

North Memorial Health Care

Consolidated Financial Statements and
Supplemental Schedules as of and for the
Years Ended December 31, 2017 and 2016,
and Independent Auditors' Report

NORTH MEMORIAL HEALTH CARE

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
North Memorial Health Care
Minneapolis, Minnesota

We have audited the accompanying consolidated financial statements of North Memorial Health Care and its subsidiaries ("North Memorial"), which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

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 North Memorial'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 North Memorial's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Memorial Health Care and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations, changes in net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Consolidating Schedules

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental schedules on pages 39-44 are presented for the purpose of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and are not a required part of the consolidated financial statements. These schedules are the responsibility of the Company's management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such schedules have been subjected to the auditing procedures applied in our audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such schedules 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 schedules are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Deloitte & Touche LLP

April 17, 2018

NORTH MEMORIAL HEALTH CARE

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2017 AND 2016

	2017	2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 39,823,883	\$ 36,046,166
Patient accounts receivable—net of allowances for uncollectible accounts of \$22,652,000 and \$33,330,000 in 2017 and 2016, respectively	119,335,835	129,944,805
Other receivables	6,587,524	7,984,031
Inventories of supplies	10,972,626	9,803,922
Prepaid expenses	9,451,996	6,486,577
Assets limited as to use (Note 3)	<u>1,956,668</u>	<u>2,168,613</u>
Total current assets	<u>188,128,532</u>	<u>192,434,114</u>
ASSETS LIMITED AS TO USE (Note 3):		
Board designated:		
Investments for capital improvements	303,993,542	273,720,566
Pending investment settlements receivable	<u>144,618</u>	<u>273,048</u>
Total board designated	304,138,160	273,993,614
Held by trustee under bond indenture agreement	2,698,538	2,575,803
Investments held for professional liability claims	4,878,729	4,713,034
Restricted investments	<u>7,474,474</u>	<u>6,145,525</u>
Total assets limited as to use	<u>319,189,901</u>	<u>287,427,976</u>
LAND, BUILDINGS, AND EQUIPMENT—Net (Note 4)	<u>300,369,216</u>	<u>304,338,312</u>
OTHER ASSETS (Note 5)	<u>35,017,461</u>	<u>35,248,495</u>
TOTAL	<u>\$ 842,705,110</u>	<u>\$ 819,448,897</u>

(Continued)

NORTH MEMORIAL HEALTH CARE

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2017 AND 2016

	2017	2016
LIABILITIES		
CURRENT LIABILITIES:		
Current maturities of long-term debt (Note 7)	\$ 11,964,290	\$ 10,128,195
Line of credit (Note 7)	4,850,000	7,600,000
Accounts payable	46,670,822	49,805,224
Estimated third-party payor settlements	1,958,338	1,120,724
Accrued expenses:		
Professional liability and other accrued claims	1,917,791	2,282,964
Salaries and benefits	25,486,387	24,604,208
Vacation pay	21,321,461	20,442,730
Interest and other	<u>2,270,728</u>	<u>4,832,577</u>
Total current liabilities	116,439,817	120,816,622
OTHER LONG-TERM LIABILITIES (Note 6)	23,853,555	23,440,447
LONG-TERM DEBT—Less current maturities (Note 7)	<u>230,246,988</u>	<u>232,097,837</u>
Total liabilities	<u>370,540,360</u>	<u>376,354,906</u>
COMMITMENTS AND CONTINGENCIES (Note 11)		
NET ASSETS:		
Unrestricted	458,886,633	429,115,858
Temporarily restricted	4,199,485	3,479,951
Permanently restricted	<u>2,394,856</u>	<u>2,301,540</u>
Total net assets attributable to North Memorial Health Care	465,480,974	434,897,349
Noncontrolling interest in joint ventures	<u>6,683,776</u>	<u>8,196,642</u>
Total net assets	<u>472,164,750</u>	<u>443,093,991</u>
TOTAL	<u>\$ 842,705,110</u>	<u>\$ 819,448,897</u>

See notes to consolidated financial statements.

(Concluded)

NORTH MEMORIAL HEALTH CARE

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
UNRESTRICTED REVENUE:		
Patient service revenue—net of contractual allowances and discounts	\$ 913,755,393	\$ 894,434,116
Provision for bad debts	<u>(34,039,870)</u>	<u>(46,658,594)</u>
Net patient service revenue—less provision for bad debts	879,715,523	847,775,522
Other operating revenue	<u>51,998,791</u>	<u>46,080,130</u>
Total unrestricted revenue	<u>931,714,314</u>	<u>893,855,652</u>
EXPENSES:		
Salaries and benefits	558,608,366	531,948,399
Supplies	126,604,675	121,505,479
Professional fees	103,327,922	97,543,743
Depreciation and amortization	40,958,818	39,607,444
Maintenance and repairs	31,600,296	29,730,482
Patient service and other taxes	15,710,820	16,649,840
Interest	10,884,117	12,107,518
Building and equipment rental	20,242,407	17,644,432
Utilities	9,746,917	9,252,055
Insurance and other	<u>17,810,762</u>	<u>17,944,866</u>
Total expenses	<u>935,495,100</u>	<u>893,934,258</u>
LOSS FROM OPERATIONS	<u>(3,780,786)</u>	<u>(78,606)</u>
NONOPERATING INCOME:		
Other nonoperating (loss) gain	(1,833,949)	2,359,001
Investment income—net	<u>40,979,340</u>	<u>22,142,010</u>
Total nonoperating income	<u>39,145,391</u>	<u>24,501,011</u>
EXCESS OF REVENUES OVER EXPENSES	35,364,605	24,422,405
LOSS ON CONSOLIDATION OF MINNETONKA ASC	(2,019,174)	-
RESTRICTED CONTRIBUTIONS FOR CAPITAL ACQUISITIONS	59,489	-
NET CHANGE IN UNREALIZED GAIN (LOSS) ON INVESTMENTS OF THE FOUNDATION	503,411	(1,355,682)
DEFINED BENEFIT PENSION PLANS-RELATED CHANGES OTHER THAN NET PERIODIC EXPENSE	<u>2,496,063</u>	<u>611,206</u>
INCREASE IN UNRESTRICTED NET ASSETS	36,404,394	23,677,929
INCREASE IN NET ASSETS ATTRIBUTABLE TO NONCONTROLLING INTEREST	<u>(6,633,619)</u>	<u>(5,193,864)</u>
INCREASE IN UNRESTRICTED NET ASSETS ATTRIBUTABLE TO NORTH MEMORIAL HEALTH CARE	29,770,775	18,484,065
UNRESTRICTED NET ASSETS—Beginning of year	<u>429,115,858</u>	<u>410,631,793</u>
UNRESTRICTED NET ASSETS—End of year	<u>\$ 458,886,633</u>	<u>\$ 429,115,858</u>

See notes to consolidated financial statements.

NORTH MEMORIAL HEALTH CARE

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Noncontrolling Interest in Joint Ventures	Total
NET ASSETS—January 1, 2016	<u>\$ 410,631,793</u>	<u>\$ 2,383,701</u>	<u>\$ 2,104,398</u>	<u>\$ 8,777,778</u>	<u>\$ 423,897,670</u>
Excess of revenues over expenses	19,228,541	-	-	5,193,864	24,422,405
Distributions paid to noncontrolling interest	-	-	-	(5,775,000)	(5,775,000)
Contributions received	-	920,694	155,228	-	1,075,922
Change in charitable remainder trust	-	-	41,914	-	41,914
Net assets released from restrictions used for operations	-	(490,486)	-	-	(490,486)
Net investment income and realized gains	-	41,381	-	-	41,381
Net change in unrealized gains on investments of the Foundation	(1,355,682)	624,661	-	-	(731,021)
Defined benefit pension plans-related changes other than net periodic expense	<u>611,206</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>611,206</u>
Increase (decrease) in net assets	<u>18,484,065</u>	<u>1,096,250</u>	<u>197,142</u>	<u>(581,136)</u>	<u>19,196,321</u>
NET ASSETS—December 31, 2016	<u>429,115,858</u>	<u>3,479,951</u>	<u>2,301,540</u>	<u>8,196,642</u>	<u>443,093,991</u>
Excess of revenues over expenses	28,730,986	-	-	6,633,619	35,364,605
Distributions paid to noncontrolling interest	-	-	-	(7,600,000)	(7,600,000)
Consolidation on Minnetonka ASC	(2,019,174)	-	-	(546,485)	(2,565,659)
Contributions received	-	1,078,697	-	-	1,078,697
Change in charitable remainder trust	-	-	93,316	-	93,316
Net assets released from restrictions used for operations	-	(577,315)	-	-	(577,315)
Net assets released from restrictions used for capital	59,489	(59,489)	-	-	-
Net investment income and realized gains	-	76,350	-	-	76,350
Net change in unrealized gains on investments of the Foundation	503,411	201,291	-	-	704,702
Defined benefit pension plans-related changes other than net periodic expense	<u>2,496,063</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,496,063</u>
Increase (decrease) in net assets	<u>29,770,775</u>	<u>719,534</u>	<u>93,316</u>	<u>(1,512,866)</u>	<u>29,070,759</u>
NET ASSETS—December 31, 2017	<u>\$ 458,886,633</u>	<u>\$ 4,199,485</u>	<u>\$ 2,394,856</u>	<u>\$ 6,683,776</u>	<u>\$ 472,164,750</u>

See notes to consolidated financial statements.

