
ProHealth Care, Inc. and Affiliates

**Consolidated Financial Statements
with Consolidating Information
September 30, 2018**

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Independent Auditor's Report

To the Board of Directors
ProHealth Care, Inc. and Affiliates

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ProHealth Care, Inc. and Affiliates (the "Corporation"), which comprise the consolidated balance sheet as of September 30, 2018 and 2017 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ProHealth Care, Inc. and Affiliates as of September 30, 2018 and 2017 and the results of their operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
ProHealth Care, Inc. and Affiliates

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2018 on our consideration of ProHealth Care, Inc. and Affiliates' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ProHealth Care, Inc. and Affiliates' internal control over financial reporting and compliance.

Plante & Moran, PLLC

December 14, 2018

Consolidated Balance Sheet

September 30, 2018 and 2017
(in thousands)

| | 2018 | 2017 |
|--|----------------------------|----------------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 20,583 | \$ 22,580 |
| Short-term investments (Note 5) | 9,203 | 14,036 |
| Patient accounts receivable - Net (Note 3) | 88,317 | 79,457 |
| Inventory of supplies | 10,282 | 9,857 |
| Other receivables | 9,747 | 5,548 |
| Assets whose use is limited or restricted (Note 5) | 15,845 | 9,472 |
| Prepaid expenses and other | 9,758 | 9,087 |
| Total current assets | 163,735 | 150,037 |
| Noncurrent Assets Whose Use is Limited or Restricted (Note 5) | 792,213 | 753,168 |
| Property and Equipment - Net (Note 6) | 619,961 | 562,723 |
| Goodwill (Note 2) | 6,553 | 5,796 |
| Intangible Assets (Note 2) | 545 | 655 |
| Other Assets (Note 7) | 55,334 | 46,470 |
| Total assets | <u><u>\$ 1,638,341</u></u> | <u><u>\$ 1,518,849</u></u> |
| Liabilities and Net Assets | | |
| Current Liabilities | | |
| Accounts payable | \$ 50,290 | \$ 36,388 |
| Current portion of long-term debt (Note 9) | 9,565 | 8,727 |
| Deferred revenue (Note 16) | 7,503 | 4,225 |
| Accrued liabilities and other (Note 8) | 50,206 | 53,886 |
| Total current liabilities | 117,564 | 103,226 |
| Long-term Debt - Net of current portion (Note 9) | 461,434 | 453,863 |
| Fair Value of Interest Rate Swap Agreement (Note 9) | 14,438 | 22,047 |
| Other Liabilities | | |
| Postretirement liability (Note 11) | 94 | 99 |
| Deferred revenue (Note 16) | 2,642 | 3,115 |
| Pension liability (Note 11) | - | 20,805 |
| Other long-term liabilities | 27,936 | 25,785 |
| Total liabilities | 624,108 | 628,940 |
| Net Assets | | |
| Unrestricted | 993,272 | 868,875 |
| Temporarily restricted (Note 13) | 10,698 | 10,916 |
| Permanently restricted (Note 13) | 6,228 | 5,652 |
| Noncontrolling interest in consolidated subsidiaries (Note 2) | 4,035 | 4,466 |
| Total net assets | 1,014,233 | 889,909 |
| Total liabilities and net assets | <u><u>\$ 1,638,341</u></u> | <u><u>\$ 1,518,849</u></u> |

ProHealth Care, Inc. and Affiliates**Consolidated Statement of Operations and
Changes in Net Assets****Years Ended September 30, 2018 and 2017****(in thousands)**

| | <u>2018</u> | <u>2017</u> |
|--|-------------------|-------------------|
| Unrestricted Revenue, Gains, and Other Support | | |
| Net patient service revenue | \$ 753,124 | \$ 715,339 |
| Provision for bad debts | (17,670) | (16,037) |
| Net patient service revenue less provision for bad debts | 735,454 | 699,302 |
| Other operating revenue | 85,157 | 66,039 |
| Total unrestricted revenue, gains, and other support | 820,611 | 765,341 |
| Expenses | | |
| Salaries and wages | 325,310 | 307,520 |
| Employee benefits and payroll taxes | 86,168 | 77,230 |
| Operating supplies and expenses | 135,064 | 124,990 |
| Depreciation and amortization | 60,397 | 60,091 |
| Interest | 18,410 | 17,719 |
| Contracted services and other | 136,045 | 131,919 |
| Total expenses | 761,394 | 719,469 |
| Operating Income | 59,217 | 45,872 |
| Nonoperating Income (Loss) | | |
| Investment income | 58,089 | 23,039 |
| Contributions | 194 | 228 |
| Unrealized investment (loss) gain | (15,036) | 38,816 |
| Change in interest rate swap value | 7,452 | 9,217 |
| Other | 1,324 | 677 |
| Total nonoperating income | 52,023 | 71,977 |
| Excess of Revenue Over Expenses | \$ 111,240 | \$ 117,849 |

ProHealth Care, Inc. and Affiliates**Consolidated Statement of Operations and
Changes in Net Assets (Continued)****Years Ended September 30, 2018 and 2017****(in thousands)**

| | 2018 | 2017 |
|--|----------------------------|--------------------------|
| Unrestricted Net Assets | | |
| Excess of revenue over expenses | \$ 111,240 | \$ 117,849 |
| Amortization of transition deferral on interest rate swap | 157 | 157 |
| Pension-related changes other than net periodic benefit cost | 10,769 | 7,952 |
| Net assets released from restriction for plant and equipment additions | 3,215 | 2,569 |
| Other | (1,415) | (872) |
| | <u>123,966</u> | <u>127,655</u> |
| Increase in unrestricted net assets | 123,966 | 127,655 |
| Temporarily Restricted Net Assets | | |
| Restricted contributions | 2,566 | 2,179 |
| Restricted investment income | 686 | 332 |
| Unrealized gain on investments | 6 | 9 |
| Net assets released from restriction | (3,200) | (2,569) |
| Other | (276) | (444) |
| | <u>(218)</u> | <u>(493)</u> |
| Decrease in temporarily restricted net assets | (218) | (493) |
| Permanently Restricted Net Assets | | |
| Contributions | 620 | 10 |
| Restricted investment income | 50 | 24 |
| Net assets released from restriction | (15) | - |
| Other | (79) | (18) |
| | <u>576</u> | <u>16</u> |
| Increase in permanently restricted net assets | 576 | 16 |
| Increase in Net Assets | 124,324 | 127,178 |
| Net Assets - Beginning of year | <u>889,909</u> | <u>762,731</u> |
| Net Assets - End of year | <u><u>\$ 1,014,233</u></u> | <u><u>\$ 889,909</u></u> |

Consolidated Statement of Cash Flows

Years Ended September 30, 2018 and 2017

(in thousands)

| | 2018 | 2017 |
|--|------------------|------------------|
| Cash Flows from Operating Activities | | |
| Increase in net assets | \$ 124,324 | \$ 127,178 |
| Adjustments to reconcile increase in net assets to net cash from operating activities: | | |
| Depreciation and amortization | 60,397 | 60,091 |
| Unrealized investment losses (gains) | 15,030 | (38,825) |
| Realized investment gains | (43,868) | (11,575) |
| Restricted contribution revenue and investment income | (3,922) | (2,545) |
| Pension-related change other than net periodic benefit costs | (10,769) | (7,952) |
| Change in fair value of interest rate swaps | (7,609) | (9,374) |
| Gain on sale of property and equipment | (1,564) | (643) |
| Provision for bad debts | 17,670 | 16,037 |
| Earnings from joint ventures | (12,303) | (6,961) |
| Changes in assets and liabilities which (used) provided cash: | | |
| Patient accounts receivable | (26,530) | (17,569) |
| Inventory of supplies | (425) | 482 |
| Prepaid expenses and other current assets | (4,870) | 2,172 |
| Other assets | (7,972) | (2,628) |
| Accounts payable | 13,902 | (2,244) |
| Deferred revenue | 2,805 | 1,479 |
| Accrued and other current liabilities | (3,517) | 3,697 |
| Other liabilities | (7,890) | (16,677) |
| Net cash provided by operating activities | 102,889 | 94,143 |
| Cash Flows from Investing Activities | | |
| Purchase of property and equipment | (99,168) | (48,022) |
| Proceeds from sale of property and equipment and assets held for sale | 4,416 | 972 |
| Purchase of investments and assets whose use is limited | (448,084) | (325,392) |
| Proceeds from sale of investments and assets whose use is limited | 435,755 | 281,624 |
| Cash paid for intangible assets | (767) | - |
| Investment in unconsolidated affiliate - Net | (268) | (7,055) |
| Distributions from joint ventures | 8,965 | 5,985 |
| Net cash used in investing activities | (99,151) | (91,888) |
| Cash Flows from Financing Activities | | |
| Payments on long-term debt and capital lease obligations | (9,657) | (9,202) |
| Restricted contribution revenue and investment income | 3,922 | 2,545 |
| Net cash used in financing activities | (5,735) | (6,657) |
| Net Decrease in Cash and Cash Equivalents | (1,997) | (4,402) |
| Cash and Cash Equivalents - Beginning of year | 22,580 | 26,982 |
| Cash and Cash Equivalents - End of year | \$ 20,583 | \$ 22,580 |
| Supplemental Cash Flow Information - Cash paid for interest | \$ 19,128 | \$ 18,435 |
| Significant Noncash Transactions - Building obtained via capital lease | \$ 17,903 | \$ - |

Note 1 - Nature of Business

ProHealth Care, Inc. (PHC) is a Wisconsin not-for-profit corporation organized to provide and deliver a variety of high-quality healthcare services in Waukesha County, Wisconsin and surrounding areas. The accompanying consolidated financial statements include the accounts of PHC and its affiliates (collectively referred to as the "Corporation"):

Waukesha Memorial Hospital, Inc. (WMH)

A not-for-profit, acute-care hospital whose sole corporate member is PHC. WMH has 255 beds available and serves Waukesha, Wisconsin and surrounding communities. WMH also owns 51 percent of ProHealth Aligned, LLC, which owns and operates an ambulatory surgery center. The operating results of the ambulatory surgery center are consolidated with WMH.

