
ProMedica Health System and Subsidiaries

**Consolidated Financial Report
with Supplemental Information
December 31, 2017 and 2016**

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Independent Auditor's Report

To the Board of Trustees
ProMedica Health System and Subsidiaries

We have audited the accompanying consolidated financial statements of ProMedica Health System and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2017 and the related consolidated statement of operations and changes in net assets and cash flows for the year 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to 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 opinions.

Opinion

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

To the Board of Trustees
ProMedica Health System and Subsidiaries

Report on Summarized Comparative Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise ProMedica Health System's consolidated financial statements. The consolidating balance sheet and consolidating statement of operations and changes in net assets are presented for the purpose of additional analysis and are not a required part of the consolidated financial statements. The consolidating balance sheet and consolidating statement of operations and changes in net assets are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating balance sheet and consolidating statement of operations and changes in net assets are fairly stated in all material respects in relation to the consolidated financial statements as a whole

Report on Prior Year Consolidated Financial Statements and Restatement

The consolidated financial statements of ProMedica Health System and Subsidiaries as of December 31, 2016 were audited by other auditors, whose report dated April 12, 2017 expressed an unqualified opinion on those statements.

Plante & Moran, PLLC

March 27, 2018

ProMedica Health System and Subsidiaries

Consolidated Balance Sheets

December 31, 2017 and 2016
(in thousands)

	2017	2016
Assets		
Current Assets		
Cash and cash equivalents	\$ 294,030	\$ 222,673
Marketable securities	295,433	294,944
Assets limited as to use or restricted	4,335	4,363
Accounts receivable - Net	255,472	235,907
Estimated third-party payor receivable	9,493	4,975
Supplies	26,247	31,642
Other current assets	122,158	92,625
Total current assets	1,007,168	887,129
Noncurrent Assets Limited as to Use or Restricted - Net of amount required to meet current obligations		
Restricted funds	135,010	110,419
Bond indenture agreement funds	12	5,011
Professional liability and workers' compensation insurance funds	65,120	88,021
Internally designated for capital acquisition	1,111,149	1,304,625
Other segregated investments	254,826	219,213
Total noncurrent assets limited as to use or restricted	1,566,117	1,727,289
Property and Equipment - Net	1,345,046	1,137,047
Other Assets		
Goodwill	70,077	40,991
Pension	25,326	-
Intangible assets and other	117,980	90,525
Investments in affiliated companies	85,429	68,520
Total other assets	298,812	200,036
Total assets	\$ 4,217,143	\$ 3,951,501

ProMedica Health System and Subsidiaries

Consolidated Balance Sheets (Continued)

December 31, 2017 and 2016
(in thousands)

	2017	2016
Liabilities and Net Assets		
Current Liabilities		
Accounts payable and accrued expenses	\$ 207,503	\$ 222,300
Contractual current installments of long-term debt	96,350	18,452
Contingent current installments of long-term debt	457,409	152,619
Estimated third-party payor settlements	28,523	36,402
Accrued liabilities and other:		
Compensation and benefits	138,624	124,883
Professional liability and workers' compensation	7,353	7,456
Postretirement plans	163	185
Claims expense	81,423	92,439
Other current liabilities	3,501	2,854
Total current liabilities	1,020,849	657,590
Long-term Debt - Less current installments	429,012	717,865
Other Liabilities		
Accrued professional liability and workers' compensation - Less current portion	49,144	38,601
Deferred compensation	41,569	38,750
Pension	20,938	41,013
Accrued postretirement plans - Less current portion	1,014	1,257
Other	66,173	59,056
Total other liabilities	178,838	178,677
Total liabilities	1,628,699	1,554,132
Net Assets		
Unrestricted:		
Controlling interest	2,444,330	2,277,182
Noncontrolling interest	9,104	9,768
Total unrestricted	2,453,434	2,286,950
Temporarily restricted	95,350	74,182
Permanently restricted	39,660	36,237
Total net assets	2,588,444	2,397,369
Total liabilities and net assets	<u>\$ 4,217,143</u>	<u>\$ 3,951,501</u>

ProMedica Health System and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

Years Ended December 31, 2017 and 2016

(in thousands)

	2017	2016
Unrestricted Revenue, Gains, and Other Support		
Patient service revenue - Net of contractual and other allowances	\$ 1,655,458	\$ 1,683,929
Provision for bad debts	(96,233)	(88,952)
Net patient service revenue, less provision for bad debts	1,559,225	1,594,977
Premium revenue	1,515,145	1,373,837
Other	64,817	62,697
Net assets released for use in operations	11,293	11,218
Total unrestricted revenue, gains, and other support	3,150,480	3,042,729
Expenses		
Salaries, wages, and employee benefits	1,068,022	1,082,722
Food and drugs	190,724	182,232
Medical expenses	1,004,059	934,983
Contracted fees	303,748	318,192
Supplies	198,138	209,410
Insurance	15,843	18,696
Utilities	26,016	27,714
Other	205,404	204,534
Total expenses	3,011,954	2,978,483
Operating Income Before Depreciation and Amortization Expense	138,526	64,246
Depreciation and Amortization	130,897	124,526
Operating Income (Loss)	7,629	(60,280)
Other (Loss) Income		
Interest expense	(34,423)	(36,775)
Loss on deconsolidation of subsidiary	-	(123,168)
Investment income	210,787	101,576
Income tax expense	(4,502)	(11,596)
Loss on extinguishment of debt	(39,365)	-
Other	9,484	3,367
Total other income (loss) - Net	141,981	(66,596)
Excess of Revenue Over (Under) Expenses Before Unusual Items	149,610	(126,876)
Restructuring and Severance Costs	(15,085)	(55,839)
Excess of Revenue Over (Under) Expenses	\$ 134,525	\$ (182,715)

ProMedica Health System and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (Continued)

Years Ended December 31, 2017 and 2016

(in thousands)

	Controlling Interest Unrestricted	Noncontrolling Interest Unrestricted	Total Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net Assets - December 31, 2015	\$ 2,445,651	\$ 10,286	\$ 2,455,937	\$ 78,758	\$ 35,810	\$ 2,570,505
Excess of revenue over (under) expenses	(183,665)	950	(182,715)	-	-	(182,715)
Restricted investment income	-	-	-	3,375	395	3,770
Restricted contributions and transfers, net	-	-	-	10,275	32	10,307
Net assets released from restrictions for operations	-	-	-	(10,123)	-	(10,123)
Net assets released from restrictions for fixed assets	6,812	-	6,812	(6,812)	-	-
Noncontrolling interest in consolidated subsidiaries	-	123	123	-	-	123
Distributions to noncontrolling interests	-	(1,591)	(1,591)	-	-	(1,591)
Loss on deconsolidation of a subsidiary	-	-	-	(1,291)	-	(1,291)
Pension and other postretirement adjustments	8,384	-	8,384	-	-	8,384
(Decrease) increase in net assets	(168,469)	(518)	(168,987)	(4,576)	427	(173,136)
Net Assets - December 31, 2016	2,277,182	9,768	2,286,950	74,182	36,237	2,397,369
Excess of revenue over expenses	133,974	551	134,525	-	-	134,525
Restricted investment income	-	-	-	7,887	3,214	11,101
Restricted contributions and transfers, net	-	-	-	32,094	209	32,303
Net assets released from restriction for operations	-	-	-	(11,096)	-	(11,096)
Net assets released from restriction for fixed assets	7,717	-	7,717	(7,717)	-	-
Noncontrolling interest in consolidated subsidiaries	273	(360)	(87)	-	-	(87)
Distributions to noncontrolling interests	-	(855)	(855)	-	-	(855)
Pension and other postretirement adjustments	25,184	-	25,184	-	-	25,184
Increase (decrease) in net assets	167,148	(664)	166,484	21,168	3,423	191,075
Net Assets - December 31, 2017	\$ 2,444,330	\$ 9,104	\$ 2,453,434	\$ 95,350	\$ 39,660	\$ 2,588,444

ProMedica Health System and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31, 2017 and 2016

(in thousands)

	2017	2016
Cash Flows from Operating Activities		
Increase (decrease) in net assets	\$ 191,075	\$ (173,136)
Adjustments to reconcile increase (decrease) in net assets to net cash from operating activities:		
Depreciation and amortization	130,897	124,526
Loss on sale of equipment	2,069	5,735
Loss on extinguishment of debt	39,365	-
Provision for bad debts	96,233	88,952
Asset impairment	616	1,743
Deconsolidation of a subsidiary	-	124,459
Noncontrolling interests in acquisitions	87	(123)
Investment income including realized and unrealized gains	(186,424)	(101,576)
Distributions to noncontrolling interests	855	1,591
Restricted contributions and other	(32,303)	(10,307)
Changes in operating assets and liabilities which (used) provided cash - Net of business combinations:		
Accounts receivable and estimated third-party payor receivables	(119,850)	(87,078)
Supplies and other current assets	(21,995)	(15,675)
Other assets	19,551	(40,018)
Accounts payable and accrued expenses	(9,177)	105,479
Estimated third-party payor settlements	(10,115)	(3,266)
Pension and other postretirement plans	(45,666)	(33,118)
Other liabilities	(7,676)	16,837
Net cash provided by operating activities	47,542	5,025
Cash Flows from Investing Activities		
Acquisition of property and equipment	(341,638)	(278,049)
Proceeds from sale of equipment	3,248	8,972
Payments for business combinations - Net of cash acquired	(69,861)	(4,999)
Cash included in deconsolidation of a subsidiary	-	(28,764)
Investments in joint ventures	(4,767)	(5,675)
Purchase of investments	(3,009,559)	(2,873,518)
Proceeds from sale of investments	3,400,125	3,142,148
Decrease in total assets limited as to use or restricted	(39,651)	(92,602)
Net cash used in investing activities	(62,103)	(132,487)
Cash Flows from Financing Activities		
Proceeds from long-term debt	465,760	-
Repayment of long-term debt	(18,533)	(20,452)
Extinguishment of long-term debt	(389,100)	-
Payments on capital lease obligations	(3,657)	(1,607)
Distributions to noncontrolling interests	(855)	(1,591)
Restricted contributions and other	32,303	10,307
Net cash provided by (used in) financing activities	85,918	(13,343)
Net Increase (Decrease) in Cash	71,357	(140,805)
Cash - Beginning of year	222,673	363,478
Cash - End of year	<u>\$ 294,030</u>	<u>\$ 222,673</u>
Supplemental Cash Flow Information		
Cash paid for interest - Net of amount capitalized	\$ 36,709	\$ 36,686
Cash paid for taxes	9,949	13,411
Acquisition of property through accounts payable	11,176	19,061
Assets deconsolidated - Net of cash - St. Luke's Hospital and related entities	-	223,040
Liabilities deconsolidated - St. Luke's Hospital and related entities	-	127,345
Net assets deconsolidated - Net of cash - St. Luke's Hospital and related entities	-	95,695

December 31, 2017 and 2016

Note 1 - Basis of Presentation and Affiliated Entities

ProMedica Health System and Subsidiaries (ProMedica), an Ohio not-for-profit corporation, and its subsidiaries (collectively, the "System") provide various types of healthcare services. ProMedica, its hospitals, and certain subsidiaries have been determined by the Internal Revenue Service (IRS) to be organizations described in Internal Revenue Code (IRC) Section 501(c)(3), exempt from taxation under IRC Section 501(a), and qualify for public charity status by meeting the requirements of IRC Section 509(a). Any income not substantially related to the System's exempt purpose may be considered unrelated business income (UBI) under IRC Section 511 and, as such, is subject to tax at normal corporate rates. Certain subsidiaries of the System are taxable entities. ProMedica is the sole member or parent of the sole member of the following subsidiaries:

The Toledo Hospital (Toledo), an Ohio not-for-profit corporation, operates a hospital and related healthcare facilities. Included in Toledo are the accounts of Toledo Children's Hospital and Wildwood Orthopedic and Spine Hospital.

Flower Hospital (Flower), an Ohio not-for-profit corporation, operates as a general acute care hospital in Sylvania, Ohio.

Fostoria Hospital Association (Fostoria), an Ohio not-for-profit corporation, operates as a general acute care hospital in Fostoria, Ohio.

Defiance Hospital, Inc. (Defiance), an Ohio not-for-profit corporation, operates as a general acute care hospital in Defiance, Ohio.

Bay Park Community Hospital (Bay Park), an Ohio not-for-profit corporation, operates as a general acute care hospital in Oregon, Ohio.

Emma L. Bixby Medical Center (Bixby), a Michigan not-for-profit corporation, operates a general acute care hospital and other healthcare-related entities in Adrian, Michigan.

Herrick Memorial Hospital, Inc. (Herrick), a Michigan not-for-profit corporation, operates as a general acute care hospital in Tecumseh, Michigan.

Memorial Hospital (Memorial), an Ohio not-for-profit corporation, operates as a general acute care hospital in Fremont, Ohio.

Mercy Memorial Hospital Corporation (Monroe), a Michigan not-for-profit corporation, operates as a general acute care hospital in Monroe, Michigan.

ProMedica Physician Group (PPG), an Ohio not-for-profit corporation, provides physician services.

ProMedica Continuum Services (PCS), an Ohio not-for-profit corporation, provides hospice and home care services.

Lenawee Long-Term Care, a Michigan not-for-profit corporation, operates as a long-term care facility in Adrian, Michigan.

ProMedica Continuing Care Services Corp. (PCCSC), an Ohio not-for-profit corporation, provides long-term and skilled nursing services.

ProMedica Indemnity Corporation (Indemnity), a Vermont not-for-profit corporation, provides medical professional liability and comprehensive general liability insurance for the System.

ProMedica Foundation (Foundation), an Ohio not-for-profit corporation, operates for the benefit of System-supported organizations.

ProMedica Insurance Corporation (PIC), an Ohio not-for-profit corporation, subject to federal income taxes, provides comprehensive healthcare services on a prepaid basis, operates a health maintenance organization (HMO), and provides a full range of healthcare services to participating members.

December 31, 2017 and 2016

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the System and its controlled subsidiaries. Investments in entities not controlled by the System are reflected in the accompanying consolidated financial statements on the equity method. All significant intercompany transactions have been eliminated in the consolidated financial statements.

Investments in Affiliated Companies

Under the equity method, the investment is originally recorded at cost and is adjusted to recognize the System's share of the net earnings or losses of the affiliate as they occur. Losses are limited to the extent of the System's investments in, advances to, and guarantees for the entity.

Cash Equivalents

The System considers liquid investments with an original maturity of three months or less, exclusive of those whose use is limited or restricted, to be cash equivalents.

