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# ProHealth Care, Inc. and Affiliates

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**Consolidated Financial Statements  
with Consolidating Information  
September 30, 2019**

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## **Independent Auditor's Report**

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

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, 2019 and 2018 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. 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, 2019 and 2018 and the results of their operations and changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

***Emphasis of Matters***

As described in Note 2 to the consolidated financial statements, the Corporation adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, using the modified retrospective adoption method, as of October 1, 2018 and ASC Topic 958, *Presentation of Financial Statements of Not-for-Profit Entities*, using the retrospective adoption method, for the year ended September 30, 2019. Our opinion is not modified with respect to these matters.

*Plante & Morse, PLLC*

December 16, 2019

## Consolidated Balance Sheet

**September 30, 2019 and 2018**  
(in thousands)

	2019	2018
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 21,097	\$ 20,583
Short-term investments (Note 6)	21,403	9,203
Patient accounts receivable - Net (Note 4)	101,003	88,317
Inventory of supplies	11,983	10,282
Other receivables	4,534	9,747
Assets whose use is limited or restricted (Note 6)	16,391	15,845
Prepaid expenses and other	9,033	9,758
Total current assets	185,444	163,735
<b>Noncurrent Assets Whose Use is Limited or Restricted</b> (Note 6)	800,716	792,213
<b>Property and Equipment - Net</b> (Note 7)	661,559	619,961
<b>Goodwill</b> (Note 2)	6,553	6,553
<b>Other Assets</b> (Note 8)	54,000	55,879
Total assets	<b>\$ 1,708,272</b>	<b>\$ 1,638,341</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 57,850	\$ 50,290
Current portion of long-term debt (Note 10)	14,035	9,565
Deferred revenue (Note 17)	8,614	7,503
Accrued liabilities and other (Note 9)	49,634	50,206
Total current liabilities	130,133	117,564
<b>Long-term Debt - Net of current portion</b> (Note 10)	447,594	461,434
<b>Fair Value of Interest Rate Swap Agreement</b> (Note 10)	21,963	14,438
<b>Other Liabilities</b>		
Postretirement liability (Note 12)	98	94
Deferred revenue (Note 17)	2,169	2,642
Other long-term liabilities	25,143	27,936
Total liabilities	627,100	624,108
<b>Net Assets</b>		
Without donor restrictions	1,059,215	993,272
With donor restrictions (Note 14)	16,368	16,926
Noncontrolling interest in consolidated subsidiaries	5,589	4,035
Total net assets	1,081,172	1,014,233
Total liabilities and net assets	<b>\$ 1,708,272</b>	<b>\$ 1,638,341</b>

**ProHealth Care, Inc. and Affiliates****Consolidated Statement of Operations and Changes in Net Assets****Years Ended September 30, 2019 and 2018****(in thousands)**

	<u>2019</u>	<u>2018</u>
<b>Unrestricted Revenue, Gains, and Other Support</b>		
Net patient service revenue before provision for bad debts		\$ 753,124
Provision for bad debts		(17,670)
		<u>735,454</u>
Net patient service revenue (Note 5)	\$ 774,069	735,454
Other operating revenue	<u>78,826</u>	<u>86,757</u>
Total unrestricted revenue, gains, and other support	852,895	822,211
<b>Expenses</b>		
Salaries and wages	341,570	325,310
Employee benefits and payroll taxes	91,335	86,168
Operating supplies and expenses	144,476	135,064
Depreciation and amortization	62,684	60,397
Interest	18,591	18,410
Contracted services and other	<u>148,139</u>	<u>136,045</u>
Total expenses	<u>806,795</u>	<u>761,394</u>
<b>Operating Income</b>	46,100	60,817
<b>Nonoperating Income (Loss)</b>		
Investment income	18,975	58,089
Contributions	172	194
Unrealized investment gain (loss)	9,175	(15,036)
Change in interest rate swap value	(7,681)	7,452
Other	<u>(189)</u>	<u>(276)</u>
Total nonoperating income	<u>20,452</u>	<u>50,423</u>
<b>Excess of Revenue Over Expenses</b>	<u>\$ 66,552</u>	<u>\$ 111,240</u>

**ProHealth Care, Inc. and Affiliates****Consolidated Statement of Operations and Changes in Net Assets (Continued)****Years Ended September 30, 2019 and 2018****(in thousands)**

	<u>2019</u>	<u>2018</u>
<b>Net Assets without Donor Restrictions</b>		
Excess of revenue over expenses	\$ 66,552	\$ 111,240
Amortization of transition deferral on interest rate swap	157	157
Pension-related changes other than net periodic benefit cost	(1,204)	10,769
Net assets released from restrictions for plant and equipment additions	3,403	3,215
Other	<u>(1,411)</u>	<u>(1,415)</u>
Increase in net assets without donor restrictions	67,497	123,966
<b>Net Assets with Donor Restrictions</b>		
Restricted contributions	2,825	3,186
Restricted investment income	230	736
Unrealized gains on investments	2	6
Net assets released from restrictions	(3,403)	(3,215)
Other	<u>(212)</u>	<u>(355)</u>
(Decrease) increase in net assets with donor restrictions	<u>(558)</u>	<u>358</u>
<b>Increase in Net Assets</b>	66,939	124,324
<b>Net Assets - Beginning of year</b>	<u>1,014,233</u>	<u>889,909</u>
<b>Net Assets - End of year</b>	<u><u>\$ 1,081,172</u></u>	<u><u>\$ 1,014,233</u></u>

## ProHealth Care, Inc. and Affiliates

# Consolidated Statement of Cash Flows

Years Ended September 30, 2019 and 2018

(in thousands)