NORTH MEMORIAL HEALTH CARE

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 29,070,759	\$ 19,196,321
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	41,047,194	40,785,235
Provision for bad debts	34,039,870	46,658,594
Defined benefit pension plans-related changes other than net periodic expense	(2,496,063)	(611,206)
Net realized gains on investments	(11,136,433)	(13,575,368)
Net change in unrealized gain on investments	(29,934,092)	(7,720,322)
Gain on sale of joint venture	(634,722)	-
Loss (Gain) on disposal of property and equipment	777,776	(882,852)
Change in beneficial interest in remainder trust	(80,587)	(41,915)
Equity loss (gain) on joint ventures—net of earnings distributions	517,531	(6,621,838)
Loss on debt refinancing	2,194,320	-
Distributions paid to noncontrolling interest	7,600,000	5,775,000
Change in other operating elements:		
Patient accounts receivable	(23,028,410)	(62,502,255)
Other assets	(3,953,134)	(1,563,100)
Other liabilities	(2,532,390)	5,051,815
Total adjustments	<u>12,380,860</u>	<u>4,751,788</u>
Net cash provided by operating activities	<u>41,451,619</u>	<u>23,948,109</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of land, buildings, and equipment	(36,548,328)	(33,756,127)
Proceeds from sale of buildings, and equipment	2,077,921	4,750,475
Purchases of investments	(39,943,997)	(160,254,958)
Proceeds from sales of investments	49,587,277	173,413,586
Capital contributions to joint ventures—net of returns of capital	1,354,061	5,296,437
Proceeds from sale of joint venture	2,808,668	-
Issuance of note receivable	-	(1,000,000)
Cash acquired from consolidation of Minnetonka ASC	252,659	-
Purchases of funds held by trustee	(80,375,065)	(25,024,180)
Sales of funds held by trustee	<u>80,252,330</u>	<u>24,991,063</u>
Net cash used in investing activities	<u>(20,534,474)</u>	<u>(11,583,704)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(10,014,692)	(10,467,924)
Proceeds from long-term debt	185,171,219	-
Retirement of long-term debt	(177,143,049)	-
(Payments) Proceeds from line of credit	(4,000,000)	7,600,000
Distributions paid to noncontrolling interest	(7,600,000)	(5,775,000)
Other	<u>(3,552,906)</u>	<u>(94,316)</u>
Net cash used in financing activities	<u>(17,139,428)</u>	<u>(8,737,240)</u>
INCREASE IN CASH AND CASH EQUIVALENTS	3,777,717	3,627,165
CASH AND CASH EQUIVALENTS—Beginning of year	<u>36,046,166</u>	<u>32,419,001</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 39,823,883</u>	<u>\$ 36,046,166</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes paid, net	\$ 315,889	\$ 159,300
Cash paid for interest	\$ 11,105,756	\$ 11,803,496
SUPPLEMENTAL DISCLOSURES OF NONCASH INFORMATION:		
Capital expenditures funded through accounts payable	<u>\$ 618,233</u>	<u>\$ 2,263,823</u>

NORTH MEMORIAL HEALTH CARE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

North Memorial Health Care ("North Memorial") is a nonprofit, tax-exempt Minnesota health services corporation, which owns and operates an acute care hospital that has a licensed capacity of 518 beds and employs more than 200 physicians in various specialties, including family medicine, oncology, emergency medicine, surgery, and cardiology. North Memorial offers a broad range of inpatient and outpatient services, including emergency and Level I trauma care, obstetrical care, high-risk maternity services, Level III neonatal intensive care, cardiovascular services, acute psychiatric, and rehabilitation services, as well as general, medical, and surgical care.

Maple Grove Hospital Corporation (MGH) is jointly owned by North Memorial (75% owner) and Fairview Health Services ("Fairview") (25% owner). MGH is a Minnesota nonprofit, tax-exempt corporation, which owns and operates a hospital with a licensed capacity of 130 beds. MGH provides emergency, obstetrical care, high-risk maternity services, Level II neonatal intensive care, and general medical and surgical care.

Minnetonka Ambulatory Surgery Center, LLC ("Minnetonka ASC") is a limited liability company organized under the laws of Minnesota. Minnetonka ASC owns and operates an ambulatory surgery center in Minnetonka, Minnesota. Ownership of Minnetonka ASC is based on a Membership Control Agreement. Pursuant to the Membership Control Agreement, North Memorial Health Care (78.7% owner) is the sole Class A member with various contributing physicians owning the Class B memberships. Without written consent from North Memorial, North Memorial will not own less than 50% of the membership interests.

North Memorial owns and operates an ambulance service, which includes advanced and basic life support ground ambulance services with 29 sites and 124 vehicles and a helicopter medical transportation service with seven bases and eight operational helicopters.

Basis of Accounting—The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).

Principles of Consolidation—The consolidated financial statements include the accounts of North Memorial, its wholly owned subsidiaries; Oakdale Health Enterprises, Inc. (OHE); Oakdale Medical Center, LLC (OMC); Associated Health Assurance Ltd. (AHAL); and the North Memorial Foundation (the "Foundation"). In addition, the consolidated financial statements include the accounts of MGH and Minnetonka ASC. All intercompany balances and transactions have been eliminated in consolidation. Investments in joint ventures are accounted for under the equity method if significant influence is demonstrated. If significant influence is not demonstrated, investments in joint ventures are accounted for under the cost method.

Cash and Cash Equivalents—North Memorial considers all operating investments purchased with an original maturity of three months or less and classified as current assets not limited to use to be cash and cash equivalents. Cash and cash equivalents held for

investment purposes are classified as assets limited as to use on the consolidated statements of financial position. Disbursements in excess of bank balances of \$6.9 million and \$4.8 million at December 31, 2017 and 2016, respectively, were included in accounts payable within the consolidated statements of financial position.

Use of Estimates—The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions 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 revenues and expenses during the reporting period. Significant estimated amounts in the consolidated financial statements include accruals for general professional liability, workers' compensation, contractual allowances, allowances for uncollectible accounts receivable, employee health and dental insurance, pension obligations, and other items measured at fair value, including certain investments. Actual results could differ from these estimates.

Concentration of Risk—North Memorial Healthcare has ten labor contracts covering 33.1% of its labor force. Three of these contracts are due to expire in 2018, which covers approximately 14% of total employees.

Other Receivables—Other receivables consist primarily of other nonpatient accounts receivable related to contract services.

Inventories of Supplies—Inventories consist principally of medical and surgical supplies and pharmaceuticals and are stated at the lower of cost (using the average-cost method) or market.

Investments and Investment Income—Investments in equity securities with readily determined fair values and all investments in debt securities are reported at fair value based upon quoted market prices in active markets or other observable inputs and are classified as trading securities. Investment in the alternative investment, the real estate investment trust, and the collective bond fund are reported at net asset value (NAV) reported by the respective fund, which approximates fair value. Purchases and sales of securities are reflected on a trade-date basis, and dividends are recorded on the ex-dividend date.

Investment income is recorded on the accrual basis and included in nonoperating income (loss), net, unless the income or loss is restricted by donor or law.

Land, Buildings, and Equipment—Land and improvements, buildings, and equipment are carried at cost. Donated items are recorded at fair value on the date of the contribution. Depreciation is calculated over the estimated useful lives of the assets using the straight-line method based on guidance from the American Hospital Association and is recorded as follows:

Land and land improvements	10 years
Buildings and improvements	10–30 years
Equipment and fixtures	3–7 years

Interest cost (net of interest income on investments held by trustee under bond indenture agreement) incurred on borrowed funds during the construction of capital assets is capitalized as a component of the cost of acquiring those assets.

North Memorial capitalizes costs associated with software purchases (included within equipment and fixtures) and amortizes the costs using the straight-line method over the software's useful life. For assets held under capital lease, depreciation is recorded over the lesser of the useful life or the lease term.

Impairment of Long-Lived Assets—Management periodically reviews the carrying value of long-lived assets for potential impairment by comparing the carrying value of these assets to the estimated undiscounted future cash flows expected to result from the use of these assets. Should the sum of the expected future net cash flows be less than the carrying value, an impairment loss would be recognized.

Pending Investment Settlements Receivable and Payable—Purchases and sales of securities are reflected on a trade-date basis. A receivable or payable is recorded for the proceeds to be paid or collected as of the settlement date of the securities purchased or sold.

Deferred Financing Costs—Deferred financing costs are amortized to interest expense over the term of the related bonds using the effective interest method.

Net Patient Service Revenue—North Memorial is a participating provider with Medicare and Medicaid and has contractual arrangements with other third-party commercial payers that provide for payments to North Memorial at amounts different from its established rates. Payments for services are based on prospectively determined rates per discharge, reimbursed costs, discounted charges, or per diem payments, negotiated between North Memorial and certain managed care organizations. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services provided, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are provided and adjusted in future periods as final settlements are determined.

Other Operating Revenue—Other operating revenue includes rent revenue, rural physician contracts, cafeteria revenue, assets released from restrictions used for operations, parking ramp revenue, pharmacy revenue, management fee revenue, and investment income on trustee-held investments and investments held for professional liability claims. Revenue is recognized upon delivery of service. Income on health care-related joint ventures is recorded as other operating revenue in the consolidated statements of operations. Income on all other joint ventures is recorded as equity earnings on joint ventures in nonoperating income in the consolidated statements of operations.

Investment Income—Investment income from board-designated investments, unrestricted investments, and temporarily restricted investments (where donor restriction does not extend to the income) is generally recorded as unrestricted nonoperating income, while earnings and losses from restricted investments are recorded as changes in restricted net assets as specified by donors in the consolidated statements of changes in net assets.

Net Assets—North Memorial records contributions based on the existence or absence of donor-imposed restrictions. Expiration of donor restrictions is recorded in the period in which the restrictions expire. Temporarily restricted net assets are for various operating and capital programs within the hospital. Permanently restricted net assets are to be held in perpetuity, and the investment earnings are primarily for the hospice program at North Memorial.

Charity Care—North Memorial provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because North Memorial does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Total cost of providing charity care was approximately \$14.4 million and \$6.2 million for 2017 and 2016, respectively. Charges for charity care patients are converted to estimated total cost by utilizing a cost-to-charge ratio.

Tax Status—North Memorial, including its wholly owned subsidiaries (except OHE), and MGH have been determined by the Internal Revenue Service to be tax exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the "Code"). AHAL, under current Bermuda law, is not required to pay taxes in Bermuda on either income or capital gains. AHAL has received an undertaking from the Bermuda government that, in the event of income or capital gains taxes being imposed, AHAL will be exempted from such taxes until the year 2035.

North Memorial is engaged in certain activities that result in unrelated business income. North Memorial recorded an income tax expense of approximately \$59,000 and \$276,000 in 2017 and 2016, respectively, which is included with patient service and other taxes in the consolidated statements of operations. North Memorial evaluates its uncertain positions on an annual basis, and there have been no uncertain tax positions recorded in 2017 or 2016.

Derivative Instruments and Hedging Activities—North Memorial makes use of certain futures contracts, puts and calls to manage its investment portfolio, which are included in investments and recorded at net asset value.