Investments

Marketable securities and assets limited as to use (held by trustees) primarily represent cash equivalents, commercial paper, bank notes, certificates of deposit, governmental securities, real estate, and equity securities. Marketable securities include cash and cash equivalents held by investment custodians, fixed-income securities, and equity securities.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Purchases and sales of investments are accounted for as of the trade date, and sales are accounted for using the first-in, first-out method. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenue over expenses, unless the income or loss is restricted by donor or law.

Based on the System's investment strategy and philosophies, management has elected to classify substantially all of its investments in equity securities with readily determinable fair values and investments in debt securities as trading securities.

Investment Risks

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

Derivative Financial Instruments

The System has limited involvement with derivative financial instruments and uses them only to manage well-defined interest rate risks.

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include the restricted assets of the foundations and other subsidiaries of the System, assets held by trustees under indenture agreements and self-insurance trust arrangements, and assets set aside by the Board of Trustees for future capital improvements and other designated purposes.

Note 2 - Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments

The System follows the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement*. This guidance defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The fair value hierarchy is as follows:

Level 1 - Quoted (unadjusted) prices for identical assets in active markets

Level 2 - Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets in active markets
- Quoted prices for identical or similar assets in nonactive markets (few transactions, limited information, noncurrent prices, high variability over time, etc.)
- Inputs other than quoted prices that are observable for the asset (interest rates, yield curves, volatilities, default rates, etc.)
- Inputs that are derived principally from or corroborated by other observable market data

Level 3 - Unobservable inputs that cannot be corroborated by observable market data

Fair values of trading securities are based on quoted market prices, where available. The System obtains pricing for each security from investment managers and the custodian or a third-party pricing service (the "pricing service"), which generally uses Level 1 or Level 2 inputs for the determination of fair value in accordance with the fair value hierarchy. Security prices are normally derived through recently reported trades for identical or similar securities, making adjustments through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or discounted cash flow analysis, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, nonbinding broker quotes, benchmark-yields, credit spread, default rates, and prepayments spreads. As the System is responsible for the determination of fair value, it performs analyses on the prices received from the pricing service relative to the prices expected by the investment managers to determine whether the prices are reasonable estimates of fair value. As a result of these reviews, the System has not adjusted the prices obtained from the pricing service.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including consideration of inputs specific to the asset. Investments measured at fair value using the net asset value (NAV) per share practical expedient are not categorized within the fair value hierarchy.

Concentrations of Credit Risk

Financial instruments, which potentially subject the System to concentrations of credit risk, consist principally of cash and cash equivalents, marketable securities, patient accounts receivable, and assets limited as to use or restricted.

The System places its cash and cash equivalents with high-quality financial institutions. Concentration of credit risk with respect to marketable securities and assets limited as to use is restricted so that no one investment or group of similar investments, outside of those backed by the U.S. government, creates a significant concentration.

Note 2 - Summary of Significant Accounting Policies (Continued)

Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from governmental programs, commercial insurance companies, self-pay patients, and other group insurance programs. Excluding governmental programs, no one payor source represents more than 10 percent of the System's patient accounts receivable.

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

Supplies

Supplies (e.g., drugs, medical and surgical supplies, and food) are stated at the lower of cost (average cost) and net realizable value.

Property and Equipment

Property and equipment acquisitions (including capitalized internal-use software) are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital leases is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Estimated useful lives for each of the categories of assets are as follows:

Land improvements	5-25 years
Buildings and improvements	5-40 years
Equipment	3-15 years

Impairment of Long-lived Assets and Long-lived Assets to be Disposed of

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

Asset Retirement Obligations

The fair value of the liability for legal obligations associated with asset retirements is recorded in the period in which it is incurred. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability, which is included in other long-term liabilities, is accreted to its present value, and the associated capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statements of operations and changes in net assets.

Goodwill

The excess of purchase price over the fair value of net tangible and intangible assets of an entity acquired in a business combination is recorded as goodwill. The System tests goodwill annually for impairment as of December 31.

Intangible Assets

Intangible assets that have finite useful lives are amortized over said useful lives on a straight-line basis over periods ranging from 1 to 50 years. The System tests intangible assets, determined to have an indefinite useful life, annually for impairment as of December 31.

Note 2 - Summary of Significant Accounting Policies (Continued)

Accrued Claims

Accrued claims include estimates of the ultimate costs for both reported claims and claims incurred but not reported (IBNR).

Premium Deficiency Reserves

The reserve for premium deficiency, included in accrued claims, and the related expense are recognized when it is probable that expected future healthcare costs, under a group of existing contracts, will exceed future premiums and stop-loss coverage recoveries anticipated over the remaining term of the contract. The methods for making such estimates and for establishing the resulting reserves are periodically reviewed and updated. Any adjustments resulting therein are reflected in current operations. Estimates in reserves are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. The System had no premium deficiency reserves accrued at December 31, 2017 and 2016.

Centers for Medicare and Medicaid Services (CMS) Payable

The System, through its wholly owned subsidiary, PIC, serves as a plan sponsor offering Medicare Part D prescription drug insurance coverage under a contract with CMS. In general, pharmacy benefits under Medicare Part D plans may vary in terms of coverage levels and out-of-pocket costs for beneficiary premiums, deductibles, and coinsurance. However, all Medicare Part D plans must offer either “standard coverage” or its actuarial equivalent (with out-of-pocket threshold and deductible amounts that do not exceed those of standard coverage). These “defined standard” benefits represent the minimum level of benefits required under law. Depending on the insurance risk, payments received by PIC for coverage under the Medicare Part D plan are recorded as net premium revenue or accrued claims.

In addition to defined standard plans, other prescription drug plans are offered containing benefits in excess of the standard coverage limits, in many cases, for an additional beneficiary premium. Pharmacy benefit costs and administrative costs under the contract are expensed as incurred and are recognized in medical expenses in the consolidated statements of operations and changes in net assets.

Net Patient Service Revenue and Provision for Bad Debts

Net patient service revenue, net of contractual and other allowances, is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits and reviews. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits and reviews.

The System recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered and estimated collectibility of deductibles and coinsurance. For uninsured patients that meet certain financial criteria, standard financial assistance discounts are recorded. For uninsured patients that do not qualify for financial assistance, the System recognizes revenue on the basis of discounted rates for services provided. Based on historical experience, trends in healthcare coverage, and other collection indicators, a significant portion of the System’s uninsured patients will be unable or unwilling to pay for the services provided. As a result, the System records a significant provision for uncollectible accounts related to uninsured patients in the period services are provided. The provision for bad debts is presented in the consolidated statements of operations and changes in net assets as a component of net patient service revenue.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Summary of Significant Accounting Policies (Continued)

Allowance for Estimated Uncollectible Accounts

The System maintains an allowance for estimated uncollectible accounts based on the expected collectibility of patient accounts receivable. The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The System assesses collectibility of accounts receivable based on historical and current collection experience, as well as current payor mix and accounts receivable aging trends to estimate the appropriate allowance for estimated uncollectible accounts and provision for bad debts. Management regularly reviews payor data in evaluating the sufficiency of the allowance for estimated uncollectible accounts.

For receivables related to services provided to patients insured under third-party payor agreements, the System analyzes contractually due amounts and provides an allowance for estimated uncollectible accounts and a provision for bad debts, if necessary, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors where realization of the amounts due is unlikely.

For self-pay patient receivables, which include uninsured patients as well as coinsurance and deductibles owed by patients with insurance, the System records a significant provision for bad debts in the period of service based on historical collection experience, indicating whether patients are unable or unwilling to pay the amounts for which they are financially responsible. The difference between the standard rates, or discounted rates, if applicable, and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for estimated uncollectible accounts.

The System's estimate for uncollectible accounts is substantially all related to self-pay patient receivables and amounted to \$124,338,000 and \$103,022,000 as of December 31, 2017 and 2016, respectively. These allowances include estimates related to both charity care of \$45,921,000 and \$39,135,000 and bad debts of \$78,417,000 and \$63,887,000 at December 31, 2017 and 2016, respectively.

Other Operating Revenue

Other operating revenue consists of retail pharmacy, cafeteria, and other sales to patients, employees, and visitors; grants; rental income; unrestricted contributions; and other miscellaneous income.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management of the System to make assumptions, estimates, and judgments that affect the amounts reported in the consolidated financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The System considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including, but not limited to, the following: recognition of net patient service revenue, which includes contractual allowances; provisions for bad debts and charity care; recorded values of investments and goodwill; reserves for losses and expenses related to healthcare professional and general liability; and risks and assumptions for measurement of pension and retiree medical liabilities. Management relies on historical experience and other assumptions believed to be reasonable in making its judgments and estimates. Actual results could differ materially from those estimates.

In addition, laws and regulations governing Medicare, Medicaid, and other third-party payor programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change in the near term. In 2017 and 2016, such changes in estimates increased patient service revenue, net of contractual and other allowances, by approximately \$18,796,000 and \$15,974,000, respectively.

Note 2 - Summary of Significant Accounting Policies (Continued)

Charity Care

The System provides care without charge to patients who meet certain criteria under its financial assistance policy. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Premium Revenue and Medical Expenses

The System has certain agreements with various HMOs or through its wholly owned subsidiary, PIC, to provide medical services to subscribing participants. Premiums are recognized as income in the month that subscribing participants and enrollees are eligible to receive healthcare services. Medical expenses represent expenses incurred under contracts with healthcare providers; such costs are charged to expense in the month in which the service is rendered. These expenses include liabilities for reported claims and an estimate of IBNR claims using past experience adjusted for current trends.

CMS deploys a risk-adjustment model that apportions premiums paid to all health plans according to health severity and certain demographic factors. The CMS risk adjustment model pays more for members whose medical history indicates they have certain medical conditions. Under this risk adjustment methodology, CMS calculates the risk-adjusted premium payment using diagnosis data from hospital inpatient, hospital outpatient, and physician treatment settings. PIC and healthcare providers collect, capture, and submit the necessary and available diagnosis data to CMS within prescribed deadlines. PIC estimates risk adjustment revenue based upon the diagnosis data submitted and expected to be submitted to CMS.

Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets, net of applicable interest income for tax-exempt borrowed funds, is capitalized as a component of the costs of acquiring those assets. Net capitalized interest was \$7,077,000 and \$4,626,000 in 2017 and 2016, respectively. Deferred debt financing costs are expensed over the life of the bonds using the bonds outstanding method.

Sick Pay Benefit

The System provides a sick time benefit to certain employees of Toledo, Flower, Bay Park, PCCSC, and the System's corporate staff. The benefit generally includes a capped payout provision at retirement or after attainment of a specified age or attendance level. The liability is an estimate based on the accrued benefits at year end, adjusted for expected employee turnover, and a discount rate of 2.75 percent and 2.50 percent for 2017 and 2016, respectively. At December 31, 2017 and 2016, the System recorded a liability of \$2,333,000 and \$2,941,000, respectively. Payments made under the program amounted to \$865,000 and \$549,000 for the years ended December 31, 2017 and 2016, respectively.

Income Taxes

Income taxes for the for-profit entities are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Note 2 - Summary of Significant Accounting Policies (Continued)

The System is subject to audit by various taxing authorities, and such audits could result in additional taxes. The System may, from time to time, engage in transactions in which the tax consequences are subject to uncertainty. Significant judgment is required in assessing and estimating the tax consequences of any such transactions. The System determines whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. The System believes that the tax positions of its entities comply, in all material respects, with applicable tax law and that they have adequately provided for any reasonably foreseeable outcome related to these matters.

Excess of Revenue Over (Under) Expenses

The System's consolidated statements of operations and changes in net assets include the performance indicator of excess of revenue over (under) expenses. Changes in unrestricted net assets which are excluded from excess of revenue over (under) expenses, consistent with industry practice, include contributions and investment income on restricted funds; pension and other postretirement adjustments; transfers of assets to and from affiliates for other than goods and services; contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets); and changes in noncontrolling interests in consolidated subsidiaries.

Donor-restricted Gifts/Restricted Net Assets

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific entity or purpose. When a donor restriction expires, that is, when a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are also reported as net assets released from restrictions. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity.

Regulatory Risk-based Capital and Statutory Deposit

PIC is subject to minimum risk-based capital and dividend approval requirements that were developed by the National Association of Insurance Commissioners (NAIC) and imposed by the Ohio Department of Insurance and the Michigan Department of Insurance and Financial Services. The formulas for determining the amounts of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Regulatory compliance is determined by a ratio of the System's regulatory total adjusted capital, as defined by the NAIC, to its authorized control-level risk-based capital. Companies below specific trigger points or ratios are classified within certain levels, each of which requires specified corrective action. As of December 31, 2017 and 2016, it is management's opinion that PIC exceeds all required risk-based capital levels.

Cash and securities of PIC with a carrying value of \$5,462,000 and \$5,497,000 were on deposit with regulatory authorities at December 31, 2017 and 2016, respectively, and included in intangible and other assets in the consolidated balance sheets.

Related Party Transactions

Certain board members of the System own or manage corporations that provide services to the System. The System enters into transactions with related parties only upon terms comparable to those that would be available from unaffiliated third parties. Related party transactions are reviewed on a sample basis for fair market value by the Audit and Compliance department.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Summary of Significant Accounting Policies (Continued)

Unusual Items

The System has embarked on a cross-functional effort to improve and enhance its operating model, achieve long-term strategic objectives, and gain greater efficiencies. Costs related to this effort include restructuring and severance costs of \$15,085,000 and \$55,839,000 as of December 31, 2017 and 2016, respectively.

Adopted Accounting Pronouncements

In May 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-09, *Financial Services Insurance (Topic 944): Disclosures About Short Duration Contracts*. This guidance expands the disclosures that the System's wholly owned subsidiaries, PIC and Indemnity, must provide about short-duration insurance contracts. It increases the transparency of significant estimates for unpaid claims and claim adjustment expenses. The new standard is effective for the year ending December 31, 2017.

Upcoming Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 provides guidance for revenue recognition. The new guidance affects any reporting organization that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, *Deferral of the Effective Date*, which results in the guidance being effective for the System January 1, 2018. The adoption will include updates as provided under ASU No. 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*; ASU No. 2016-10, *Identifying Performance Obligations and Licensing*; and ASU No. 2016-12, *Narrow-Scope Improvements and Practical Expedients*. The most significant impact will be to the presentation of the consolidated statement of operations and changes in net assets where the provision for bad debts will be recorded as a direct reduction to patient service revenue and will not be presented as a separate line item. The System adopted the new standard on January 1, 2018 and has concluded that the adoption will not have a material effect on the consolidated statements of operations and changes in net assets.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which will supersede the current lease requirements in ASC 840. This guidance 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 guidance in ASU No. 2016-02 will be effective for the System beginning January 1, 2019 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The new lease standard is expected to have a significant impact on the System's consolidated balance sheets resulting from the System's operating leases, as disclosed in Note 19, that will be reported on the balance sheet upon adoption. At adoption, the System will recognize a lease liability and corresponding right-to-use asset based on the present value of the minimum lease payments. The effects on the results of operations are not expected to be significant as recognition and measurement of expenses and cash flows for leases will generally be consistent with current guidance.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Summary of Significant Accounting Policies (Continued)

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance requires significant changes to the financial reporting model of organizations that follow the FASB not-for-profit rules, including changing from three classes of net assets to two classes: net assets with donor restrictions and net assets without donor restrictions. This also requires changes in the way certain information is aggregated and reported by the System, including required disclosures about the liquidity and availability of resources. The guidance in ASU No. 2016-14 is effective for the System beginning January 1, 2018 and is not expected to have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This guidance requires the presentation of the service cost component of net benefit cost to be in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. All other components of net benefit cost should be presented separately from the service cost component and outside of income from operations. The guidance in ASU No. 2017-07 is effective for the System beginning January 1, 2019. The System is currently evaluating the impact this guidance may have on its consolidated financial statements.