	2019	2018
<b>Cash Flows from Operating Activities</b>		
Increase in net assets	\$ 66,939	\$ 124,324
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Depreciation and amortization	62,684	60,397
Unrealized investment (gains) losses	(9,177)	15,030
Realized investment gains	(3,547)	(43,868)
Restricted contribution revenue and investment income	(3,055)	(3,922)
Pension-related change other than net periodic benefit costs	1,204	(10,769)
Change in fair value of interest rate swaps	7,525	(7,609)
Gain on sale of property and equipment	(1,907)	(1,564)
Provision for bad debts	-	17,670
Earnings from joint ventures	(8,423)	(12,303)
Changes in assets and liabilities that (used) provided cash:		
Patient accounts receivable	(12,686)	(26,530)
Inventory of supplies	(1,701)	(425)
Prepaid expenses and other current assets	5,934	(4,870)
Other assets	1,664	(7,972)
Accounts payable	7,560	13,902
Deferred revenue	639	2,805
Accrued and other current liabilities	(411)	(3,517)
Other liabilities	(3,995)	(7,890)
Net cash provided by operating activities	109,247	102,889
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(104,403)	(99,168)
Proceeds from sale of property and equipment and assets held for sale	3,103	4,416
Purchase of investments and assets whose use is limited	(233,141)	(448,084)
Proceeds from sale of investments and assets whose use is limited	224,554	435,755
Cash paid for intangible assets	-	(767)
Investment in unconsolidated affiliate - Net	-	(268)
Distributions from joint ventures	8,581	8,965
Net cash used in investing activities	(101,306)	(99,151)
<b>Cash Flows from Financing Activities</b>		
Payments on long-term debt and capital lease obligations	(10,482)	(9,657)
Restricted contribution revenue and investment income	3,055	3,922
Net cash used in financing activities	(7,427)	(5,735)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	514	(1,997)
<b>Cash and Cash Equivalents - Beginning of year</b>	20,583	22,580
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 21,097</b>	<b>\$ 20,583</b>
<b>Supplemental Cash Flow Information - Cash paid for interest</b>	\$ 19,497	\$ 19,128
<b>Significant Noncash Transactions - Building obtained via capital lease</b>	\$ -	\$ 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.

**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 for patients, insurance companies, and governmental agencies are based on gross charges, reduced by explicit price concessions provided to third-party payors, discounts provided to qualifying individuals as part of our financial assistance policy, and implicit price concessions provided primarily to self-pay patients. Estimates for explicit price concessions are based on provider contracts, payment terms for relevant prospective payment systems, and historical experience adjusted for economic conditions and other trends affecting the Corporation's ability to collect outstanding amounts.

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 significant implicit price concessions 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.

Patient accounts receivable is based on the estimated transaction price for completed contracts, which total approximately \$101,003,000 at September 30, 2019. Prior to the adoption of ASU 2014-09, patient accounts receivable at September 30, 2018 were approximately \$107,336,000 less allowances for uncollectible accounts of \$19,019,000.

***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, 2019 and 2018

### **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 donor-restricted assets. Amounts required to meet current liabilities of the Corporation have been reclassified as current assets in the consolidated balance sheet.

#### ***Inventory of Supplies***

Inventory of supplies, which consist of medical and office supplies and pharmaceutical products, is 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. Capitalized interest totaled \$157,000 and \$0 for the years ended September 30, 2019 and 2018, respectively. 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 a medical practice acquisition. There was no goodwill added in 2019.

It is reasonably possible that management's estimates of the carrying amount of goodwill will change in the near term. Amortization expense on definite life intangibles totaled approximately \$122,000 and \$120,000 in 2019 and 2018, 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, 2019 and 2018

### **Note 2 - Significant Accounting Policies (Continued)**

#### ***Classification of Net Assets***

Net assets of the Corporation are classified based on the presence or absence of donor-imposed restrictions.

Net assets without donor restrictions - Net assets that are not subject to donor-imposed restrictions or for which the donor-imposed restrictions have expired or been fulfilled. Net assets in this category may be expended for any purpose in performing the primary objectives of the Corporation.

Net assets with donor restrictions - Net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Corporation or by the passage of time. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are released to net assets without donor restrictions.

Earnings, gains, and losses on donor-restricted net assets are classified as net assets without donor restrictions unless specifically restricted by the donor or by applicable state law.

#### ***Revenue Recognition - Patient Service Revenue***

The Corporation recognizes patient service revenue at the time in which performance obligations are satisfied. These amounts are due from patients, third-party payors (including managed care payors and governmental programs), and others, and subject to contractual adjustments, discounts, and implicit price concessions and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Corporation bills patients and third-party payors several days after the services are performed or shortly after discharge.

The Corporation determines performance obligations based on the nature of the services provided in both inpatient and outpatient settings. Revenue is recognized for performance obligations satisfied over time based on actual charges incurred in relation to total expected charges. This method provides a faithful depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations. Generally, performance obligations satisfied over time relate to patients in our hospitals receiving inpatient acute-care services or patients receiving services in our patient centers or other clinical settings. The Corporation measures the performance obligation from admission into the hospital, or the commencement of outpatient services or other visit, to the point when there are no further services required for the patient, which is generally the time of discharge or completion of the outpatient services or other visit.

The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute-care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Corporation determines the transaction price based on established gross charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Corporation's self-pay discount policy, and implicit price concessions provided primarily to uninsured patients. The Corporation determines estimates of contractual adjustments and discounts based on contractual agreements, self-pay discount policies, and historical experience. The Corporation determines estimates of implicit price concessions based on its historical collection experience with this class of patients.

## Notes to Consolidated Financial Statements

September 30, 2019 and 2018

### Note 2 - Significant Accounting Policies (Continued)

In assessing collectibility, the portfolio approach was elected, as the Corporation has large volume of similar contracts with similar classes of customers. Management reasonably expects that the effect of applying a portfolio approach to a group of contracts would not differ materially from considering each contract separately. Management's judgment to group the contracts by portfolio is based on the payment behavior expected in each portfolio category. As a result, aggregating all of the contracts (which are at the patient level) by the particular payor or group of payors, will result in the recognition of the same amount of revenue as applying the analysis at the individual patient level.

#### ***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 \$1,620,000 and \$1,472,000 of services to indigent patients during 2019 and 2018, 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 is recognized based on the terms of each payor contract, typically multiyear. 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.

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 downside risk in the event that these are not met. The Corporation recognized \$2,367,000 of incentives in 2019 for shared savings earned on the 2018 plan year and \$5,649,000 of incentives in 2018 for shared savings earned on the 2017 plan year. Also, the Corporation recorded \$0 of downside risk reserve on the 2019 and 2018 plan years recorded in contracted services and other. Final determination of the 2019 and 2018 plan years' 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 each calendar year.

To participate in this new program, CMS requires a financial guarantee of all participants in the event the downside 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, which expired on March 31, 2019. In 2019, this letter of credit was amended to approximately \$2,451,000, expiring on December 31, 2020. Given the stand-alone size of ProHealth Solutions, LLC, the Corporation's obligated group guaranteed this letter of credit under terms of the Master Trust Indenture.

## Notes to Consolidated Financial Statements

September 30, 2019 and 2018

### **Note 2 - Significant Accounting Policies (Continued)**

#### ***Contributions***

Unconditional promises to give cash and other assets to the Corporation are reported at fair value on the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value on the date the gift becomes unconditional or is received. The gifts are reported as contributions with donor restrictions 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 the purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statement of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying financial statements.