Oconomowoc Memorial Hospital, Inc. (OMH)

A not-for-profit, acute-care hospital whose sole corporate member is PHC. OMH has 58 available beds and provides general acute care and support activities in Oconomowoc, Wisconsin and surrounding communities.

WMH and OMH are collectively referred to as the "Hospitals."

ProHealth Medical Group (PHMG)

A not-for-profit corporation that owns and manages primary and specialty care practices located throughout Waukesha County.

Waukesha Health System, Inc. (WHS)

A for-profit Wisconsin corporation whose sole stockholder is PHC. WHS and its subsidiaries, Empathia, Inc. and National Avenue Development Corporation, provide selected health services to the community, including employee assistance services, a counseling center that provides outpatient counseling and psychiatric services, and a health and fitness center. WHS also provides a variety of support services to healthcare providers.

National Regency of New Berlin, Inc. (National Regency)

A not-for-profit corporation whose sole corporate member is PHC. National Regency owns and operates assisted and independent living facilities in Waukesha County, Wisconsin and a medical office building located adjacent to WMH.

ProHealth Home Care, Inc. (PHHC)

A not-for-profit home health nursing and hospice agency that provides skilled nursing, therapy, and hospice services in patients' homes. PHHC also operates an inpatient and residential hospice facility, AngelsGrace Hospice.

ProHealth Solutions, LLC (PHS)

A for-profit limited liability corporation Accountable Care Organization (ACO) that provides a comprehensive quality improvement program with new information technology to measure specific clinical and efficiency outcomes for each physician that is part of the ACO. PHS clinically integrates the independent physicians association, Waukesha Elmbrook Health Care, consisting of approximately 460 physicians with the entire PHC system. PHC has a 64 percent ownership and controlling interest in PHS.

ProHealth Care Foundation, Inc. (PHCF or the "PHC Foundation")

A not-for-profit corporation whose sole corporate member is PHC. PHCF operates for charitable, educational, and scientific purposes exclusively for the benefit of PHC and its affiliates. Distributions of PHCF's assets to or for the benefit of PHC and its affiliates are made at the discretion of PHCF's board of directors.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies

Basis of Consolidation

All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less. Cash balances held in the bank accounts exceed the federal depository insurance limit. The Corporation's cash is only insured up to the federal depository insurance limit.

Short-term Investments

Short term investments primarily include funds of funds debt securities and U.S. Treasury government obligations with maturity dates of one year or less. These investments include assets designated by the board of directors for future capital improvement over which the board retains control and may, at its discretion, subsequently use for other purposes.

Accounts Receivable

Accounts receivable from patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and are adjusted for economic conditions and other trends affecting the Corporation's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. Net accounts receivable is based on expected payment rates from payors based on current reimbursement methodologies.

For receivables associated with services provided to patients who have third-party coverage, the Corporation analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Corporation records a provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the consolidated balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in nonoperating income. Unrealized gains or losses on investments are excluded from income from operations and are included in nonoperating income (loss) on the consolidated statement of operations and changes in net assets.

The Corporation has designated all investments as trading securities.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

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

Assets Whose Use is Limited

Assets whose use is limited include assets designated by the board of directors for future capital improvement over which the board retains control and may, at its discretion, subsequently use for other purposes. Assets whose use is limited also include assets temporarily restricted or permanently restricted by donor. Amounts required to meet current liabilities of the Corporation have been reclassified as current assets in the consolidated balance sheet.

Inventories

Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at cost, determined on a first-in, first-out basis, or net realizable value.

Property and Equipment

Property and equipment are recorded at cost. The straight-line method is used for computing depreciation and amortization. Assets are depreciated over their estimated useful lives. Equipment under capital lease obligations is amortized on the straight-line method over the shorter of the period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated statement of operations and changes in net assets. Interest incurred on borrowed funds during the construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no interest capitalized during the years ended September 30, 2018 and 2017. Costs of maintenance and repairs are charged to expense when incurred.

Goodwill and Other Intangible Assets

The recorded amounts of goodwill from prior business combinations are based on management's best estimates of the fair values of assets acquired and liabilities assumed at the date of acquisition. Goodwill is not amortized, but rather is assessed at least on an annual basis for impairment. During 2018, \$767,000 was added to goodwill as a part of the medical practice acquisition.

It is reasonably possible that management's estimates of the carrying amount of goodwill will change in the near term. Amortization expense on intangibles totaled approximately \$120,000 and \$127,000 in 2018 and 2017, respectively.

Investments in Affiliated Organizations

Investments in affiliated organizations in which less than a majority interest is held are accounted for using the equity method.

Derivative Instruments

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

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Fair Value of Financial Instruments

The carrying values of financial instruments, including cash, accounts receivable, accounts payable, and debt, approximate fair value. Investments are recorded at fair value under generally accepted accounting principles. The fair value of the Corporation's debt obligations is determined by applying the yield of openly marketed bonds that have substantially the same characteristics as the Corporation's debt instruments. The interest rate swaps are recorded at fair value on the Corporation's consolidated balance sheet.

Classification of Net Assets

Net assets of the Corporation are classified as permanently restricted, temporarily restricted, noncontrolling interest in consolidated subsidiaries, or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the Corporation's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Noncontrolling interest in consolidated subsidiaries represents the net assets attributed to entities not wholly owned by the Corporation. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Permanently restricted net assets result from donor-imposed restrictions that limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments to the Corporation 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 the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

The Corporation recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Corporation recognizes revenue on the basis of standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Corporation's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources in total was approximately \$753,124,000 and \$715,339,000 for the years ended September 30, 2018 and 2017, respectively. For the years ended September 30, 2018 and 2017, total net patient service revenue is composed of approximately \$745,570,000 and \$709,684,000 from third-party payors and approximately \$7,554,000 and \$5,655,000 from self-pay payors, respectively.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation that applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Corporation's total expenses divided by gross patient service revenue. The Corporation estimates that it provided approximately \$1,472,000 and \$1,551,000 of services to indigent patients during 2018 and 2017, respectively.

Other Operating Revenue

Other operating revenue consists of revenue that is integral to operations but not directly related to patient care (i.e., rental, retail pharmacy, cafeteria, dietary revenue, ACO memberships, and Employee Assistance Program services).

PHS receives revenue from administration fees, membership services, and incentive plans, which are recognized based on the terms of each payor contract, typically multi-year. Incentive fees are earned as performance measures or criteria thresholds have been met over the contract period. Certain advancement of incentive funds are recorded as deferred revenue until all related contingencies are settled. PHS executed an agreement with the Centers for Medicare and Medicaid Services (CMS) in 2012 for participation in the Medicare Shared Savings Program (MSSP). Participation in this program ended on December 31, 2016. No incentives on this program were recorded in 2018 and 2017.

Effective January 1, 2017, PHS began participating in the Medicare Next Generation ACO Model, which offers a new opportunity in accountable care that sets predictable financial targets, enables providers and beneficiaries greater opportunities to coordinate care, and aims to attain the highest quality standards of care. This Next Generation ACO Model offers higher financial incentives for achieving specified targets compared to the prior MSSP. However, there is potential for down-side risk in the event that these are not met. The Corporation recognized \$5,649,000 of incentives in 2018 for shared savings earned on the 2017 plan year. Also in 2018, the Corporation recorded \$738,000 of downside risk reserve on the 2018 plan year recorded in contracted services and other. Final determination of the 2018 plan year gain or loss does not occur until completion of the claims run out, which is not expected to occur until 8-10 months following the end of the 2018 calendar year.

To participate in this new program, CMS requires a financial guarantee of all participants in the event the down-side risk materializes and a participant owes money back to CMS. This financial guarantee must equate to 2 percent of the attributed lives' Part A and B beneficiary spend from the base year. During 2017, PHS executed a letter of credit of approximately \$2,215,000, expiring on March 31, 2019. In 2018, this letter of credit was amended to approximately \$2,056,000, expiring on December 31, 2019. Given the stand-alone size of ProHealth Solutions, the Corporation's obligated group guaranteed this letter of credit under terms of the Master Trust Indenture.

Contributions

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of operations and changes in net assets as net assets released from restrictions.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

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

Federal Income Tax

PHC, WMH, OMH, National Regency, PHMG, PHCF, and PHHC are not-for-profit corporations, as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and are exempt from federal income taxes pursuant to Section 501(a) of the Code. All of these entities are, however, subject to federal and state income taxes on any unrelated business income under the provisions of Section 511 of the Code.

WHS is a for-profit corporation that accounts for income taxes under the asset and liability method of accounting. A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the year. Deferred tax liabilities or assets are recognized for the estimated future tax effects of temporary differences between financial reporting and tax accounting.

PHS is treated as a partnership for income tax purposes. Income and losses of PHS are passed to its members. PHS income passed through to PHC is not considered taxable to PHC unless it is considered unrelated business income.

Excess of Revenue Over (Under) Expenses

The consolidated statement of operations and changes in net assets includes excess of revenue over (under) expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over (under) expenses, consistent with industry practice, include pension-related changes other than net periodic benefit cost, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions by which donor restriction were to be used for the purposes of acquiring such assets).