Note 3 - Accounts Receivable

The details of accounts receivable are set forth below (in thousands):

	2017	2016
Accounts receivable	\$ 379,810	\$ 338,929
Less allowances for charity care and bad debt	124,338	103,022
Net accounts receivable	<u>\$ 255,472</u>	<u>\$ 235,907</u>
	2017	2016
Commercial and other payors	52 %	53 %
Medicare	21	25
Self-pay	18	13
Medicaid	9	9
Total	<u>100 %</u>	<u>100 %</u>

Note 4 - Charity Care

The System maintains records to identify and monitor the level of direct patient charity care it provides. These records include the charges forgone for services and supplies furnished under its charity care policy and equivalent service statistics. During 2017 and 2016, gross charges forgone, based on established rates, approximated \$59,804,000 and \$58,259,000, respectively. The cost of charity care provided approximated \$11,076,000 and \$11,765,000 in 2017 and 2016, respectively.

The System calculates a cost-to-charge ratio of adjusted total costs to gross charges for each subsidiary to determine the aggregate System cost of charity care.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 4 - Charity Care (Continued)

In addition to providing direct patient charity care, the System demonstrates its exempt purpose to benefit the community by operating emergency rooms that are open to the public, regardless of ability to pay, 24 hours a day, seven days per week. Additionally, ProMedica offers Urgent Care and After Hours facilities for non-life threatening emergencies and a new telehealth option for patients to speak to a physician using their computer or mobile device. Through its Academic Affiliation, the System provides facilities for the education and training of healthcare professionals and the development of an academic medical center, while maintaining research programs for the study of new patient procedures, drugs, and innovative medical devices that offer the promise of improving health care. The System also provides community health services, such as free or low-cost clinics, including the Hemophilia Clinic and the Heart Failure Clinic; women’s health programs, such as free or low-cost mammograms; and multiple health promotion and wellness programs, such as lectures at local senior centers, free public health and infant mortality screenings; services to combat hunger, including food reclamation and food clinic programs; and various community advocacy projects that support organizations providing basic needs of food, clothing, and shelter to our community members. The ProMedica Ebeid Institute for Population Health (the "Institute") is committed to building healthy communities and includes Market on the Green, a full-service grocery that provides nutritious meal options to residents in a designated food desert. The Institute also provides cooking and nutrition classes as well as financial counseling services through its financial opportunity center. As part of its efforts to combat food insecurity, the System also partners with the Lenawee Health Network to bring fresh produce to Lenawee County, Michigan residents from August through October with the Veggie Mobile. The System also subsidizes necessary health services, including emergency and medically necessary care, Neonatal Intensive Care, Children’s Safe Harbor, the Cystic Fibrosis Center, and Autism Center, as well as diabetes treatment and support services at the ProMedica Mary Ellen Falzone Diabetes Center.

Note 5 - Net Patient Service Revenue

Patient service revenue, net of contractual allowances and discounts (before the provision for bad debts), generated by major payor source, for the years ended December 31, 2017 and 2016 is as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Commercial and other payors	\$ 836,906	\$ 876,730
Medicare	575,531	562,251
Medicaid	196,191	198,062
Self-pay	<u>46,830</u>	<u>46,886</u>
Total	<u>\$ 1,655,458</u>	<u>\$ 1,683,929</u>

Certain subsidiaries of the System have agreements with third-party payors that provide for payment to the System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

Commercial and Other - Certain subsidiaries of the System have also entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment under these agreements includes capitation fees, prospectively determined rates per discharge or per diem, and discounts from established charges.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 5 - Net Patient Service Revenue (Continued)

Medicare - Inpatient acute care, psychiatric, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Critical Access Hospitals (Defiance, Fostoria, and Herrick) and medical education costs are reimbursed at prospective rates, but traditional Medicare payments are later settled during the annual cost reporting process. Outpatient services are paid based upon either the Ambulatory Payment Classification (APC) methodology or a prospectively determined fee schedule for therapy and laboratory services. Under APCs, the hospital is paid a prospectively determined rate based on the procedures provided to patients. Outpatient services are reimbursed based upon either the Enhanced Ambulatory Payment Group (EAPG) methodology or prospectively determined fee schedules.

Medicaid - Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services are reimbursed based upon prospectively determined fee schedules.

Program examination of cost reports has been finalized for various facilities with dates ranging from 2014 to 2016 for the Medicare program and with dates ranging from 2010 to 2014 for the Medicaid program. Cost reports for the Blue Cross Blue Shield program (Michigan providers only) have been finalized through 2016. Provisions for estimated reimbursement adjustments have been made in the accompanying consolidated financial statements.

System hospitals participate in various state supplemental payment programs designed to assist hospitals that have a disproportionate amount of uncompensated care. Ohio hospitals (Toledo, Defiance, Fostoria, Bay Park, Flower, and Memorial) participate in the Hospital Care Assurance and Medicaid Supplemental Payments programs. Michigan hospitals (Bixby, Herrick, and Monroe) participate in the Disproportionate Share Hospital Payment and Quality Assurance Assessment programs. During 2017 and 2016, the System received distributions of approximately \$51,308,000 and \$64,694,000, respectively. All hospitals are subject to assessments used to fund state supplemental payment programs. During 2017 and 2016, the System incurred assessments of approximately \$35,396,000 and \$35,610,000, respectively.

Note 6 - Assets Limited as to Use or Restricted

As of December 31, 2017 and 2016, restricted assets of the foundations and other subsidiaries of the System, assets held by trustees under indenture agreements and self-insurance trust arrangements, and assets set aside by the Board of Trustees for future capital improvements and other designated purposes consisted of the following (in thousands):

	2017	2016
Cash and cash equivalents	\$ 6,019	\$ 12,556
Equity securities	769,962	860,727
Fixed-income securities	572,270	608,285
Long-short equity hedge funds	72,920	113,339
Real return strategy funds	79,355	84,910
Real estate	8,428	6,746
Beneficial interest in perpetual trusts	32,096	28,554
Other	29,402	16,535
Total	<u>\$ 1,570,452</u>	<u>\$ 1,731,652</u>

Assets limited as to use, which are required for obligations classified as current liabilities, are reported in current assets.

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 7 - Property and Equipment

Property and equipment as of December 31, 2017 and 2016 consisted of the following (in thousands):

	2017	2016
Land and improvements	\$ 149,717	\$ 140,467
Building and improvements	1,331,801	1,213,059
Equipment	883,743	804,268
Construction in progress	277,785	159,841
Total cost	2,643,046	2,317,635
Less accumulated depreciation and amortization	1,298,000	1,180,588
Property and equipment - Net	<u>\$ 1,345,046</u>	<u>\$ 1,137,047</u>

Property and equipment includes assets recorded under capital leases of \$18,820,000 and \$17,925,000 with accumulated amortization for such assets of \$6,514,000 and \$3,724,000 as of December 31, 2017 and 2016, respectively. The associated charges to income are recorded in depreciation and amortization expense.

As of December 31, 2017 and 2016, construction contract commitments of \$182,434,000 and \$343,491,000, respectively, exist for the construction and remodeling of System facilities.

Note 8 - Goodwill and Intangible Assets

Intangibles as of December 31, 2017 and 2016 consisted of the following (in thousands):

	Average Life (Years)	2017 Gross Carrying Amount	Accumulated Amortization	Net	2016 Gross Carrying Amount	Accumulated Amortization	Net
Amortized intangible assets:							
Physician charts	10	\$ 1,446	\$ (1,078)	\$ 368	\$ 1,446	\$ (933)	\$ 513
Customer relationships	5-50	40,147	(4,213)	35,934	5,582	(4,035)	1,547
Other	1-15	7,671	(2,840)	4,831	4,084	(2,298)	1,786
Total		<u>\$ 49,264</u>	<u>\$ (8,131)</u>	<u>\$ 41,133</u>	<u>\$ 11,112</u>	<u>\$ (7,266)</u>	<u>\$ 3,846</u>

	2017 Gross Carrying Amount	2016 Gross Carrying Amount
Carrying amount of intangible assets not subject to amortization:		
Goodwill	\$ 70,077	\$ 40,991
Other	13,948	1,548
Total	<u>\$ 84,025</u>	<u>\$ 42,539</u>

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 8 - Goodwill and Intangible Assets (Continued)

During 2017, the System recorded goodwill and intangible assets related to PIC's acquisition of Health Resources, Inc. (HRI) as discussed in Note 23.

Aggregate amortization expense for the years ended December 31, 2017 and 2016 was \$924,000 and \$901,000, respectively.

Estimated amortization expense for each of the next five years and thereafter is as follows (in thousands):

Years Ending	Amount
2018	\$ 3,692
2019	3,617
2020	2,912
2021	2,706
2022	488
Thereafter	27,718
Total	<u>\$ 41,133</u>

Note 9 - Debt

Long-term debt as of December 31, 2017 and 2016, net of unamortized bond discount, premium, and debt issuance costs, consisted of the following (in thousands):

	2017	2016
Hospital Revenue Bonds - Series 2017A, interest at 2.24% payable monthly	\$ 54,554	\$ -
Hospital Revenue Bonds - Series 2017B, interest at 2.24% payable monthly	119,858	-
Hospital Revenue Bonds - Series 2017C, interest at 2.10% payable monthly	84,828	-
Hospital Revenue Bonds - Series 2017D, interest at 2.28% payable monthly	39,648	-
Hospital Revenue Bonds - Series 2017F, based on the 30-day London InterBank Offered Rate (LIBOR) index and interest payable monthly. (1.65% as of December 31, 2017)	62,383	-
Hospital Revenue Bonds - Series 2017G, interest based on Securities Industry and Financial Market Association (SIFMA) and payable monthly (1.72% as of December 31, 2017)	79,883	-
Hospital Refunding Revenue Bonds - Series 2017H, interest at 2.18% payable monthly	24,809	-
Taxable Bonds - Series 2015A, interest at 4.98% payable semiannually	270,389	270,295
Hospital Revenue Bonds - Series 2015B, interest at 4.00% payable semiannually	45,165	45,108
Taxable Hospital Refunding Revenue Bonds - Series 2015C, based on the 30-day LIBOR index and interest payable monthly (2.08% as of December 31, 2017)	19,125	23,640
Taxable Hospital Revenue Bonds - Series 2015D, based on the 30-day LIBOR index and interest payable monthly (2.18% as of December 31, 2017)	4,987	4,985

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 9 - Debt (Continued)

	2017	2016
Taxable Bonds - Series 2015E, based on the 30-day LIBOR index and interest payable monthly (2.13% as of December 31, 2017)	\$ 34,912	\$ 36,846
Hospital Revenue Bonds - Series 2011A, interest at 4.00% to 5.00% payable semiannually	4,046	178,123
Hospital Refunding Revenue Bonds - Series 2011B, interest at 4.13% to 4.38% payable semiannually	154	16,753
Hospital Revenue Refunding Bonds - Series 2011C, based on the 30-day LIBOR index and interest payable monthly (1.60% as of December 31, 2017)	8,896	12,978
Hospital Refunding Revenue Bonds - Series 2011D, interest at 4.00% to 5.25% payable semiannually	97,309	135,179
Hospital Refunding Revenue Bonds - Series 2011E, interest at 3.00% to 3.63% payable semiannually	2,181	7,405
Hospital Revenue Bonds - Series 2008A, extinguished December 2017, based on the 30-day LIBOR index and interest payable monthly (0.96% as of December 31, 2017)	-	62,481
Hospital Revenue Bonds - Series 2008D, extinguished December 2017, interest at 5.00% to 5.13% payable semiannually	-	51,329
Adjustable Rate Taxable Loan - 2014, extinguished November 2017, based on the 30-day LIBOR index and interest payable monthly (1.09% as of December 31, 2017)	-	1,480
Adjustable Rate Taxable Securities - Series 1998, extinguished December 2017, interest at the rate established weekly based on the 30-day commercial paper index and interest payable monthly (1.37% as of December 31, 2017)	-	3,222
Adjustable Rate Loan - 2012, extinguished November 2017, based on the 30-day LIBOR index and interest payable monthly (1.37% as of December 31, 2017)	-	6,383
Qualified Low-Income Community Investment Loans - 2015, interest at 1.00% to 2.58%, payable quarterly	14,365	14,352
Capital lease obligations	14,663	16,943
Other	616	1,434
Total	982,771	888,936
Less current installments of long-term debt, net of current portion of unamortized bond discount, premium, and debt issuance costs - Contractual current installments	96,350	18,452
Contingent current installments	457,409	152,619
Total	\$ 429,012	\$ 717,865

Certain subsidiaries of the System are participants in a Master Trust Indenture (Indenture), amended and restated as of June 15, 2011, pursuant to which the System's revenue bonds are general obligations of the ProMedica Healthcare Obligated Group (the "Obligated Group"). The Obligated Group consists of the following subsidiaries: Toledo, Flower, Bay Park, Defiance, Fostoria, Bixby, Herrick, Memorial, Monroe, PCCSC, and Lenawee Long-Term Care.

Note 9 - Debt (Continued)

The bonds were issued by the County of Lucas, Ohio (Lucas County) and the County of Lenawee, Michigan and are payable solely pursuant to related loan agreements or leases between the borrowing subsidiaries and the issuing authority. The Indenture and related loan agreements and leases require compliance with certain financial covenants each year by the Obligated Group. The Obligated Group has complied with the requirements of the financial covenants each year.

In connection with the issuance of the revenue bonds through Lucas County, the Ohio members of the Obligated Group have entered into a lease agreement (the "Lease") to lease its hospital facilities to, and lease back its hospital facilities from, Lucas County. Pursuant to the Lease, the Obligated Group agrees to make payments of basic rent in amounts sufficient to pay the principal and interest on the Lucas County revenue bonds issued for the benefit of the Obligated Group.