For each investment manager, futures positions are purchased in the relevant index in an amount equal to the residual cash position within that investment manager's investment balance. Upon entering into a financial futures contract, North Memorial is required to pledge to the broker an amount of cash, U.S. government securities, or other assets, equal to a certain percentage of the contract amount (initial margin deposit). North Memorial recognizes a gain or loss equal to the daily variation margin, which is recorded in investment income. Should market conditions move unexpectedly, North Memorial may not achieve the anticipated benefits of the financial futures contracts and may realize a loss. Individual managers are allowed to use futures to replicate an index, but not as a speculative tool. North Memorial contracts with a defensive equity manager who uses direct purchases and index futures contracts, and then purchases or sells puts and calls to dampen volatility. All futures, puts and calls are marked to market and may result in gains or losses.

Excess of Revenue over Expenses—The performance indicator is the excess of revenue over expenses. Excess of revenue over expenses includes all changes in unrestricted net assets except for assets acquired using contributions which were restricted by the donors, income from restricted investments, pension-related changes other than net periodic pension costs, and distributions to noncontrolling interests.

Subsequent Events—North Memorial has evaluated subsequent events through April 17, 2018, the date this report was issued, and no significant events have been identified.

New Accounting Pronouncements—In May 2014, the Financial Accounting Standards Board (FASB) issued *Revenue from Contracts with Customers* (Accounting Standards Update (ASU) No. 2014-09), which provides a framework for the recognition of revenue,

with the objective that recognized revenue properly reflect amounts an entity is entitled to receive in exchange for goods and services. This guidance, which includes additional disclosure requirements regarding revenue, cash flows, and obligations related to contracts with customers, will be effective for North Memorial beginning January 1, 2018. North Memorial is evaluating the effect that this guidance will have on its consolidated financial statements and related disclosures. North Memorial believes the most significant impact will be to the presentation of the consolidated statements of operations, where the provision for bad debts will be reflected as a direct reduction to revenues and will not be presented as a separate line item. At this time, North Memorial does not expect the adoption to have a significant impact on recognition of net patient service revenue.

In February 2016, the FASB issued *Leases* (ASU No. 2016-02), which is intended to improve financial reporting related to leasing transactions. This guidance requires a lessee to recognize on the balance sheet assets and liabilities for rights and obligations created by leased assets with lease terms of more than twelve months. The new guidance will also require disclosures to help users of the financial statements better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. This guidance will be effective for North Memorial beginning January 1, 2019, and early application is permitted. North Memorial is evaluating the effect that this guidance will have on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued *Presentation of Financial Statements of Not-For-Profit Entities* (ASU No. 2016-14), which simplifies and improves how not-for-profit entities classify net assets as well as the information presented in the financial statements and notes about liquidity, financial performance and cash flows. This guidance will be effective for North Memorial beginning January 1, 2018. North Memorial is evaluating the effect that this guidance will have on its consolidated financial statements and related disclosures.

In 2017, the FASB issued *Business Combinations* (ASU No. 2017-01), which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of businesses. In addition, the FASB issued *Not-For-Profit Entities – Consolidation* (ASU 2017-02) to clarify when a not-for-profit entity that is a general or limited partner should consolidate a for-profit limited partnership or similar legal entity. North Memorial has evaluated and concluded that ASU No. 2017-01 and 2017-02 do not apply or will not significantly impact the consolidated financial statements.

2. NET PATIENT SERVICE REVENUE AND ACCOUNTS RECEIVABLE

North Memorial has agreements with third-party payers that provide for payments to North Memorial at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments.

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services provided, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Settlements are accrued on an estimated basis in the period the related services are provided and are adjusted in future periods, as final settlements are determined.

North Memorial recognizes patient service revenue associated with services provided to patients who have third-party payer coverage based on contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, North Memorial generally recognizes revenue based on standard rates for services provided less a discount comparable to that provided its largest commercial payer. Based on historical experience, a portion of uninsured patients and patients responsible for copayments and deductibles will be unable or unwilling to pay for the services provided. Thus, North Memorial records a provision for bad debts related to patient responsibility amounts in the period the services are provided.

Patient accounts receivable represent amounts due from federal and state agencies, managed health care plans, commercial insurance companies, employers, and patients. North Memorial grants credit to patients, most of who are insured under third-party payer agreements, without collateral or any other security to support amounts due. North Memorial determines an allowance for uncollectible accounts by considering a number of factors including, but not limited to, the length of time accounts receivable are past due, previous loss history, the existence of a third-party payer, reimbursement trends, and other collection indicators. Accounts are written off when all reasonable internal and external collection efforts have been performed and payments subsequently received on such receivables are credited to the allowance.

North Memorial recognizes that revenues and receivables from government agencies are significant to its operations, but does not believe there are significant credit risks associated with these government agencies. In 2017, net revenue from the top three third-party payers accounted for 16.9%, 16.0%, and 14.0% of net patient service revenue. In 2016, net revenue from the top three third-party payers accounted for 20.5%, 19.1%, and 12.7% of net patient service revenue.

Net patient service revenue before the provision for uncollectible accounts for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Medicare	\$ 289,731,584	\$ 284,930,873
Medicaid	136,893,695	126,292,211
Commercial	409,720,860	401,168,416
Self-pay and other	<u>77,409,254</u>	<u>82,042,616</u>
Net patient service revenue before provision for bad debts	<u>\$ 913,755,393</u>	<u>\$ 894,434,116</u>

North Memorial's allowance for uncollectible accounts was 19% and 26% of net patient accounts receivable at December 31, 2017 and 2016, respectively.

North Memorial grants credit to its patients who are mostly insured under third-party payer agreements. The mix of receivables, net of contractual allowances from patients and third-party payers as of December 31, 2017 and 2016, was as follows:

	2017	2016
Medicare	14 %	15 %
Medicaid	3	2
Commercial	47	44
Self-pay and other	<u>36</u>	<u>39</u>
	<u>100 %</u>	<u>100 %</u>

3. ASSETS LIMITED AS TO USE

Assets limited as to use include assets held by trustees under provisions of certain bond indentures, assets related to restricted net assets, assets held for professional liability claims, collateral held for securities lending, and assets that have been designated by governing boards for replacement and expansion of buildings and equipment.

Investments in marketable securities are generally carried at fair value based on quoted market prices and net unrealized gains and losses on investments are included in investment income—net in the consolidated statements of operations. Realized gains and losses on sales of investments are recorded using the average cost method. The investments in the alternative investment, the real estate investment trust, and the collective bond fund are recorded at fair value based on the Net Asset Value per share. Net earnings on these investments are included in investment income—net in the consolidated statements of operations.

North Memorial invests in various securities, including equity securities, U.S. government and agency securities, corporate and foreign bonds, mutual funds, and derivatives, such as futures contracts. These derivative positions are not designated as hedges for accounting purposes. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of investment securities could occur and such changes could materially affect the value of investments.

Investments at fair value as of December 31, 2017 and 2016, were as follows:

	2017	2016
Marketable securities:		
Cash and cash equivalents	\$ 8,000,941	\$ 6,700,132
Equity securities	38,297,773	32,040,002
Equity mutual funds	125,088,280	110,680,704
Bond mutual funds	89,231,309	83,943,845
Other investments	200,000	200,000
Marketable alternatives	32,373,263	28,983,669
Real estate investment trust	27,747,160	26,700,867
Pending investment settlements receivable	144,618	273,048
Accrued interest	<u>63,225</u>	<u>74,322</u>
 Total	 <u>\$ 321,146,569</u>	 <u>\$ 289,596,589</u>
 Reported as:		
Assets limited as to use—current—required for current liabilities	\$ 1,956,668	\$ 2,168,613
Assets limited as to use—long term	<u>319,189,901</u>	<u>287,427,976</u>
 Total assets limited as to use	 <u>\$ 321,146,569</u>	 <u>\$ 289,596,589</u>

North Memorial has elected the fair value option for its debt and equity securities to improve financial reporting. The election of the fair value option results in these securities being recorded at fair value, with unrealized gains and losses being recorded in investment income—net in the consolidated statements of operations.

Total return on unrestricted investments and its classification in the consolidated statements of operations and changes in net assets for the years ended December 31, 2017 and 2016, are summarized as follows:

	2017	2016
Return on investments:		
Other operating revenue	\$ <u>495,989</u>	\$ <u>218,719</u>
 Nonoperating income:		
Dividend and interest income	4,735,012	5,017,727
Earnings on other investments	99,772	1,143,386
Net realized gains on sales of investments	6,260,573	8,260,575
Net change in unrealized gains on investments	<u>29,883,983</u>	<u>7,720,322</u>
 Total nonoperating income	 <u>40,979,340</u>	 <u>22,142,010</u>
 Total return on unrestricted investments	 <u>\$ 41,475,329</u>	 <u>\$ 22,360,729</u>

Investment income—net in the consolidated statements of operations is net of investment management fees of \$596,248 and \$706,365 during 2017 and 2016, respectively.

4. LAND, BUILDINGS, AND EQUIPMENT

Land, buildings, and equipment as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Land and land improvements	\$ 26,754,159	\$ 26,780,109
Buildings and improvements	383,023,322	373,705,744
Equipment and fixtures	<u>373,703,239</u>	<u>356,278,787</u>
Total land, buildings, and equipment	783,480,720	756,764,640
Less accumulated depreciation	<u>(495,176,071)</u>	<u>(466,051,683)</u>
Land, buildings, and equipment—net	288,304,649	290,712,957
Construction in progress	<u>12,064,567</u>	<u>13,625,355</u>
Total	<u>\$ 300,369,216</u>	<u>\$ 304,338,312</u>

North Memorial recorded depreciation expense of approximately \$40,745,146 and \$39,988,629 for the years ended December 31, 2017 and 2016, respectively.

5. OTHER ASSETS

Other assets as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Investments in joint ventures—health care	\$ 14,560,275	\$ 16,040,155
Cash surrender value of life insurance policies and deferred compensation plan assets	362,626	268,326
Investment in land	1,692,266	2,582,925
Pledges receivable—long-term	48,545	54,874
Goodwill	5,578,304	3,607,000
Intangible assets	875,000	666,667
Note receivable—preferred one	7,350,000	7,006,250
Revolving line of credit	-	1,025,188
Beneficial interest in remainder trust	1,075,697	995,110
Insurance security deposit	<u>3,474,748</u>	<u>3,002,000</u>
Total	<u>\$ 35,017,461</u>	<u>\$ 35,248,495</u>

Deferred compensation plan assets consist of mutual funds and are recorded at fair value, which is based on quoted market prices.

During 2014, North Memorial entered into an interest-bearing surplus note with Preferred One for \$6,250,000, at 5.5%. Interest and principal repayments are subject to prior written approval of the Minnesota Department of Commerce, payable on March 31 of each year. Principal and interest can be prepaid at any time, with no penalty. As of December 31, 2017, PreferredOne had not requested permission from the Minnesota Department of Commerce for any repayment.

