u>

An estimated \$(215) in prior service cost and \$(4,526) in net actuarial loss will be included as components of periodic pension expense in fiscal 2018. An estimated \$14 in prior service credit and \$76 in net actuarial gain will be included as components of periodic postretirement medical plan expense in fiscal 2018.

## Assumptions

The actuarial assumptions used to determine benefit obligations at the measurement date and net periodic benefit cost for the Plans are as follows:

Assumptions Used to Determine Benefit Obligations and Net Periodic Benefit Cost	Pension Plans		Postretirement Healthcare Plans	
	2017	2016	2017	2016
	Discount rate — benefit obligation	3.80 %	3.55 %	3.15 %
Discount rate — pension expense	3.55	3.90-4.40	2.75%	3.00-3.40
Rate of increase in compensation levels				
2016–2017	3.50-4.00	3.50-4.00	-	-
2018 and after	4.00	4.00	-	-
Expected return on plan assets	6.25	5.50-7.00	6.25	5.50
Health care cost trend rate (initial)	-	-	7.50	7.50
Health care cost trend rate (ultimate)	-	-	5.00	5.00
Health care cost trend year	-	-	2022	2022

The discount rate utilized to measure the Plans' obligations is based on the yield on high-quality fixed-income investments as of the measurement dates of June 30, 2017 and 2016. Future expected actuarially determined cash flows for the Plans are matched against the Towers Watson U.S. RATE:Link 10-90 Pension Discount Curve (a theoretical yield curve derived from bonds with yields that are within the 10th to 90th percentiles of the yields in a universe of AA graded corporate bonds chosen using defined selection criteria) as of June 30, 2017 and 2016, to arrive at a single discount rate by plan. Peer data and historical returns are reviewed to ensure reasonableness and appropriateness.

MidMichigan Health determines the expected long-term rate of return on plan assets by performing a detailed analysis, with the assistance of MidMichigan Health's actuaries and investment consultants, of historical and expected returns based on the strategic asset allocation approved by the investment committee (the "Investment Committee") under the direction of the Board and the underlying return fundamentals of each asset class. For the years ended June 30, 2017 and 2016, the actual rate of return on plan assets was 11.8% and 2.7%, respectively.

Assumed health care cost trend rates generally have a significant effect on the amounts reported for the Postretirement Healthcare Plan. However, since MidMichigan Health's postretirement costs are capped and the Postretirement Healthcare Plan is closed to any new participants, the impact has been significantly mitigated.

## Plan Assets

MidMichigan Health's primary investment objective for its Plans is to achieve a total return on plan assets that meets or exceeds the return on the Plans' liability over a full market cycle with consideration of the Plans' current funded status. MidMichigan Health employs a total return investment approach whereby a mix of equities and fixed-income investments are used to maximize the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and MidMichigan Health's consolidated financial condition. The investment portfolio includes a diversified blend of equity and fixed-income investments. Furthermore, equity investments are diversified across US and non-US stocks, as well as growth, value, and small and large capitalizations. Investment management of the Plans is delegated to professional investment management firms that must adhere to policy guidelines and objectives. An independent investment consultant is used to measure and report on investment performance; perform asset and liability modeling studies and recommend changes to objectives, guidelines, managers, or asset class structure; and inform MidMichigan Health of current investment trends and issues.

Based on consideration of the Plans' projected benefit obligation and long-term investment horizon, the Plans' ability to tolerate risk is in the moderate-to-aggressive range. Asset allocation is consistent with this level of risk, with assets being a mix of equities and fixed-income securities. Equity investments are diversified across US and non-US stocks. Minimum and maximum ranges are established for each asset class to control risk and maximize the effectiveness of the Plans' asset allocation strategy. Asset allocation is reviewed quarterly and rebalanced, if necessary. To protect against risk, derivative instruments may only be utilized when consistent with the manager's stated style and objectives and may not be used for speculative purposes. Specific investment guidelines, restrictions, and investment return objectives exist for each asset class and corresponding investment manager.