Hospital Revenue Bonds - 2017A

In December 2017, the Obligated Group issued \$54,710,000 in fixed rate bonds, Series 2017A, through Lucas County with a direct placement bank loan with a base term of four years. The Series 2017A bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017A bonds were used to advance refund the Series 2008D bonds. At December 31, 2017, outstanding bonds consist of \$54,710,000 that mature in increasing amounts from \$6,480,000 on November 15, 2035 to \$6,970,000 on November 15, 2040. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$156,000.

Hospital Revenue Bonds - 2017B

In December 2017, the Obligated Group issued \$120,010,000 in fixed rate bonds, Series 2017B, through Lucas County with a direct placement bank loan with a base term of four years. The Series 2017B bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017B bonds were used to advance refund a portion of the Series 2011A bonds. At December 31, 2017, outstanding bonds consist of \$120,010,000 that mature in increasing amounts from \$2,385,000 on November 15, 2022 to \$19,080,000 on November 15, 2041. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$152,000.

Hospital Revenue Bonds - 2017C

In December 2017, the Obligated Group issued \$84,980,000 in fixed rate bonds, Series 2017C, through Lucas County with a direct placement bank loan with a base term of four years. The Series 2017C bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017C bonds were used to advance refund a portion of the Series 2011A bonds. At December 31, 2017, outstanding bonds consist of \$84,980,000 that mature in increasing amounts from \$1,685,000 on November 15, 2022 to \$13,520,000 on November 15, 2041. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$152,000.

Hospital Revenue Bonds - 2017D

In December 2017, the Obligated Group issued \$39,800,000 in fixed rate bonds, Series 2017D, through Lucas County with a direct placement bank loan with a base term of seven years. The Series 2017D bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017D bonds were used to advance refund a portion of the Series 2011D bonds. At December 31, 2017, outstanding bonds consist of \$39,800,000 that mature in increasing amounts from \$820,000 on November 15, 2022 to \$6,090,000 on November 15, 2029. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$152,000.

Note 9 - Debt (Continued)

Hospital Revenue Bonds - 2017F

In December 2017, the Obligated Group issued \$62,500,000 in variable rate bonds, Series 2017C, through Lucas County with a direct placement bank loan with a base term of four years. The Series 2017F bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017F bonds were used to refinance the Series 2008A bonds. At December 31, 2017, outstanding bonds consist of \$62,500,000 that mature in increasing amounts from \$11,600,000 on November 15, 2030 to \$13,450,000 on November 15, 2034. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$117,000.

Hospital Revenue Bonds - 2017G

In December 2017, the Obligated Group issued \$80,000,000 in variable rate bonds, Series 2017G, through Lucas County with a direct placement bank loan with a base term of one year. The Series 2017G bonds are included in contractual current installments of long-term debt at December 31, 2017. The proceeds from the 2017G bonds were used to finance the construction of certain healthcare facilities of the Obligated Group located in Ohio. At December 31, 2017, outstanding bonds consist of \$80,000,000 that mature in increasing amounts from \$5,005,000 on November 15, 2042 to \$20,215,000 on November 15, 2048. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$117,000.

Hospital Refunding Revenue Bonds - 2017H

In December 2017, the Obligated Group issued \$24,945,000 in fixed rate bonds, Series 2017H, through the County of Lenawee Hospital Financing Authority with a direct placement bank loan with a base term of four years. The Series 2017H bond direct loan is included in contingent current installments of long-term debt at December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds from the 2017H bonds were used to advance refund a portion of the Series 2011B and 2011E bonds. At December 31, 2017, outstanding bonds consist of \$24,945,000 that mature in increasing amounts from \$690,000 on November 15, 2022 to \$6,450,000 on November 15, 2035. Balances reported at December 31, 2017 include unamortized debt issuance costs of \$136,000.

Taxable Bonds

Series 2015A, with an outstanding principal of \$273,000,000 at December 31, 2017, was issued in September 2015. The taxable fixed rate bonds mature on November 15, 2045 and are subject to optional redemption prior to maturity. The proceeds of the Series 2015A bonds were used for authorized corporate purposes of the System's subsidiaries, including financing or refinancing capital expenditures and paying current operating expenditures. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$2,611,000 and \$2,705,000, respectively.

Hospital Revenue Bonds

Series 2015B, with an outstanding principal of \$46,755,000 at December 31, 2017, was issued in September 2015 and consists of tax-exempt fixed rate bonds. The bonds mature on November 15, 2045 and are subject to optional redemption prior to maturity. The proceeds of the Series 2015B bonds were used for acquiring and improving healthcare facilities in Ohio. Balances reported at December 31, 2017 and 2016 include unamortized bond discount of \$1,086,000 and \$1,125,000, respectively, and debt issuance costs of \$504,000 and \$522,000, respectively.

Note 9 - Debt (Continued)

Taxable Hospital Revenue Refunding Bonds

Series 2015C, with an outstanding principal of \$19,185,000 at December 31, 2017, was issued in November 2015 as a taxable directly placed bank loan with a base term of six years. Principal payments are due annually and range from \$4,635,000 due on November 15, 2018 to \$4,960,000 due in 2021. The contractual current portion of the Series 2015C bonds is \$4,635,000 at December 31, 2017 with the remaining \$14,550,000 included in contingent current installments of long-term debt based on certain subjective acceleration definitions within the agreement. The proceeds of the Series 2015C bonds were used to extinguish the Hospital Refunding Revenue Bonds - Series 2005B. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$60,000 and \$75,000, respectively.

Taxable Hospital Revenue Bonds

Series 2015D, with an outstanding principal of \$5,000,000 at December 31, 2017, was issued in November 2015 as a taxable directly placed bank loan with a base term of 10 years. Principal payments of \$1,250,000 are due annually beginning on November 15, 2022 with the final payment due in 2025. The Series 2015D bonds are included in contingent current installments of long-term debt as of December 31, 2017 based on certain subjective acceleration definitions within the agreement. The proceeds of the Series 2015D bonds were used for authorized corporate purposes of the System's subsidiaries, including financing or refinancing capital expenditures and paying current operating expenditures. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$13,000 and \$15,000, respectively.

Taxable Bonds

Series 2015E, with an outstanding principal of \$35,000,000 as of December 31, 2017, was issued in November 2015 as a taxable directly placed bank loan with a base term of 10 years. Principal payments range from \$1,945,000 due on November 15, 2018 to \$21,385,000 in 2025. The contractual current portion of the Series 2015E bonds is \$1,945,000 at December 31, 2017, with the remaining \$33,055,000 included in contingent current installments of long-term debt based on certain subjective acceleration definitions within the agreement. The proceeds of the Series 2015E bonds were used to pay off a temporary bank line of credit that was used to extinguish the Monroe Hospital Finance Authority 2006 Revenue and Refunding bonds. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$88,000 and \$99,000, respectively.

Hospital Revenue Bonds

Series 2011A was partially refunded in December 2017 using the proceeds from the Series 2017B and Series 2017D bond issues. The outstanding principal of \$4,110,000 at December 31, 2017 consists of \$4,110,000 in outstanding serial bonds, which mature in increasing amounts from \$100,000 on November 15, 2018 to \$1,800,000 in 2021. Balances reported at December 31, 2017 and 2016 include unamortized bond discount of \$26,000 and \$1,169,000, respectively, and debt issuance costs of \$38,000 and \$1,723,000, respectively. In February 2011, the Obligated Group issued the fixed rate bonds through Lucas County. A portion of the proceeds from the Series 2011A Bonds was used to extinguish Series 2008B variable rate demand bonds with the remainder used to finance the cost of acquisition, construction, and renovation of certain healthcare facilities of the Obligated Group located in Ohio.

Note 9 - Debt (Continued)

Hospital Refunding Revenue Bonds

Series 2011B was partially refunded in December 2017 using the proceeds from the Series 2017H bonds. The remaining outstanding principal of \$160,000 at December 31, 2017 consists of \$160,000 of outstanding serial bonds, which mature in increasing amounts from \$65,000 on November 15, 2018 to \$95,000 in 2019. Balances reported at December 31, 2017 and 2016 include unamortized bond discount of \$4,000 and \$474,000, respectively, and debt issuance costs of \$2,000 and \$158,000, respectively. In February 2011, the Obligated Group issued the fixed rate bonds through the County of Lenawee Hospital Finance Authority. The proceeds from the Series 2011B Bonds were used to extinguish Series 2008C variable rate demand bonds.

Hospital Revenue Refunding Bonds

Series 2011C, with outstanding principal of \$8,990,000 at December 31, 2017, consists of principal payments totaling the outstanding par in increasing amounts over the term of the loan ranging from \$4,375,000 due on November 15, 2018, to \$4,615,000 due on November 15, 2019. The contractual current portion of the Series 2011C bonds is \$4,375,000 at December 31, 2017 with the remaining \$4,615,000 included in contingent current installments of long-term debt based on certain subjective acceleration definitions within the agreement. In May 2011, the Obligated Group refinanced a portion of Series 1999 Hospital Revenue Bonds with the Series 2011C bonds, which were directly placed via a bank loan with a base term of eight years. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$94,000 and \$142,000, respectively.

Hospital Refunding Revenue Bonds

Series 2011D was partially refunded in December 2017 using the proceeds from the Series 2017D bonds. The remaining outstanding principal of \$94,930,000 at December 31, 2017 consists of bonds, which mature in varying amounts from \$1,035,000 due on November 15, 2018 to \$880,000 in 2030. Balances reported at December 31, 2017 and 2016; include unamortized bond premium of \$3,067,000 and \$4,773,000, respectively, and debt issuance costs of \$688,000 and \$1,019,000, respectively. In December 2011, the Obligated Group issued the fixed rate bonds through Lucas County. The proceeds from the Series 2011D Bonds were used to extinguish the remaining maturities of Series 1999 Hospital Revenue Bonds that were not refunded with Series 2011C issuance.

Hospital Refunding Revenue Bonds

Series 2011E was partially refunded in December 2017 with the proceeds from the Series 2017H bonds. The remaining outstanding principal of \$2,220,000 at December 31, 2017 consists of bonds, which mature in increasing amounts from \$525,000 due on November 15, 2018 to \$585,000 in 2021. Balances reported at December 31, 2017 and 2016 include unamortized bond discount of \$18,000 and \$63,000, respectively, and debt issuance costs of \$21,000 and \$72,000, respectively. In December 2011, the Obligated Group issued the fixed rate bonds through the County of Lenawee Hospital Finance Authority. The proceeds from the Series 2011E Bonds were used to extinguish Series 1999A Hospital Revenue and Refunding Bonds.

Hospital Revenue Bonds

Series 2008A was extinguished in December 2017 with the proceeds of the Series 2017F bonds. Balances reported at December 31, 2016 included unamortized debt issuance costs of \$19,000.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 9 - Debt (Continued)

Hospital Revenue Bonds

Series 2008D was extinguished in December 2017 with the proceeds from the Series 2017A bonds. Balances reported at December 31, 2016 include unamortized bond discount of \$1,310,000 and debt issuance costs of \$361,000. The proceeds from the bonds were used to extinguish a portion of Series 2005A auction rate bonds with the remainder used to finance the cost of acquiring, constructing, renovating, and equipping certain healthcare facilities located in Ohio.

Adjustable Rate Taxable Loan

The 2014 loan was extinguished in November 2017. The proceeds of the loan were used to extinguish the Adjustable Rate Taxable Notes - Series 2000.

Adjustable Rate Taxable Securities

Series 1998 was extinguished in December 2017 and was issued to finance the acquisition and construction of Wildwood Health Pavilion. Balances reported at December 31, 2016 included unamortized debt issuance costs of \$16,000.

Adjustable Rate Loan

The 2012 loan, extinguished in November 2017, was issued to finance the acquisition of real estate by the System. Balances reported at December 31, 2016 included unamortized debt issuance costs of \$32,000.

Qualified Low-income Community Investment (QLICI) Loans

The 2015 loans, with an outstanding principal balance of \$14,740,000 at December 31, 2017, mature in December 2045 and were issued to finance the acquisition and rehabilitation of the System's corporate headquarters. The loans require quarterly interest-only payments through December 2022, with principal and interest payments beginning thereafter until the loans mature. The loans are included in contingent current installments of long-term debt based on certain subjective acceleration definitions within the loan agreement. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$375,000 and \$388,000, respectively.

Capital Lease

Capital lease obligations consist of property, equipment, and information technology leases.

Other

Other long-term debt consists of an equipment loan and a note payable. Balances reported at December 31, 2017 and 2016 include unamortized debt issuance costs of \$0 and \$7,000, respectively.

The table below indicates the future maturities on long-term debt at December 31, 2017. While presentation in the consolidated balance sheets of current maturities of long-term debt includes certain amounts contingently payable, the schedule below has been prepared based on contractual maturities of the debt outstanding at December 31, 2017. Accordingly, if covenants are violated, debt repayments may become more accelerated than presented below (in thousands).

Years Ending	Amount
2018	\$ 96,350
2019	17,146
2020	17,862
2021	17,282
2022	24,797
Thereafter	809,334
Total	<u>\$ 982,771</u>

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 10 - Derivatives

In 2004, the System entered into a forward starting interest rate swap agreement with an outstanding notional amount of \$62,500,000. The swap originally effectively converted a portion of the Series 2005A auction rate securities to a synthetic fixed rate of 3.643 percent. The swap converts \$62,500,000 of the Series 2017F debt to synthetic fixed and has an expiration date of November 15, 2034. This variable-to-fixed swap arrangement is not designated as a hedge.

The System also had an interest rate swap agreement, not designated as a hedge, which was terminated in 2017 and had an outstanding notional amount of \$3,215,000 as of December 31, 2016. The interest rate swap was scheduled to mature on January 1, 2019. During the term of the agreement, the swap in effect converted variable rate debt to fixed rate debt. The agreement entitled Toledo, on a monthly basis, to pay a fixed rate of 5.765 percent, in return for receiving a rate based upon a 30 day commercial paper index (0.73 percent at December 31, 2016).

Any gains or losses recognized on derivatives that are not designated as hedging instruments are recognized in current year earnings.