The Corporation reports gifts of property and equipment as contributions without donor restrictions 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 Expenses***

The consolidated statement of operations and changes in net assets includes excess of revenue over expenses. Excluded from excess of revenue over expenses, consistent with industry practice, are amortization of transition deferral on interest rate swap, pension-related changes other than net periodic benefit cost, net assets released from restrictions for plant and equipment additions, and permanent transfers of assets to and from affiliates for other than goods and services.

#### ***Functional Allocation of Expenses***

Costs of providing the program and support services have been reported on a functional basis (see Note 15). The consolidated financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses required allocation on a reasonable basis that is consistently applied. Costs have been allocated between the various programs and support services based on estimates determined by management. Although the methods of allocation used are considered appropriate, other methods could be used that would produce different amounts.

## Notes to Consolidated Financial Statements

September 30, 2019 and 2018

### **Note 2 - Significant Accounting Policies (Continued)**

#### ***Upcoming Accounting Pronouncement***

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.

#### ***Adoption of New Accounting Pronouncements***

Effective October 1, 2018, the Corporation adopted ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), using a modified retrospective method of application to all contracts existing on October 1, 2018. The core principle of the guidance in ASU No. 2014-09 is that an entity should recognize revenue to depict the transfer of promised 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 adoption of ASU No. 2014-09 resulted in changes to the Corporation's presentation for disclosure of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU No. 2014-09, a significant portion of the Corporation's provision for doubtful accounts related to self-pay patients, as well as copays, coinsurance, and amounts and deductibles owed by patients with insurance. Under ASU No. 2014-09, the estimated uncollectible amounts due from these patients are generally considered implicit price concessions that are a direct reduction to operating revenue, with a corresponding material reduction in the amounts presented separately as provision for doubtful accounts. For the year ended September 30, 2019, the Corporation recorded approximately \$20,679,000 of implicit price concessions as a direct reduction of patient service revenue that would have been recorded as provision for doubtful accounts prior to the adoption of ASU No. 2014-09. At September 30, 2019, the Corporation recorded approximately \$20,214,000 as a direct reduction of accounts receivable that would have been reflected as allowance for doubtful accounts prior to the adoption of ASU No. 2014-09. The adoption of ASU No. 2014-09 also resulted in changes to the Corporation's presentation and disclosure of customer contract assets and liabilities in Note 4 and the assessment of variable consideration under customer contracts, which is further discussed in Note 5.

For the year ended September 30, 2019, the Corporation adopted ASU No. 2016-14, *Not-for-Profit Entities*. This standard requires net assets to be classified in two categories, net assets without donor restrictions and net assets with donor restrictions, rather than the three previous classifications. In addition, the underwater portion of donor-restricted endowments is now reported as net assets with donor restrictions. This standard also requires changes in the way certain information is aggregated and reported by the Corporation, including disclosures of quantitative and qualitative information about the liquidity and availability of resources and the presentation of expenses by both functional and natural classification. The standard also clarifies the definition of management and general and prohibits certain expenses from being allocated out of management and general. As a result of the adoption of this standard, the financial information for the year ended September 30, 2018 has been restated as follows: management and general expenses have increased by approximately \$7,133,000 from the amounts previously reported, with a corresponding decrease in program expenses. Additionally, net assets of approximately \$10,698,000 previously reported as temporarily restricted net assets and net assets of approximately \$6,228,000 reported as permanently restricted net assets have been reported as net assets with donor restrictions.

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 2 - Significant Accounting Policies (Continued)**

***Subsequent Events***

The consolidated financial statements and related disclosures include evaluation of events up through and including December 16, 2019, which is the date the consolidated financial statements were available to be issued.

**Note 3 - Liquidity and Availability of Resources**

The following reflects the Corporation's financial assets as of September 30, 2019 (in thousands), reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the consolidated balance sheet date.

Cash and cash equivalents	\$ 21,097
Short-term investments	21,403
Patient accounts receivable	101,003
Other receivables	4,534
Assets whose use is limited or restricted	<u>817,107</u>
Financial assets - At year end	965,144
Less those unavailable for general expenditures within one year due to:	
Contractual or donor-imposed restrictions - Assets whose use is limited or restricted	12,830
Board designations:	
Assets whose use is limited or restricted - Plant replacement and expansion	807,665
Assets whose use is limited or restricted - PHC Foundation	17,705
Assets whose use is limited or restricted - Unemployment compensation and other	<u>310</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 126,634</u>

The Corporation has certain board-designated assets whose use is limited or restricted, which are more fully described in Note 6. These amounts are not available for general expenditure within the next year; however, the board-designated amounts could be made available if necessary.

The Corporation maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management plan, the Corporation invests cash in excess of daily requirements in various investments, including short-term investments and money market funds. These funds could be drawn upon, if necessary, to meet unanticipated liquidity needs. The Corporation also realizes there could be unanticipated liquidity needs.

As of September 30, 2019, the Corporation was in compliance with the bond covenants in Note 10.

**Note 4 - Patient Accounts Receivable**

Patient accounts receivable is based on the estimated transaction price for completed contracts, which total approximately \$101,003,000 at September 30, 2019. Prior to the adoption of ASU No. 2014-09, patient accounts receivable at September 30, 2018 was composed of approximately \$107,336,000 less allowances for uncollectible accounts of approximately \$19,019,000. For some contracts, the Corporation recognizes revenue before its right to some or all consideration becomes unconditional, which results in the Corporation recording contract assets. At September 30, 2019, the Corporation had approximately \$2,394,000 of contract assets within patient accounts receivable on the consolidated balance sheet.

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 4 - Patient Accounts Receivable (Continued)**

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:

	2019	2018
Medicare	29 %	30 %
Medicaid	6	6
Commercial and other	50	47
Self-pay	15	17
Total	100 %	100 %

**Note 5 - Patient Service Revenue**

The Corporation is a provider of services under contractual arrangements with the Medicare and Medicaid programs and other payment arrangements with certain commercial carriers. Patient service revenue includes amounts estimated to be reimbursable by these programs under the provisions of various payment formulas. Amounts received by the Corporation for treatment of patients covered by such programs are recorded at the consideration in which the Corporation expects to be entitled.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare entities have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in entities entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Corporation's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Corporation. In addition, the contracts the Corporation has with commercial payors also provide for retroactive audit and review of claims.