Upcoming Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for the Corporation's year ending September 30, 2019. Management does not expect that this standard will have a significant impact on the calculation of net patient service revenue.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Corporation's year ending September 30, 2020 and will be applied using a modified retrospective transition method. Management expects that this new standard will significantly increase long-term assets and liabilities upon adoption. The effect on the results of operations is not expected to be significant.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations that follow the FASB not-for-profit rules, including changing from three classes of net assets to two classes: net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by the Corporation, including required disclosures about the liquidity and availability of resources. The new standard is effective for the Corporation's year ending September 30, 2019 and thereafter and must be applied on a retrospective basis. The standard is expected to have an impact on the presentation of net assets and result in enhanced disclosures related to liquidity and availability.

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard requires service cost to be included with salaries and wages within operating expenses, the other components of net benefit cost to be presented separately outside of income from operations, and capitalization of only the service cost component, when applicable. The new standard is effective for the Corporation's year ending September 30, 2020 and must be applied on a retrospective basis.

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including December 14, 2018, which is the date the consolidated financial statements were available to be issued.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable at September 30 are set forth below (in thousands):

| | 2018 | 2017 |
|---|------------------|------------------|
| Patient accounts receivable | \$ 107,337 | \$ 97,697 |
| Less allowance for uncollectible accounts | 19,020 | 18,240 |
| Patient accounts receivable - Net | <u>\$ 88,317</u> | <u>\$ 79,457</u> |

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

| | 2018 | 2017 |
|------------|--------------|--------------|
| Medicare | 30 % | 31 % |
| Medicaid | 6 | 7 |
| Commercial | 47 | 45 |
| Self-pay | 17 | 17 |
| Total | <u>100 %</u> | <u>100 %</u> |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 4 - Net Patient Service Revenue and Cost Report Settlements

The Corporation has agreements with third-party payors that provide for payments to the Corporation at amounts different from its established rates. A significant portion of the Corporation's net patient service revenue is received from Medicare and Medicaid programs. A summary of the basis of reimbursement with these third-party payors for Medicare, Medicaid, and Managed Care are as follows:

- **Medicare** - Inpatient acute and most outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Certain inpatient nonacute and outpatient services and medical education costs related to Medicare beneficiaries are paid based upon cost reimbursement methodologies.
- **Medicaid** - Inpatient and outpatient acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates.
- **Managed Care** - The Corporation has entered into reimbursement agreements with managed care and commercial organizations. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined per diem rates, and established fee schedules.

Note 5 - Assets Limited as to Use and Investments

The composition of assets whose use is limited or restricted and investments at fair value at September 30 is set forth in the following tables (in thousands):

| | 2018 | 2017 |
|---|-------------------|-------------------|
| Limited by the board: | | |
| Plant replacement and expansion | \$ 786,731 | \$ 746,215 |
| Designated for PHC Foundation | 16,924 | 16,818 |
| Reserved for unemployment compensation and other | 304 | 308 |
| Restricted by donors | 13,302 | 13,335 |
| | <u>817,261</u> | <u>776,676</u> |
| Total assets whose use is limited or restricted and investments | <u>\$ 817,261</u> | <u>\$ 776,676</u> |
| | 2018 | 2017 |
| Cash, money market funds, certificates of deposit, and accrued interest | \$ 19,253 | \$ 30,134 |
| Private equities and hedge funds | 219,951 | 197,653 |
| Real estate funds | 90,259 | 71,985 |
| Corporate bonds | 31,955 | 34,729 |
| Common stocks and equity securities | 414,308 | 395,362 |
| U.S. Treasury obligations | 40,654 | 45,932 |
| Other | 881 | 881 |
| | <u>817,261</u> | <u>776,676</u> |
| Total | <u>\$ 817,261</u> | <u>\$ 776,676</u> |

The composition of investment returns on the Corporation's assets whose use is limited or restricted and investments for the years ended September 30, 2018 and 2017 is as follows (in thousands):

| | 2018 | 2017 |
|---------------------------------------|------------------|------------------|
| Investment income | \$ 14,957 | \$ 11,820 |
| Unrealized (loss) gain on investments | (15,030) | 38,825 |
| Net realized gains | 43,868 | 11,575 |
| | <u>43,795</u> | <u>62,220</u> |
| Total | <u>\$ 43,795</u> | <u>\$ 62,220</u> |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 5 - Assets Limited as to Use and Investments (Continued)

Investment returns included in the accompanying consolidated statement of operations and changes in net assets for the years ended September 30, 2018 and 2017 are as follows (in thousands):

| | 2018 | 2017 |
|---|------------------|------------------|
| Nonoperating gain - Net - Unrestricted net assets | \$ 43,053 | \$ 61,855 |
| Restricted investment income | 736 | 356 |
| Restricted unrealized gains on investments | 6 | 9 |
| Total | <u>\$ 43,795</u> | <u>\$ 62,220</u> |

Note 6 - Property and Equipment

The cost of property and equipment and depreciable lives at September 30 are summarized as follows (in thousands):

| | 2018 | 2017 | Depreciable Life - Years |
|--|-------------------|-------------------|-----------------------------|
| Land | \$ 42,191 | \$ 44,227 | - |
| Land improvements | 10,399 | 12,682 | 5 - 20 |
| Buildings | 708,317 | 679,488 | 20 - 40 |
| Building improvements | 17,477 | 13,275 | 10 - 40 |
| Equipment | 414,410 | 524,726 | 3 - 5 |
| Capital leased equipment and buildings | 82,475 | 64,572 | 20 |
| Construction in progress | 56,917 | 9,330 | - |
| Total cost | 1,332,186 | 1,348,300 | |
| Less accumulated depreciation and amortization | 712,225 | 785,577 | |
| Net property and equipment | <u>\$ 619,961</u> | <u>\$ 562,723</u> | |

Depreciation and amortization expense on property and equipment totaled approximately \$60,274,000 and \$59,964,000 in 2018 and 2017, respectively. Accumulated amortization on leased buildings and equipment under capital leases was approximately \$24,847,000 and \$21,827,000 at September 30, 2018 and 2017, respectively, which is included in accumulated depreciation and amortization in the table above.

During 2018, the Corporation commenced a 20-year lease on a new medical office building, which added a \$17,903,000 capital lease obligation and capital lease asset (see Note 9).

Construction in progress at September 30, 2018 principally consists of costs associated with the construction, renovation, and remodeling of existing facilities. Contractual commitments related to construction in progress totaled approximately \$53,171,000 at September 30, 2018.

Note 7 - Other Assets

The detail of other assets at September 30 is given below (in thousands):

| | 2018 | 2017 |
|---------------------------------|------------------|------------------|
| Investments in joint ventures | \$ 18,769 | \$ 18,455 |
| Deferred compensation (Note 12) | 24,830 | 24,823 |
| Prepaid pension (Note 11) | 7,307 | - |
| Other | 4,428 | 3,192 |
| Total | <u>\$ 55,334</u> | <u>\$ 46,470</u> |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 7 - Other Assets (Continued)

Joint Ventures

The Corporation has entered into a number of joint venture arrangements, including a 49 percent ownership interest in the Rehabilitation Hospital of Wisconsin, a 50 percent ownership interest in the Lake Country Endoscopy Center, a 49 percent ownership interest in the Orthopedic Surgery Center, and a 45 percent ownership interest in a medical office building. In 2017, the Corporation acquired a 50 percent ownership interest in the Moreland Endoscopy Center. In 2018, the Corporation acquired a 50 percent ownership interest in the Southern Lakes Endoscopy Center.

Also in 2018, the Corporation divested from a 45 percent interest in a medical office joint venture. As part of a final member distribution dissolving the joint venture, the Corporation recorded a \$3,292,000 gain in other operating revenue.

The total assets and total liabilities, inclusive of net assets, of these joint ventures are approximately \$18,402,000 and \$19,250,000 as of September 30, 2018 and 2017, respectively. The total excess of revenue over expenses for these joint ventures is approximately \$18,285,000 and \$14,380,000 for the years ended September 30, 2018 and 2017, respectively.

Note 8 - Accrued Liabilities

The details of current accrued liabilities and other at September 30 are as follows (in thousands):

| | 2018 | 2017 |
|-----------------------------|-----------|-----------|
| Payroll and related items | \$ 32,222 | \$ 29,308 |
| Paid time off | 11,425 | 10,971 |
| Interest | 2,002 | 1,991 |
| Pension liability (Note 11) | - | 6,142 |
| Other | 4,557 | 5,474 |
| Total | \$ 50,206 | \$ 53,886 |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 9 - Long-term Debt

A summary of long-term debt obligations at September 30, 2018 and 2017 is as follows (in thousands):

| | 2018 | 2017 |
|--|-------------------|-------------------|
| Revenue Refunding Bonds, Series 2015, at interest rates ranging from 2.75 percent to 5.00 percent, maturing in 2039 | \$ 133,630 | \$ 133,630 |
| Revenue Bonds, Series 2014A, variable interest rates based on market conditions (2.16 percent at September 30, 2018), maturing in 2044 | 102,050 | 102,050 |
| Revenue Bonds, Series 2014B, variable interest rates based on market conditions (2.18 percent at September 30, 2018), maturing in 2044 | 102,050 | 102,050 |
| Revenue Refunding Bonds, Series 2012, at interest rates ranging from 3.00 percent to 5.00 percent, maturing in 2032 | 40,270 | 40,985 |
| Revenue Refunding Bonds, Series 2011, at interest rates ranging from 4.38 percent to 5.00 percent, maturing in 2019 | 1,815 | 6,095 |
| Capital leases | 51,273 | 36,283 |
| Note payable to bank, interest rate of 3.36 percent at September 30, 2018 | 29,627 | 30,474 |
| Total | 460,715 | 451,567 |
| Less current portion | (9,565) | (8,727) |
| Add unamortized bond premium | 12,526 | 13,428 |
| Less bond issuance costs | (2,242) | (2,405) |
| Long-term portion | \$ 461,434 | \$ 453,863 |

The revenue bonds were issued on behalf of the Corporation by the Wisconsin Health and Educational Facilities Authority (WHEFA) and provide for a security interest in substantially all revenue of the obligated group, except for certain restricted contributions and grants.