As of December 31, the fair value of derivatives held and amount recognized in income is as follows (in thousands):

	Fair Value of Derivatives Included in Other Long-term Liabilities	
	2017	2016
Derivatives not designated as hedging instruments:		
\$62,500,000 2017F interest rate swap maturing on November 15, 2034	\$ 17,332	\$ 17,097
\$3,215,000 interest rate swap terminated in 2017	-	178
Total derivatives not designated as hedging instruments	<u>\$ 17,332</u>	<u>\$ 17,275</u>
	Amount of (Loss) Gain Recognized on Derivatives	
	2017	2016
\$62,500,000 2017F interest rate swap maturing on November 15, 2034	\$ (235)	\$ 892
\$3,215,000 interest rate swap terminated in 2017	113	173
Total amount recognized in investment income	<u>\$ (122)</u>	<u>\$ 1,065</u>

Note 11 - Estimated Self-insurance Costs

Certain subsidiaries of the System are self-insured or are insured by Indemnity up to certain amounts for the purpose of providing for workers' compensation, medical malpractice claims, and property coverage. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents. Professional insurance consultants have been retained to determine appropriate funding requirements and medical malpractice and workers' compensation liabilities. The amounts funded have been placed in self-insurance fund accounts, which are reported in assets limited as to use or restricted in the accompanying consolidated balance sheets. The System has recorded a medical malpractice liability of \$38,117,000 and \$31,438,000 at December 31, 2017 and 2016, respectively. The workers' compensation liability was \$7,123,000 and \$6,690,000 in 2017 and 2016, respectively. The recorded liability for workers' compensation and medical malpractice represents anticipated losses stated at their present value. The interest rate assumptions used for medical malpractice and workers' compensation was 4.5 percent in 2017 and 2016.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 11 - Estimated Self-insurance Costs (Continued)

Activity for medical malpractice for the years ended December 31, 2017 and 2016 is summarized as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Gross liability - Beginning of year	\$ 30,878	\$ 27,749
Less reinsurance recoverable	<u>(6,886)</u>	<u>(6,350)</u>
Net liability - Beginning of year	23,992	21,399
Incurred related to:		
Current year	3,140	4,167
Prior years	<u>7,589</u>	<u>2,439</u>
Total incurred	10,729	6,606
Paid related to:		
Current year	8	173
Prior years	<u>4,326</u>	<u>3,841</u>
Total paid	4,334	4,014
Net liability - End of year	30,386	23,992
Plus reinsurance recoverable	<u>10,077</u>	<u>6,886</u>
Gross liability - End of year	<u>\$ 40,463</u>	<u>\$ 30,878</u>

Total incurred per the consolidated statements of operations and changes in net assets includes \$4,629,000 in deposit liability recoupment related to a nonrisk insurance policy.

As a result of changes to estimates for incurred claims and claim adjustment expenses attributable to insured events of prior years, the provision for claims and claim adjustment expenses increased by \$7,589,000 and \$2,439,000 during 2017 and 2016, respectively.

The System is also self-insured for the purpose of providing medical health insurance benefits for certain employees. An accrual of \$13,002,000 and \$14,636,000 has been recorded for claims that have been incurred, but not yet received, at December 31, 2017 and 2016, respectively, and is included in accounts payable and accrued expenses in the consolidated balance sheets.

It is the opinion of management that estimated self-insurance costs accrued as of December 31, 2017 and 2016 are adequate to provide for potential losses resulting from pending or threatened litigation.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 12 - Accrued Claims

PIC contracts with various healthcare providers for the provision of certain medical care related to its members. PIC compensates those providers on a variety of bases, including capitation, fixed fee for service, and discounted charges. Medical expenses include all amounts incurred by PIC under membership contracts with individual members and employer groups. Contracts with providers for medical services are executed between the providers and PIC.

Cost of medical claims represents expenses incurred under contracts with healthcare providers; such costs are charged to expense in the month in which the service is rendered. These expenses include liabilities for incurred and reported claims, and an estimate of incurred, but not reported, claims using past experience adjusted for current trends.

Activity in accrued claims expense for the years ended December 31, 2017 and 2016 is summarized as follows (in thousands):

	2017	2016
Balance - Beginning of year	\$ 92,439	\$ 87,848
Incurred related to:		
Current year	1,024,822	956,941
Prior years	(2,312)	(13,883)
Total incurred	1,022,510	943,058
Paid related to:		
Current year	(963,199)	(867,056)
Prior years	(71,427)	(71,411)
Total paid	(1,034,626)	(938,467)
Purchased through HRI acquisition	1,100	-
Balance - End of year	<u>\$ 81,423</u>	<u>\$ 92,439</u>

PIC estimates the amount of the accrued claims liability costs IBNR in accordance with GAAP and using standard actuarial developmental methodologies based upon historical data, including the period between the date services are rendered and the date claims are received and paid, denied claim activity, expected medical cost inflation, seasonality patterns, and changes in membership, among other things. PIC's IBNR best estimate also includes a provision for adverse deviation, which is an estimate for known environmental factors that are reasonably likely to affect the required level of IBNR reserves. This provision for adverse deviation is intended to capture the potential adverse development from factors, such as changes in current payment patterns versus historical payment patterns, potential unknown high cost cases, increased usage of higher cost services, accelerated utilization of services, and/or exceptional situations that require judgmental adjustments in setting the reserves for claims.

PIC consistently applies the IBNR estimation methodology from period to period. The IBNR best estimate is made on an accrual basis and adjusted in future periods as required. Any adjustments to the prior-period estimates are included in the current period. As additional information becomes known, assumptions are adjusted accordingly to change the estimate of IBNR. The degree of uncertainty in the estimates of incurred claims is greater for the most recent months' incurred services. Revised estimates for prior periods are determined in each year based on the most recent updates of paid claims for prior periods. Estimates for service costs IBNR are subject to the impact of changes in the regulatory environment, economic conditions, changes in claims trends, and numerous other factors. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts estimated. Management believes that the liability for accrued claims expenses is adequate to cover the ultimate net cost of medical expenses.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 13 - Liability for Unpaid Claims and Claim Adjustment Expenses (Continued)

Accident Year	Cumulative Paid Claims and Allocated Claims Adjustment Expenses, Net of Reinsurance, for the Years Ended December 31 (in thousands)		
	2015	2016	2017
2015	\$ 774,082	\$ 845,493	\$ 845,493
2016		867,056	938,483
2017			963,199
Total			<u>\$ 2,747,175</u>
Purchased IBNR from HRI acquisition			<u>\$ 1,100</u>
Total liability for claims and claim adjustment expenses - Net of reinsurance			<u>\$ 81,423</u>

The reconciliation of the net incurred and paid claims development tables to the liability for unpaid claims and claim adjustment expenses in the accompanying consolidated balance sheet is as follows:

	2017
Liability for claims and claim adjustment expenses - Net of reinsurance:	
ProMedica Indemnity Corporation	\$ 30,386
ProMedica Insurance Corporation	<u>81,423</u>
Subtotal	111,809
Reinsurance recoverable on unpaid claims:	
ProMedica Indemnity Corporation	10,077
ProMedica Insurance Corporation	<u>-</u>
Subtotal	<u>10,077</u>
Total gross liability for unpaid claims and claim adjustment expenses	<u>\$ 121,886</u>

The following is supplementary information about average historical claims duration as of December 31, 2017 for ProMedica Indemnity Corporation:

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance									
Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
5.4 %	6.8 %	21.3 %	25.4 %	23.7 %	9.8 %	3.1 %	1.9 %	4.9 %	- %

Note 14 - Pension and Other Postretirement Plans

Noncontributory Defined Benefit Pension Plans (Pension Plans)

The System sponsors a noncontributory qualified defined benefit pension plan, which covers certain full-time and part-time employees of the System. The System makes contributions to the plan required to satisfy the Employee Retirement Income Security Act of 1974 (ERISA) funding standards. The System is not required to make a plan contribution in 2018 and reserves the right to make contributions that exceed ERISA funding standards.

The System froze plan participation effective December 31, 2014 for all plan participants and froze benefit accruals for all plan participants as of December 31, 2016. As a result of the benefit accrual freeze, the System reduced its benefit obligation by \$26,920,000 and recognized a plan curtailment gain of \$15,038,000, which is included in the System's consolidated statement of operations and changes in net assets as of December 31, 2016.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

During 2016, the System offered an early retirement incentive to a specific class of employees who met certain age and service requirements. The special termination benefits included one-time supplemental benefits and pension additions. As a result of this incentive, the System's benefit obligation increased by \$11,247,000, which is included in the System's consolidated balance sheet and consolidated statement of operations and changes in net assets as of December 31, 2016.

The System also sponsors a noncontributory qualified defined benefit pension plan, which covers certain eligible employees of Monroe. Participation in the plan was frozen effective June 30, 2005 and benefit accruals were frozen effective September 30, 2009, which remained in effect through 2017. The System is not required to make a plan contribution in 2018 and reserves the right to make contributions that exceed ERISA funding standards.

The System also participates in a supplemental defined benefit plan (the "supplemental plan") for a small group of retirees. Participation in the supplemental plan and determination of benefits is at the discretion of the System. The pension costs for this plan are not prefunded.

The System also sponsored a noncontributory qualified defined benefit pension plan, which covers certain full-time and part-time employees of St. Luke's Hospital and subsidiaries. As a result of the System's divestiture of St. Luke's Hospital and subsidiaries, the System no longer sponsored the plan and reduced its net pension obligation by \$52,324,000 as of June 30, 2016.

Defined Contribution Benefits

The System sponsors defined contribution pension plans established under Section 401(k) and Section 403(b) of the IRC, which covers certain full-time and part-time employees. Employer contributions are based upon each employee's deferrals and service-based accruals. The pension expense under these plans for 2017 and 2016 was approximately \$35,027,000 and \$21,558,000, respectively.

Deferred Compensation

The System sponsors deferred compensation plans established under Section 457 of the IRC. The System's liability under the plans is primarily funded with assets held in a grantor trust and by an insurance company.

The System has nonqualified deferred compensation plans that permit eligible employees to defer a portion of their compensation. The deferred amounts are distributable in cash based on completion of length of service requirements, retirement, or termination of employment. At December 31, 2017 and 2016, the assets and liabilities under these plans totaled \$41,569,000 and \$38,750,000, respectively.

Postretirement Healthcare Benefit Plans (Other Postretirement Plans)

The System provides certain healthcare benefits for certain retirees. The benefit costs for these plans are not prefunded.

The changes in projected benefit obligations, accumulated postretirement obligations, changes in plan assets, and funded status for both pension and postretirement plans for the years ended December 31, 2017 and 2016 are as follows (in thousands):

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Change in benefit obligation:				
Benefit obligation - Beginning of year	\$ 519,791	\$ 724,710	\$ 1,442	\$ 1,839
Divestiture of St. Luke's	-	(191,586)	-	-
Service cost	2,942	19,004	-	-
Interest cost	18,693	22,008	44	55
Actuarial loss (gain)	4,973	1,233	(194)	(308)
Participant contributions	-	-	27	42
Benefits paid	(49,869)	(39,905)	(142)	(186)
Special termination benefits	-	11,247	-	-
Curtailement	-	(26,920)	-	-
Benefit obligation - End of year	496,530	519,791	1,177	1,442
Change in plan assets:				
Fair value of plan assets - Beginning of year	478,707	597,289	-	-
Divestiture of St. Luke's	-	(139,262)	-	-
Actual return on plan assets	65,018	31,862	-	-
Employer contributions	6,999	28,723	115	144
Participants' contributions	-	-	27	42
Benefits paid	(49,869)	(39,905)	(142)	(186)
Fair value of plan assets - End of year	500,855	478,707	-	-
Funded status	4,325	(41,084)	(1,177)	(1,442)
Net asset (liability) recognized	\$ 4,325	\$ (41,084)	\$ (1,177)	\$ (1,442)

Amounts recognized in the consolidated balance sheets (in thousands):

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Other assets - Long term	\$ 25,326	\$ -	\$ -	\$ -
Other liabilities - Current	(63)	(71)	-	-
Other liabilities - Long term	(20,938)	(41,013)	-	-
Accrued postretirement plans - Current	-	-	(163)	(185)
Accrued postretirement plans - Long term	-	-	(1,014)	(1,257)
Net asset (liability)	4,325	(41,084)	(1,177)	(1,442)
Amounts recognized in unrestricted net assets	108,695	133,922	(1,707)	(1,749)
Net amount recognized	\$ 113,020	\$ 92,838	\$ (2,884)	\$ (3,191)

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

Amounts recognized in unrestricted net assets as of December 31, 2017 and 2016 consist of the following (in thousands):

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Beginning balance	\$ 133,922	\$ 183,219	\$ (1,749)	\$ (1,653)
Recognized in net periodic benefit cost:				
Amortization of net (loss) gain	(1,612)	(8,666)	236	212
Amortization of prior service credit	-	860	-	-
Curtailment	-	(11,882)	-	-
Divestiture of St. Luke's	-	(40,155)	-	-
Net (gain) loss	(23,615)	10,546	(194)	(308)
Ending balance	<u>\$ 108,695</u>	<u>\$ 133,922</u>	<u>\$ (1,707)</u>	<u>\$ (1,749)</u>

Amount included in unrestricted net assets under FASB ASC Topic 715 consists of (in thousands):

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Net actuarial loss (gain)	\$ 108,695	\$ 133,922	\$ (1,707)	\$ (1,749)

Components of net periodic benefit cost for the years ended December 31, 2017 and 2016 consisted of the following (in thousands):

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Service cost	\$ 2,942	\$ 19,004	\$ -	\$ -
Interest cost	18,693	22,008	44	55
Expected return on plan assets	(36,431)	(41,176)	-	-
Amortization of prior service cost	-	(860)	-	-
Recognized net actuarial loss (gain)	1,612	8,666	(236)	(212)
Special termination benefits	-	11,247	-	-
Curtailment	-	(15,038)	-	-
Net benefit (credit) cost	<u>\$ (13,184)</u>	<u>\$ 3,851</u>	<u>\$ (192)</u>	<u>\$ (157)</u>

The estimated amounts to be amortized from unrestricted net assets into net periodic benefit cost during 2018 are as follows (in thousands):

	Pension Plans	Other Postretirement Plans
Net actuarial loss (gain)	\$ 1,637	\$ (234)

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

	Pension Plans		Other Postretirement Plans	
	2017	2016	2017	2016
Benefit obligations:				
Discount rate	3.50%	3.75%-4.00%	3.00%	3.25%
Rate of compensation increase	3.00%	3.00%	N/A	N/A
Net periodic benefit cost:				
Discount rate	3.75%-4.00%	3.00%-4.00%	3.25%	3.00%-3.25%
Expected long-term return on plan assets	7.50%	7.50%	N/A	N/A
Rate of compensation increase	3.00%	3.50%	N/A	N/A

For 2017 and 2016, the System assumed a long-term asset rate of 7.50 percent. In developing the expected long-term rate of return assumption, the System evaluated input from investment advisers, including a review of asset class return expectations based on historical compounded returns for such asset classes.

For the years ended December 31, 2017 and 2016, the total accumulated benefit obligation for all pension and postretirement plans was \$492,800,000 and \$516,070,000, respectively.