Cost report settlements under reimbursement agreements with Medicare, Medicaid, and certain other payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care using the expected value method. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the Corporation's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available) or as years are settled or are no longer subject to such audits, reviews, and investigations. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Adjustments arising from a change in the transaction price were not significant in 2019 or 2018.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Corporation also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended September 30, 2019 and 2018, changes in its estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant.

## Notes to Consolidated Financial Statements

September 30, 2019 and 2018

### Note 5 - Patient Service Revenue (Continued)

Self-pay revenue is derived from patients who do not have any form of healthcare coverage and from patients with third-party healthcare coverage related to the patient responsibility portion, including deductibles and copayments. The Corporation estimates the transaction price for self-pay patients and the patient responsibility portion using various metrics, such as historical cash collection experience and environmental trends. Because the Corporation provides care to patients regardless of their ability to pay, management has determined that the difference between the amounts billed to patients and the amounts the Corporation expects to collect represent implicit price concessions. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

In some circumstances, after settlement by the responsible third-party, the patient will be billed for the residual amount due to the Corporation. The Corporation has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less; however, the Corporation does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Patients who meet the Corporation's criteria for charity care are provided care without charge or at amounts less than established rates. The Corporation does not report a charity care patient's charges in revenue or accounts receivable, as it is policy not to pursue collection of amounts related to these patients, and, therefore, contracts with these patients do not exist.

The Corporation has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected primarily by payor. The composition of patient service revenue by primary payor for the years ended September 30 is as follows:

	2019	2018
Medicare	\$ 252,366	\$ 240,837
Medicaid	25,527	24,526
Commercial and other	487,380	460,977
Self-pay	8,796	9,114
Total	<u>\$ 774,069</u>	<u>\$ 735,454</u>

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 is 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.

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 6 - 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):

	<u>2019</u>	<u>2018</u>
Limited by the board:		
Plant replacement and expansion	\$ 807,665	\$ 786,731
Designated for PHC Foundation	17,705	16,924
Reserved for unemployment compensation and other	310	304
Restricted by donors	<u>12,830</u>	<u>13,302</u>
 Total assets whose use is limited or restricted and investments	 <u>\$ 838,510</u>	 <u>\$ 817,261</u>
	<u>2019</u>	<u>2018</u>
Cash, money market funds, certificates of deposit, and accrued interest	\$ 18,801	\$ 19,253
Private equities and hedge funds	212,855	219,951
Real estate funds	95,342	90,259
Corporate bonds	32,858	31,955
Common stocks and equity securities	436,722	414,308
U.S. Treasury obligations	41,051	40,654
Other	<u>881</u>	<u>881</u>
 Total	 <u>\$ 838,510</u>	 <u>\$ 817,261</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, 2019 and 2018 is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Investment income	\$ 15,658	\$ 14,957
Unrealized gain (loss) on investments	9,177	(15,030)
Net realized gains	<u>3,547</u>	<u>43,868</u>
 Total	 <u>\$ 28,382</u>	 <u>\$ 43,795</u>

Investment returns included in the accompanying consolidated statement of operations and changes in net assets for the years ended September 30, 2019 and 2018 are as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Nonoperating gain - Net - Net assets without donor restrictions	\$ 28,150	\$ 43,053
Restricted investment income	230	736
Restricted unrealized gains on investments	<u>2</u>	<u>6</u>
 Total	 <u>\$ 28,382</u>	 <u>\$ 43,795</u>

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 7 - Property and Equipment**

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

	2019	2018	Depreciable Life - Years
Land	\$ 45,267	\$ 42,191	-
Land improvements	12,672	10,399	5-20
Buildings	740,724	708,317	20-40
Building improvements	22,230	17,477	10-40
Equipment	425,561	414,410	3-5
Capital leased equipment and buildings	83,426	82,475	20
Construction in progress	55,510	56,917	-
<b>Total cost</b>	<b>1,385,390</b>	<b>1,332,186</b>	
Less accumulated depreciation and amortization	723,831	712,225	
<b>Net property and equipment</b>	<b>\$ 661,559</b>	<b>\$ 619,961</b>	

Depreciation and amortization expense on property and equipment totaled approximately \$62,562,000 and \$60,274,000 in 2019 and 2018, respectively. Accumulated amortization on leased buildings and equipment under capital leases was approximately \$29,260,000 and \$24,847,000 at September 30, 2019 and 2018, 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 10).

Construction in progress at September 30, 2019 principally consists of costs associated with the construction, renovation, and remodeling of existing facilities. Contractual commitments related to construction in progress totaled approximately \$86,877,000 at September 30, 2019, which predominantly represents commitments on the construction of the Mukwonago hospital. Capitalized interest of approximately \$157,000 has been included in property and equipment at September 30, 2019.

**Note 8 - Other Assets**

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

	2019	2018
Investments in joint ventures	\$ 18,611	\$ 18,769
Deferred compensation (Note 13)	21,969	24,830
Prepaid pension (Note 12)	5,478	7,307
Other	7,942	4,973
<b>Total</b>	<b>\$ 54,000</b>	<b>\$ 55,879</b>

**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 50 percent ownership in the Moreland Endoscopy Center, a 49 percent ownership interest in the Orthopedic Surgery Center, and a 45 percent ownership interest in a medical office building. In 2018, the Corporation acquired a 50 percent ownership interest in the Southern Lakes Endoscopy Center.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

**Note 8 - Other Assets (Continued)**

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 \$15,937,000 and \$18,402,000 as of September 30, 2019 and 2018, respectively. The total excess of revenue over expenses for these joint ventures is approximately \$17,100,000 and \$18,285,000 for the years ended September 30, 2019 and 2018, respectively.

**Note 9 - Accrued Liabilities**

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

	2019	2018
Payroll and related items	\$ 31,027	\$ 32,222
Paid time off	11,479	11,425
Interest	1,945	2,002
Other	5,183	4,557
Total	<u>\$ 49,634</u>	<u>\$ 50,206</u>

**Note 10 - Long-term Debt**

A summary of long-term debt obligations at September 30, 2019 and 2018 is as follows (in thousands):

	2019	2018
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, 2019), maturing in 2044	102,050	102,050
Revenue Bonds, Series 2014B, variable interest rates based on market conditions (2.18 percent at September 30, 2019), 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	39,540	40,270
Revenue Refunding Bonds, Series 2011, at interest rates ranging from 4.38 percent to 5.00 percent, maturing in 2019	-	1,815
Capital leases	48,737	51,273
Note payable to bank, interest rate of 3.34 percent at September 30, 2019	26,078	29,627
Total	452,085	460,715
Less current portion	(14,035)	(9,565)
Add unamortized bond premium	11,627	12,526
Less bond issuance costs	(2,083)	(2,242)
Long-term portion	<u>\$ 447,594</u>	<u>\$ 461,434</u>

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 (the "Obligated Group"), except for certain restricted contributions and grants.