MidMichigan Health's actual weighted-average asset allocations as of June 30, 2017 and 2016, by investment category, as well as the ongoing target allocation percentages, are as follows:

	<b>Pension Plans</b>	<b>Pension Plans</b>		<b>Postretirement Healthcare Plans</b>	
	<b>Target</b>	<b>Actual</b>		<b>Actual*</b>	
	<b>2017</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Cash and cash equivalents	- %	1.3 %	2.5 %	0.2 %	0.2 %
US equity	22.5	23.2	21.9	34.0	33.6
Non-US equity	20.5	21.2	18.8	-	-
Global equity	15.0	15.1	15.4	26.5	24.9
Emerging markets equity	2.0	2.2	2.1	-	-
Fixed income	<u>40.0</u>	<u>37.0</u>	<u>39.3</u>	<u>39.3</u>	<u>41.3</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

\* Given the nature of the Postretirement Healthcare Plan (curtailed), the Investment Committee reviews and sets its allocation annually. The actual allocation approximates the targeted allocation for the Postretirement Healthcare Plan.

The Plans' asset portfolio by asset category as of June 30, 2017 and 2016, is as follows:

Asset Category as of June 30, 2017	Level 1	Level 2	Level 3	Total Fair Value
<b>Pension plans:</b>				
Cash and cash equivalents	\$ -	\$ 6,177	\$ -	\$ 6,177
Mutual funds:				
Fixed-income funds	38,146	-	-	38,146
US equity fund	41,584	-	-	41,584
Non-US equity fund	43,705	-	-	43,705
Emerging markets fund	9,917	-	-	9,917
Subtotal	<u>\$ 133,352</u>	<u>\$ 6,177</u>	<u>\$ -</u>	<u>139,529</u>
Investments measured at net asset value:				
Equity securities:				
Collective funds — fixed income				125,581
Collective funds — US equity				61,106
Collective funds — non-US equity				50,251
Collective funds — global equity				<u>66,807</u>
Total pension plans assets				<u>\$ 443,274</u>
<b>Postretirement plans:</b>				
Cash and cash equivalents	\$ -	\$ 35	\$ -	\$ 35
Mutual funds:				
Fixed-income funds	<u>6,565</u>	<u>-</u>	<u>-</u>	<u>6,565</u>
Subtotal	<u>\$ 6,565</u>	<u>\$ 35</u>	<u>\$ -</u>	<u>6,600</u>
Investments measured at net asset value:				
Equity securities:				
Collective funds — US equity				5,266
Collective funds — global equity				<u>4,422</u>
Total postretirement plans assets				<u>\$ 16,288</u>

Asset Category as of June 30, 2016	Level 1	Level 2	Level 3	Total Fair Value
<b>Pension plans:</b>				
Cash and cash equivalents	\$ -	\$ 11,250	\$ -	\$ 11,250
Mutual funds:				
Fixed-income funds	82,409	-	-	82,409
US equity fund	31,036	-	-	31,036
Non-US equity fund	29,834	-	-	29,834
Emerging markets fund	<u>7,773</u>	<u>-</u>	<u>-</u>	<u>7,773</u>
Subtotal	<u>\$ 151,052</u>	<u>\$ 11,250</u>	<u>\$ -</u>	<u>162,302</u>
Investments measured at net asset value:				
Equity securities:				
Collective funds — fixed income				65,703
Collective funds — US equity				51,497
Collective funds — non-US equity				41,142
Collective funds — global equity				<u>58,189</u>
Total pension plans assets				<u>\$ 378,833</u>
<b>Postretirement plans:</b>				
Cash and cash equivalents	\$ -	\$ 32	\$ -	\$ 32
Mutual funds:				
Fixed-income funds	<u>6,321</u>	<u>-</u>	<u>-</u>	<u>6,321</u>
Subtotal	<u>\$ 6,321</u>	<u>\$ 32</u>	<u>\$ -</u>	<u>6,353</u>
Investments measured at net asset value:				
Equity securities:				
Collective funds — US equity				4,769
Collective funds — global equity				<u>3,820</u>
Total postretirement plans assets				<u>\$ 14,942</u>

As of June 30, 2017 and 2016, there were no security transfers between Levels 1 and 2 and no securities valued using Level 3 unobservable inputs.

### Cash Flows

MidMichigan Health's funding policy is to contribute annually, not less than the minimum required by applicable laws and regulations. MidMichigan Health contributed \$42,750 and \$12,000 to its Pension Plans in fiscal 2017 and 2016, respectively. Pension contributions are expected to be \$30,500 in fiscal 2018.