PHC, WMH, OMH, and National Regency are members of the obligated group (the "Obligated Group"). As members of the Obligated Group, the members jointly and severally have guaranteed the payment of any and all amounts due on the revenue bonds issued by WHEFA to the Obligated Group, which aggregates to approximately \$379,815,000 at September 30, 2018.

On January 29, 2015, the Obligated Group issued Revenue Refunding Bonds, Series 2015 for \$133,630,000 to advance refund the remaining Series 2009 bonds and pay the cost of issuance. The bonds consist of fixed-rate serial bonds, payable in annual installments ranging from \$2,950,000 to \$12,380,000, maturing in 2034, and one term bond due in 2039.

On December 18, 2014, the Obligated Group issued Revenue Bonds, Series 2014A and 2014B for \$102,400,000, whose proceeds were used to refund the remaining Series 2008A, 2008B, and 2005 bonds; finance certain capital expenditures of the Corporation; and pay the cost of issuance. As a result of the National Regency's 2005 Adjustable Demand Revenue Bonds refinance, National Regency became part of the Corporation's Obligated Group. The bonds require monthly variable-interest payments and annual principal payments ranging from \$2,765,000 to \$25,290,000, maturing in 2044.

On May 4, 2012, the Obligated Group issued Revenue Refunding Bonds, Series 2012 for \$44,650,000 to refund the remaining Series 1999 bonds, refund the 2001A bonds, and advance refund a portion of the Series 2009 bonds. The bonds consist of fixed-rate serial bonds, payable in annual installments ranging from \$730,000 in 2019 to \$3,795,000 in 2028, and fixed-rate term bonds, payable in annual installments ranging from \$2,770,000 in 2030 to \$8,380,000 in 2032.

On January 1, 2011, the Obligated Group issued Revenue Refunding Bonds, Series 2011 for \$35,060,000 to refund all of the Series 1995 bonds and refund a portion of the Series 1999 bonds. The bonds consist of fixed-rate term bonds and mature in 2019.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 9 - Long-term Debt (Continued)

The loan agreements contain various covenants and restrictions, including the maintenance of certain financial ratios and the establishment and maintenance of debt service funds under the control of the bond trustee.

In 2008, the Corporation entered into a real estate put agreement with Investors Associated, LLP. The put agreement required the Corporation to purchase the properties or find a third-party buyer upon receipt of notification from Investors Associated, LLP. In 2011, the put option was exercised. The Corporation purchased the facilities outright as a result of the put option being exercised for approximately \$46,400,000, of which the Corporation signed a note payable totaling approximately \$31,400,000 related to the purchase of these facilities. The note is payable in annual installments commencing in 2017. Interest on the note is calculated as a fluctuating annual interest rate based on LIBOR plus 125 basis points.

In December 2016, the Corporation entered into a long-term property lease, which included construction by the lessor of a building with approximately 50,000 square feet of space. The Corporation was not deemed to be the accounting owner of the project as of September 30, 2017. In 2018, construction was finalized, and the 20-year lease commenced, which added a \$17,903,000 capital lease obligation and capital lease asset with an annual interest rate of 5.00 percent.

Scheduled future maturities of long-term debt and minimum payments of capital lease obligations as of September 30, 2018 are as follows (in thousands):

| Years Ending | Long-term Debt | Capital Lease Obligation |
|---|----------------|--------------------------|
| 2019 | \$ 6,095 | \$ 6,575 |
| 2020 | 5,761 | 10,850 |
| 2021 | 5,856 | 6,792 |
| 2022 | 5,992 | 6,986 |
| 2023 | 6,094 | 7,186 |
| Thereafter | 379,644 | 32,452 |
| Subtotal | 409,442 | 70,841 |
| Less amount representing interest under capital lease obligations | - | (19,568) |
| Total | \$ 409,442 | \$ 51,273 |

Derivative Instruments and Hedging Activities

The derivative instruments used by the Corporation are interest rate swap agreements that are used to manage variability in cash flows and to essentially convert variable-rate interest on long-term debt to fixed-rate interest. The variable interest rate on the debt generally exposes the Corporation to variability in cash flows in rising or declining interest rate environments. The interest rate swaps reduce the variability of the cash flow of the debt.

(a) Objectives and Strategies

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

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 9 - Long-term Debt (Continued)

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

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

(b) Risk Management Policies

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

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

(c) Transactions

Effective May 11, 2005, the Corporation entered into an interest rate swap matched to its Series 2005 bonds. Under the terms of this interest rate swap, the Corporation pays a fixed rate of 3.6 percent and receives a variable rate of interest equal to 70 percent of the one-month LIBOR index, reset weekly. The Corporation received no net cash under the interest rate swap agreements in 2018 or 2017.

Under the terms of the interest rate swap agreement related to the Series 2008A bonds, the Corporation pays a fixed rate of 3.52 percent and receives a variable rate of interest equal to 70 percent of the one-month LIBOR index, reset weekly. Under the terms of the interest rate swap agreement related to the Series 2008B bonds, the Corporation pays a fixed rate of 4.12 percent and receives a variable rate of interest equal to 70 percent of the one-month LIBOR index, reset weekly.

The Corporation does not record the interest rate swaps using hedge accounting; therefore, all changes in fair value are included in nonoperating income (loss) in the consolidated statement of operations and changes in net assets.

The fair value of the interest rate swaps of approximately \$14,438,000 and \$22,047,000 is included in the consolidated balance sheet at September 30, 2018 and 2017, respectively. During the years ended September 30, 2018 and 2017, the change in fair value of the interest rate swaps was approximately \$7,452,000 and \$9,217,000, respectively, and was included in the nonoperating income reported in the consolidated statement of operations and changes in net assets. Included in unrestricted net assets is approximately \$157,000 of unrealized gains related to the amortization of transition deferral of interest rate swaps during 2018 and 2017.

Activity relating to the Series 2005 adjustable demand revenue bonds was recorded using hedge accounting through December 2008. As of March 2009, it was determined that the swap was ineffective and no longer qualified for hedge accounting treatment. The accumulated change in fair value of approximately \$2,598,000 through December 2008 was not included in the consolidated statement of operations and changes in net assets. The amount is being amortized into the consolidated statement of operations and changes in net assets as a component of nonoperating gains (losses) through 2034.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 9 - Long-term Debt (Continued)

Net cash paid under the interest rate swap agreements was approximately \$3,205,000 and \$4,013,000 during 2018 and 2017, respectively.

The interest rate swap agreements at September 30, 2018, whose notional amounts refinanced by the 2014A and 2014B Revenue Bonds remain unchanged to the original debt amortization, are as follows:

| | <u>Notional Amount</u> | <u>Maturity Date</u> | <u>Fixed Pay Rate (%)</u> |
|-------------|------------------------|----------------------|---------------------------|
| 2005 bonds | \$ 16,485,000 | August 15, 2034 | 3.60 |
| 2008A bonds | 44,140,000 | August 23, 2023 | 3.52 |
| 2008B bonds | 57,775,000 | February 1, 2034 | 4.12 |
| Total | <u>\$ 118,400,000</u> | | |

Note 10 - Operating Leases

PHC, WMH, OMH, PHHC, PHMG, WHS, and PHS are obligated under certain facility and equipment operating leases. Total rent expense under these leases was approximately \$6,039,000 and \$6,359,000 for 2018 and 2017, respectively.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year (in thousands):

| <u>Years Ending September 30</u> | <u>Rental Commitments</u> |
|--------------------------------------|-------------------------------|
| 2019 | \$ 2,892 |
| 2020 | 2,608 |
| 2021 | 2,565 |
| 2022 | 1,534 |
| 2023 | - |
| Thereafter | - |
| Total | <u>\$ 9,599</u> |

Note 11 - Pension and Other Postretirement Benefit Plans

Certain affiliates of the Corporation participate in the PHC defined benefit contributory group pension plan (the "pension plan") covering certain full-time and regularly scheduled part-time employees who meet defined age and length of service requirements. The Corporation funds the amount calculated by the pension plan's consulting actuaries to meet the minimum Employee Retirement Income Security Act of 1974 (ERISA) funding requirements after consideration of employee contributions.

As of January 1, 2006, the pension plan was curtailed, allowing participants the option of remaining in the pension plan or becoming participants in a defined contribution retirement savings plan.

Certain affiliates of the Corporation participate in the PHC postretirement benefit plan (the "PHC postretirement plan") covering all full-time and regularly scheduled part-time employees who meet defined length of service requirements. The PHC postretirement plan provides health, vision, and pharmacy benefits to eligible retirees based on cumulative years of service.

During 2010, the Corporation modified the PHC postretirement plan to eliminate the postretirement benefit for participants who retire after December 31, 2010. In addition, the benefit for participants who retire prior to December 31, 2010 expired as of December 31, 2013. The plan amendment had a significant impact on the projected benefit obligation of the PHC postretirement plan, as reflected in the table below.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 11 - Pension and Other Postretirement Benefit Plans (Continued)

During 2015, the Corporation passed a resolution offering a lump-sum window payout for eligible pension plan participants, effective March 2015. No settlement accounting was required. The Corporation also approved a hard freeze of the pension plan effective June 30, 2016. At September 30, 2018 and 2017, approximately \$0 and \$6,142,000, respectively, of the liability is classified as current within accrued liabilities and other (see Note 8) and the remainder as pension liability on the accompanying consolidated balance sheet.