## Notes to Consolidated Financial Statements

**September 30, 2019 and 2018**

### **Note 10 - Long-term Debt (Continued)**

PHC, WMH, OMH, and National Regency are members of 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 \$377,270,000 at September 30, 2019.

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 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 consisted of fixed-rate term bonds and matured in 2019.

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 the 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.

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 10 - Long-term Debt (Continued)**

Scheduled future maturities of long-term debt and minimum payments of capital lease obligations as of September 30, 2019 are as follows (in thousands):

<u>Years Ending</u>	<u>Long-term Debt</u>	<u>Capital Lease Obligations</u>
2020	\$ 5,761	\$ 11,015
2021	5,856	6,989
2022	5,992	7,181
2023	6,094	7,373
2024	6,256	7,564
Thereafter	<u>373,389</u>	<u>25,060</u>
Subtotal	403,348	65,182
Less amount representing interest under capital lease obligations	<u>-</u>	<u>(16,445)</u>
Total	<u>\$ 403,348</u>	<u>\$ 48,737</u>

***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.

***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.

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.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

**Note 10 - Long-term Debt (Continued)**

**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.

**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 2019 or 2018.

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 \$21,963,000 and \$14,438,000 is included in the consolidated balance sheet at September 30, 2019 and 2018, respectively. During the years ended September 30, 2019 and 2018, the change in fair value of the interest rate swaps was approximately \$(7,681,000) and \$7,452,000, respectively, and was included in the nonoperating income (loss) 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 2019 and 2018.

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.

Net cash paid under the interest rate swap agreements was approximately \$2,535,000 and \$3,205,000 during 2019 and 2018, respectively.

The interest rate swap agreements at September 30, 2019, 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	\$ 15,115,000	August 15, 2034	3.60 %
2008A bonds	43,040,000	August 23, 2023	3.52
2008B bonds	56,450,000	February 1, 2034	4.12
Total	<u>\$ 114,605,000</u>		

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 11 - 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 \$3,294,000 and \$3,131,000 for 2019 and 2018, 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):

Years Ending September 30	Rental Commitments
2020	\$ 3,308
2021	3,054
2022	1,886
2023	278
2024	145
Total	<u>\$ 8,671</u>

**Note 12 - 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.

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.

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.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

**Note 12 - Pension and Other Postretirement Benefit Plans (Continued)**

Obligations and funded status at September 30, 2019 and 2018 are as follows (in thousands):

***Obligations and Funded Status***

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 266,961	\$ 289,689	\$ 94	\$ 99
Service cost	650	1,674	-	-
Interest cost	12,256	11,857	4	5
Curtailment loss	-	112	-	-
Actuarial loss (gain)	33,440	(17,726)	5	(5)
Benefits paid	(12,301)	(18,645)	(5)	(5)
Benefit obligation at end of year	301,006	266,961	98	94
Change in plan assets:				
Fair value of plan assets at beginning of year	274,268	262,742	-	-
Actual return on plan assets	44,516	7,005	-	-
Employer contributions	-	16,500	5	5
Benefits paid	(12,300)	(11,979)	(5)	(5)
Fair value of plan assets at end of year	306,484	274,268	-	-
Funded status at end of year	\$ 5,478	\$ 7,307	\$ (98)	\$ (94)

The \$5,478,000 and \$7,307,000 overfunded status of pension benefits at September 30, 2019 and 2018, respectively, is recorded as a prepaid pension asset recorded with other assets on the consolidated balance sheet (see Note 8). The accumulated benefit obligation for all defined benefit pension plans was approximately \$301,006,000 and \$266,961,000 at September 30, 2019 and 2018, respectively. The accumulated benefit obligation for the postretirement benefit plan was approximately \$98,000 and \$94,000 at September 30, 2019 and 2018, respectively.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

**Note 12 - 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	
	2019	2018	2019	2018
<b>Net Periodic Benefit Cost</b>				
Service cost	\$ 649	\$ 1,674	\$ -	\$ -
Interest cost	12,255	11,857	4	5
Expected return on plan assets	(13,451)	(15,629)	-	-
Amortization of prior service cost	1,092	1,659	-	1
Net periodic benefit cost (income)	545	(439)	4	6
<b>Other Changes in Plan Assets and Benefit Obligations Recognized in Net Assets without donor restrictions</b>				
Net loss (gain)	1,282	(10,677)	6	(6)
Prior service credit	-	(86)	-	-
Total recognized in net assets without donor restrictions	1,282	(10,763)	6	(6)
Total recognized in net periodic benefit cost and net assets without donor restrictions	\$ 1,827	\$ (11,202)	\$ 10	\$ -

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

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Discount rate	3.73%	4.70%	3.73%	4.70%
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	
	2019	2018	2019	2018
Discount rate	4.70%	4.23%	4.70%	4.23%
Expected long-term return on plan assets	4.34	5.19 - 7.00	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 and 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, 2019 and 2018

**Note 12 - 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	
	2019	2018
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**

	2019	2018
Asset category:		
Equity securities	14.00 %	17.00 %
Debt securities	81.00	64.00
Cash equivalents	2.00	1.00
Other	3.00	18.00
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, 2019 by major asset classes are as follows (in thousands):

Asset Classes	Fair Value Measurements at September 30, 2019			
	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	\$ 7,232	\$ -	\$ -	\$ 7,232
Equity securities	42,991	-	-	42,991
U.S. Treasury and government securities	-	14,579	-	14,579
Corporate bonds	-	232,344	-	232,344
Investments valued at NAV	-	-	-	9,338
Total	\$ 50,223	\$ 246,923	\$ -	\$ 306,484

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 12 - Pension and Other Postretirement Benefit Plans (Continued)**

	Fair Value Measurements at September 30, 2018			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Asset Classes</b>				
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
<b>Total</b>	<b>\$ 226,088</b>	<b>\$ -</b>	<b>\$ 638</b>	<b>\$ 274,268</b>

The tables above present information about the pension plan assets measured at fair value at September 30, 2019 and 2018 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 2019 and 2018.

**Cash Flow**

**Contributions**

The Corporation did not contribute to its pension and postretirement plan benefits during 2019. The Corporation is anticipating to fully annuitize and terminate the pension plan during 2020. It is anticipated that there will be a \$30 million to \$40 million contribution to fund the final annuity purchases. This estimate could vary depending on interest rates, insurance company pricing, and the number of participants electing to have a lump sum versus annuity option.