During 2016, North Memorial entered into an interest bearing revolving line of credit with Minnetonka ASC. As a result of the consolidation of Minnetonka ASC as of January 1, 2017, the line of credit was eliminated.

6. OTHER LONG-TERM LIABILITIES

Other long-term liabilities as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Professional liability and other accrued claims—long term (Note 11)	\$ 6,994,754	\$ 5,961,778
Pension and benefit obligation, including net benefit pension obligation—long term	16,136,950	17,408,509
Multicare note payable	600,000	-
Pending investment settlements payable	<u>121,851</u>	<u>70,160</u>
Total	<u>\$ 23,853,555</u>	<u>\$ 23,440,447</u>

7. LONG-TERM DEBT

Long-term debt as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Maple Grove Hospital Healthcare Facilities Revenue Bonds, Series 2007, retired in 2017	\$ -	\$ 130,850,688
Maple Grove Hospital Healthcare Facilities Revenue Bonds, Series 2017, 3.0% to 5.0%, City of Robbinsdale Series 2011A, retired in 2017	119,390,000	-
City of Robbinsdale Series 2011B, retired in 2017	-	41,973,958
City of Robbinsdale Series 2017A, 2.9%, maturing in variable installments from \$2,310,000 to \$5,010,000 through 2026	-	11,272,500
City of Robbinsdale Series 2017B, 2.9%, maturing in increasing installments from \$1,075,000 in 2018 to \$1,370,000 in 2026	38,870,000	-
Bremer Promissory Note	10,830,000	-
Minnetonka ASC Equipment Note, 4.35%, maturing in increasing monthly installments through 2020	6,703,797	-
Healthcare facilities revenue bonds, Series 2015, 4.0% to 5.0%, maturing in increasing installments from \$1,135,000 in 2018 to \$3,725,000 in 2035	1,013,404	-
OMC mortgage, 2.965%, principal and interest payments due monthly through October 2032	42,790,000	43,885,000
Capital lease obligations	12,231,849	12,873,824
Unamortized discount on Series 2007 bonds, retired in 2017	-	514,457
Unamortized premium on Series 2015 bonds	-	(1,665,556)
Unamortized premium on MG Series 2017 bonds	3,325,484	3,513,719
Deferred financing costs	9,129,537	-
	<u>(2,072,793)</u>	<u>(992,558)</u>
 Total long-term debt	 242,211,278	 242,226,032
 Less: Current Maturities of Long Term Debt	 <u>(11,964,290)</u>	 <u>(10,128,195)</u>
 Long-term portion, less unamortized discount and debt issuance costs	 <u>\$ 230,246,988</u>	 <u>\$ 232,097,837</u>

North Memorial, through a master trust indenture originally dated in 1993, created the Obligated Group, which consists solely of North Memorial Medical Center. The Obligated Group has pledged and assigned revenue, accounts receivable, and all proceeds therefrom, whether cash or noncash, for payment of all obligations of the Obligated Group issued under this master indenture and all supplemental indentures. The Obligated Group must meet a certain financial ratio covenant and is limited in the amount of additional debt it

may incur. North Memorial was in compliance with the financial ratio covenant of default within this agreement as of December 31, 2017 and 2016.

North Memorial retired the Series 2011A and B Bonds during 2017.

The City of Robbinsdale, Minnesota on behalf of North Memorial, issued a private placement for Health Care Facilities Revenue Bonds, Series 2017A and B, in the amounts of \$38,870,000 and \$10,830,000, respectively. The proceeds of the Series 2017A and B bonds were loaned to North Memorial pursuant to a loan agreement with the City of Robbinsdale dated December 5, 2017. The proceeds were used to refund the Series 2011A and B bonds, of which the Series 2011A was due in full on May 1, 2018. The Series 2017A and B matched the maturities of the Series 2011A and B issue and no new funds were borrowed other than cost of issuance. The Series 2011A and B bonds were issued at \$60,000,000 and \$15,000,000, respectively, and had maturities up to 15 years with an effective interest rate of 4.53% and 4.74%, respectively. The Series 2017A and B bonds mature on May 1, 2026 with an effective interest rate of 2.89%.

Maple Grove Hospital retired the Series 2007 Bonds during 2017.

In May 2017, the City of Maple Grove, Minnesota, issued Health Care Facilities Revenue bonds, Series 2017 on behalf of Maple Grove Hospital, in the aggregate amount of \$119,390,000. The proceeds of the Series 2017 bonds were loaned to MGH pursuant to a loan agreement dated May 25, 2017, with the City of Maple Grove. The 2017 issue proceeds were used to refund the Series 2007 bonds, which were secured by a pledge of revenues of MGH, and the guarantees of North Memorial and Fairview, who had guaranteed 75% and 25% respectively, of MGH's obligations under the bonds. The 2017 issue matched the maturities of the 2007 issue and no new funds were borrowed other than cost of issuance. The 2007 Series bonds were issued at \$143,605,000 and had maturities up to 30 years with an effective interest rate of 5.12%. The 2017 Series bonds have maturities up to 20 years with an effective interest rate of 3.57%.

In May 2006, OMC entered into a \$17,200,000 taxable mortgage. The proceeds, along with other available funds, were used to build a medical office building in Maple Grove, Minnesota. The interest rate is reset each 60 months at the five-year U.S. Constant Maturity Treasury Index, plus 212.5 basis points. The interest rate was reset during 2013 from 4.45% to 2.965%. Principal payments are amortized based on the initial interest rate over a period of 25 years.

In August 2015, the City of Maple Grove, on behalf of North Memorial, issued Health Care Facilities Revenue Refunding Bonds, Series 2015, in the aggregate amount of \$44,915,000. The proceeds of the Series 2015 bonds were loaned to North Memorial pursuant to a loan agreement dated August 26, 2015, with the City of Maple Grove. The 2015 issue proceeds were used to refund the Series 2005 bonds, which could be called after 10 years with no penalty. The 2015 issue matched the maturities of the 2005 issue and no new funds were borrowed other than cost of issuance. The 2005 Series bonds had a debt service reserve fund in the amount of \$4.9 million, which was used to retire principle of the 2005 Series. The 2015 Series was issued with no debt service reserve fund. The 2005 Series bonds were issued at \$53,800,000 and had maturities up to 30 years with an effective interest rate of 4.92%. The 2015 Series bonds were issued at \$44,915,000 and have maturities up to 20 years with an effective interest rate of 3.83%.

During 2015, North Memorial opened a revolving \$25,000,000 line of credit to be used for backup liquidity needs and general working capital. The line of credit bears interest at the

LIBOR rate plus 0.9% and is secured by gross revenue and property. The amount outstanding was \$3,600,000 and \$7,600,000 as of December 31, 2017 and 2016, respectively. As of the date of this report, outstanding borrowings totaled \$11,400,000.

During 2013, North Memorial entered two capital leases with two unrelated parties. The leases have implicit rates ranging from 1.14% to 2.37%. As of December 31, 2017, costs of the leased capital assets were recorded in equipment and fixtures for \$5,017,630. The leases were paid off in full in 2017.

During September 2016, OMC entered into a \$12 million Promissory Note (the "Note"). The proceeds may be requested against the Note to fund the costs of renovation and improvements of medical office buildings located in Robbinsdale. Borrowings on the Note occur as draw requests are submitted to the lender for work completed to date. During the construction phase, interest is calculated at the one-month London Inter-Bank Offer Rate ("LIBOR"), plus 1.90 basis points (3.47% at December 31, 2017), with interest payments due monthly beginning October 1, 2016. Effective October 1, 2018, the funding deadline will have passed and the payments become equal blended monthly installments of principal and interest in an amount sufficient to fully amortize the outstanding principal balance as of October 1, 2018 over a ten-year period ending September 14, 2028. The interest rate beginning October 1, 2018 is fixed over the remainder of the Note term at 1.90 basis points in excess of LIBOR as determined at the funding deadline. As of December 31, 2017, borrowings on the Note equaled \$6,703,797 with the outstanding balance totaling \$8,066,326 as of the date of this report.

In May 2015, Minnetonka Ambulatory Surgery Center, LLC entered into a \$1,659,450 Equipment Note. Borrowings have been used to fund the purchase of equipment used in clinic operations located in the City of Minnetonka. The note is to be re-paid in equal blended monthly installments of principal and interest in an amount sufficient to fully amortize the outstanding principal over a five-year period. The interest rate is fixed over the term of the note at 4.35%.

In May 2015, Minnetonka Ambulatory Surgery Center, LLC opened a revolving \$1,250,000 line of credit to be used for backup liquidity needs and general working capital. The line of credit bears interest at .15% below prime rate (4.35% at December 31, 2017) and is 100% guaranteed by North Memorial. The amount outstanding was \$1,250,000 as of December 31, 2017 and 2016, respectively. As of the date of this report, outstanding borrowings totaled \$1,250,000.

Scheduled maturities on long-term debt as of December 31, 2017, are as follows:

**Years Ending
December 31**

2018	\$ 11,964,290
2019	12,182,155
2020	12,328,233
2021	12,507,945
2022	12,911,921
Thereafter	<u>180,316,734</u>
Total	<u>\$ 242,211,278</u>

8. LEASES

North Memorial has entered into operating leases for office space, medical equipment, and a helicopter. Rental expense on cancelable and noncancelable leases was approximately \$20,242,000 and \$17,644,000 in 2017 and 2016, respectively.

Future minimum lease payments under noncancelable operating leases as of December 31, 2017, are as follows:

Years Ending December 31	
2018	\$ 5,847,011
2019	5,536,070
2020	5,416,349
2021	4,864,424
2022	4,828,847
Thereafter	<u>20,874,131</u>
Total	<u>\$ 47,366,832</u>

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

GAAP establishes a framework for measuring fair value by creating a hierarchy for observable independent market inputs and unobservable market assumptions, and expands disclosures about fair value measurements. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

Level 1 Inputs—Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs—Inputs include directly or indirectly observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities exchanged in active or inactive markets; quoted prices for identical assets or liabilities exchanged in inactive markets; other inputs that are considered in fair value determinations of the assets or liabilities, such as interest rates and yield curves that are observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs—Inputs include unobservable inputs used in the measurement of assets and liabilities. Management is required to use its own assumptions regarding unobservable inputs because there is little, if any, market activity in the assets, liabilities, or related observable inputs that can be corroborated at the measurement date. Unobservable inputs reflect North Memorial's own judgment about the assumptions that market participants would use in pricing the asset or liability. Level 3 assets include financial instruments whose values are determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include money market funds, common stocks, equity mutual funds, and fixed-income mutual funds. Level 2 investments represent pooled funds invested primarily in debt securities and collateral received under securities lending agreements invested primarily in debt securities. The fair value of such pooled funds is generally based on net asset values per fund share (the unit of account), derived from the quoted prices in active market of the underlying securities.