In November 2018, the board passed a resolution to terminate the pension plan. The termination will likely occur in the next fiscal year. As part of the termination, the Corporation will purchase annuity contracts from the existing plan assets for all beneficiaries to receive the full amount of their vested benefits.

The Corporation also has deferred compensation agreements with certain employees and executives.

Obligations and funded status at September 30, 2018 and 2017 are as follows (in thousands):

Obligations and Funded Status

| | Pension Benefits | | Other Postretirement Benefits | |
|--|------------------|-------------|-------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Change in benefit obligation: | | | | |
| Benefit obligation at beginning of year | \$ 289,689 | \$ 286,424 | \$ 99 | \$ 106 |
| Service cost | 1,674 | 1,637 | - | - |
| Interest cost | 11,857 | 11,434 | 5 | 5 |
| Curtailement loss | 112 | - | - | - |
| Actuarial (gain) loss | (17,726) | 1,112 | (5) | 1 |
| Benefits paid | (18,645) | (10,918) | (5) | (13) |
| Benefit obligation at end of year | 266,961 | 289,689 | 94 | 99 |
| Change in plan assets: | | | | |
| Fair value of plan assets at beginning of year | 262,742 | 232,867 | - | - |
| Actual return on plan assets | 7,005 | 25,793 | - | - |
| Employer contributions | 16,500 | 15,000 | 5 | 13 |
| Benefits paid | (11,979) | (10,918) | (5) | (13) |
| Fair value of plan assets at end of year | 274,268 | 262,742 | - | - |
| Funded status at end of year | \$ 7,307 | \$ (26,947) | \$ (94) | \$ (99) |

The \$7,307,000 overfunded status of pension benefits is recorded as a prepaid pension asset recorded with other assets on the consolidated balance sheet (see Note 7). The accumulated benefit obligation for all defined benefit pension plans was approximately \$266,961,000 and \$289,671,000 at September 30, 2018 and 2017, respectively. The accumulated benefit obligation for the postretirement benefit plan was approximately \$93,000 and \$99,000 at September 30, 2018 and 2017, respectively.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 11 - Pension and Other Postretirement Benefit Plans (Continued)

Components of net periodic benefit cost and other amounts recognized in unrestricted net assets are as follows (in thousands):

| | Pension Benefits | | Other Postretirement Benefits | |
|---|------------------|-------------|-------------------------------|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Net Periodic Benefit Cost | | | | |
| Service cost | \$ 1,674 | \$ 1,637 | \$ - | \$ - |
| Interest cost | 11,857 | 11,434 | 5 | 4 |
| Expected return on plan assets | (15,629) | (17,893) | - | - |
| Amortization of prior service cost | 1,659 | 1,601 | 1 | 10 |
| Net periodic (income) benefit cost | (439) | (3,221) | 6 | 14 |
| Other Changes in Plan Assets and Benefit Obligations Recognized in Unrestricted Net Assets | | | | |
| Net gain | (10,677) | (7,907) | (6) | (17) |
| Prior service credit | (86) | (28) | - | - |
| Total recognized in unrestricted net assets | (10,763) | (7,935) | (6) | (17) |
| Total recognized in net periodic benefit cost and unrestricted net assets | \$ (11,202) | \$ (11,156) | \$ - | \$ (3) |

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

| | Pension Benefits | | Other Postretirement Benefits | |
|-------------------------------|------------------|-------|-------------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Discount rate | 4.70% | 4.23% | 4.70% | 4.23% |
| Rate of compensation increase | 0.00 | 0.00 | 0.00 | 0.00 |

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

| | Pension Benefits | | Other Postretirement Benefits | |
|--|------------------|-------|-------------------------------|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Discount rate | 4.23% | 4.07% | 4.23% | 4.07% |
| Expected long-term return on plan assets | 5.19 - 7.00 | 7.50 | 0.00 | 0.00 |
| Rate of compensation increase | 0.00 | 0.00 | 0.00 | 0.00 |

The overall expected rate of return on plan assets represents a weighted-average composite rate based on the historical rates of returns of the respective asset classes adjusted for anticipated market movements. The determination is influenced by the asset allocation, as well as the PHC investment policy. During 2016, the Corporation revised the investment allocation utilizing a liability driven investment strategy. PHC's investment strategy is of a long-term nature and is intended to ensure that funds are available to pay benefits as they become due and to maximize the trust's total return at an appropriate level of investment risk.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 11 - Pension and Other Postretirement Benefit Plans (Continued)

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. The healthcare cost trend rate represents the increases in healthcare cost for the current period while the ultimate healthcare cost trend rate represents the increase for future periods.

Assumed Healthcare Cost Trend Rates at September 30

| | Pension Benefits | |
|---|------------------|--------|
| | 2018 | 2017 |
| Healthcare cost trend rate assumed for next year | 5.00 % | 5.00 % |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.00 % | 5.00 % |

Pension Plan Assets

| | 2018 | 2017 |
|-------------------|----------|----------|
| Asset category: | | |
| Equity securities | 17.00 % | 53.00 % |
| Debt securities | 64.00 | 19.00 |
| Cash equivalents | 1.00 | 1.00 |
| Other | 18.00 | 27.00 |
| Total | 100.00 % | 100.00 % |

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

The Corporation's overall investment strategy is to achieve a mix of approximately 15 percent equity securities and 85 percent fixed-income securities. The Corporation continues to derisk the pension portfolio investments and will continue to divest other holdings, which currently include hedge funds and real estate companies.

The fair values of the Corporation's pension plan assets at September 30, 2018 by major asset classes are as follows (in thousands):

| Asset Classes | Fair Value Measurements at September 30, 2018 | | | |
|-----------------------------|--|---|---|------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Money market funds | \$ 2,614 | \$ - | \$ - | \$ 2,614 |
| Equity securities | 46,733 | - | - | 46,733 |
| Mutual funds - Fixed income | 176,741 | - | - | 176,741 |
| Insurance contracts | - | - | 638 | 638 |
| Investments valued at NAV | - | - | - | 47,542 |
| Total | \$ 226,088 | \$ - | \$ 638 | \$ 274,268 |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 11 - Pension and Other Postretirement Benefit Plans (Continued)

| | Fair Value Measurements at September 30, 2017 | | | Total |
|-----------------------------|--|--|--|-------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Asset Classes | | | | |
| Money market funds | \$ 1,796 | \$ - | \$ - | \$ 1,796 |
| Equity securities | 140,044 | - | - | 140,044 |
| Mutual funds - Fixed income | 50,330 | - | - | 50,330 |
| Insurance contracts | - | - | 725 | 725 |
| Investments valued at NAV | - | - | - | 69,847 |
| Total | \$ 192,170 | \$ - | \$ 725 | \$ 262,742 |

The tables above present information about the pension plan assets measured at fair value at September 30, 2018 and 2017 and the valuation techniques used by the Corporation to determine those fair values.

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

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

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

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

The Corporation's policy is to recognize transfers between levels of the fair value hierarchy as of the actual date of the event of change in circumstances that caused the transfer. There were no transfers between levels of the fair value hierarchy during 2018 and 2017.

Cash Flow

Contributions

The Corporation contributed approximately \$16,500,000 to its pension and postretirement benefit plans in 2018. As the pension and postretirement benefit plans are over 100 percent funded status, the Corporation will continue to monitor required levels of incremental funding, but currently has no plans to make additional contributions to the plan in 2019.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 11 - Pension and Other Postretirement Benefit Plans (Continued)

Estimated Future Benefit Payments

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

| Years Ending | Pension Benefits | Postretirement Benefits |
|--------------|------------------|-------------------------|
| 2019 | \$ 12,397 | \$ 7 |
| 2020 | 13,468 | 7 |
| 2021 | 14,297 | 7 |
| 2022 | 14,977 | 7 |
| 2023 | 15,747 | 7 |
| Thereafter | 86,608 | 35 |
| Total | \$ 157,494 | \$ 70 |

Defined Contribution Plan

The Corporation also sponsors a defined contribution retirement savings plan. The Corporation matches each participant's contribution based on two different matching plans. Under the first matching plan, employees hired prior to November 1, 2004 who elected to continue their benefit accruals in the PHC pension plan receive a fixed amount equal to 50 percent of their salary deferrals that do not exceed 4 percent of their compensation. The second matching plan is available to all other employees who are not covered by the PHC pension plan or who chose to freeze their benefit accruals as of January 1, 2006. These employees receive a fixed amount equal to 50 percent of their salary deferrals that do not exceed 10 percent of their compensation. Effective July 1, 2016, with the hard freeze of the pension plan, all employees under the defined contribution plan receive a fixed amount equal to 50 percent of their salary deferrals that do not exceed 10 percent of their compensation.

The Corporation's expense for the defined contribution retirement savings plan was approximately \$9,459,000 and \$9,397,000 in 2018 and 2017, respectively.

Note 12 - Commitments and Contingencies

Deferred Compensation

Other long-term liabilities include approximately \$25,206,000 and \$25,190,000 at September 30, 2018 and 2017, respectively, primarily relating to employee deferred compensation agreements at PHMG. Although these deferred compensation liabilities are unsecured, assets designated to fund these liabilities are reported in other assets (see Note 7). Such assets are subject to the claims of the general creditors of the Corporation. Any underfunding from other assets would be funded from operating cash.

Unemployment Compensation

The Corporation has elected the reimbursement method to finance the cost of unemployment compensation benefits. Unemployment compensation expense is charged to operating expense when the claims are incurred. The Corporation has obtained letters of credit of approximately \$3,389,000 and \$3,377,000 as of September 30, 2018 and 2017, as required by the State of Wisconsin, as collateral for payment of possible future unemployment claims.