MidMichigan Health expects to pay the following for pension benefits and expected postretirement benefits:

Estimated benefit payments	Pension Plans	Postretirement Healthcare Plans	
		Before Subsidy	Part D Subsidy
2018	\$ 31,038	\$ 492	\$ 45
2019	28,739	510	46
2020	29,727	524	46
2021	29,669	527	46
2022	30,284	510	45
2023 through 2027	158,745	1,901	215

### Other Postretirement Benefit Plans

MidMichigan Health maintains a voluntary tax-deferred retirement savings plan, 403(b) plan, covering substantially all of its employees, except Alpena. Under this defined contribution plan, employees may elect to contribute a percentage of their salary, which may be matched with a discretionary employer contribution in accordance with the provisions of the plan. Benefits are based on matching 50% of an employee's contribution up to 4% of covered compensation. MidMichigan Health maintains a 401(a) plan for Alpena employees. MidMichigan Health makes matching contributions in accordance with the provisions of the plan. Additionally all employees may make elective contributions to the Plan up to the limits contained in the IRC. Employer and employee contributions are self-directed by plan participants in these plans. Matching amounts become 100% vested after three years of service, and employee elective deferrals are 100% vested from the date of contribution. Employer contributions to the plans were \$6,365 and \$4,288 for the years ended June 30, 2017 and 2016, respectively.

MidMichigan Health also sponsors a nonqualified deferred compensation plan, 457(b) plan that permits eligible employees to defer a portion of their compensation. The deferred amounts are distributable in cash after retirement or termination of employment. As of June 30, 2017 and 2016, the assets under these plans totaled \$23,311 and \$19,803, respectively, and the liabilities totaled \$25,774 and \$19,785, respectively. Although these assets are held in a trust, these assets belong to MidMichigan Health and are subject to the claims of MidMichigan Health's general creditors.

MidMichigan Health also sponsors certain nonqualified supplemental plan arrangements that provide retirement benefits to certain employees, as designated by the compensation committee of the Board of Directors. MidMichigan Health has accrued liabilities for the supplemental plan based on actuarial valuations. The supplemental pension plan is unfunded. Benefits are paid when incurred from operating funds.

It is MidMichigan Health's policy to meet all regulatory requirements, including ERISA, the Pension Protection Act of 2006, and the IRC.

## 13. COMMITMENTS AND CONTINGENCIES

### Professional and General Liability Programs

MidMichigan Health self-insures primary medical, professional, and general liability claims. Until March 31, 2017, MidMichigan Health operated a primary captive insurance company, MAG, domiciled offshore where it operated and provided professional and general liability insurance coverage to MidMichigan Health and its subsidiaries. MAG was dissolved effective April 1, 2017, and the remaining assets and liabilities were transferred back to

MidMichigan Health. MidMichigan Health has limited its liability by membership in Caymich Insurance Company, Ltd. ("Caymich"), which provides excess insurance above the self-insurance and MAG limits.

Effective April 1, 2017, coverage limits per claim are \$3 million and \$8 million annual aggregate. Caymich self-insures the next layer, with shared risk among its seven members, and purchases reinsurance above that layer. The first \$20 million reinsured limit is also shared among its seven members, and the remaining \$30 million reinsured limit is MidMichigan Health's unshared limit. The total Caymich limit is \$59 million (\$9 million in the retained layer and \$50 million in the reinsured layers). As of June 30, 2016, the coverage limit per claim through MAG was \$3 million while the annual aggregate was \$8 million. The total amount available for the subsequent layer was \$65 million (shared with the Caymich members). The same structure and limits were in effect from April 1, 2016, through March 31, 2017, as described above. MidMichigan Health also self-insures \$100 per claim in property damage, with commercial insurance providing coverage up to \$650 million per occurrence. Segregated funds, included in assets limited as to use have been established to settle claims, subject to self-insurance.

MidMichigan Health has engaged an independent actuary to assist in its estimate of a range of loss for known claims and unreported incidents and has recorded a liability of \$16,749 and \$16,854 as of June 30, 2017 and 2016, respectively. The discount rate used in calculating the present value of the liability was 3.5% for fiscal years ended June 30, 2017 and 2016. Loss reserves are determined based on assumptions that are reviewed and adjusted as necessary.