Financial assets and liabilities measured at fair value on a recurring basis, by type of inputs applicable to the fair value measurements, as of December 31, 2017 and 2016, consisted of the following:

Description	2017			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value investments:				
Cash and cash equivalents	\$ 8,000,941	\$ 8,000,941	\$ -	\$ -
Equity securities:				
Small and mid-cap equities	37,879,059	37,879,059	-	-
Large-cap equities	418,714	418,714	-	-
Equity mutual funds:				
Large-cap equities	66,189,004	66,189,004	-	-
International equities	58,899,276	58,899,276	-	-
Bond mutual funds	62,700,070	62,700,070	-	-
Other investments	200,000	200,000	-	-
Pending investment settlements receivable	<u>144,618</u>	<u>144,618</u>	<u>-</u>	<u>-</u>
Total recurring fair value measurements	234,431,682	<u>\$ 234,431,682</u>	<u>\$ -</u>	<u>\$ -</u>
Accrued Interest	63,225			
Assets valued at net asset value (a)	<u>86,651,662</u>			
Total investments	<u>\$ 321,146,569</u>			
Deferred compensation assets/liabilities	<u>\$ 297,716</u>	<u>\$ 237,837</u>	<u>\$ 59,879</u>	<u>\$ -</u>

(a) In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset per value share (or its equivalent) practical expedient have not been classified in the fair value heirarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value heirarchy to the amounts presented in the statement of financial position.

2016				
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value investments:				
Cash and cash equivalents	\$ 6,700,132	\$ 6,700,132	\$ -	\$ -
Equity securities:				
Small and mid-cap equities	31,655,335	31,655,335	-	-
Large-cap equities	384,667	384,667	-	-
Equity mutual funds:				
Large-cap equities	58,594,893	58,594,893	-	-
International equities	52,085,811	52,085,811	-	-
Bond mutual funds	83,943,845	83,943,845	-	-
Other investments	200,000	200,000	-	-
Pending investment settlements receivable	<u>273,048</u>	<u>273,048</u>	<u>-</u>	<u>-</u>
 Total recurring fair value measurements	 \$ 233,837,731	 <u>\$ 233,837,731</u>	 <u>\$ -</u>	 <u>\$ -</u>
Accrued Interest	74,322			
Assets valued at net asset value (a)	<u>81,144,697</u>			
 Total investments	 <u>\$ 289,596,589</u>			
 Deferred compensation assets/liabilities	 <u>\$ 191,051</u>	 <u>\$ 191,051</u>	 <u>\$ -</u>	 <u>\$ -</u>

(a) In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset per value share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

North Memorial's investments do not have redemption or other restrictions, with the exception of the investments in the alternative investment, real estate investment trust (REIT) and collective bond fund.

For the years end December 31, 2017 and 2016, there were no transfers in or out of Levels 1, 2 or 3.

North Memorial holds interest in an alternative investment, real estate investment trust and collective bond fund where the fair value of the investments held is estimated based on the net asset value of the fund. The following table summarizes the attributes relating to the nature of the risk of such investment at December 31, 2017 and 2016.

Fair Value Estimated Using Net Asset Value per Share				
December 31, 2017				
Investment	Fair Value *	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Alternative investment	\$ 32,373,263	\$ -	Monthly	5 days
Real estate investment trust	27,747,160	-	Quarterly	30 days
Collective bond fund	<u>26,531,239</u>	<u>-</u>	Monthly	30 days
Total	<u>\$ 86,651,662</u>	<u>\$ -</u>		

Fair Value Estimated Using Net Asset Value per Share				
December 31, 2016				
Investment	Fair Value *	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Alternative investment	\$ 28,983,669	\$ -	Monthly	5 days
Real estate investment trust	26,700,867	-	Quarterly	30 days
Collective bond fund	<u>25,460,161</u>	<u>-</u>	Monthly	30 days
Total	<u>\$ 81,144,697</u>	<u>\$ -</u>		

* The fair values of the investments have been estimated using the net asset value of the investment.

The alternative investment is managed as a collective fund by Parametric. The investment consists of 50% short-term treasuries, S&P 500 index futures with a notional value equal to 50% of the investment, and puts and calls around the S&P 500 index. The 50% not invested in treasuries is used as a margin fund for the futures positions and purchasing puts. Additional cash is raised by selling calls. The goal of the fund is to equal or exceed the return of the S&P 500 index over a full market cycle with 40% lower volatility. The individual treasuries, index futures, puts and calls are marketed to market daily. The investments are highly liquid. New investments/redemptions are limited bi-weekly. The Net Asset Value of the fund is determined by Parametric and is calculated at the close of business on the last business day of each month by adding the value of the fund's assets less the fund's liabilities.

North Memorial's investment in a REIT is valued at estimated fair value based on the proportionate share of the REIT's fair value as recorded in the REIT's audited fair value financial statements based on discounted cash flows of property income adjusted for terminal capitalization rates, discount rates, rental data, capital expenditures and other lease incentives, and growth assumptions which are derived from market transactions, as well as other financial and industry market data. The REIT invests primarily in real estate.

The REIT allocates gains, losses, and expenses to the partners based on the ownership percentage as described in the partnership agreement.

North Memorial's investment in a collective bond fund (Babson) is managed by a trustee. The Babson trustee computes a Net Asset Value for the fund assets, which is provided to Wells Fargo Bank, N.A. The estimated fair value is calculated using the Net Asset Value times the number of shares.

The carrying value of financial instruments classified as current assets and current liabilities is a reasonable estimate of their fair values due to their short-term nature.

The estimated fair value of the Series 2017 A and B bonds and the OMC mortgage approximates carrying value at December 31, 2017 and 2016. The estimated fair value of the Series 2011 A and B bonds approximated carrying value at December 31, 2016. The estimated fair value of the Series 2015 bonds at December 31, 2017 and 2016, was \$47,544,085 and \$47,187,322, respectively. The estimated fair value of the Series 2017 bonds at December 31, 2017 was \$131,835,505. The estimated fair value of the Series 2007 bonds at December 31, 2016, was \$131,892,443. The estimated fair value of North Memorial's debt is based on discounted cash flows at current market rates for similar debt at December 31, 2017 and 2016. The estimated fair value of the capital lease obligations was approximately \$1,400,000 at December 31, 2016. The estimated fair value is determined based on current borrowing rates available to management for similar type of debt issues

10. BENEFIT PLANS

Defined Benefit Pension Plans—North Memorial has a qualified defined benefit pension plan covering substantially all employees as of February 28, 1999, except those covered by bargaining agreements and seasonal or part-time employees. The plan provides pension benefits based on years of service and the employee's highest compensation during five consecutive years of employment. It is the policy of North Memorial to contribute annually the amount necessary to prevent a deficiency in the plan's funding standard account. Effective February 28, 1999, the qualified defined benefit pension plan was amended to suspend the accrual of additional benefits for future service. North Memorial's employees will retain their vested benefits, which will be paid according to the provisions of the plan.

North Memorial has two nonqualified defined benefit pension plans. The Restoration Plan restores pension benefits due to Internal Revenue Service restrictions on wage limits and covers certain executives and physicians. The benefit is payable at vesting or if the employee is involuntarily terminated. The Restoration Plan is frozen and final plan asset disbursement was made in 2017. The Supplemental Plan (SERP) covers certain current and former executives. The benefit is payable as a lump sum or an annuity when the vesting date is reached. The amounts recognized in the consolidated statements of operations for the Restoration Plan and the SERP during 2017 and 2016 were \$250,150 and \$256,768, respectively.

The information for the defined benefit pension plans as of and for the years ended December 31, 2017 and 2016, is as follows:

	Qualified Plan		Nonqualified Plans	
	2017	2016	2017	2016
Change in projected benefit obligation:				
Projected benefit obligation—beginning of year	\$ 64,902,646	\$ 63,936,881	\$ 4,082,292	\$ 4,238,665
Service cost	150,000	150,000	-	-
Interest cost	2,475,383	2,640,330	149,716	169,318
Actuarial (loss) gain	4,086,603	2,254,235	211,526	165,885
Benefits paid	<u>(4,916,881)</u>	<u>(4,078,800)</u>	<u>(410,755)</u>	<u>(410,755)</u>
Projected benefit obligation—end of year	<u>66,697,751</u>	<u>64,902,646</u>	<u>4,032,779</u>	<u>4,163,113</u>
Change in plan assets:				
Fair value of assets—beginning of year	50,353,465	49,130,917	-	-
Actual return on assets	8,155,760	4,085,287	-	-
Employer contribution	821,726	1,216,061	410,755	410,755
Benefits paid	<u>(4,916,881)</u>	<u>(4,078,800)</u>	<u>(410,755)</u>	<u>(410,755)</u>
Fair value of assets—end of year	<u>54,414,070</u>	<u>50,353,465</u>	<u>-</u>	<u>-</u>
Funded status—end of year	<u>\$ (12,283,681)</u>	<u>\$ (14,549,181)</u>	<u>\$ (4,032,779)</u>	<u>\$ (4,163,113)</u>
Amounts recognized in the consolidated statements of financial position:				
Current liabilities	\$ -	\$ -	\$ -	\$ (480,436)
Noncurrent liabilities	<u>(12,283,681)</u>	<u>(14,549,181)</u>	<u>-</u>	<u>(3,682,677)</u>
Net amount recognized	<u>\$ (12,283,681)</u>	<u>\$ (14,549,181)</u>	<u>\$ -</u>	<u>\$ (4,163,113)</u>
Amounts recognized in change in net assets—net gain (loss)				
	<u>\$ 2,710,135</u>	<u>\$ 569,781</u>	<u>\$ -</u>	<u>\$ (77,691)</u>
Components of net periodic pension cost:				
Service cost	\$ 150,000	\$ 150,000	\$ -	\$ -
Interest cost	2,475,383	2,640,330	149,716	169,318
Expected return on assets	(3,265,021)	(3,194,502)	-	-
Amortization of unrecognized net loss	1,905,999	1,933,231	-	-
Amortization of unrecognized prior service benefit	<u>-</u>	<u>-</u>	<u>100,434</u>	<u>87,450</u>
Net periodic pension cost	<u>\$ 1,266,361</u>	<u>\$ 1,529,059</u>	<u>\$ 250,150</u>	<u>\$ 256,768</u>

	Qualified Plan		Restoration Plan		SERP	
	2017	2016	2017	2016	2017	2016
Weighted-average assumptions:						
Used to determine benefit obligation at December 31:						
Discount rate	3.64 %	4.21 %	N/A	4.98 %	3.40 %	3.86 %
Rate of increase in compensation	N/A	N/A	N/A	N/A	N/A	N/A
Used to determine net periodic benefit cost for the year ended December 31:						
Discount rate	4.21	4.57	N/A	4.98	3.86	4.24
Long-term rate of return on assets	7.10	7.10	N/A	N/A	N/A	N/A

To determine the expected long-term rate of return on assets assumption, North Memorial considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

The qualified defined benefit pension plan weighted-average asset allocations for equity securities, debt securities, real estate/property, and alternatives was 61%, 18%, 10%, and 11%, respectively, at December 31, 2017. The qualified defined benefit pension plan weighted-average asset allocations for equity securities, debt securities, real estate/property, and alternatives was 61%, 14%, 14%, and 11%, respectively, at December 31, 2016.