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 12 - 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
2020	\$ 13,436	\$ 7
2021	14,277	7
2022	14,969	7
2023	15,717	7
2024	16,402	7
Thereafter	88,729	32
Total	\$ 163,530	\$ 67

***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 \$10,167,000 and \$9,459,000 in 2019 and 2018, respectively.

**Note 13 - Commitments and Contingencies**

***Deferred Compensation***

Other long-term liabilities include approximately \$21,969,000 and \$25,206,000 at September 30, 2019 and 2018, 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 8). 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 \$3,395,000 and \$3,389,000 as of September 30, 2019 and 2018, respectively, 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, 2019 and 2018

**Note 13 - 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 14 - Net Assets with Donor Restrictions**

Net assets with donor restrictions 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.

Net assets with donor restrictions are available for the following purposes or periods at September 30, 2019 and 2018 (in thousands):

	2019	2018
Specific healthcare services and programs	\$ 7,542	\$ 6,919
AngelsGrace property, plant, and equipment	2,068	2,286
Regional cancer center property, plant, and equipment	30	1,493
Investments to be held in perpetuity, the income from which is expendable to support healthcare services	6,728	6,228
Total net assets with donor restrictions	<u>\$ 16,368</u>	<u>\$ 16,926</u>

**Note 15 - Functional Expenses**

The Corporation provides various services to its members. Expenses related to providing these services are as follows as of September 30, 2019:

	Healthcare Services			Support Services	Total
	Acute Care	Senior Housing Services	Counseling Services	Management and General	
Salaries and wages	\$ 264,983	\$ 3,716	\$ 12,098	\$ 60,773	\$ 341,570
Employee benefits and payroll taxes	64,956	999	3,303	22,077	91,335
Operating supplies and expenses	141,857	947	68	1,604	144,476
Depreciation and amortization	56,334	2,240	253	3,857	62,684
Interest	17,732	859	-	-	18,591
Contracted services and other	91,467	2,734	7,334	46,604	148,139
Total	<u>\$ 637,329</u>	<u>\$ 11,495</u>	<u>\$ 23,056</u>	<u>\$ 134,915</u>	<u>\$ 806,795</u>

**Notes to Consolidated Financial Statements**

**September 30, 2019 and 2018**

**Note 15 - Functional Expenses (Continued)**

Expenses related to providing these services are as follows as of September 30, 2018:

	Healthcare Services			Support Services	Total
	Acute Care	Senior Housing Services	Counseling Services	Management and General	
Salaries and wages	\$ 252,193	\$ 3,615	\$ 12,213	\$ 57,289	\$ 325,310
Employee benefits and payroll taxes	61,099	970	3,224	20,875	86,168
Operating supplies and expenses	132,575	952	74	1,463	135,064
Depreciation and amortization	55,548	2,020	170	2,659	60,397
Interest	17,550	860	-	-	18,410
Contracted services and other	86,356	2,634	7,396	39,659	136,045
<b>Total</b>	<b>\$ 605,321</b>	<b>\$ 11,051</b>	<b>\$ 23,077</b>	<b>\$ 121,945</b>	<b>\$ 761,394</b>

The Corporation performed a thorough review and analysis of expenses at the entity, department, and account level to assign expenses to the specific categories and subcategories in the tables above. The methodology used was applied across all entities to ensure consistency in reporting at both the entity and consolidated levels. For comparative purposes, the Corporation also applied the same methodology to fiscal year 2018 expenses and has included the restated expense amounts per the new categorization in the table above.

Salaries and wages, employee benefits and payroll taxes, operating supplies and expenses, depreciation and amortization, interest, and contracted services and other are allocated based on the related function.

**Note 16 - 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, 2019 and 2018 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.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

Note 16 - Fair Value (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2019 (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, 2019
<b>Assets</b>				
Assets whose use is limited or restricted and investments:				
Domestic corporate bonds	\$ -	\$ 28,976	\$ -	\$ 28,976
United States government bonds	-	41,051	-	41,051
Domestic stock	218,298	-	-	218,298
Fixed income - Mutual funds	87,082	-	-	87,082
Foreign corporate bonds	-	3,882	-	3,882
Foreign stock	131,342	-	-	131,342
Investments valued at NAV				308,197
Other assets - Mutual funds	21,969	-	-	21,969
<b>Total assets</b>	<b>\$ 458,691</b>	<b>\$ 73,909</b>	<b>\$ -</b>	<b>\$ 840,797</b>
<b>Liabilities - Fair value of interest rate swap agreements</b>				
	\$ -	\$ 21,963	\$ -	\$ 21,963
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
<b>Assets</b>				
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
Other assets - Mutual funds	24,830	-	-	24,830
<b>Total assets</b>	<b>\$ 439,138</b>	<b>\$ 72,609</b>	<b>\$ -</b>	<b>\$ 821,957</b>
<b>Liabilities - Fair value of interest rate swap agreements</b>				
	\$ -	\$ 14,438	\$ -	\$ 14,438

Assets whose use is limited or restricted and investments on the consolidated balance sheet, as further discussed in Note 6, at September 30, 2019 and 2018 included cash and money market funds, pledges receivable, certificates of deposit, and cost method equity securities of approximately \$19,682,000 and \$20,134,000, 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.

Notes to Consolidated Financial Statements

September 30, 2019 and 2018

**Note 16 - Fair Value (Continued)**

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, 2019 and 2018 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 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.

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

	Investments Held at September 30, 2019		
	Fair Value	Unfunded Commitments	Redemption Frequency and Notice Period
Funds of hedge funds:			
Fixed income	\$ 41,238	\$ -	Monthly with 2 -10 days' notice
Global low volatility	36,507	-	Daily with 2 days' notice
Diversifiers	131,557	-	Monthly to quarterly with 5 to 70 days' notice, respectively
Real estate funds	95,342	559	Quarterly with 90 days' notice
Private equity funds	3,553	2,419	(1)
<b>Total</b>	<b>\$ 308,197</b>	<b>\$ 2,978</b>	
	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
Diversifiers	97,156	-	Monthly to quarterly with 5 to 70 days' notice, respectively
Real estate funds	90,259	619	Quarterly with 90 days' notice
Private equity funds	5,227	2,419	(1)
<b>Total</b>	<b>\$ 310,210</b>	<b>\$ 3,038</b>	

(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 be substantially liquidated over the next three to five years.

## Notes to Consolidated Financial Statements

September 30, 2019 and 2018

### **Note 16 - Fair Value (Continued)**

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.