Healthcare Trend Rate Postretirement Plans

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the postretirement plans. The postretirement benefit obligation includes assumed healthcare trend rates as follows:

	2017	2016
Healthcare cost trend rate	6.50 %	7.00 %
Ultimate trend rate	5.50 %	5.50 %
Year that the rate reaches the ultimate rate	2020	2020

A 1 percentage point change in assumed healthcare cost trend rates would have the following effects as of December 31, 2017 (in thousands):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total service cost and interest cost components	\$ 4	\$ (4)
Effect on accumulated postretirement benefit obligation	104	(96)

Plan Assets

Assets of the defined benefit plans, which consist primarily of U.S. government and corporate obligations, listed common stocks, and money market funds, are held in a separate trust with investment management provided by various outside managers. The System invests the assets of the plans in a diversified portfolio consisting of an array of asset classes that attempt to maximize returns while minimizing volatility. The System targets to hold two years of beneficiary payments in short-term securities with the balance in a longer-duration allocation.

The System's overall investment strategy is to maximize total return while providing for expected retirement payments over a two-year horizon utilizing a wide diversification of asset types, fund strategies, and fund managers. The target allocations for plan assets are 59 percent equity securities, 35 percent fixed-income securities, and 6 percent real return strategy funds. Equity securities primarily include investments in large-cap and mid-cap companies, located in the United States as well as global and international strategies, and a long-short equity manager. Fixed-income securities include investment grade corporate bonds of companies from diversified industries, and U.S. Treasuries and agencies. Real return strategy funds include all asset mutual funds and a private capital investment.

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

The fair values of the System's pension plan assets at December 31, 2017 and 2016 by major asset classes are as follows (in thousands):

Asset Category	Fair Value Measurements at December 31, 2017			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$ 1,661	\$ 8,137	\$ -	\$ 9,798
U.S. equity securities -				
Marketable equity securities	92,572	-	-	92,572
International equity securities:				
International equity mutual fund	16,071	-	-	16,071
Marketable international securities	49,113	-	-	49,113
Fixed-income securities:				
U.S. Treasuries and agencies	-	61,162	-	61,162
Corporate obligations	-	75,483	-	75,483
Domestic fixed-income mutual funds	57,262	-	-	57,262
International fixed-income mutual funds	10,137	-	-	10,137
Real return strategy funds:				
All asset mutual funds	18,644	-	-	18,644
Private capital	-	-	7,079	7,079
Total investments at fair value	<u>\$ 245,460</u>	<u>\$ 144,782</u>	<u>\$ 7,079</u>	397,321
Investments measured at net asset value:				
International equity commingled fund				75,133
Long-short equity hedge funds				28,401
Total				<u>\$ 500,855</u>

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

Asset Category	Fair Value Measurements at December 31, 2016			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and cash equivalents	\$ 3,979	\$ 15,931	\$ -	\$ 19,910
U.S. equity securities -				
Marketable equity securities	94,444	-	-	94,444
International equity securities:				
International equity mutual fund	18,072	-	-	18,072
Marketable international securities	44,989	-	-	44,989
Fixed-income securities:				
U.S. Treasuries and agencies	-	73,618	-	73,618
Corporate obligations	-	83,094	-	83,094
Domestic fixed-income mutual funds	15,916	-	-	15,916
International fixed-income mutual funds	6,547	-	-	6,547
Real return strategy funds:				
All asset mutual funds	18,188	-	-	18,188
Private capital	-	-	6,783	6,783
Total investments at fair value	<u>\$ 202,135</u>	<u>\$ 172,643</u>	<u>\$ 6,783</u>	381,561
Investments measured at net asset value:				
International equity commingled fund				67,419
Long-short equity hedge funds				29,727
Total				<u>\$ 478,707</u>

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Pension and Other Postretirement Plans (Continued)

Cash Flow

Expected Contributions - The System expects to contribute \$2,463,000 to its pension plans and \$163,000 to its postretirement plans to pay anticipated benefit payments in 2018. The System may elect to make additional contributions

Expected Benefit Payments - The System expects to pay the following for pension benefits, which reflect expected future service, as appropriate, and expected postretirement benefits, net of participant contributions (in thousands):

Years Ending December 31	Pension Plans	Other Postretirement Plans
2018	\$ 26,733	\$ 163
2019	30,630	154
2020	29,800	144
2021	38,487	133
2022	34,349	120
Thereafter	166,696	424

Note 15 - Temporarily and Permanently Restricted Net Assets

As of December 31, 2017 and 2016, temporarily restricted net assets relate to the following (in thousands):

	2017	2016
Research	\$ 16,911	\$ 14,196
Healthcare services	78,439	59,986
Total net assets	<u>\$ 95,350</u>	<u>\$ 74,182</u>

Permanently restricted net assets of \$39,660,000 and \$36,237,000 as of December 31, 2017 and 2016, respectively, relate to investments held in perpetuity, the income from which is expendable to support healthcare services. All endowed assets are included within the permanently restricted net asset class; therefore, no distributions from permanently restricted net assets are permitted in order to maintain the endowed corpus. Certain permanently restricted net asset investments are included with the System's pooled investments, following the same investment policies and objectives.

System Endowment Funds

The System's endowments consist of funds established for a variety of purposes. Its endowments include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The System considers various factors in making a determination to appropriate or accumulate donor-restricted endowment funds. The System employs a diversified investment approach in order to minimize risk and maximize returns, utilizing both intermediate and long-term portfolios. The System's asset allocation objective for the long-term portfolio is to maximize total return while preserving capital values. The short-term portfolio is intended to preserve the principal of the fund and to meet current liquidity requirements.

The System can appropriate each year all available earnings in accordance with donor restrictions. The endowment corpus is to be maintained in perpetuity. Certain donor-restricted endowments require a portion of annual earnings to be maintained in perpetuity along with the corpus. Only amounts exceeding the amounts required to be maintained in perpetuity are expended.

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 15 - Temporarily and Permanently Restricted Net Assets (Continued)

Endowment net asset composition by type of fund as of December 31, 2017 is as follows (in thousands):

	Unrestricted Net Assets	Permanently Restricted Net Assets	Total
Donor-restricted endowment funds	\$ -	\$ 39,120	\$ 39,120
Board-designated quasi-endowment funds	16,582	540	17,122
Total endowment funds	<u>\$ 16,582</u>	<u>\$ 39,660</u>	<u>\$ 56,242</u>

Endowment net asset composition by type of fund as of December 31, 2016 is as follows (in thousands):

	Unrestricted Net Assets	Permanently Restricted Net Assets	Total
Donor-restricted endowment funds	\$ -	\$ 35,697	\$ 35,697
Board-designated quasi-endowment funds	14,632	540	15,172
Total endowment funds	<u>\$ 14,632</u>	<u>\$ 36,237</u>	<u>\$ 50,869</u>

Changes in endowment net assets for the fiscal years ended December 31, 2017 and 2016 are as follows (in thousands):

	Unrestricted Net Assets	Permanently Restricted Net Assets	Total
Endowment net assets - December 31, 2015	\$ 13,970	\$ 35,810	\$ 49,780
Investment income	662	395	1,057
Contributions and transfers - Net	-	32	32
Endowment net assets - December 31, 2016	14,632	36,237	50,869
Investment income	1,975	3,214	5,189
Contributions and transfers - Net	-	209	209
Termination of board designated endowments	(25)	-	(25)
Endowment net assets - December 31, 2017	<u>\$ 16,582</u>	<u>\$ 39,660</u>	<u>\$ 56,242</u>

The endowment amounts classified as permanently restricted net assets as of December 31, 2017 and 2016 are as follows (in thousands):

	2017	2016
Permanently restricted net assets:		
Hospital operations support	\$ 12,719	\$ 11,470
Medical program support	18,890	17,028
Scholarship funds	216	382
Research funds	1,776	1,621
Community service funds	3,903	3,580
Other funds	2,156	2,156
Total endowment funds classified as permanently restricted	<u>\$ 39,660</u>	<u>\$ 36,237</u>

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 15 - Temporarily and Permanently Restricted Net Assets (Continued)

Funds with Deficiencies

Periodically, the fair value of assets associated with the individual donor-restricted endowment funds may fall below the level that the donor requires the System to retain as a fund of perpetual duration. Deficiencies of this nature would be reported in unrestricted net assets. These deficiencies could result from unfavorable market fluctuations and/or continued appropriation for certain programs that were deemed prudent by the System. As of December 31, 2017 and 2016, the System did not have funds with deficiencies.

Pledges Receivable

The System occasionally receives unconditional promises to give with payments due in future periods. Pledges receivable are recorded in assets limited as to use or restricted. As of December 31, 2017 and 2016, the System had pledges receivable of \$22,088,000 and \$10,646,000, respectively, net of an allowance of \$406,000 and \$492,000, respectively, for uncollectibility and discounted at 3.6 percent, with amounts due as follows (in thousands):

Years Receivable	Amount
2018-2019	\$ 15,789
2020-2021	3,257
2022 and thereafter	<u>3,042</u>
Total	<u>\$ 22,088</u>

Note 16 - Income Taxes

Certain entities of the System are for-profit entities and are subject to federal income taxes. The provision for income taxes on income for the years ended December 31, 2017 and 2016 consists of the following (in thousands):

	<u>2017</u>	<u>2016</u>
Current income tax (benefit) expense	\$ (3,877)	\$ 13,221
Deferred income tax expense (benefit)	<u>8,379</u>	<u>(1,625)</u>
Income tax expense	<u>\$ 4,502</u>	<u>\$ 11,596</u>

The actual effective tax rate differs from the federal statutory rate due to certain system entities that are exempt from income tax.

The components of the net deferred tax assets and liabilities as of December 31, 2017 and 2016 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Deferred tax assets and liabilities:		
Reserves and accrued liabilities	\$ (6,091)	\$ 1,965
Unrealized (gain) loss on marketable securities	(348)	253
Depreciation and amortization	<u>(14,213)</u>	<u>(1,219)</u>
Net deferred tax (liability) asset	<u>\$ (20,652)</u>	<u>\$ 999</u>

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 16 - Income Taxes (Continued)

As of December 31, 2017 and 2016, the amounts included in the net deferred tax (liability) asset are classified in the consolidated balance sheets as follows (in thousands):

	2017	2016
Other current assets	\$ -	\$ 1,371
Intangible assets and other	1,299	10
Other liabilities-long-term	(21,951)	(382)

Listed below are the tax years that remain subject to examination by major tax jurisdiction:

United States	2014 - 2017
Ohio	2014 - 2017
Michigan	2013 - 2017
Indiana	2014 - 2017
Kentucky	2014 - 2017

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, reducing the U.S. federal corporate tax rate from 35 percent to 21 percent, eliminating the corporate alternative minimum tax (AMT), and changing the ability to carryforward and carryback certain operating losses.

Note 17 - Functional Expenses

The System provides general healthcare services to residents within its geographic locations, including medical/surgical, pediatric, critical, and emergency care. Total expenses, including depreciation, amortization, and interest, related to providing these services for the years ended December 31, 2017 and 2016 are as follows (in thousands):

	2017	2016
Healthcare services	\$ 2,576,876	\$ 2,583,081
General and administrative	600,398	556,703
Total	\$ 3,177,274	\$ 3,139,784

Note 18 - Fair Value Measurements

The following methods and assumptions were used to estimate fair value of each class of financial instruments in accordance with FASB ASC Topic 820, *Fair Value Measurement*:

Cash Equivalents

The carrying value of cash equivalents approximates fair value as maturities are less than three months. Fair values of cash equivalent instruments that do not trade on a regular basis in active markets are classified as Level 2.

Equity and Fixed-income Securities

The estimated fair values of debt securities are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in the establishing the prices. Fair values of debt securities that do not trade on a regular basis in active markets are classified as Level 2. Fair value estimates for publicly traded equity securities are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices.

Note 18 - Fair Value Measurements (Continued)

Exchange Traded/Mutual Funds

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

Commingled Funds

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

Hedge Funds

Hedge fund utilizes a “fund-of-funds” approach resulting in diversified multistrategy, multimanager investment. Underlying investments in these funds are equity securities. These funds are valued at net asset value, which is calculated using the most recent financial statements.

Real Estate Held for Investment

The estimated fair market value of real estate held for investment is obtained using fair market appraisals.

Derivatives

Fair values of the System’s interest rate swaps are estimated utilizing the terms of the swaps and publicly available market yield curves. Because the swaps are unique and are not actively traded, the fair values are classified as Level 2.

Private Capital

Private capital is invested in discounted loans and structured credit tied to residential and commercial real estate markets in the United States and Europe. Management’s estimates of the fair value of this investment are provided by the third-party administrator and the fund manager/general partner. Management obtains and considers the audited financial statements of this investment when evaluating the overall reasonableness of the fair value. In addition to a review of external information provided, management’s internal procedures include reviews of returns against benchmarks and discussions with fund managers of performance, change in personnel or process, and evaluations of current market conditions for these investments. Investment managers also meet with System management on a periodic basis. Because of the inherent uncertainty, valuations may differ materially from those obtained had an active market existed. The investment is a closed-end fund and has significant redemption restrictions that prohibit redemptions during the fund’s life, which has an initial term of five years with two optional one and one-half year extension options exercisable at the sole discretion of the general partner. As of December 31, 2017 and 2016, unfunded capital commitments totaled \$2,500,000 and \$4,000,000, respectively.

Beneficial Interests in Perpetual Trusts

Beneficial interests in perpetual trusts are valued using the net asset value of the underlying assets multiplied by the System’s percentage share in the applicable trust.

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 18 - Fair Value Measurements (Continued)

The following tables present information about the fair value of the System's financial instruments as of December 31, 2017 and 2016, according to the valuation techniques used by the System. The assets are included in marketable securities and assets limited as to use current and noncurrent (in thousands).