MidMichigan Health is subject to various other regulatory investigations, legal proceedings, and claims that are incidental to its normal business activities. Management believes the ultimate disposition of such litigation will not have a material effect on the consolidated financial position of MidMichigan Health. Management also believes that MidMichigan Health is in substantial compliance with current laws and regulations.

#### **Workers' Compensation Self-Insurance Program**

MidMichigan Health is a qualified self-insurer within the State of Michigan. MidMichigan Health maintains a trust fund for the payment of claims, which includes provisions for known claims and unreported incidents discounted to their present value at 2.75% as of June 30, 2017 and 2016. Excess commercial insurance was purchased, on a statutory basis, from an unrelated commercial insurer. As of June 30, 2017 and 2016, the amount recorded for MidMichigan Health's self-insured workers' compensation liability was \$2,682 and \$2,949, respectively. Loss reserves are determined based on assumptions that are reviewed and adjusted as necessary.

#### **Obligations under Operating Leases**

MidMichigan Health leases certain buildings and equipment under noncancelable operating lease agreements with third parties. Total rental expense for operating leases was approximately \$2,206 and \$2,015 for the years ended June 30, 2017 and 2016, respectively, and was included in purchased services and other in the accompanying consolidated statements of operations and changes in net assets.

Total future minimum payments under these leases as of June 30, 2017, are as follows:

<b>Years Ending June 30</b>	
2018	\$ 1,502
2019	971
2020	700
2021	540
2022	442
Thereafter	<u>2,555</u>
Total	<u>\$ 6,710</u>

#### **14. JOINT VENTURES AND OTHER AFFILIATIONS**

MidMichigan Health maintains investments in several unconsolidated joint ventures, with ownership interests ranging from 14% to 51%. Investments in unconsolidated joint ventures, accounted for on the equity method, totaled \$8,265 and \$10,220 as of June 30, 2017 and 2016, respectively, and are included in investments in joint ventures in the accompanying consolidated balance sheets. Income recognized from these joint ventures, reported in other revenue, was \$528 and \$577 during the years ended June 30, 2017 and 2016, respectively.

The summarized financial information for unconsolidated joint ventures as of June 30, 2017 and 2016, consisted of the following:

	<b>2017</b>	<b>2016</b>
Total assets	\$ 20,425	\$ 20,371
Total liabilities	5,989	3,807
Net assets	14,435	16,564
Net revenues	17,944	15,301
(Deficit) excess of revenue over expenses	(250)	2,095

#### **15. FUNCTIONAL EXPENSES**

The functional classifications of expenses for the years ended June 30, 2017 and 2016, were as follows:

	<b>2017</b>	<b>2016</b>
Patient care	\$ 624,151	\$ 490,715
Support services	141,505	158,925
Medicaid hospital assessment	<u>15,585</u>	<u>15,398</u>
Total	<u>\$ 781,241</u>	<u>\$ 665,038</u>

## 16. UNIVERSITY OF MICHIGAN HEALTH SYSTEM TRANSACTION

On June 21, 2013, the University of Michigan Regents through its operating division, the University of Michigan Health System (UMHS), and Michigan Health Corporation, together with MidMichigan Health, executed an affiliation agreement (the "Agreement"). The Agreement objectives include improvement of the health of our residents; increased access to high-quality service; achievement of significant efficiencies; enhancement of clinical integration; and the furtherance of both MidMichigan Health's and UMHS's missions.

As a result of this transaction, MidMichigan Health established two member classes:

- The Michigan Health Corporation member class, consisting of a one-tenth of one percent (0.1%) membership interest in MidMichigan Health during the initial term of the Agreement; and
- The MidMichigan Health member class, consisting of a 99.9% membership interest in MidMichigan Health during the initial term of the Agreement.

In order to preserve the benefits of the affiliation, the Agreement was amended on June 30, 2016. The Amendment resulted in the following changes to the Agreement, after the initial term expires June 30, 2017:

- The automatic renewal for successive 20 year terms;
- The right to purchase up to an additional 8% interest expiring on June 30, 2019;
- The continuation of the reserve powers (such as termination, dissolution, and approval of certain capital expenditures in excess of various thresholds); and
- With respect to the financials provisions:
  - The elimination of all value sharing payments; and
  - The indexing for inflation of the annual distribution amount.

The Agreement includes certain restrictive covenants, including the rights of first refusal related to the provision of clinical care, exclusivity, and noncompetes upon the termination of the Agreement and allows for MidMichigan Health's use of the MidMichigan/UMHS Brand.