The following objectives guide the decisions and investment strategy of North Memorial's Pension Committee (the "Pension Committee") for the qualified defined benefit pension plan: (1) the plan has a life limited to the life span of employees in the plan as of the freeze date of January 1, 1999, (2) the plan will meet the pension benefit obligations of North Memorial for the employee group covered by the plan, (3) the plan assets will be invested with the objective of meeting current and future payment requirements within acceptable risk parameters, and (4) the Pension Committee has expressed its desire to terminate the plan at such time as the assets would fully fund a lump-sum payout as defined under the Employee Retirement Income Security Act of 1974 or transfer of the obligation through the purchase of annuities.

The asset allocation strategy contains guideline percentages, at market value, of the total plan assets invested in various asset classes and includes ranges for each class. Asset classes are allowed to fluctuate within the approved ranges and are rebalanced when a class falls outside the acceptable range. The Pension Committee may also make tactical decisions to overweight certain asset classes within the approved ranges. The current asset allocation is as follows:

Asset Class	Strategic Target	Target Range
US equities	35 %	30%–40%
International equities	25	20–30
Fixed-income securities	20	15–25
Private equity real estate	10	5–15
Marketable alternatives	10	5–15

Accounting guidance establishes a framework for measuring fair value by creating a hierarchy for observable independent market inputs and unobservable market assumptions, and for disclosures about fair value measurements. The Plan classifies its investments into Level 1, which refers to securities valued using quoted prices from active markets for identical assets; Level 2, which refers to securities not traded on an active market, but for which observable market inputs are readily available; and Level 3, which refers to securities valued based on significant unobservable inputs. Assets or liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Financial assets of the qualified plan measured at fair value on a recurring basis, by type at December 31, 2017 and 2016 are set forth by level within the fair value hierarchy. The assets of qualified plan exclude net unsettled funds of \$349,930 and \$444,130 for 2017 and 2016 respectively.

Description	2017			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 365,537	\$ 365,537	\$ -	\$ -
Bond mutual funds	6,892,259	6,892,259	-	-
Equity mutual funds:				
Large-cap equities	11,791,314	11,791,314	-	-
International equities	13,609,634	13,609,634	-	-
Common stock—small- and mid-cap equities	<u>7,533,092</u>	<u>7,533,092</u>	<u>-</u>	<u>-</u>
 Total recurring fair value measurements	 40,191,836	 <u>\$ 40,191,836</u>	 <u>\$ -</u>	 <u>\$ -</u>
 Assets valued at net asset value ^(a)	 <u>13,872,305</u>			
 Total Pension Plan Assets	 <u>\$ 54,064,141</u>			

^(a) In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset per value share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of net assets.

Description	2016			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 324,681	\$ 324,681	\$ -	\$ -
Bond mutual funds	3,990,254	3,990,254	-	-
Equity mutual funds:				
Large-cap equities	10,959,679	10,959,679	-	-
International equities	12,451,950	12,451,950	-	-
Common stock—small- and mid-cap equities	<u>7,173,289</u>	<u>7,173,289</u>	<u>-</u>	<u>-</u>
Total recurring fair value measurements	34,899,852	<u>\$ 34,899,852</u>	<u>\$ -</u>	<u>\$ -</u>
Assets valued at net asset value ^(a)	<u>15,009,483</u>			
Total Pension Plan Assets	<u>\$ 49,909,335</u>			

^(a) In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset per value share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of net assets.

For the years end December 31, 2017 and 2016, there were no transfers in or out of Levels 1, 2 or 3.

The Plan's investments do not have redemption or other restrictions, with the exception of the investments in the alternative investment, real estate investment trust and collective bond fund.

A summary of the Plan's investments at December 31, 2017 and 2016 in which fair value is estimated based on the net asset value is as follows:

Fair Value Estimated Using Net Asset Value per Share				
December 31, 2017				
Investment	Fair Value *	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Alternative investment	\$ 5,966,153	\$ -	Monthly	5 days
Real estate investment trust	5,492,520	-	Quarterly	30 days
Collective bond fund	<u>2,413,632</u>	<u>-</u>	Monthly	30 days
Total	<u>\$ 13,872,305</u>	<u>\$ -</u>		

Fair Value Estimated Using Net Asset Value per Share				
December 31, 2016				
Investment	Fair Value *	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Alternative investment	\$ 5,584,948	\$ -	Monthly	5 days
Real estate investment trust	7,108,341	-	Quarterly	30 days
Collective bond fund	<u>2,316,194</u>	<u>-</u>	Monthly	30 days
Total	<u>\$ 15,009,483</u>	<u>\$ -</u>		

* The fair values of the investments have been estimated using the net asset value of the investment.

The alternative investment fund is managed as a collective fund by Parametric. The investment consists of 50% short-term treasuries, S&P 500 index futures with a notional value equal to 50% of the investment, and puts and calls around the S&P 500 index. The 50% not invested in treasuries is used as a margin fund for the futures positions and purchasing puts. Additional cash is raised by selling calls. The goal of the fund is to equal or exceed the return of the S&P 500 index over a full market cycle with 40% lower volatility. The individual treasuries, index futures, puts and calls are marketed to market daily. The investments are highly liquid. New investments/redemptions are limited bi-weekly. The Net Asset Value of the fund is determined by Parametric and is calculated at the close of business on the last business day of each month by adding the value of the fund's assets less the fund's liabilities.

The Plan's investment in a REIT is valued at estimated fair value based on the proportionate share of the REIT's fair value as recorded in the REIT's audited fair value financial statements based on discounted cash flows of property income adjusted for terminal capitalization rates, discount rates, rental data, capital expenditures and other lease incentives, and growth assumptions which are derived from market transactions, as well as other financial and industry market data. The REIT invests primarily in real estate. The REIT allocates gains, losses, and expenses to the partners based on the ownership percentage as described in the partnership agreement.

The plan's investment in the collective bond fund (Babson) is managed by a trustee. The Babson trustee computes a Net Asset Value for the fund assets, which is provided to Wells Fargo Bank, N.A. The estimated fair value is calculated using the Net Asset Value times the number of shares.

Contributions to the qualified and nonqualified pension plans will be \$630,000 and \$405,008, respectively, in 2017. Benefit payments for the qualified and nonqualified plans, which reflect expected future service, as appropriate, as of December 31, 2018, are expected to be paid as follows:

Years Ending December 31,	Qualified Plan	Nonqualified Plans
2018	\$ 5,838,227	\$ 405,008
2019	5,389,479	392,124
2020	5,260,191	378,477
2021	5,597,766	364,047
2022	5,833,397	348,826
2023–2027	22,673,980	1,488,866

Defined Contribution Plans—North Memorial has a defined contribution Money Purchase plan for noncontract employees. Employees must complete one year of continuous service, as defined in the plan agreement, to become a participant. Under the plan, North Memorial contributes a certain percentage of an eligible employee’s wages to the plan, which will be held in trust until paid to the employee upon retirement or termination. North Memorial contributed \$5,954,075 and \$5,403,842 in 2017 and 2016, respectively, to the defined contribution Money Purchase plan.

Effective January 1, 2012, North Memorial adopted a Safe Harbor 401(k) Plan. Under the safe harbor provisions, North Memorial matches 100% of certain non-contract employee contributions on the first 3% of covered compensation and 50% of the contributions between 3% to 5% of covered compensation, subject to certain Code limitations. The union contract determines the amount of matching contribution for contract employees who participate in the plan. The Plan did not elect safe harbor provisions for non-contract employees. North Memorial contributed \$10,490,358 and \$9,366,780 in 2017 and 2016, respectively, to the 401K plan.

Multiemployer Pension Plan—North Memorial contributes to a union-sponsored multiemployer pension plan under the terms of a collective bargaining agreement. Contributions are determined in accordance with the provisions of the negotiated labor contract and generally are based on salary and the number of hours worked. The risks of participating in a multiemployer plan are different from a single-employer plan in the following aspects:

- a. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
- b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- c. If North Memorial chooses to stop participating in its multiemployer plan, it may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

North Memorial’s participation in the plan for the year ended December 31, 2017, is outlined in the table below. The “EIN/Pension Plan Number” column provides the Employee Identification Number (EIN) and the three-digit plan number. Unless otherwise noted, the

most recent Pension Protection Act (PPA) zone status available in 2018 and 2017 is for the plan's year-end at December 31, 2017 and 2016, respectively. The zone status is based on information that North Memorial received from the plan. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date of the collective bargaining agreement to which the plan is subject. There have been no significant changes that affect the comparability of 2017 and 2016 contributions.

Pension Fund	EIN/Pension Plan Number	Pension Protection Act Zone Status ^(a)		FIP/RP Status Pending/Implemented	Contributions for the Years Ended December 31,		Surcharge Imposed	Expiration Date of Collective Bargaining Agreement
		January 1,	January 1,		December 31,	December 31,		
		2017	2016		2017	2016		
Twin Cities Hospitals—Minnesota Nurses Association	41-6184922		Green	N/A	\$8,593,125	\$8,249,196	No	6/1/2016

^(a) The Plan's funding level on January 1, 2018, is determined based on the actual December 31, 2017, asset values and projected liabilities as of January 1, 2018, that are a rollforward of liabilities from the previous valuation date of January 1, 2017, assuming no actuarial gains/losses occur during the period.