Malpractice Insurance

The Corporation has professional liability insurance for claim losses less than \$1,000,000 per claim and \$3,000,000 per year for claims incurred during a policy year, regardless of when the claim is reported (occurrence coverage). Losses in excess of these amounts are covered through the Corporation's mandatory participation in the Injured Patients and Families Compensation Fund of the State of Wisconsin.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 12 - Commitments and Contingencies (Continued)

Regulatory Investigations

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to the regulatory investigations and compliance audits of healthcare providers. The Corporation is subject to these regulatory efforts. Management is currently unaware of any regulatory matters that may have a material adverse effect on the Corporation's consolidated financial position or results of operations.

Litigation

The Corporation is subject to various legal proceedings and claims that are incidental to its normal business activities. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the consolidated financial position or results of operations of the Corporation.

Note 13 - Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at September 30, 2018 and 2017 (in thousands):

| | 2018 | 2017 |
|---|------------------|------------------|
| Specific healthcare services and programs | \$ 6,919 | \$ 6,921 |
| AngelsGrace property, plant, and equipment | 2,286 | 2,503 |
| Regional cancer center property, plant, and equipment | 1,493 | 1,492 |
| Total temporarily restricted | <u>\$ 10,698</u> | <u>\$ 10,916</u> |

Permanently restricted net assets are composed of endowments and a beneficial interest in a perpetual charitable trust (the "Trust"). The Trust consists of funds invested and administered outside of the Corporation. The Corporation has the irrevocable right to receive a portion of the income earned on the trust assets in perpetuity in accordance with the trust agreement.

Permanently restricted net assets at September 30, 2018 and 2017 are restricted to the following (in thousands):

| | 2018 | 2017 |
|--|----------|----------|
| Investments to be held in perpetuity, the income from which is expendable to support healthcare services | \$ 6,228 | \$ 5,652 |

Note 14 - Functional Expenses

Expenses related to providing services for the years ended September 30, 2018 and 2017 are as follows (in thousands):

| | 2018 | 2017 |
|-------------------------------------|-------------------|-------------------|
| Healthcare services | \$ 611,765 | \$ 563,157 |
| Senior housing services | 11,051 | 11,150 |
| Counseling services | 22,290 | 21,925 |
| Medical office building services | 1,478 | 1,442 |
| Administrative and support services | 114,810 | 121,795 |
| Total | <u>\$ 761,394</u> | <u>\$ 719,469</u> |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 15 - Fair Value

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

The following tables present information about the Corporation's assets and liabilities measured at fair value on a recurring basis at September 30, 2018 and 2017 and the valuation techniques used by the Corporation to determine those fair values.

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis at
September 30, 2018 (in thousands)

| | Quoted Prices in | | | |
|--|--|--|--|-------------------------------------|
| | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at September 30, 2018 |
| Assets | | | | |
| Assets whose use is limited or restricted and investments: | | | | |
| Domestic corporate bonds | \$ - | \$ 27,386 | \$ - | \$ 27,386 |
| United States government bonds | - | 40,654 | - | 40,654 |
| Domestic stock | 214,967 | - | - | 214,967 |
| Fixed income - Mutual funds | 75,877 | - | - | 75,877 |
| Foreign corporate bonds | - | 4,569 | - | 4,569 |
| Foreign stock | 123,464 | - | - | 123,464 |
| Investments valued at NAV | | | | 310,210 |
| Total assets | \$ 414,308 | \$ 72,609 | \$ - | \$ 797,127 |
| Liabilities - Fair value of interest rate swap agreements | | | | |
| | \$ - | \$ 14,438 | \$ - | \$ 14,438 |

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 15 - Fair Value (Continued)

| Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2017 (in thousands) | | | | |
|--|--|--|--|-------------------------------------|
| | Quoted Prices in | | | Balance at September 30, 2017 |
| | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets | | | | |
| Assets whose use is limited or restricted and investments: | | | | |
| Domestic corporate bonds | \$ - | \$ 29,333 | \$ - | \$ 29,333 |
| United States government bonds | - | 45,932 | - | 45,932 |
| Domestic stock | 182,924 | - | - | 182,924 |
| Fixed income - Mutual funds | 93,380 | - | - | 93,380 |
| Foreign corporate bonds | - | 5,396 | - | 5,396 |
| Foreign stock | 119,058 | - | - | 119,058 |
| Investments valued at NAV | | | | 269,638 |
| Total assets | \$ 395,362 | \$ 80,661 | \$ - | \$ 745,661 |
| Liabilities - Fair value of interest rate swap agreements | | | | |
| | \$ - | \$ 22,047 | \$ - | \$ 22,047 |

Assets whose use is limited or restricted and investments on the consolidated balance sheet, as further discussed in Note 5, at September 30, 2018 and 2017 included cash and money market funds, pledges receivable, certificates of deposit, and cost method equity securities of approximately \$20,134,000 and \$31,015,000, respectively. Cash, certificates of deposit, and money market funds are not measured at fair value on a recurring basis and, therefore, are not included in the table above.

The fair value of the various government and corporate bonds was determined primarily based on Level 2 inputs. The Corporation estimates the fair value of these investments using quoted prices for similar assets in active markets. The fair value of these assets was determined primarily based on quoted market prices from the Corporation's custodial banks.

The fair value of the investments valued at net asset value (NAV) at September 30, 2018 and 2017 was determined primarily based on unobservable inputs. The Corporation estimates the fair value of these investments based on the most recent investment statement provided for the respective funds. The Corporation holds shares or interests in investment companies at year end whereby the fair value of the investment held is estimated based on the net asset value per share (or its equivalent) of the investment company.

The Corporation's policy is to recognize transfers between levels of fair value hierarchy as of the end of the reporting period.

Investments in Entities that Calculate Net Asset Value per Share

The Corporation holds shares or interests in investment companies at year end whereby the fair value of the investments is measured on a recurring basis using net asset value per share (or its equivalent) of the investment company.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 15 - Fair Value (Continued)

At year end, the fair value and unfunded commitments of those investments are as follows (in thousands):

| | Investments Held at September 30, 2018 | | |
|-----------------------|--|----------------------|--|
| | Fair Value | Unfunded Commitments | Redemption Frequency and Notice Period |
| Funds of hedge funds: | | | |
| Fixed income | \$ 76,828 | \$ - | Monthly with 2 - 10 days' notice |
| Global low volatility | 40,740 | - | Daily with 2 days' notice |
| | | | Monthly to quarterly with 5 to 70 days' notice, respectively |
| Diversifiers | 97,156 | - | Quarterly with 90 days' notice |
| Real estate funds | 90,259 | 619 | |
| Private equity funds | 5,227 | 2,419 | (1) |
| Total | <u>\$ 310,210</u> | <u>\$ 3,038</u> | |

| | Investments Held at September 30, 2017 | | |
|-----------------------|--|----------------------|--|
| | Fair Value | Unfunded Commitments | Redemption Frequency and Notice Period |
| Funds of hedge funds: | | | |
| Fixed income | \$ 78,116 | \$ - | Monthly with 2 - 10 days' notice |
| Global low volatility | 37,970 | - | Daily with 2 days' notice |
| | | | Monthly to quarterly with 5 to 70 days' notice, respectively |
| Diversifiers | 72,259 | - | Quarterly with 90 days' notice |
| Real estate funds | 73,285 | 619 | |
| Private equity funds | 8,008 | 2,302 | (1) |
| Total | <u>\$ 269,638</u> | <u>\$ 2,921</u> | |

(1) These funds generally have a stated life of 10 to 15 years, providing little to no short-term redemption liquidity and seeking to deliver enhanced long-term returns. Distributions are received through the liquidation of the underlying assets of the funds. The intention is to hold these investments through liquidation. It is estimated that this portfolio will substantially liquidated over the next three to five years.

The fixed-income allocation contains investments in corporate loans and emerging markets fixed-income government securities. In addition, the funds may also invest in bonds, notes, other indebtedness of any kind, including high-yield bonds, convertible securities, total return and credit default swaps, and other derivatives on similar assets, options, warrants, rights, private claims, equity and debt derivatives, and other securities and instruments of U.S. and non-U.S. issuers that are traded publicly and privately.

The global equity allocation invests in equity securities across the global equity markets with a lower volatility than the broad global equity benchmark.

The diversifiers allocation contains both a defensive equity strategy and a relative value hedge fund strategy. The defensive equity strategy is designed to provide a hedged equity approach in a more efficient manner. The strategy invests in the S&P 500 and Treasury bills and writes options to generate income. The strategy invests in all exchange-traded instruments that are valued on a daily basis. The fund itself is valued, balanced, and reconciled on a monthly basis. The relative value hedge fund makes investments sourced from its underlying hedge fund managers based on unique opportunities in the market. The fund invests opportunistically across the credit spectrum, with a main focus on corporate debt, structured credit, RMBS, asset backed, commercial real estate, CLOs, and sovereign bonds. Investments in the fund are split between managed accounts, coinvestments, and direct opportunities. The investments are valued on a monthly basis. The fair values of the investments in this class have been estimated using net asset value per share of the investments.