The Agreement may be terminated under certain conditions. The termination payments range from MidMichigan Health making an exit payment to UMHS, from \$20 million to \$75 million.

### *Recognition of Membership Interest of UMHS by MidMichigan Health*

MidMichigan Health has concluded that its affiliation with UMHS meets the criteria for classifying the agreement as a collaborative arrangement. MidMichigan Health has evaluated the financial statement impact and classification of this collaborative arrangement for the periods ended June 30, 2017 and 2016. The impacts on the consolidated balance sheets as of June 30, 2017 and 2016, are as follows:

A long-term asset and a long-term liability of \$3.0 million were recorded to reflect the value of the option provided by MidMichigan Health to Michigan Health Corporation to purchase up to an additional 8% interest (total interest of 20%) at an agreed-upon 5% discount to MidMichigan Health's fair market value at the time of Michigan Health Corporation's notice of its intent to purchase the additional interest.

For the years ended June 30, 2017 and 2016, the long-term asset continued to be amortized over its remaining seven-year estimated life and the liability remained at \$3.0 million for both years.. Approximately \$0.4 million was recorded in depreciation and amortization in the consolidated statements of operations and changes in net assets to reflect the estimated long-term asset. The annual distributions of \$4.40 million and \$3.75 million are included in fees in fiscal 2017 and 2016, respectively, in the consolidated statements of operations and changes in net assets.

*Related-Party Transactions*

As of and for the years ended June 30, 2017 and 2016, the only significant related-party transactions with UMHS or Michigan Health Corporation are the payments by MidMichigan Health to Michigan Health Corporation of \$4.40 million and \$3.75 million, respectively, the annual distribution.

In addition to the Affiliation Agreement, UMHS and Alpena are the sole members of the North East Michigan Cancer Center (NEMCC). NEMCC was formed in 2001 to provide radiation oncology treatment to patients to northeastern Michigan.

**17. SUBSEQUENT EVENTS**

Management has evaluated subsequent events through October 11, 2017, the date the consolidated financial statements were issued. As a result of this evaluation, MidMichigan Health has no subsequent events to disclose.