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2017				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2017
Assets				
Cash and cash equivalents	\$ 17,462	\$ 19,902	\$ -	\$ 37,364
U.S. equity securities:				
U.S. equity mutual funds	25,473	-	-	25,473
Marketable equity securities	332,913	-	-	332,913
International equity securities:				
International equity mutual funds	44,025	-	-	44,025
Marketable international equity securities	109,439	-	-	109,439
Fixed-income securities:				
U.S. Treasuries and agencies	-	298,281	-	298,281
Corporate, municipal, and other governmental bonds	-	376,364	-	376,364
Domestic fixed-income mutual funds	78,122	-	-	78,122
International fixed-income mutual funds	35,299	-	-	35,299
Real return strategy funds:				
All asset mutual funds	59,130	-	-	59,130
Private capital	-	-	20,225	20,225
Other	32,956	-	-	32,956
Beneficial interests in perpetual trusts	-	-	32,096	32,096
Domestic real estate	-	-	8,428	8,428
Total	\$ 734,819	\$ 694,547	\$ 60,749	1,490,115
Investments measured at net asset value:				
U.S. equity commingled funds				78,086
International equity commingled funds				224,764
Long-short equity hedge funds				72,920
Total assets limited as to use and marketable securities				<u>\$ 1,865,885</u>
Liabilities				
Derivatives	\$ -	\$ 17,332	\$ -	\$ 17,332

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 18 - Fair Value Measurements (Continued)

	Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2016
Assets				
Cash and cash equivalents	\$ 24,424	\$ 45,879	\$ -	\$ 70,303
U.S. equity securities:				
U.S. equity mutual funds	18,108	-	-	18,108
Marketable equity securities	359,226	-	-	359,226
International equity securities:				
International equity mutual funds	82,311	-	-	82,311
Marketable international equity securities	169,639	-	-	169,639
Fixed-income securities:				
U.S. Treasuries and agencies	-	299,464	-	299,464
Corporate, municipal, and other governmental bonds	-	452,280	-	452,280
Domestic fixed-income mutual funds	74,335	-	-	74,335
International fixed-income mutual funds	22,271	-	-	22,271
Real return funds:				
All asset mutual funds	65,529	-	-	65,529
Private capital	-	-	19,381	19,381
Other	20,584	-	-	20,584
Beneficial interests in perpetual trusts	-	-	28,554	28,554
Domestic real estate	-	-	6,746	6,746
Total	\$ 836,427	\$ 797,623	\$ 54,681	1,688,731
Investments measured at net asset value:				
International equity commingled funds				225,527
Long-short equity hedge funds				113,338
Total assets limited as to use and marketable securities				\$ 2,027,596
Liabilities				
Derivatives	\$ -	\$ 17,275	\$ -	\$ 17,275

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 18 - Fair Value Measurements (Continued)

The following is a summary of the fair value of System investments with a reported NAV per share as of December 31, 2017 and 2016 (in thousands):

	Investments Held at December 31, 2017		
	Fair Value	Redemption Frequency, if Eligible	Redemption Notice Period
U.S. equity commingled funds	\$ 78,086	Monthly	0-5 days
International equity commingled funds	224,764	Daily/monthly	0-6 days
Long-short equity hedge funds	72,920	Monthly/quarterly	60-90 days
Total	<u>\$ 375,770</u>		

	Investments Held at December 31, 2016		
	Fair Value	Redemption Frequency, if Eligible	Redemption Notice Period
International equity commingled funds	\$ 225,527	Daily/monthly	0-6 days
Long-short equity hedge funds	113,338	Monthly/quarterly	60-90 days
Total	<u>\$ 338,865</u>		

U.S. Equity Commingled Funds - Composed of shares or units in commingled funds that are not publicly traded. Underlying assets in these funds include publicly traded options that are valued at their NAV calculated by the fund manager.

International Equity Commingled Funds - Composed of shares or units in commingled funds that are not publicly traded. Underlying assets in these funds primarily include publicly traded equity securities that are valued at their NAV calculated by the fund manager and have daily liquidity.

Long-short Equity Hedge Funds - Composed of investments in a hedge fund that invest both in long and short U.S. and international equities. Management of the hedge fund has the ability to shift investments from value-to-growth strategies, from small-to-large capitalization stocks, and from a net long position to a net short position. The fair value of investments in this class has been estimated using the NAV per share of the investments.

There are no unfunded commitments of System investments with a reported NAV per share.

The System's policy is to recognize transfers between all levels as of the beginning of the reporting period. The following table summarizes the changes in Level 3 assets for the years ended December 31, 2017 and 2016 (in thousands):

	2017	2016
Balance - Beginning of year	\$ 54,681	\$ 53,963
Unrealized gain on market value adjustment - Recognized investment income	4,386	653
Sales	(257)	(4,116)
Purchases	1,939	4,181
Total	<u>\$ 60,749</u>	<u>\$ 54,681</u>

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 19 - Commitments and Contingencies

Operating Leases

The System leases various equipment and facilities under operating leases. Total rental expense in 2017 and 2016 for all operating leases was approximately \$20,409,000 and \$22,322,000, respectively.

The following is a schedule by year of future minimum lease payments under operating leases as of December 31, 2017 that have initial or remaining lease terms in excess of one year (in thousands):

Years Ending December 31	Amount
2018	\$ 13,657
2019	8,643
2020	5,139
2021	3,375
2022	2,551
Thereafter	7,125
Total	<u>\$ 40,490</u>

Litigation

The System is involved in litigation and regulatory investigations arising in the course of business. Based in part on consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on the System's consolidated financial position or results of operations.

Note 20 - Asset Retirement Obligations

FASB ASC Topic 410, *Asset Retirement and Environmental Obligations*, requires that the fair value of the liability for an asset retirement obligation be recognized in the period in which it is incurred and the settlement date is estimable and capitalized as part of the carrying amount of the related tangible long-lived asset. The liability is recorded at fair value, and the capitalized cost is depreciated over the remaining useful life of the related asset.

The System has determined it has legal obligations to perform certain asset retirement activities associated with planned and estimated demolition and remediation at various hospitals, long-term care facilities, medical office buildings, and other facilities. During 2017 and 2016, changes to the asset retirement obligation are as follows (in thousands):

	2017	2016
Balance - January 1	\$ 24,081	\$ 19,064
Additions	400	6,298
Accretion expense	521	296
Divestiture of St. Luke's Hospital	-	(1,297)
Settlements	(696)	(280)
Balance - December 31	<u>\$ 24,306</u>	<u>\$ 24,081</u>

ProMedica Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 21 - Leasing Revenue Activity

The System leases space to tenants under various operating lease agreements. These agreements, without giving effect to renewal options, have expiration dates ranging from 2017 to 2032. The rental revenue for the years ended December 31, 2017 and 2016 was \$6,843,000 and \$7,213,000, respectively. As of December 31, 2017, the aggregate future minimum base rental payments to the System under noncancelable operating leases by year are as follows (in thousands):

<u>Years Ending</u>	<u>Amount</u>
2018	\$ 5,833
2019	4,849
2020	4,133
2021	3,337
2022	1,666
Thereafter	<u>5,486</u>
Total	<u>\$ 25,304</u>

Note 22 - Investments in Affiliated Companies

The summarized financial position and results of operations for the entities accounted for under the equity method as of and for the years ended December 31 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Total assets	\$ 303,905	\$ 303,098
Total liabilities	105,941	121,710
Net assets	197,964	181,388
Revenue - Net	258,294	236,807
Net Income	6,153	7,211

Included in the table above is the System's investment in Lima Memorial Hospital that represents approximately 59 percent and 66 percent of the total equity method investments as of December 31, 2017 and 2016, respectively. Lima Memorial Hospital operates as a not-for-profit hospital.

Note 23 - Business Combinations

Acquisition of Health Resources, Inc. (HRI)

On December 29, 2017, ProMedica Insurance Corporation acquired HRI through a stock acquisition. HRI, headquartered in Evansville, Indiana, offers dental benefit programs to employer groups located in Indiana and Kentucky. PIC recorded the purchase as an acquisition and paid total consideration of \$86,200,000. PIC recorded amortizable intangible assets of \$38,300,000 and an indefinite-lived intangible asset of \$12,400,000 in its consolidated balance sheet. PIC also recorded goodwill of \$28,000,000 for the excess of total consideration paid over the fair value of the identifiable acquisition-date net assets. HRI is included in PIC's consolidated balance sheet at December 31, 2017.

Divestiture of St. Luke's Hospital

Effective July 1, 2016, the System deconsolidated St. Luke's Hospital (SLH) and related subsidiaries pursuant to a divestiture order issued by the Federal Trade Commission.

The System was the sole member or parent of the sole member of SLH and related subsidiaries before the divestiture, but did not retain any ownership interest after the divestiture. Pursuant to the divestiture order, the System is required to provide transitional systems support for supply chain, accounting, accounts payable, revenue cycle, and lab services through June 30, 2017 and information technology systems support through December 31, 2017.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 23 - Business Combinations (Continued)

As a result of the divestiture, a loss of \$123,168,000 was recorded in unrestricted net assets and a loss of \$1,291,000 was recorded in temporarily restricted net assets within the consolidated statements of operations and changes in net assets as of December 31, 2016. The amounts recognized represent the carrying value of the consolidated net assets of St. Luke’s Hospital and related subsidiaries at June 30, 2016.

The following is St. Luke’s Hospital and subsidiaries financial data:

	Six Months Ended June 30, 2016
St. Luke's Hospital and related subsidiaries (in thousands):	
Total unrestricted revenue, gains, and other support	\$ 94,996
Excess of expenses over revenue	(1,291)
Total assets	251,804
Total liabilities	127,345
Net assets	124,459

Note 24 - University of Toledo College of Medicine and Life Sciences Affiliation

ProMedica and the University of Toledo are partners in a 50-year Academic Affiliation Agreement (the “Agreement”) to support the academic programs of the College of Medicine and Life Sciences (including research, education of medical students, and residency programs) which is anticipated to develop Toledo Hospital and Toledo Children’s Hospital into a premier academic medical center and preeminent quaternary center.

The Agreement includes a financial commitment by ProMedica to provide academic support to The University of Toledo through payments for certain defined services, research, branding rights, and other related services for value and benefits to ProMedica. ProMedica made initial payments totaling \$40 million over the three-year period ending in 2017, which have been deferred and are being expensed over 30 years to match the estimated years of benefit realization. In addition, ProMedica incurred transitional payments expense of \$6,250,000 in 2016 and \$16,250,000 in 2017 and is obligated to make payments of \$27,500,000 in 2018; \$40,000,000 in 2019; and \$47,500,000 in 2020. Beginning in 2021 through 2065, annual support payments will be at least \$50,000,000 and calculated based on the aggregate of: (i) 3 percent of base year 2015 net patient service revenue; plus, (ii) 2 percent of the difference in the current year net patient service revenue, excluding net patient service revenue generated from facilities acquired by ProMedica after 2015, and the base year of 2015; plus, (iii) one quarter of 1 percent of net patient service revenue generated in the then-current year from facilities acquired by ProMedica after 2015. The amount of annual support payments will be reassessed every five years, starting in the academic year 2030.

In addition, ProMedica also committed \$250,000,000 to construct and renovate certain lab and teaching space on The University of Toledo and Toledo Hospital campuses, with \$100,000,000 expended by 2027, and the remaining \$150,000,000 expended by 2040.

As of December 31, 2017 and 2016, the carrying amount of the deferred payments is \$38,229,000 and \$32,450,000, respectively, and is included in intangible assets and other.

Management has evaluated the expected future benefits to be received under the Agreement in relation to future payments. It is expected that future payments beyond 2017 will be expensed as incurred and will approximate the annual benefits received.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 25 - Subsequent Events

Management has evaluated all events subsequent to the consolidated balance sheet date of December 31, 2017 through the date the consolidated financial statements were issued and has determined that there are no subsequent events, except as discussed below, that require disclosure under FASB ASC Topic 855, *Subsequent Events*.

Effective January 1, 2018, the System became the sole member of Community Health Center of Branch County (CHC) and Community Health Center Foundation (CHC Foundation). CHC is an 87 bed hospital in Coldwater, Michigan providing medical care and services. Consideration of \$17 million was paid in the acquisition of CHC and CHC Foundation and an inherent contribution was recorded for the excess of fair value of net assets acquired over the consideration paid.

Supplemental Information

Independent Auditor's Report on Supplemental Information

To the Board of Trustees
ProMedica Health System and Subsidiaries

We have audited the consolidated financial statements of ProMedica Health System and Subsidiaries as of and for the year ended December 31, 2017 and have issued our report thereon dated March 27, 2018, which contained an unmodified opinion on those consolidated financial statements. Our audit was performed for the purpose of forming an opinion on the 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Plante & Moran, PLLC

March 27, 2018

ProMedica Health System and Subsidiaries

Consolidating Balance Sheet

December 31, 2017

(in thousands)

	The Toledo Hospital	Flower Hospital	Defiance Hospital, Inc.	Bay Park Community Hospital	Emma L. Bixby Medical Center	Herrick Memorial Hospital, Inc.	Lenawee Long-Term Care	Fostoria Hospital Association	Memorial Hospital	Mercy Memorial Hospital Corporation	ProMedica Continuing Care Services Corp.	Eliminations	Total Obligated Group	Non-obligated Group	Consolidating Adjustments and Eliminations	Consolidated ProMedica Health System and Subsidiaries Total
Assets																
Current Assets																
Cash and cash equivalents	\$ 76,387	\$ 26,489	\$ 149	\$ 2,801	\$ 5,798	\$ 1,514	\$ 4,057	\$ 3,800	\$ 3,894	\$ 6,832	\$ 6,195	\$ -	\$ 137,916	\$ 156,114	\$ -	\$ 294,030
Marketable securities	6,118	-	193	-	-	203	-	-	-	-	-	-	6,514	288,919	-	295,433
Assets limited as to use or restricted	-	-	-	-	-	-	-	-	-	-	-	-	-	4,335	-	4,335
Accounts receivable - Net	153,281	37,310	9,508	11,117	10,746	3,631	1,283	6,367	10,346	19,318	4,726	-	267,633	34,393	(46,554)	255,472
Intercompany accounts receivable	2,592	5,338	1,689	1,001	1,505	597	28	398	680	10,203	18,113	(8,271)	33,873	75,534	(109,407)	-
Estimated third-party payor receivable	3,387	907	205	395	1,083	164	-	137	277	2,852	-	-	9,407	86	-	9,493
Supplies	7,543	3,983	736	1,095	1,363	461	-	1,015	802	1,922	1	-	18,921	7,326	-	26,247
Other current assets	5,689	1,749	165	377	381	49	15	382	616	802	93	-	10,318	141,072	(29,232)	122,158
Total current assets	254,997	75,776	12,645	16,786	20,876	6,619	5,383	12,099	16,615	41,929	29,128	(8,271)	484,582	707,779	(185,193)	1,007,168
Noncurrent Assets Limited as to Use or Restricted - Net of amounts required to meet current obligations																
Restricted funds	1,980	145	-	1	(57)	-	-	-	-	-	-	-	2,069	155,200	(22,259)	135,010
Bond indenture agreement funds	6	1	2	3	-	-	-	-	-	-	-	-	12	-	-	12
Professional liability and workers' compensation insurance funds	-	-	-	-	-	-	-	-	-	-	-	-	-	65,120	-	65,120
Internally designated for capital acquisition	6,918	420,576	243,105	71,301	86,690	51,572	12,502	87,330	35,804	66,135	839	-	1,082,772	28,377	-	1,111,149
Other segregated investments	29,892	-	-	-	56	-	-	-	1,642	53	-	-	31,643	219,683	3,500	254,826
Total noncurrent assets limited as to use or restricted	38,796	420,722	243,107	71,305	86,689	51,572	12,502	87,330	37,446	66,188	839	-	1,116,496	468,380	(18,759)	1,566,117
Property and Equipment - Net	697,955	63,415	34,228	45,702	25,578	14,146	1,240	19,475	38,295	74,305	2,716	-	1,017,055	330,646	(2,655)	1,345,046
Other Assets																
Goodwill	17,958	-	61	-	-	-	-	-	-	-	-	-	18,019	52,058	-	70,077
Pension	-	-	-	-	-	-	-	-	-	-	-	-	-	25,326	-	25,326
Intangible assets and other	155	-	-	-	-	-	-	75	482	1,100	-	-	1,812	116,168	-	117,980
Investments in affiliated companies	5,379	319	-	146	134	-	-	-	298	781	691	-	7,748	2,143,902	(2,066,221)	85,429
Total other assets	23,492	319	61	146	134	-	-	75	780	1,881	691	-	27,579	2,337,454	(2,066,221)	298,812
Total assets	\$1,015,240	\$ 560,232	\$ 290,041	\$ 133,939	\$ 133,277	\$ 72,337	\$ 19,125	\$ 118,979	\$ 93,136	\$ 184,303	\$ 33,374	\$ (8,271)	\$2,645,712	\$3,844,259	\$ (2,272,828)	\$ 4,217,143