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

Note 15 - Fair Value (Continued)

The real estate funds class includes several real estate funds that invest primarily in U.S. commercial real estate. These investments include office, apartments, retail, industrial, and hotels. Each property receives one self-contained (long-form) third-party appraisal annually and three restricted (short-form) third-party appraisals for the quarters that do not receive the long-form appraisal. The fair values of the investments in this class have been estimated using the net asset value of the Corporation's ownership interest in partners' capital. The real estate funds class also includes some limited partnership structures that are primarily illiquid in nature. Private real estate encompasses a broad array of strategies and securities, including core, core plus, enhanced value, and opportunistic. Core and leveraged core strategies usually are based on investments in existing properties with a fairly stable income stream. Enhanced value investments are made in properties with low leasing levels or significant lease rollover activity or that are undergoing redevelopment. Opportunistic strategies include new construction, empty properties, or projects undergoing significant redevelopment. Other strategies, such as mezzanine or special situations, will invest in debt, preferred equity, or other parts of a company's capital structure. Some strategies will utilize leverage, which can enhance returns and potential losses. Investments may be in any country, although funds will typically specialize in specific regions and countries. The fair values of the investments in this class have been estimated using the net asset value of the Corporation's ownership interest in partners' capital.

The private equity funds class includes several private equity funds that invest primarily in unlisted companies (companies that are not traded on public exchanges) or, in some cases, listed companies are purchased and taken as private. The fair values of the investments in this class have been estimated using the net asset value per share of the investments.

Note 16 - Sale and Leaseback of Buildings

During 2010, the Corporation and its affiliates entered into an agreement to sell various facilities and then lease the facilities back under lease arrangements. The sale on certain facilities resulted in a gain on sale, which has been deferred and is being recognized over the period of the leases. The deferred revenue related to the sale and leaseback is presented as liabilities on the consolidated balance sheet.

Consolidating Information

Independent Auditor's Report on Consolidating Information

To the Board of Directors
ProHealth Care, Inc. and Affiliates

We have audited the consolidated financial statements of ProHealth Care, Inc. and Affiliates as of and for the years ended September 30, 2018 and 2017 and have issued our report thereon dated December 14, 2018, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the 2018 consolidated financial statements as a whole. The consolidating information is presented for the purpose of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the 2018 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2018 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 2018 consolidated financial statements as a whole.

Plante & Moran, PLLC

December 14, 2018

Consolidating Balance Sheet

September 30, 2018

(in thousands)

| | ProHealth Care, Inc. | Waukesha Memorial Hospital, Inc. & Subs | Oconomowoc Memorial Hospital, Inc. | National Regency of New Berlin, Inc. | Eliminations | Total Obligated Group | ProHealth Medical Group | Empathia, Inc. | National Avenue Development Corporation | Waukesha Health System, Inc. | ProHealth Home Care, Inc. | ProHealth Solutions, LLC | ProHealth Care Foundation, Inc. | Eliminations | Total |
|---|-------------------------|--|--|---|--------------------|-----------------------------|-------------------------------|-------------------|--|---------------------------------------|---------------------------------|--------------------------------|--|---------------------|--------------------|
| Assets | | | | | | | | | | | | | | | |
| Current Assets | | | | | | | | | | | | | | | |
| Cash and cash equivalents | \$ 2,053 | \$ 4,276 | \$ 276 | \$ 6,196 | \$ - | \$ 12,801 | \$ 974 | \$ 2,699 | \$ 230 | \$ 296 | \$ 363 | \$ 382 | \$ 2,838 | \$ - | \$ 20,583 |
| Short-term investments | 9,203 | - | - | - | - | 9,203 | - | - | - | - | - | - | - | - | 9,203 |
| Patient accounts receivable - Net | - | 65,794 | 13,066 | - | - | 78,860 | 7,593 | - | - | 223 | 1,641 | - | - | - | 88,317 |
| Inventory of supplies | - | 7,925 | 1,808 | 38 | - | 9,771 | - | 69 | - | 440 | 2 | - | - | - | 10,282 |
| Other receivables | 42,179 | 19,470 | 3,464 | 394 | (34,622) | 30,885 | 26,654 | 764 | - | 1,120 | 105 | 5,786 | 18 | (55,585) | 9,747 |
| Assets whose use is limited or restricted | 4,280 | 1,631 | 184 | - | - | 6,095 | - | 25 | - | - | - | 9,725 | - | - | 15,845 |
| Prepaid expenses and other | 2,229 | 6,468 | 303 | 79 | - | 9,079 | 555 | 151 | - | 93 | 16 | 80 | - | (216) | 9,758 |
| Total current assets | 59,944 | 105,564 | 19,101 | 6,707 | (34,622) | 156,694 | 35,776 | 3,708 | 230 | 2,172 | 2,127 | 15,973 | 2,856 | (55,801) | 163,735 |
| Noncurrent Assets Whose Use is Limited or Restricted | | | | | | | | | | | | | | | |
| Property and Equipment - Net | 28,178 | 383,592 | 91,450 | 42,872 | - | 546,092 | 61,368 | 237 | 856 | 7,569 | 3,835 | 4 | - | - | 619,961 |
| Goodwill | 269 | - | - | - | - | 269 | 6,284 | - | - | - | - | - | - | - | 6,553 |
| Intangible Assets | - | - | - | - | - | - | 197 | 213 | - | - | - | 135 | - | - | 545 |
| Other Assets | 207,510 | 16,370 | 1,817 | - | - | 225,697 | 24,437 | 1,101 | - | 284 | 92 | 1 | 950 | (197,228) | 55,334 |
| Total assets | <u>\$ 988,735</u> | <u>\$ 513,022</u> | <u>\$ 133,718</u> | <u>\$ 80,332</u> | <u>\$ (34,622)</u> | <u>\$1,681,185</u> | <u>\$ 128,062</u> | <u>\$ 10,903</u> | <u>\$ 1,086</u> | <u>\$ 10,050</u> | <u>\$ 6,054</u> | <u>\$ 20,305</u> | <u>\$ 33,725</u> | <u>\$ (253,029)</u> | <u>\$1,638,341</u> |

ProHealth Care, Inc. and Affiliates

Consolidating Balance Sheet (Continued)

September 30, 2018

(in thousands)

| | ProHealth Care, Inc. | Waukesha Memorial Hospital, Inc. & Subs | Oconomowoc Memorial Hospital, Inc. | National Regency of New Berlin, Inc. | Eliminations | Total Obligated Group | ProHealth Medical Group | Empathia, Inc. | National Avenue Development Corporation | Waukesha Health System, Inc. | ProHealth Home Care, Inc. | ProHealth Solutions, LLC | ProHealth Care Foundation, Inc. | Eliminations | Total |
|--|-------------------------|--|--|---|--------------------|-----------------------------|-------------------------------|-------------------|--|---------------------------------------|---------------------------------|--------------------------------|--|---------------------|--------------------|
| Liabilities and Net Assets | | | | | | | | | | | | | | | |
| Current Liabilities | | | | | | | | | | | | | | | |
| Accounts payable | \$ 32,432 | \$ 42,670 | \$ 19,952 | \$ 1,807 | \$ (34,622) | \$ 62,239 | \$ 27,380 | \$ 849 | \$ 39 | \$ 1,559 | \$ 772 | \$ 11,243 | \$ 1,794 | \$ (55,585) | \$ 50,290 |
| Current portion of long-term debt | 3,958 | 3,252 | 399 | - | - | 7,609 | 1,399 | - | - | 557 | - | - | - | - | 9,565 |
| Deferred revenue | 104 | 114 | 20 | - | - | 238 | 517 | 466 | - | 10 | - | 6,488 | - | (216) | 7,503 |
| Accrued liabilities and other | 8,140 | 24,253 | 3,298 | 1,453 | - | 37,144 | 10,905 | 761 | 45 | 492 | 853 | - | 6 | - | 50,206 |
| Total current liabilities | 44,634 | 70,289 | 23,669 | 3,260 | (34,622) | 107,230 | 40,201 | 2,076 | 84 | 2,618 | 1,625 | 17,731 | 1,800 | (55,801) | 117,564 |
| Long-term Debt - Net of current portion | 44,359 | 278,375 | 97,484 | 21,350 | - | 441,568 | 14,436 | - | - | 5,430 | - | - | - | - | 461,434 |
| Fair Value of Interest Rate Swap Agreement | - | 11,296 | 1,703 | 1,439 | - | 14,438 | - | - | - | - | - | - | - | - | 14,438 |
| Other Liabilities | | | | | | | | | | | | | | | |
| Postretirement liability | - | 94 | - | - | - | 94 | - | - | - | - | - | - | - | - | 94 |
| Deferred revenue | - | - | - | - | - | - | 2,642 | - | - | - | - | - | - | - | 2,642 |
| Other long-term liabilities | 1,755 | 1,223 | 214 | 151 | - | 3,343 | 22,357 | 1,291 | - | 85 | - | 812 | 48 | - | 27,936 |
| Total liabilities | 90,748 | 361,277 | 123,070 | 26,200 | (34,622) | 566,673 | 79,636 | 3,367 | 84 | 8,133 | 1,625 | 18,543 | 1,848 | (55,801) | 624,108 |
| Net Assets | | | | | | | | | | | | | | | |
| Unrestricted | 897,987 | 147,095 | 10,259 | 54,132 | - | 1,109,473 | 48,426 | 7,536 | 1,002 | 1,917 | 2,143 | 1,121 | 18,882 | (197,228) | 993,272 |
| Temporarily restricted | - | 1,256 | 84 | - | - | 1,340 | - | - | - | - | 2,286 | - | 7,072 | - | 10,698 |
| Permanently restricted | - | - | 305 | - | - | 305 | - | - | - | - | - | - | 5,923 | - | 6,228 |
| Noncontrolling interest in consolidated subsidiaries | - | 3,394 | - | - | - | 3,394 | - | - | - | - | - | 641 | - | - | 4,035 |
| Total net assets | 897,987 | 151,745 | 10,648 | 54,132 | - | 1,114,512 | 48,426 | 7,536 | 1,002 | 1,917 | 4,429 | 1,762 | 31,877 | (197,228) | 1,014,233 |
| Total liabilities and net assets | <u>\$ 988,735</u> | <u>\$ 513,022</u> | <u>\$ 133,718</u> | <u>\$ 80,332</u> | <u>\$ (34,622)</u> | <u>\$1,681,185</u> | <u>\$ 128,062</u> | <u>\$ 10,903</u> | <u>\$ 1,086</u> | <u>\$ 10,050</u> | <u>\$ 6,054</u> | <u>\$ 20,305</u> | <u>\$ 33,725</u> | <u>\$ (253,029)</u> | <u>\$1,638,341</u> |