\* \* \* \* \*

**MIDMICHIGAN HEALTH ADDITIONAL INFORMATION**

## MIDMICHIGAN HEALTH

## CONSOLIDATING BALANCE SHEET INFORMATION

AS OF JUNE 30, 2017

*(Dollars in thousands)*

	Midland	Alpena	Gratiot	Clare	Gladwin	MPG	Foundation	MHC	MHDA	MCCO	MAG	MH	Total	Eliminations	Consolidated
<b>ASSETS</b>															
<b>CURRENT ASSETS:</b>															
Cash and cash equivalents	\$ 1,530	\$ 12,344	\$ 140	\$ 626	\$ 862	\$ 390	\$ -	\$ 247	\$ 557	\$ 733	\$ -	\$ 3,059	\$ 20,488	\$ -	\$ 20,488
Accounts receivable for patient services — net	40,546	11,950	15,966	6,941	3,743	3,747	-	4,354	-	-	-	-	87,247	-	87,247
Estimated receivables from third-party payors	2,221	(29)	2,856	1,998	1,408	-	-	531	-	-	-	-	8,985	-	8,985
Inventories	4,122	2,151	1,167	450	497	-	-	-	-	-	-	-	8,387	-	8,387
Prepaid expenses and other current assets	2,775	473	346	353	213	390	-	121	188	291	-	3,308	8,458	-	8,458
Assets limited or restricted as to use — current portion	11,170	-	2,114	303	422	-	-	-	-	-	-	4,250	18,259	-	18,259
Total current assets	62,364	26,889	22,589	10,671	7,145	4,527	-	5,253	745	1,024	-	10,617	151,824	-	151,824
<b>ASSETS LIMITED AS TO USE AND INVESTMENTS:</b>															
Investments — less current portion	76,864	7,282	495	3,839	7,450	2,316	-	2,590	-	-	-	50,153	150,989	-	150,989
Limited as to use by Board for capital acquisitions	332,765	33,123	25,506	16,242	41,993	-	-	5,404	-	-	-	-	455,033	-	455,033
Self-insurance, deferred compensation, and other	-	55	-	-	-	-	-	-	-	-	-	48,138	48,193	-	48,193
Limited as to use by donor or time restriction	-	4,705	-	-	-	-	35,557	-	-	-	-	-	40,262	-	40,262
Total assets limited as to use and investments	409,629	45,165	26,001	20,081	49,443	2,316	35,557	7,994	-	-	-	98,291	694,477	-	694,477
PROPERTY AND EQUIPMENT — net	154,936	66,614	48,335	11,794	4,739	2,946	-	767	48,005	-	-	50,614	388,750	-	388,750
INVESTMENTS IN SUBSIDIARIES	-	-	-	-	-	-	-	-	-	-	-	704,523	704,523	(704,523)	-
INVESTMENTS IN JOINT VENTURES	3,190	3,274	270	-	-	-	-	-	-	-	-	1,531	8,265	-	8,265
OTHER ASSETS	13,342	1,120	149	-	-	110	-	-	-	-	-	6,465	21,186	-	21,186
TOTAL ASSETS	\$ 643,461	\$ 143,062	\$ 97,344	\$ 42,546	\$ 61,327	\$ 9,899	\$ 35,557	\$ 14,014	\$ 48,750	\$ 1,024	\$ -	\$ 872,041	\$ 1,969,025	\$ (704,523)	\$ 1,264,502
<b>LIABILITIES AND NET ASSETS</b>															
<b>CURRENT LIABILITIES:</b>															
Accounts payable and accrued expenses	\$ 5,795	\$ 5,471	\$ 2,206	\$ 250	\$ 241	\$ 702	\$ -	\$ 255	\$ 312	\$ -	\$ -	\$ 15,844	\$ 31,076	\$ -	\$ 31,076
Salaries, wages, and payroll-related liabilities	7,205	6,023	2,048	811	441	7,676	-	719	-	46	-	18,748	43,717	-	43,717
Estimated third-party settlements payable	15,569	1,036	2,172	875	1,009	-	-	131	-	-	-	-	20,792	-	20,792
Current portion of long-term debt	4,785	131	573	97	77	-	-	-	-	-	-	-	5,663	-	5,663
Current portion of self-insurance, deferred compensation, and other liabilities	61	512	19	-	-	-	-	239	-	-	-	4,250	5,081	-	5,081
Total current liabilities	33,415	13,173	7,018	2,033	1,768	8,378	-	1,344	312	46	-	38,842	106,329	-	106,329
<b>LONG-TERM LIABILITIES:</b>															
Self-insurance, deferred compensation, and other liabilities — less current portion	9,983	6,685	3,461	1,497	1,706	763	-	457	25	46	-	50,107	74,730	-	74,730
Accrued pension and postretirement benefits	-	58,053	-	-	-	-	-	-	-	-	-	94,818	152,871	-	152,871
Long-term debt — less current portion	159,696	-	34,560	4,710	7,776	-	-	-	-	-	-	-	206,742	-	206,742
Total long-term liabilities	169,679	64,738	38,021	6,207	9,482	763	-	457	25	46	-	144,925	434,343	-	434,343
Total liabilities	203,094	77,911	45,039	8,240	11,250	9,141	-	1,801	337	92	-	183,767	540,672	-	540,672
<b>NET ASSETS:</b>															
Unrestricted	440,367	60,446	52,305	34,306	50,077	758	-	12,213	48,413	932	-	688,274	1,388,091	(704,523)	683,568
Temporarily restricted	-	4,705	-	-	-	-	20,904	-	-	-	-	-	25,609	-	25,609
Permanently restricted	-	-	-	-	-	-	14,653	-	-	-	-	-	14,653	-	14,653
Total net assets	440,367	65,151	52,305	34,306	50,077	758	35,557	12,213	48,413	932	-	688,274	1,428,353	(704,523)	723,830
TOTAL LIABILITIES AND NET ASSETS	\$ 643,461	\$ 143,062	\$ 97,344	\$ 42,546	\$ 61,327	\$ 9,899	\$ 35,557	\$ 14,014	\$ 48,750	\$ 1,024	\$ -	\$ 872,041	\$ 1,969,025	\$ (704,523)	\$ 1,264,502

MIDMICHIGAN HEALTH

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS INFORMATION

FOR THE YEAR ENDED JUNE 30, 2017

(Dollars in thousands)