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. 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 net asset value per share of the investments.

### **Note 17 - 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.

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## Consolidating Information

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## 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, 2019 and 2018 and have issued our report thereon dated December 16, 2019, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the 2019 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 2019 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2019 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 2019 consolidated financial statements as a whole.

*Plante & Moran, PLLC*

December 16, 2019

Consolidating Balance Sheet

September 30, 2019

(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
<b>Assets</b>															
<b>Current Assets</b>															
Cash and cash equivalents	\$ 2,818	\$ 6,787	\$ 605	\$ 5,623	\$ -	\$ 15,833	\$ 435	\$ 3,090	\$ 128	\$ 258	\$ 391	\$ 492	\$ 470	\$ -	\$ 21,097
Short-term investments	20,403	-	-	-	-	20,403	-	-	-	-	-	1,000	-	-	21,403
Patient accounts receivable - Net	-	75,308	14,163	-	-	89,471	9,582	-	-	188	1,762	-	-	-	101,003
Inventory of supplies	-	9,295	2,157	35	-	11,487	-	74	-	418	4	-	-	-	11,983
Other receivables	15,137	14,494	1,384	545	(21,939)	9,621	6,434	967	-	889	126	2,162	-	(15,665)	4,534
Assets whose use is limited or restricted	5,761	-	-	-	-	5,761	-	25	-	-	-	10,605	-	-	16,391
Prepaid expenses and other	1,979	5,898	209	129	-	8,215	741	167	-	69	28	64	-	(251)	9,033
<b>Total current assets</b>	<b>46,098</b>	<b>111,782</b>	<b>18,518</b>	<b>6,332</b>	<b>(21,939)</b>	<b>160,791</b>	<b>17,192</b>	<b>4,323</b>	<b>128</b>	<b>1,822</b>	<b>2,311</b>	<b>14,323</b>	<b>470</b>	<b>(15,916)</b>	<b>185,444</b>
<b>Noncurrent Assets Whose Use is Limited or Restricted</b>															
	720,120	4,934	7,500	26,740	-	759,294	-	5,852	-	25	-	5,392	30,153	-	800,716
<b>Property and Equipment - Net</b>	<b>44,400</b>	<b>395,216</b>	<b>101,871</b>	<b>50,443</b>	<b>-</b>	<b>591,930</b>	<b>57,481</b>	<b>94</b>	<b>747</b>	<b>7,479</b>	<b>3,828</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>661,559</b>
<b>Goodwill</b>	<b>269</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>269</b>	<b>6,284</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,553</b>
<b>Other Assets</b>	<b>233,316</b>	<b>18,744</b>	<b>1,677</b>	<b>-</b>	<b>-</b>	<b>253,737</b>	<b>21,719</b>	<b>851</b>	<b>-</b>	<b>240</b>	<b>73</b>	<b>75</b>	<b>1,120</b>	<b>(223,815)</b>	<b>54,000</b>
<b>Total assets</b>	<b>\$1,044,203</b>	<b>\$ 530,676</b>	<b>\$ 129,566</b>	<b>\$ 83,515</b>	<b>\$ (21,939)</b>	<b>\$1,766,021</b>	<b>\$ 102,676</b>	<b>\$ 11,120</b>	<b>\$ 875</b>	<b>\$ 9,566</b>	<b>\$ 6,212</b>	<b>\$ 19,790</b>	<b>\$ 31,743</b>	<b>\$ (239,731)</b>	<b>\$1,708,272</b>

**ProHealth Care, Inc. and Affiliates**

**Consolidating Balance Sheet (Continued)**

**September 30, 2019**

**(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
<b>Liabilities and Net Assets</b>															
<b>Current Liabilities</b>															
Accounts payable	\$ 23,060	\$ 43,706	\$ 10,877	\$ 1,679	\$ (21,939)	\$ 57,383	\$ 7,919	\$ 934	\$ 19	\$ 1,374	\$ 1,138	\$ 4,526	\$ 223	\$ (15,666)	\$ 57,850
Current portion of long-term debt	1,039	5,528	913	291	-	7,771	5,604	-	-	660	-	-	-	-	14,035
Deferred revenue	36	214	37	-	-	287	534	645	-	-	-	7,399	-	(251)	8,614
Accrued liabilities and other	7,919	23,891	3,156	1,511	-	36,477	11,041	804	33	449	824	-	6	-	49,634
Total current liabilities	32,054	73,339	14,983	3,481	(21,939)	101,918	25,098	2,383	52	2,483	1,962	11,925	229	(15,917)	130,133
<b>Long-term Debt - Net of current portion</b>	42,573	273,533	96,833	21,067	-	434,006	8,818	-	-	4,770	-	-	-	-	447,594
<b>Fair Value of Interest Rate Swap Agreement</b>	-	17,105	2,602	2,256	-	21,963	-	-	-	-	-	-	-	-	21,963
<b>Other Liabilities</b>															
Postretirement liability	-	98	-	-	-	98	-	-	-	-	-	-	-	-	98
Deferred revenue	-	-	-	-	-	-	2,169	-	-	-	-	-	-	-	2,169
Other long-term liabilities	2,411	1,376	117	151	-	4,055	19,610	525	-	86	-	823	44	-	25,143
Total liabilities	77,038	365,451	114,535	26,955	(21,939)	562,040	55,695	2,908	52	7,339	1,962	12,748	273	(15,917)	627,100
<b>Net Assets</b>															
Without donor restrictions	967,165	160,712	14,663	56,560	-	1,199,100	46,981	8,212	823	2,227	2,182	4,482	19,022	(223,814)	1,059,215
With donor restrictions	-	1,484	368	-	-	1,852	-	-	-	-	2,068	-	12,448	-	16,368
Noncontrolling interest in consolidated subsidiaries	-	3,029	-	-	-	3,029	-	-	-	-	-	2,560	-	-	5,589
Total net assets	967,165	165,225	15,031	56,560	-	1,203,981	46,981	8,212	823	2,227	4,250	7,042	31,470	(223,814)	1,081,172
Total liabilities and net assets	<u>\$1,044,203</u>	<u>\$ 530,676</u>	<u>\$ 129,566</u>	<u>\$ 83,515</u>	<u>\$ (21,939)</u>	<u>\$1,766,021</u>	<u>\$ 102,676</u>	<u>\$ 11,120</u>	<u>\$ 875</u>	<u>\$ 9,566</u>	<u>\$ 6,212</u>	<u>\$ 19,790</u>	<u>\$ 31,743</u>	<u>\$ (239,731)</u>	<u>\$1,708,272</u>