ProMedica Health System and Subsidiaries

Consolidating Balance Sheet (Continued)

December 31, 2017

(in thousands)

	The Toledo Hospital	Flower Hospital	Defiance Hospital, Inc.	Bay Park Community Hospital	Emma L. Bixby Medical Center	Herrick Memorial Hospital, Inc.	Lenawee Long-Term Care	Fostoria Hospital Association	Memorial Hospital	Mercy Memorial Hospital Corporation	ProMedica Continuing Care Services Corp.	Eliminations	Total Obligated Group	Non-obligated Group	Consolidating Adjustments and Eliminations	Consolidated ProMedica Health System and Subsidiaries Total
Liabilities and Net Assets																
Current Liabilities																
Accounts payable and accrued expenses	\$ 60,079	\$ 17,657	\$ 3,460	\$ 2,829	\$ 3,526	\$ 146	\$ 247	\$ 1,415	\$ 3,902	\$ 5,248	\$ 3,563	\$ -	\$ 102,072	\$ 122,723	\$ (17,292)	\$ 207,503
Intercompany accounts payable	33,060	5,643	1,095	1,905	2,288	1,334	334	1,127	2,106	5,141	1,847	(8,271)	47,609	61,796	(109,405)	-
Contractual current installments of long-term debt	88,138	728	1,173	1,444	463	119	8	76	514	2,516	1	-	95,180	1,170	-	96,350
Contingent current installments of long-term debt	301,975	28,443	15,917	26,041	9,412	13,058	2,343	10,659	-	32,967	2,229	-	443,044	14,365	-	457,409
Estimated third-party payor settlements	7,040	1,806	3,387	491	3,714	2,594	572	1,699	850	5,843	208	-	28,204	319	-	28,523
Accrued liabilities and other:																
Compensation and benefits	24,499	7,054	1,728	2,000	3,900	740	424	837	1,350	4,615	2,643	-	49,790	88,834	-	138,624
Professional liability and workers' compensation	-	-	-	-	-	-	215	-	138	-	-	-	353	7,000	-	7,353
Postretirement plans	91	-	-	-	34	38	-	-	-	-	-	-	163	-	-	163
Claims expense	-	-	-	-	-	(1)	-	-	-	-	-	-	(1)	127,978	(46,554)	81,423
Other current liabilities	63	3	-	3	-	-	-	-	-	-	-	-	69	15,373	(11,941)	3,501
Total current liabilities	514,945	61,334	26,760	34,713	23,337	18,028	4,143	15,813	8,860	56,330	10,491	(8,271)	766,483	439,558	(185,192)	1,020,849
Long-term Debt - Less current installments	344,434	8,616	19,524	25,718	1,424	311	11	275	25,197	-	22	-	425,532	3,480	-	429,012
Other Liabilities																
Accrued professional liability and workers' compensation - Less current portion	-	-	-	-	191	130	-	-	-	181	-	-	502	48,642	-	49,144
Deferred compensation	4,278	-	-	-	-	-	-	-	-	-	-	-	4,278	37,291	-	41,569
Pension	320	-	-	-	-	-	-	-	-	20,618	-	-	20,938	-	-	20,938
Accrued postretirement plans - Less current portion	620	-	-	-	113	281	-	-	-	-	-	-	1,014	-	-	1,014
Other	23,346	2,538	407	493	1,422	941	196	1,925	2,226	1,626	791	-	35,911	30,262	-	66,173
Total other liabilities	28,564	2,538	407	493	1,726	1,352	196	1,925	2,226	22,425	791	-	62,643	116,195	-	178,838
Total liabilities	887,943	72,488	46,691	60,924	26,487	19,691	4,350	18,013	36,283	78,755	11,304	(8,271)	1,254,658	559,233	(185,192)	1,628,699

ProMedica Health System and Subsidiaries

Consolidating Balance Sheet (Continued)

December 31, 2017

(in thousands)

	The Toledo Hospital	Flower Hospital	Defiance Hospital, Inc.	Bay Park Community Hospital	Emma L. Bixby Medical Center	Herrick Memorial Hospital, Inc.	Lenawee Long-Term Care	Fostoria Hospital Association	Memorial Hospital	Mercy Memorial Hospital Corporation	ProMedica Continuing Care Services Corp.	Eliminations	Total Obligated Group	Non-obligated Group	Consolidating Adjustments and Eliminations	Consolidated ProMedica Health System and Subsidiaries Total
Net Assets																
Unrestricted:																
Controlling interest	\$ 125,317	\$ 487,599	\$ 243,350	\$ 73,014	\$ 106,847	\$ 52,646	\$ 14,775	\$ 100,966	\$ 56,853	\$ 105,548	\$ 22,070	\$ -	\$ 1,388,985	\$ 3,124,221	\$ (2,068,876)	\$ 2,444,330
Noncontrolling interest	-	-	-	-	-	-	-	-	-	-	-	-	-	9,104	-	9,104
Total unrestricted	125,317	487,599	243,350	73,014	106,847	52,646	14,775	100,966	56,853	105,548	22,070	-	1,388,985	3,133,325	(2,068,876)	2,453,434
Temporarily restricted	1,980	145	-	1	(57)	-	-	-	-	-	-	-	2,069	112,040	(18,759)	95,350
Permanently restricted	-	-	-	-	-	-	-	-	-	-	-	-	-	39,661	(1)	39,660
Total net assets	127,297	487,744	243,350	73,015	106,790	52,646	14,775	100,966	56,853	105,548	22,070	-	1,391,054	3,285,026	(2,087,636)	2,588,444
Total liabilities and net assets	<u>\$1,015,240</u>	<u>\$ 560,232</u>	<u>\$ 290,041</u>	<u>\$ 133,939</u>	<u>\$ 133,277</u>	<u>\$ 72,337</u>	<u>\$ 19,125</u>	<u>\$ 118,979</u>	<u>\$ 93,136</u>	<u>\$ 184,303</u>	<u>\$ 33,374</u>	<u>\$ (8,271)</u>	<u>\$2,645,712</u>	<u>\$3,844,259</u>	<u>\$ (2,272,828)</u>	<u>\$ 4,217,143</u>

ProMedica Health System and Subsidiaries

Consolidating Statement of Operations and Changes in Unrestricted Net Assets

Year Ended December 31, 2017
(in thousands)

	The Toledo Hospital	Flower Hospital	Defiance Hospital, Inc.	Bay Park Community Hospital	Emma L. Bixby Medical Center	Herrick Memorial Hospital, Inc.	Lenawee Long-Term Care	Fostoria Hospital Association	Memorial Hospital	Mercy Memorial Hospital Corporation	ProMedica Continuing Care Services Corp.	Eliminations	Total Obligated Group	Non-obligated Group	Consolidating Adjustments and Eliminations	Consolidated ProMedica Health System and Subsidiaries Total
Unrestricted Revenue, Gains, and Other Support																
Patient service revenue - Net of contractual and other allowances	\$ 818,126	\$ 239,720	\$ 67,879	\$ 82,341	\$ 91,771	\$ 27,366	\$ 11,086	\$ 38,790	\$ 63,174	\$ 132,219	\$ 35,072	\$ (17,967)	\$ 1,589,577	\$ 338,290	\$ (272,409)	\$ 1,655,458
Provision for bad debts	(38,282)	(10,532)	(4,375)	(5,949)	(6,315)	(1,983)	(366)	(2,474)	(4,049)	(7,162)	(23)	-	(81,510)	(14,723)	-	(96,233)
Net patient service revenue, less provision for bad debts	779,844	229,188	63,504	76,392	85,456	25,383	10,720	36,316	59,125	125,057	35,049	(17,967)	1,508,067	323,567	(272,409)	1,559,225
Premium revenue	-	-	-	-	-	-	-	-	-	-	-	-	-	1,520,382	(5,237)	1,515,145
Other	19,027	4,555	657	491	2,285	249	7	2,989	1,897	6,246	185	(4,351)	34,237	47,460	(16,880)	64,817
Net assets released for use in operations	7,125	465	59	74	107	241	-	23	91	115	753	-	9,053	14,837	(12,597)	11,293
Total unrestricted revenue, gains, and other support	805,996	234,208	64,220	76,957	87,848	25,873	10,727	39,328	61,113	131,418	35,987	(22,318)	1,551,357	1,906,246	(307,123)	3,150,480
Expenses																
Salaries, wages, and employee benefits	289,536	80,714	19,072	27,973	33,028	8,062	6,508	11,315	18,640	60,784	30,316	(22,318)	563,630	543,338	(38,946)	1,068,022
Food and drugs	56,873	36,385	3,956	3,707	4,248	679	758	4,936	4,942	12,478	1,581	-	130,543	60,181	-	190,724
Medical expenses	-	-	-	-	-	-	-	-	-	-	-	-	-	1,245,274	(241,215)	1,004,059
Contracted fees	69,438	17,391	6,544	5,225	8,376	4,968	379	3,609	8,396	16,055	1,269	-	141,650	162,098	-	303,748
Supplies	119,287	15,828	4,546	9,062	7,872	1,214	295	2,300	4,062	11,723	1,110	-	177,299	20,950	(111)	198,138
Insurance	5,946	1,636	506	686	1,011	568	-	276	453	1,754	432	-	13,268	14,053	(11,478)	15,843
Utilities	7,622	2,150	780	888	1,207	529	136	654	1,120	1,786	241	-	17,113	8,903	-	26,016
Other	175,581	44,629	13,256	18,122	23,205	9,452	1,770	8,147	15,894	37,167	(792)	-	346,431	(140,954)	(73)	205,404
Total expenses	724,283	198,733	48,660	65,663	78,947	25,472	9,846	31,237	53,507	141,747	34,157	(22,318)	1,389,934	1,913,843	(291,823)	3,011,954
Operating Income (Loss) Before Depreciation and Amortization Expense	81,713	35,475	15,560	11,294	8,901	401	881	8,091	7,606	(10,329)	1,830	-	161,423	(7,597)	(15,300)	138,526
Depreciation and Amortization	50,000	9,684	3,884	4,686	2,991	1,815	191	2,121	5,149	9,506	418	-	90,445	40,497	(45)	130,897
Operating Income (Loss)	31,713	25,791	11,676	6,608	5,910	(1,414)	690	5,970	2,457	(19,835)	1,412	-	70,978	(48,094)	(15,255)	7,629
Other (Loss) Income																
Interest expense	(19,244)	(1,757)	(1,609)	(2,396)	(382)	(708)	(126)	(536)	(1,199)	(599)	(116)	-	(28,672)	(5,803)	52	(34,423)
Investment income	16,645	60,538	31,098	8,619	9,903	5,871	1,048	9,893	2,035	9,908	13	-	155,571	56,161	(945)	210,787
Income tax expense	-	-	-	-	-	-	-	-	-	-	-	-	-	(4,502)	-	(4,502)
Loss on extinguishment of debt	(28,041)	(2,523)	(1,272)	(2,507)	(1,176)	(2,071)	(384)	(1,165)	-	-	(226)	-	(39,365)	-	-	(39,365)
Other	1,612	677	48	122	(11)	-	1	(68)	(138)	10	324	-	2,577	31,500	(24,593)	9,484

ProMedica Health System and Subsidiaries

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

Year Ended December 31, 2017

(in thousands)

	The Toledo Hospital	Flower Hospital	Defiance Hospital, Inc.	Bay Park Community Hospital	Emma L. Bixby Medical Center	Herrick Memorial Hospital, Inc.	Lenawee Long-Term Care	Fostoria Hospital Association	Memorial Hospital	Mercy Memorial Hospital Corporation	ProMedica Continuing Care Services Corp.	Eliminations	Total Obligated Group	Non-obligated Group	Consolidating Adjustments and Eliminations	Consolidated ProMedica Health System and Subsidiaries Total
Total other (loss) income - Net	\$ (29,028)	\$ 56,935	\$ 28,265	\$ 3,838	\$ 8,334	\$ 3,092	\$ 539	\$ 8,124	\$ 698	\$ 9,319	\$ (5)	\$ -	\$ 90,111	\$ 77,356	\$ (25,486)	\$ 141,981
Excess of Revenue Over (Under) Expenses Before Unusual Items	2,685	82,726	39,941	10,446	14,244	1,678	1,229	14,094	3,155	(10,516)	1,407	-	161,089	29,262	(40,741)	149,610
Restructuring and Severance Costs	-	-	-	-	-	-	-	-	-	-	-	-	-	(15,085)	-	(15,085)
Excess of Revenue Over (Under) Expense	2,685	82,726	39,941	10,446	14,244	1,678	1,229	14,094	3,155	(10,516)	1,407	-	161,089	14,177	(40,741)	134,525
Transfer (to) from Affiliate	(140,594)	(84,793)	(5,449)	(5,233)	(6,926)	(3,957)	-	(1,072)	4,865	12,143	18,538	-	(212,478)	195,353	17,125	-
Net Assets Released from Restriction for Fixed Assets	8,572	1,062	598	27	1,308	192	-	47	224	81	11	-	12,122	123	(4,528)	7,717
Noncontrolling Interest in Consolidated Subsidiaries	-	-	-	-	-	-	-	-	-	-	-	-	-	(87)	-	(87)
Distributions to Noncontrolling Interests	-	-	-	-	-	-	-	-	-	-	-	-	-	(855)	-	(855)
Pension and Other Postretirement Adjustments	(105)	-	-	-	21	56	-	-	-	(857)	-	-	(885)	26,069	-	25,184
(Decrease) Increase in Unrestricted Net Assets	\$ (129,442)	\$ (1,005)	\$ 35,090	\$ 5,240	\$ 8,647	\$ (2,031)	\$ 1,229	\$ 13,069	\$ 8,244	\$ 851	\$ 19,956	\$ -	\$ (40,152)	\$ 234,780	\$ (28,144)	\$ 166,484