In January 2018, North Memorial contributed approximately \$8,850,000 to the Twin City Hospitals—Minnesota Nurses Association Pension Plan for 2018, which is North Memorial's proportionate share of the minimum contribution requirement according to the collective bargaining agreement. North Memorial may be contingently liable for its share of the plan's unfunded vested liabilities. North Memorial's estimated withdrawal liability as of December 31, 2017, was approximately \$22,200,000. The plan has not been terminated, nor has North Memorial undertaken to withdraw from participation; therefore, no liability is recorded in the consolidated financial statements.

North Memorial was listed in the Twin City Hospitals—Minnesota Nurses Association Pension Plan Form 5500 as providing more than 5% of the total contributions for the plan year ended December 31, 2016. At the date the financial statements were issued, Forms 5500 were not available for the plan year ended in 2017.

Postretirement Health Care Plan—North Memorial has postretirement medical benefit plans for certain retired nurses between the ages of 55 and 65 with 10 years or more of service and select employees offered early retirement during 1997. North Memorial offers continuation of the current medical insurance benefits to these retirees at 100% of the active COBRA rate. The amounts recognized in the consolidated statements of operations as of December 31, 2017 and 2016, were \$33,798 and \$33,036, respectively.

The accumulated postretirement benefit obligation was \$1,479,443 and \$1,342,665, respectively, as of December 31, 2017 and 2016, and is included in accrued salaries and other liabilities in the consolidated statements of financial position. The postretirement health care benefit plans are unfunded.

For measurement purposes, a 3.45% discount rate in 2017 and 3.85% in 2016 was assumed. The 2016 annual health care cost increase assumed 7% in 2017 and 2018, then reducing 0.5% per year for four years, reaching 5.0% in 2022 and after.

Other Plans—North Memorial offers certain key executives and employed physicians deferred compensation plans created in accordance with applicable provisions of the Code. The plans permit qualifying employees to defer a portion of their salary until future years. The accumulated deferred compensation balance is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plans and all income attributable to those amounts (until paid or made available to the employee or other beneficiary) are solely the property and rights of North Memorial (not restricted to the payment of benefits under the plan), subject only to the claim of general creditors. Participants' rights under the plans are equal to those of general creditors of North Memorial in an amount equal to the fair market value of the deferred account for each participant. The related assets and liabilities, totaling \$297,715 and \$191,015 as of December 31, 2017 and 2016, respectively, are reported at contract value, which approximates fair value, and are included in other liabilities—pension and benefit obligation.

Health and welfare, medical, dental, long-term disability, and life insurance benefits are provided for certain employees and are funded by employer and employee contributions. North Memorial's contribution to the plans were approximately \$52,880,000 and \$45,930,000 for 2017 and 2016, respectively.

11. COMMITMENTS AND CONTINGENCIES

Insurance—North Memorial purchases primary professional liability coverage on a first-dollar basis from AHAL, North Memorial's wholly owned captive insurance company domiciled in Bermuda. The consolidated financial statements include the investments held for professional liability claims, claims payments, and estimated professional liability reserves. The liability for losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience and an actuarial report, for future development of reported losses. These estimates are continually reviewed and are subject to the impact of future changes in such factors as claim severity and frequency. Although management has made its best estimate of the liability for losses and loss adjustment expenses using the available information, ultimate settlement could vary significantly from such liability. Any adjustments to recorded liabilities will be reflected in the periods in which they become known.

Annual premiums paid to the captive for the professional liability coverage were approximately \$915,000 and \$879,000 in 2017 and 2016, respectively. AHAL insures North Memorial for hospital professional liability for \$2 million for each claim and \$4 million in the annual aggregate. In addition, North Memorial purchases excess professional liability insurance above the AHAL limits from commercial carriers. MGH purchases professional liability insurance on a first-dollar basis from a commercial carrier with limits of \$1 million per occurrence and \$3 million annual aggregate and a \$20 million excess professional liability policy from a commercial carrier. North Memorial and MGH also purchase a shared \$20 million liability policy in excess of the individual liability limits.

North Memorial also purchases professional liability primary and excess coverage for employed physicians, general liability and umbrella coverage, auto, insurance, property and business interruption insurance, directors and officers liability, and helicopter liability coverage from commercial carriers.

North Memorial was self-insured for workers' compensation prior to November 30, 1997, up to the Workers' Compensation Reinsurance Association retention limit, which varied at

levels up to \$580,000. North Memorial has secured its obligation to the State of Minnesota with a restricted deposit account totaling \$552,126 and \$548,144 at December 31, 2017 and 2016, respectively and is included in cash and cash equivalents on the consolidated statements of financial position.

As of December 1, 1997, North Memorial purchased workers' compensation insurance from a commercial carrier, which then reinsured the risk with AHAL. Under this arrangement, AHAL has a maximum per-claim loss of \$750,000 and a maximum annual loss of \$16.8 million. MGH purchases worker's compensation from a commercial carrier with a \$250,000 per-claim limit and a maximum annual loss of \$1.5 million.

Litigation—North Memorial is involved in certain litigation arising during the normal course of conducting business. Management does not believe any material adverse financial impact will result from these legal proceedings.

Regulatory Environment—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, which represent a total of approximately 47% and 46% of total net patient service revenue for 2017 and 2016, respectively, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal and state government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues for patient services. Management believes that North Memorial is in substantial compliance with current laws and regulations.

Debt Guarantees—In accordance with GAAP, a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee with the exception for guarantees entered into prior to fiscal year 2002. North Memorial has evaluated the risks associated with each of the guarantees and has deemed them to be insignificant and, therefore, has not recorded any liabilities related to the debt guarantees.

North Radiation Therapy Center, LLC—North Memorial has a 50% interest in North Radiation Therapy Center, LLC which has debt outstanding of \$1,404,620 as of December 31, 2017. North Memorial has guaranteed 50% of the payments on this debt.

Monticello Surgery Center, LLC—North Memorial has a 21.5% interest in Monticello Surgery Center, LLC. North Memorial has guaranteed 20% of the payments on two separate notes totaling \$2,700,000 as of December 31, 2017.

CDI Roseville, LLC—North Memorial has a 25% interest in CDI Roseville, LLC that has debt outstanding of \$936,408 as of December 31, 2017. North Memorial has guaranteed 25% of the payments on this debt.

12. FUNCTIONAL EXPENSES

North Memorial provides general health care services to residents within its geographic location. Expenses related to providing these services included in the consolidated statements of operations for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Health care services	\$ 816,029,903	\$ 774,298,509
General and administrative	<u>119,465,197</u>	<u>119,635,749</u>
Total expenses	<u>\$ 935,495,100</u>	<u>\$ 893,934,258</u>

13. RELATED PARTY

The related-party transactions and balances as of and for the years ended December 31, 2017 and 2016, are summarized as follows:

	2017	2016
Statements of financial position—other receivables—due from affiliates	\$ 288,754	\$ 3,968,202
Statements of operations:		
Other operating revenue:		
Management fees earned from affiliates	115,048	130,693
Rental income earned from affiliates	4,020,290	4,034,379
Contract services earned from affiliates	3,327,030	4,649,293

14. JOINT VENTURES

North Memorial maintains investments in various entities, which are being accounted for under the equity method of accounting. These entities are generally involved in health care and insurance-related activities. The financial information of North Memorial's equity investments as of and for the years ended December 31, 2017 and 2016, is summarized as follows:

	2017	2016
Revenue	\$ 96,381,091	\$ 82,599,097
Operating expenses and other	81,971,929	69,976,808
Net income (loss)	14,409,162	12,622,289
Total assets	53,469,563	47,176,649
Total liabilities	24,406,812	24,697,196

In 2017, North Memorial acquired Multicare Associates, LLC. This acquisition included the buyout of Multicare's 50% ownership interest in the Blaine Urgency Center (BUC), as well as Multicare's operations in Blaine, Fridley, Roseville, and their interest in a Sleep Center. Prior to the acquisition, North Memorial held the other 50% interest in BUC. After the close of this transaction, BUC's operating results and related balance sheet were consolidated into North Memorial's financial results.

As part of the transaction with Multicare Associates, North Memorial entered into a Membership Interest Purchase Agreement for a 50% ownership interest in Multicare Sleep Center, LLC for a total purchase price of \$130,000. The entity is accounted for under the equity method of accounting.

North Memorial had a 50% interest in Plymouth City Center Medical Building, LLC. In 2017, North Memorial sold its interest in the Plymouth City Center Medical Building, LLC and recorded a gain of \$926,000 on the sale.

In 2016, North Memorial entered into a Membership Interest Purchase Agreement for a 20% ownership interest in Monticello Surgery Center, LLC for a total purchase price of \$100,000. This entity is accounted for under the equity method of accounting and opened for business in March 2017.

In 2016, North Memorial entered into a Membership Interest Purchase Agreement for a 25% ownership interest in CDI Roseville, LLC for a total purchase price of \$902,078. The purchase price consisted of \$560,517 of cash investment and the guarantee of 25% of certain equipment financing and other liabilities in the amount of \$341,561. The entity is accounted for under the equity method of accounting.

North Memorial had a 25% interest in Preferred One Insurance Company. In 2016, North Memorial sold its interest in PreferredOne Administrative Services, Inc. and affiliates and recorded a gain of approximately \$1.9 million on the sale.