## ProHealth Care, Inc. and Affiliates

# Consolidating Statement of Operations and Changes in Net Assets

Year Ended September 30, 2019

(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
<b>Unrestricted Revenue, Gains, and Other Support</b>															
Net patient service revenue	\$ -	\$ 524,592	\$ 103,074	\$ -	\$ -	\$ 627,666	\$ 131,958	\$ -	\$ -	\$ 725	\$ 13,720	\$ -	\$ -	\$ -	\$ 774,069
Other operating revenue	127,669	19,149	3,591	19,928	(108,447)	61,890	14,312	13,924	86	12,693	890	14,351	-	(39,320)	78,826
Total unrestricted revenue, gains, and other support	127,669	543,741	106,665	19,928	(108,447)	689,556	146,270	13,924	86	13,418	14,610	14,351	-	(39,320)	852,895
<b>Expenses</b>															
Salaries and wages	67,698	125,196	25,936	5,327	-	224,157	100,754	4,512	-	4,160	7,987	-	-	-	341,570
Employee benefits and payroll taxes	22,369	37,484	6,617	999	(221)	67,248	20,906	1,422	-	648	2,501	-	-	(1,390)	91,335
Operating supplies and expenses	1,401	105,261	22,822	986	(208)	130,262	10,472	22	2	4,262	687	1	-	(1,232)	144,476
Depreciation and amortization	2,478	42,501	7,625	2,789	-	55,393	5,681	211	109	970	256	64	-	-	62,684
Interest	204	10,362	3,677	859	-	15,102	2,845	-	-	644	-	-	-	-	18,591
Contracted services and other	45,839	151,566	34,579	6,157	(108,018)	130,123	31,627	7,243	154	2,443	2,147	9,284	-	(34,882)	148,139
Total expenses	139,989	472,370	101,256	17,117	(108,447)	622,285	172,285	13,410	265	13,127	13,578	9,349	-	(37,504)	806,795
<b>Operating Income (Loss)</b>	(12,320)	71,371	5,409	2,811	-	67,271	(26,015)	514	(179)	291	1,032	5,002	-	(1,816)	46,100
<b>Nonoperating (Loss) Income</b>															
Investment income	16,028	1,379	29	651	-	18,087	84	125	-	-	-	171	508	-	18,975
Contributions	980	82	20	-	-	1,082	-	-	-	-	-	-	1,255	(2,165)	172
Equity in earnings of unconsolidated investees	808	-	-	-	-	808	-	-	-	-	-	-	-	(808)	-
Unrealized investment gain (loss)	10,320	(1,734)	-	330	-	8,916	-	83	-	-	107	69	-	-	9,175
Change in interest rate swap value	-	(5,810)	(899)	(972)	-	(7,681)	-	-	-	-	-	-	-	-	(7,681)
Other	(980)	(82)	(20)	-	-	(1,082)	-	(9)	-	34	-	-	(4,854)	5,722	(189)
Total nonoperating income (expense)	27,156	(6,165)	(870)	9	-	20,130	84	199	-	34	-	278	(3,022)	2,749	20,452
<b>Excess of Revenue Over (Under) Expenses</b>	<b>\$ 14,836</b>	<b>\$ 65,206</b>	<b>\$ 4,539</b>	<b>\$ 2,820</b>	<b>\$ -</b>	<b>\$ 87,401</b>	<b>\$ (25,931)</b>	<b>\$ 713</b>	<b>\$ (179)</b>	<b>\$ 325</b>	<b>\$ 1,032</b>	<b>\$ 5,280</b>	<b>\$ (3,022)</b>	<b>\$ 933</b>	<b>\$ 66,552</b>

## ProHealth Care, Inc. and Affiliates

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

Year Ended September 30, 2019

(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
<b>Net Assets without Donor Restrictions</b>															
Excess of revenue over (under) expenses	\$ 14,836	\$ 65,206	\$ 4,539	\$ 2,820	\$ -	\$ 87,401	\$ (25,931)	\$ 713	\$ (179)	\$ 325	\$ 1,032	\$ 5,280	\$ (3,022)	\$ 933	\$ 66,552
Amortization of transition deferral on interest rate swap	-	-	-	157	-	157	-	-	-	-	-	-	-	-	157
Transfer from (to) affiliate	54,461	(49,929)	(42)	(550)	-	3,940	24,780	-	-	-	(1,200)	-	-	(27,520)	-
Pension-related changes other than net periodic benefit cost	(118)	(618)	(114)	-	-	(850)	(292)	(36)	-	(15)	(11)	-	-	-	(1,204)
Net assets released from restrictions for plant and equipment additions	-	-	21	-	-	21	-	-	-	-	218	-	3,164	-	3,403
Other	(1)	(1,407)	-	1	-	(1,407)	(2)	(1)	-	-	-	-	(2)	1	(1,411)
Increase (decrease) in net assets without donor restrictions	69,178	13,252	4,404	2,428	-	89,262	(1,445)	676	(179)	310	39	5,280	140	(26,586)	67,497
<b>Net Assets with Donor Restrictions</b>															
Restricted contributions	-	431	-	-	-	431	-	-	-	-	-	-	2,394	-	2,825
Restricted investment income	-	-	7	-	-	7	-	-	-	-	-	-	223	-	230
Unrealized gains on investments	-	-	-	-	-	-	-	-	-	-	-	-	2	-	2
Change in provision for uncollectible pledges	-	(203)	(7)	-	-	(210)	-	-	-	-	-	-	(2)	-	(212)
Net assets released from restrictions	-	-	(21)	-	-	(21)	-	-	-	-	(218)	-	(3,164)	-	(3,403)
Increase (decrease) in net assets with donor restrictions	-	228	(21)	-	-	207	-	-	-	-	(218)	-	(547)	-	(558)
<b>Increase (Decrease) in Net Assets</b>	69,178	13,480	4,383	2,428	-	89,469	(1,445)	676	(179)	310	(179)	5,280	(407)	(26,586)	66,939
<b>Net Assets - Beginning of year</b>	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
<b>Net Assets - End of year</b>	<u>\$ 967,165</u>	<u>\$ 165,225</u>	<u>\$ 15,031</u>	<u>\$ 56,560</u>	<u>\$ -</u>	<u>\$1,203,981</u>	<u>\$ 46,981</u>	<u>\$ 8,212</u>	<u>\$ 823</u>	<u>\$ 2,227</u>	<u>\$ 4,250</u>	<u>\$ 7,042</u>	<u>\$ 31,470</u>	<u>\$ (223,814)</u>	<u>\$1,081,172</u>