ProHealth Care, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets

Year Ended September 30, 2018

(in thousands)

| | ProHealth Care, Inc. | Waukesha Memorial Hospital, Inc. & Subs | Oconomowoc Memorial Hospital, Inc. | National Regency of New Berlin, Inc. | Eliminations | Total Obligated Group | ProHealth Medical Group | Empathia, Inc. | National Avenue Development Corporation | Waukesha Health System, Inc. | ProHealth Home Care, Inc. | ProHealth Solutions, LLC | ProHealth Care Foundation, Inc. | Eliminations | Total |
|--|-------------------------|--|--|---|--------------|-----------------------------|-------------------------------|-------------------|--|---------------------------------------|---------------------------------|--------------------------------|--|-----------------|-------------------|
| Unrestricted Revenue, Gains, and Other Support | | | | | | | | | | | | | | | |
| Net patient service revenue | \$ - | \$ 514,711 | \$ 101,828 | \$ - | \$ - | \$ 616,539 | \$ 122,594 | \$ - | \$ - | \$ 736 | \$ 13,255 | \$ - | \$ - | \$ - | \$ 753,124 |
| Provision for bad debts | - | (12,087) | (2,119) | - | - | (14,206) | (3,435) | - | - | (31) | 2 | - | - | - | (17,670) |
| Net patient service revenue less provision for bad debts | - | 502,624 | 99,709 | - | - | 602,333 | 119,159 | - | - | 705 | 13,257 | - | - | - | 735,454 |
| Other operating revenue | 134,819 | 17,510 | 3,784 | 20,248 | (110,856) | 65,505 | 33,018 | 14,176 | 188 | 10,912 | 950 | 18,771 | - | (58,363) | 85,157 |
| Total unrestricted revenue, gains, and other support | 134,819 | 520,134 | 103,493 | 20,248 | (110,856) | 667,838 | 152,177 | 14,176 | 188 | 11,617 | 14,207 | 18,771 | - | (58,363) | 820,611 |
| Expenses | | | | | | | | | | | | | | | |
| Salaries and wages | 63,972 | 119,826 | 23,585 | 5,047 | - | 212,430 | 96,717 | 4,740 | - | 3,980 | 7,443 | - | - | - | 325,310 |
| Employee benefits and payroll taxes | 21,218 | 34,910 | 5,820 | 970 | (3) | 62,915 | 19,898 | 1,407 | - | 480 | 2,204 | - | - | (736) | 86,168 |
| Operating supplies and expenses | 1,262 | 97,910 | 21,735 | 1,003 | (121) | 121,789 | 9,950 | 23 | - | 3,580 | 687 | 1 | - | (966) | 135,064 |
| Depreciation and amortization | 1,532 | 43,167 | 6,938 | 2,557 | - | 54,194 | 4,708 | 125 | 110 | 934 | 258 | 68 | - | - | 60,397 |
| Interest | 92 | 10,423 | 3,698 | 860 | - | 15,073 | 2,637 | - | - | 700 | - | - | - | - | 18,410 |
| Contracted services and other | 38,336 | 155,840 | 36,654 | 5,895 | (110,732) | 125,993 | 32,412 | 7,238 | 181 | 2,637 | 1,902 | 20,512 | - | (54,830) | 136,045 |
| Total expenses | 126,412 | 462,076 | 98,430 | 16,332 | (110,856) | 592,394 | 166,322 | 13,533 | 291 | 12,311 | 12,494 | 20,581 | - | (56,532) | 761,394 |
| Operating Income (Loss) | 8,407 | 58,058 | 5,063 | 3,916 | - | 75,444 | (14,145) | 643 | (103) | (694) | 1,713 | (1,810) | - | (1,831) | 59,217 |
| Nonoperating Income (Loss) | 39,791 | 6,825 | 867 | 2,653 | - | 50,136 | 539 | 275 | - | 462 | - | 338 | (3,593) | 3,866 | 52,023 |
| Excess of Revenue Over (Under) Expenses | \$ 48,198 | \$ 64,883 | \$ 5,930 | \$ 6,569 | \$ - | \$ 125,580 | \$ (13,606) | \$ 918 | \$ (103) | \$ (232) | \$ 1,713 | \$ (1,472) | \$ (3,593) | \$ 2,035 | \$ 111,240 |

ProHealth Care, Inc. and Affiliates

Consolidating Statement of Operations and Changes in Net Assets (Continued)

Year Ended September 30, 2018

(in thousands)

| | ProHealth Care, Inc. | Waukesha Memorial Hospital, Inc. & Subs | Oconomowoc Memorial Hospital, Inc. | National Regency of New Berlin, Inc. | Eliminations | Total Obligated Group | ProHealth Medical Group | Empathia, Inc. | National Avenue Development Corporation | Waukesha Health System, Inc. | ProHealth Home Care, Inc. | ProHealth Solutions, LLC | ProHealth Care Foundation, Inc. | Eliminations | Total |
|---|-------------------------|--|--|---|--------------|-----------------------------|-------------------------------|-------------------|--|---------------------------------------|---------------------------------|--------------------------------|--|---------------------|--------------------|
| Unrestricted | | | | | | | | | | | | | | | |
| Excess of revenue over (under) expenses | \$ 48,198 | \$ 64,883 | \$ 5,930 | \$ 6,569 | \$ - | \$ 125,580 | \$ (13,606) | \$ 918 | \$ (103) | \$ (232) | \$ 1,713 | \$ (1,472) | \$ (3,593) | \$ 2,035 | \$ 111,240 |
| Amortization of transition deferral on interest rate swap | - | - | - | 157 | - | 157 | - | - | - | - | - | - | - | - | 157 |
| Transfer from (to) affiliate | 48,474 | (42,287) | (614) | (875) | - | 4,698 | 41,090 | - | - | - | (1,598) | - | - | (44,190) | - |
| Pension-related changes other than net periodic benefit cost | 710 | 6,030 | 1,358 | - | - | 8,098 | 2,064 | 271 | - | 212 | 124 | - | - | - | 10,769 |
| Net assets released from restriction for plant and equipment additions | - | - | 756 | - | - | 756 | - | - | - | - | 218 | - | 2,241 | - | 3,215 |
| Other | - | (1,375) | - | 1 | - | (1,374) | (1) | - | - | 1 | (2) | 1 | (40) | - | (1,415) |
| Increase (decrease) in unrestricted net assets | 97,382 | 27,251 | 7,430 | 5,852 | - | 137,915 | 29,547 | 1,189 | (103) | (19) | 455 | (1,471) | (1,392) | (42,155) | 123,966 |
| Temporarily Restricted | | | | | | | | | | | | | | | |
| Restricted contributions | - | 462 | - | - | - | 462 | - | - | - | - | - | - | 2,104 | - | 2,566 |
| Restricted investment income | - | 1 | 10 | - | - | 11 | - | - | - | - | - | - | 675 | - | 686 |
| Unrealized gains on investments | - | - | - | - | - | - | - | - | - | - | - | - | 6 | - | 6 |
| Net assets released from restriction | - | - | (756) | - | - | (756) | - | - | - | - | (218) | - | (2,226) | - | (3,200) |
| Other | - | (310) | (82) | - | - | (392) | - | - | - | - | - | - | 116 | - | (276) |
| Increase (decrease) in temporarily restricted net assets | - | 153 | (828) | - | - | (675) | - | - | - | - | (218) | - | 675 | - | (218) |
| Permanently Restricted | | | | | | | | | | | | | | | |
| Contributions | - | - | - | - | - | - | - | - | - | - | - | - | 620 | - | 620 |
| Restricted investment income | - | - | - | - | - | - | - | - | - | - | - | - | 50 | - | 50 |
| Net assets released from restriction | - | - | - | - | - | - | - | - | - | - | - | - | (15) | - | (15) |
| Other | - | - | - | - | - | - | - | - | - | - | - | - | (79) | - | (79) |
| Increase in permanently restricted net assets | - | - | - | - | - | - | - | - | - | - | - | - | 576 | - | 576 |
| Increase (Decrease) in Net Assets | 97,382 | 27,404 | 6,602 | 5,852 | - | 137,240 | 29,547 | 1,189 | (103) | (19) | 237 | (1,471) | (141) | (42,155) | 124,324 |
| Net Assets - Beginning of year | 800,605 | 124,341 | 4,046 | 48,280 | - | 977,272 | 18,879 | 6,347 | 1,105 | 1,936 | 4,192 | 3,233 | 32,018 | (155,073) | 889,909 |
| Net Assets - End of year | <u>\$ 897,987</u> | <u>\$ 151,745</u> | <u>\$ 10,648</u> | <u>\$ 54,132</u> | <u>\$ -</u> | <u>\$1,114,512</u> | <u>\$ 48,426</u> | <u>\$ 7,536</u> | <u>\$ 1,002</u> | <u>\$ 1,917</u> | <u>\$ 4,429</u> | <u>\$ 1,762</u> | <u>\$ 31,877</u> | <u>\$ (197,228)</u> | <u>\$1,014,233</u> |