* * * * *

SUPPLEMENTAL SCHEDULES

NORTH MEMORIAL HEALTH CARE

SUPPLEMENTAL CONSOLIDATING SCHEDULE OF FINANCIAL POSITION INFORMATION AS OF DECEMBER 31, 2017

	North Memorial Health Care	Maple Grove Hospital Corporation	Eliminations	2017
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	\$ 4,179,576	\$ 35,644,307	\$ -	\$ 39,823,883
Patient accounts receivable—net of allowances for uncollectible accounts	92,068,956	27,266,879	-	119,335,835
Other receivables	11,731,778	-	(5,144,254)	6,587,524
Inventories of supplies	8,624,980	2,347,646	-	10,972,626
Prepaid expenses	8,722,369	729,627	-	9,451,996
Assets limited to as use	<u>1,956,668</u>	<u>-</u>	<u>-</u>	<u>1,956,668</u>
Total current assets	<u>127,284,327</u>	<u>65,988,459</u>	<u>(5,144,254)</u>	<u>188,128,532</u>
ASSETS LIMITED AS TO USE:				
Board designated:				
Investments for capital improvements	294,552,726	9,440,816	-	303,993,542
Pending investment settlements receivable	<u>144,618</u>	<u>-</u>	<u>-</u>	<u>144,618</u>
Total board designated	294,697,344	9,440,816	-	304,138,160
Held by trustee under bond indenture agreement	779,860	1,918,678	-	2,698,538
Investments held for professional liability claims	4,878,729	-	-	4,878,729
Restricted investments	<u>7,474,474</u>	<u>-</u>	<u>-</u>	<u>7,474,474</u>
Total assets limited as to use	<u>307,830,407</u>	<u>11,359,494</u>	<u>-</u>	<u>319,189,901</u>
LAND, BUILDINGS, AND EQUIPMENT—Net	<u>208,427,244</u>	<u>92,282,218</u>	<u>(340,246)</u>	<u>300,369,216</u>
OTHER ASSETS	<u>31,120,461</u>	<u>3,897,000</u>	<u>-</u>	<u>35,017,461</u>
TOTAL	<u>\$ 674,662,439</u>	<u>\$ 173,527,171</u>	<u>\$ (5,484,500)</u>	<u>\$ 842,705,110</u>

(Continued)

	North Memorial Health Care	Maple Grove Hospital Corporation	Eliminations	2017
LIABILITIES				
CURRENT LIABILITIES:				
Current maturities of long-term debt	\$ 7,683,708	\$ 4,280,582	\$ -	\$ 11,964,290
Line of credit	4,850,000	-	-	4,850,000
Accounts payable	43,053,317	7,695,948	(4,078,443)	46,670,822
Estimated third-party payor settlements	1,082,293	876,045	-	1,958,338
Accrued expenses:				
Professional liability and other accrued claims	1,917,791	-	-	1,917,791
Salaries and benefits	22,469,145	3,017,242	-	25,486,387
Vacation pay	19,046,741	2,274,720	-	21,321,461
Interest and other	<u>1,407,834</u>	<u>1,928,706</u>	<u>(1,065,812)</u>	<u>2,270,728</u>
Total current liabilities	101,510,829	20,073,243	(5,144,255)	116,439,817
OTHER LONG-TERM LIABILITIES	23,853,555	-	-	23,853,555
LONG-TERM DEBT—Less current maturities	<u>108,498,419</u>	<u>123,248,569</u>	<u>(1,500,000)</u>	<u>230,246,988</u>
Total liabilities	<u>233,862,803</u>	<u>143,321,812</u>	<u>(6,644,255)</u>	<u>370,540,360</u>
NET ASSETS:				
Unrestricted	434,205,295	30,205,359	(5,524,021)	458,886,633
Temporarily restricted	4,199,485	-	-	4,199,485
Permanently restricted	2,394,856	-	-	2,394,856
Noncontrolling interest in Maple Grove Hospital	-	-	7,551,558	7,551,558
Noncontrolling interest in Minnetonka ASC	<u>-</u>	<u>-</u>	<u>(867,782)</u>	<u>(867,782)</u>
Total net assets	<u>440,799,636</u>	<u>30,205,359</u>	<u>1,159,755</u>	<u>472,164,750</u>
TOTAL	<u>\$ 674,662,439</u>	<u>\$ 173,527,171</u>	<u>\$ (5,484,500)</u>	<u>\$ 842,705,110</u>

See note to consolidating financial statement information.

(Concluded)

NORTH MEMORIAL HEALTH CARE

SUPPLEMENTAL CONSOLIDATING SCHEDULE OF OPERATIONS INFORMATION FOR THE YEAR ENDED DECEMBER 31, 2017

	North Memorial Health Care	Maple Grove Hospital Corporation	Eliminations	2017
UNRESTRICTED REVENUE:				
Patient service revenue—net of contractual allowances and discounts	\$ 719,501,204	\$ 195,079,305	\$ (825,116)	\$ 913,755,393
Provision for bad debts	<u>(27,499,670)</u>	<u>(6,540,200)</u>	<u>-</u>	<u>(34,039,870)</u>
Net patient service revenue—less provision for bad debts	692,001,534	188,539,105	(825,116)	879,715,523
Other operating revenue	<u>106,003,340</u>	<u>854,947</u>	<u>(54,859,496)</u>	<u>51,998,791</u>
Total unrestricted revenue	<u>798,004,874</u>	<u>189,394,052</u>	<u>(55,684,612)</u>	<u>931,714,314</u>
EXPENSES:				
Salaries and benefits	488,303,224	70,305,142	-	558,608,366
Supplies	102,424,497	24,180,178	-	126,604,675
Professional fees	93,212,618	41,224,072	(31,108,768)	103,327,922
Depreciation and amortization	32,520,098	8,098,474	340,246	40,958,818
Maintenance and repairs	28,704,454	2,942,726	(46,884)	31,600,296
Patient service and other taxes	11,023,878	4,686,942	-	15,710,820
Interest	5,296,027	5,669,949	(81,859)	10,884,117
Building and equipment rental	22,995,074	1,239,788	(3,992,455)	20,242,407
Utilities	8,910,800	942,047	(105,930)	9,746,917
Insurance and other	<u>16,679,090</u>	<u>1,884,642</u>	<u>(752,970)</u>	<u>17,810,762</u>
Total expenses	<u>810,069,760</u>	<u>161,173,960</u>	<u>(35,748,620)</u>	<u>935,495,100</u>
(LOSS) INCOME FROM OPERATIONS	<u>(12,064,886)</u>	<u>28,220,092</u>	<u>(19,935,992)</u>	<u>(3,780,786)</u>
NONOPERATING INCOME:				
Equity earnings and losses on joint ventures—net	(279,474)	(1,554,475)	-	(1,833,949)
Investment income—net	<u>39,907,154</u>	<u>1,154,045</u>	<u>(81,859)</u>	<u>40,979,340</u>
Total nonoperating (loss) income	<u>39,627,680</u>	<u>(400,430)</u>	<u>(81,859)</u>	<u>39,145,391</u>
EXCESS OF REVENUES OVER EXPENSES	<u>\$ 27,562,794</u>	<u>\$ 27,819,662</u>	<u>\$ (20,017,851)</u>	<u>\$ 35,364,605</u>

See note to consolidating financial statement information.

NORTH MEMORIAL FOUNDATION

SUPPLEMENTAL SCHEDULE OF FINANCIAL POSITION INFORMATION AS OF DECEMBER 31, 2017

ASSETS

CASH	\$ 281,281
INVESTMENTS—At fair value	7,474,474
OTHER RECEIVABLES	15,758
PLEDGES RECEIVABLE	58,545
BENEFICIAL INTEREST IN REMAINDER TRUST	<u>1,075,697</u>
TOTAL	<u>\$ 8,905,755</u>

LIABILITIES AND NET ASSETS

LIABILITIES:

Amounts held for others	\$ 26,019
Accounts payable	<u>19,623</u>
Total liabilities	<u>45,642</u>

NET ASSETS:

Unrestricted	2,265,772
Temporarily restricted	4,199,485
Permanently restricted	<u>2,394,856</u>
Total net assets	<u>8,860,113</u>

TOTAL	<u>\$ 8,905,755</u>
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NORTH MEMORIAL FOUNDATION

SUPPLEMENTAL SCHEDULE OF ACTIVITIES INFORMATION FOR THE YEAR ENDED DECEMBER 31, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT:				
Contributions	\$ 789,493	\$ 349,631	\$ -	\$1,139,124
Special event revenue	-	729,066	-	729,066
Cost of direct benefits to donors	-	(249,052)	-	(249,052)
Investment income	(108,497)	76,350	-	(32,147)
Net change in interest in beneficial trust	-	-	93,316	93,316
Net assets released from restrictions	<u>387,752</u>	<u>(387,752)</u>	<u>-</u>	<u>-</u>
Total revenues, gains, and other support	<u>1,068,748</u>	<u>518,243</u>	<u>93,316</u>	<u>1,680,307</u>
EXPENSES AND LOSSES:				
Program services	226,051	-	-	226,051
Management and general	190,729	-	-	190,729
Fundraising	376,485	-	-	376,485
Foundation and fundraising grants to North Memorial	<u>387,752</u>	<u>-</u>	<u>-</u>	<u>387,752</u>
Total expenses and losses	<u>1,181,017</u>	<u>-</u>	<u>-</u>	<u>1,181,017</u>
(DEFICIENCY) EXCESS OF REVENUES, GAINS, AND OTHER SUPPORT OVER EXPENSES AND LOSSES	(112,269)	518,243	93,316	499,290
NET CHANGE IN UNREALIZED GAINS ON INVESTMENTS	<u>503,411</u>	<u>201,291</u>	<u>-</u>	<u>704,702</u>
CHANGE IN NET ASSETS	391,142	719,534	93,316	1,203,992
NET ASSETS—Beginning of year	<u>1,874,630</u>	<u>3,479,951</u>	<u>2,301,540</u>	<u>7,656,121</u>
NET ASSETS—End of year	<u>\$ 2,265,772</u>	<u>\$4,199,485</u>	<u>\$2,394,856</u>	<u>\$8,860,113</u>

NORTH MEMORIAL HEALTH CARE

NOTE TO SUPPLEMENTAL FINANCIAL SCHEDULE INFORMATION AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2017

1. BASIS OF REPORTING

North Memorial Health Care Information—The supplemental consolidating schedule of financial position information as of December 31, 2017 and the supplemental consolidating schedule of operations information for the year then ended, presents North Memorial and its wholly owned subsidiaries, but excludes the effects of consolidating the results of MGH (which became a controlled affiliate effective September 1, 2011) and the balance of North Memorial's investment in MGH.

Maple Grove Hospital Corporation Information—The supplemental consolidating schedule of financial position information as of December 31, 2017, and the supplemental consolidating schedule of operations information for the year then ended presents MGH financial information on a standalone basis.

North Memorial Foundation Information—The supplemental consolidating schedule of financial position information as of December 31, 2017, and the supplemental consolidating schedule of operations information for the year then ended presents the North Memorial Foundation financial information on a standalone basis.

Eliminations—The eliminations shown on the supplemental consolidating schedule of financial position information as of December 31, 2017, and the supplemental consolidating schedule of operations information for the year then ended reflect the elimination of intercompany balances and transactions.

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