	Midland	Alpena	Gratiot	Clare	Gladwin	MPG	Foundation	MHC	MHDA	MCCO	MAG	MH	Total	Eliminations	Consolidated
REVENUE:															
Patient service revenue (net of contractual allowances and discounts)	\$ 412,430	\$ 141,358	\$ 108,448	\$ 55,036	\$ 32,609	\$ 28,800	\$ -	\$ 22,849	\$ -	\$ -	\$ -	\$ -	\$ 801,530	\$ -	\$ 801,530
Provision for uncollectible accounts	(16,620)	(6,792)	(6,346)	(4,356)	(2,925)	(1,906)	-	(220)	-	-	-	-	(39,165)	-	(39,165)
Net patient service revenue less provision for uncollectible accounts	395,810	134,566	102,102	50,680	29,684	26,894	-	22,629	-	-	-	-	762,365	-	762,365
Other revenue	25,573	4,731	2,241	921	544	75,916	10,040	207	4,489	1,910	3,049	61,834	191,455	(156,985)	34,470
Total revenue	421,383	139,297	104,343	51,601	30,228	102,810	10,040	22,836	4,489	1,910	3,049	61,834	953,820	(156,985)	796,835
EXPENSES:															
Salaries and wages	114,944	54,109	32,548	14,852	8,215	78,567	-	11,110	62	565	-	24,790	339,762	-	339,762
Employee benefits	32,966	18,289	8,559	4,223	2,181	13,158	-	2,989	23	172	-	5,662	88,222	-	88,222
Supplies	73,430	32,104	15,805	5,569	3,249	6,071	-	4,186	32	2	6	458	140,912	-	140,912
Purchased services and other	60,320	12,843	25,409	8,068	5,162	20,303	10,040	4,147	1,102	1,038	-	17,002	165,434	(84,652)	80,782
Fees	25,320	13,403	8,781	3,656	2,854	719	-	210	150	64	342	7,471	62,970	-	62,970
Depreciation and amortization	18,395	4,718	5,387	1,741	1,087	542	-	124	3,048	-	-	10,635	45,677	-	45,677
Utilities	4,662	1,404	1,750	545	347	1,212	-	197	59	-	-	20	10,196	-	10,196
Interest	5,585	8	1,410	185	311	-	-	-	-	-	-	-	7,499	-	7,499
Insurance	1,881	1,290	655	262	143	1,202	-	120	28	-	2,701	(456)	7,826	(2,605)	5,221
Physician practice investment	46,850	-	8,495	10,094	4,289	-	-	-	-	-	-	-	69,728	(69,728)	-
Total expenses	384,353	138,168	108,799	49,195	27,838	121,774	10,040	23,083	4,504	1,841	3,049	65,582	938,226	(156,985)	781,241
OPERATING INCOME (LOSS) - BEFORE OTHER ITEMS	37,030	1,129	(4,456)	2,406	2,390	(18,964)	-	(247)	(15)	69	-	(3,748)	15,594	-	15,594
OTHER ITEMS:															
Impairment of goodwill	-	(56,215)	-	-	-	-	-	-	-	-	-	-	(56,215)	-	(56,215)
Asset charges for electronic health record legacy costs	-	(3,058)	-	-	-	-	-	-	-	-	-	(10,959)	(14,017)	-	(14,017)
Total other items	-	(59,273)	-	-	-	-	-	-	-	-	-	(10,959)	(70,232)	-	(70,232)
OPERATING INCOME (LOSS)	37,030	(58,144)	(4,456)	2,406	2,390	(18,964)	-	(247)	(15)	69	-	(14,707)	(54,638)	-	(54,638)
NONOPERATING INCOME:															
Investment income	9,755	259	995	504	1,238	59	-	311	-	-	-	2,554	15,675	-	15,675
Total nonoperating income	9,755	259	995	504	1,238	59	-	311	-	-	-	2,554	15,675	-	15,675
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENSES	\$ 46,785	\$ (57,885)	\$ (3,461)	\$ 2,910	\$ 3,628	\$ (18,905)	\$ -	\$ 64	\$ (15)	\$ 69	\$ -	\$ (12,153)	\$ (38,963)	\$ -	\$ (38,963)

(Continued)

MIDMICHIGAN HEALTH

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS INFORMATION

FOR THE YEAR ENDED JUNE 30, 2017

(Dollar in thousands)

	Midland	Alpena	Gratiot	Clare	Gladwin	MPG	Foundation	MHC	MHDA	MCCO	MAG	MH	Total	Eliminations	Consolidated
<b>UNRESTRICTED NET ASSETS:</b>															
Excess (deficiency) of revenue over expenses	\$ 46,785	\$ (57,885)	\$ (3,461)	\$ 2,910	\$ 3,628	\$ (18,905)	\$ -	\$ 64	\$ (15)	\$ 69	\$ -	\$ (12,153)	\$ (38,963)	\$ -	\$ (38,963)
Net assets released from restrictions used for purchase of property and equipment	-	2,128	-	-	-	-	814	-	-	-	-	-	2,942	-	2,942
Change in unrealized investment return	29,641	1,026	2,533	1,378	3,288	88	-	821	2	-	-	6,218	44,995	-	44,995
Equity earnings from subsidiaries	-	-	-	-	-	-	-	-	-	-	-	69,849	69,849	(69,849)	-
Distributions to parent	-	-	-	-	-	-	-	(5,000)	-	-	(120)	-	(5,120)	5,120	-
Transfers to/from subsidiaries	(32,291)	83,273	(2,189)	(2,518)	14	16,798	(814)	-	21,000	-	-	(59,273)	24,000	(24,000)	-
Postretirement-related changes other than net period postretirement cost	896	27,476	-	-	-	-	-	-	-	-	-	45,331	73,703	-	73,703
<b>INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS</b>	<b>45,031</b>	<b>56,018</b>	<b>(3,117)</b>	<b>1,770</b>	<b>6,930</b>	<b>(2,019)</b>	<b>-</b>	<b>(4,115)</b>	<b>20,987</b>	<b>69</b>	<b>(120)</b>	<b>49,972</b>	<b>171,406</b>	<b>(88,729)</b>	<b>82,677</b>
<b>RESTRICTED NET ASSETS</b>															
<b>TEMPORARILY RESTRICTED NET ASSETS:</b>															
Pledges, contributions, grants, and interest income	(16,555)	575	(91)	(18)	(104)	-	31,757	(109)	-	-	-	(2,556)	12,899	-	12,899
Net assets released from restrictions	-	(2,147)	-	-	-	-	(10,854)	-	-	-	-	-	(13,001)	-	(13,001)
<b>(DECREASE) INCREASE IN TEMPORARILY RESTRICTED NET ASSETS</b>	<b>(16,555)</b>	<b>(1,572)</b>	<b>(91)</b>	<b>(18)</b>	<b>(104)</b>	<b>-</b>	<b>20,903</b>	<b>(109)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2,556)</b>	<b>(102)</b>	<b>-</b>	<b>(102)</b>
<b>PERMANENTLY RESTRICTED NET ASSETS:</b>															
Pledges, contributions, grants, and interest income	(13,809)	-	-	-	-	-	14,534	(448)	-	-	-	-	277	-	277
Investment losses on trustee-held investments	-	-	-	-	-	-	120	-	-	-	-	-	120	-	120
<b>(DECREASE) INCREASE IN PERMANENTLY RESTRICTED NET ASSET:</b>	<b>(13,809)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14,654</b>	<b>(448)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>397</b>	<b>-</b>	<b>397</b>
<b>INCREASE (DECREASE) IN NET ASSETS</b>	<b>14,667</b>	<b>54,446</b>	<b>(3,208)</b>	<b>1,752</b>	<b>6,826</b>	<b>(2,019)</b>	<b>35,557</b>	<b>(4,672)</b>	<b>20,987</b>	<b>69</b>	<b>(120)</b>	<b>47,416</b>	<b>171,701</b>	<b>(88,729)</b>	<b>82,972</b>
NET ASSETS — Beginning of year	425,700	10,705	55,513	32,554	43,251	2,777	-	16,885	27,426	863	120	640,858	1,256,652	(615,794)	640,858
NET ASSETS — End of year	\$ 440,367	\$ 65,151	\$ 52,305	\$ 34,306	\$ 50,077	\$ 758	\$ 35,557	\$ 12,213	\$ 48,413	\$ 932	\$ -	\$ 688,274	\$ 1,428,353	\$ (704,523)	\$ 723,830

(Concluded)