



ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Financial Statements
and Supplementary Schedules

December 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

ST. CHARLES HEALTH SYSTEM, INC.

Table of Contents

| | Page |
|--|-------------|
| Independent Auditors' Report | 1 |
| Consolidated Balance Sheets | 3 |
| Consolidated Statements of Operations | 4 |
| Consolidated Statements of Changes in Net Assets | 5 |
| Consolidated Statements of Cash Flows | 6 |
| Notes to Consolidated Financial Statements | 7 |
| Supplementary Schedules | |
| I Balance Sheet Information | 31 |
| II Statement of Operations Information | 32 |



KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
St. Charles Health System, Inc.:

We have audited the accompanying consolidated financial statements of St. Charles Health System, Inc., which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' 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 auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of St. Charles Health System, Inc. as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information included in schedules I and II is presented for purposes of additional analysis 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.

KPMG LLP

Portland, Oregon
March 28, 2018

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Balance Sheets

December 31, 2017 and 2016

| Assets | 2017 | 2016 |
|---|--------------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| Current assets: | | |
| Cash and cash equivalents | \$ 59,891,000 | 57,259,000 |
| Assets limited as to use, current portion | 4,302,000 | 3,321,000 |
| Patient accounts receivable, net of reserves for doubtful accounts of \$43,705,000 and \$35,707,000 at December 31, 2017 and 2016, respectively | 87,232,000 | 92,069,000 |
| Other receivables, net | 25,329,000 | 15,034,000 |
| Supplies inventory | 14,709,000 | 13,829,000 |
| Prepaid expenses and other current assets | <u>8,760,000</u> | <u>10,350,000</u> |
| Total current assets | 200,223,000 | 191,862,000 |
| Assets limited as to use, net of current portion | 542,179,000 | 490,354,000 |
| Property and equipment, net | 334,195,000 | 302,343,000 |
| Other assets | <u>3,040,000</u> | <u>3,661,000</u> |
| Total assets | \$ <u><u>1,079,637,000</u></u> | \$ <u><u>988,220,000</u></u> |
| Liabilities and Net Assets | | |
| Current liabilities: | | |
| Accounts payable | \$ 45,213,000 | 33,626,000 |
| Accrued liabilities | 57,444,000 | 53,913,000 |
| Estimated third-party payor settlements payable, net | 3,627,000 | 2,382,000 |
| Deferred revenue | 1,351,000 | 398,000 |
| Long-term obligations, current portion | <u>3,188,000</u> | <u>4,596,000</u> |
| Total current liabilities | 110,823,000 | 94,915,000 |
| Long-term obligations, net of current portion | 295,222,000 | 299,105,000 |
| Other liabilities | <u>14,658,000</u> | <u>11,851,000</u> |
| Total liabilities | <u>420,703,000</u> | <u>405,871,000</u> |
| Net assets: | | |
| Unrestricted, SCHS | 646,867,000 | 571,777,000 |
| Unrestricted, noncontrolling interests | 4,856,000 | 4,952,000 |
| Temporarily restricted | 5,672,000 | 4,118,000 |
| Permanently restricted | <u>1,539,000</u> | <u>1,502,000</u> |
| Total net assets | <u>658,934,000</u> | <u>582,349,000</u> |
| Total liabilities and net assets | \$ <u><u>1,079,637,000</u></u> | \$ <u><u>988,220,000</u></u> |

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Operations

Years ended December 31, 2017 and 2016

| | <u>2017</u> | <u>2016</u> |
|--|----------------------|--------------------|
| Operating revenues: | | |
| Net patient service revenue prior to provision for bad debts | \$ 655,121,000 | 640,492,000 |
| Provision for bad debts | <u>5,874,000</u> | <u>15,656,000</u> |
| Net patient service revenue | 649,247,000 | 624,836,000 |
| Premium revenue | 57,278,000 | 60,903,000 |
| Other revenue | <u>42,374,000</u> | <u>38,342,000</u> |
| Total operating revenues | <u>748,899,000</u> | <u>724,081,000</u> |
| Expenses: | | |
| Salaries and wages | 334,169,000 | 312,678,000 |
| Employee benefits | 92,981,000 | 84,752,000 |
| Professional fees and assessments | 44,657,000 | 43,471,000 |
| Depreciation and amortization | 35,242,000 | 34,319,000 |
| Interest | 6,792,000 | 7,242,000 |
| Medical supplies, drugs, and other | <u>211,133,000</u> | <u>204,125,000</u> |
| Total expenses | <u>724,974,000</u> | <u>686,587,000</u> |
| Excess of revenues over expenses from operations | <u>23,925,000</u> | <u>37,494,000</u> |
| Other income: | | |
| Investment income, net | 56,407,000 | 24,493,000 |
| Loss on extinguishment of 2005B Bonds | — | (3,214,000) |
| Other, net | <u>2,218,000</u> | <u>(740,000)</u> |
| Total other income, net | <u>58,625,000</u> | <u>20,539,000</u> |
| Excess of revenue over expenses | 82,550,000 | 58,033,000 |
| Net assets released from restriction for capital | 948,000 | 873,000 |
| Other transfers | (5,000) | (14,000) |
| Distributions to noncontrolling interests | <u>(8,499,000)</u> | <u>(6,869,000)</u> |
| Increase in unrestricted net assets | \$ <u>74,994,000</u> | <u>52,023,000</u> |

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Changes in Net Assets

Years ended December 31, 2017 and 2016

| | <u>Unrestricted – SCHS</u> | <u>Unrestricted – noncontrolling interests</u> | <u>Temporarily restricted</u> | <u>Permanently restricted</u> | <u>Total</u> |
|--------------------------------------|--------------------------------|--|-----------------------------------|-----------------------------------|--------------------|
| Net assets at December 31, 2015 | \$ 520,042,000 | 4,664,000 | 4,222,000 | 1,505,000 | 530,433,000 |
| Excess of revenue over expenses | 50,876,000 | 7,157,000 | — | — | 58,033,000 |
| Restricted contributions | — | — | 888,000 | — | 888,000 |
| Net assets released from restriction | 873,000 | — | (1,623,000) | — | (750,000) |
| Other transfers | (310,000) | — | 310,000 | — | — |
| Distributions | — | (6,869,000) | — | — | (6,869,000) |
| Other changes in net assets | 296,000 | — | 321,000 | (3,000) | 614,000 |
| Change in net assets | <u>51,735,000</u> | <u>288,000</u> | <u>(104,000)</u> | <u>(3,000)</u> | <u>51,916,000</u> |
| Net assets at December 31, 2016 | <u>571,777,000</u> | <u>4,952,000</u> | <u>4,118,000</u> | <u>1,502,000</u> | <u>582,349,000</u> |
| Excess of revenue over expenses | 74,147,000 | 8,403,000 | — | — | 82,550,000 |
| Restricted contributions | — | — | 2,933,000 | — | 2,933,000 |
| Net assets released from restriction | 948,000 | — | (1,559,000) | — | (611,000) |
| Other transfers | (5,000) | — | 5,000 | — | — |
| Distributions | — | (8,499,000) | — | — | (8,499,000) |
| Other changes in net assets | — | — | 175,000 | 37,000 | 212,000 |
| Change in net assets | <u>75,090,000</u> | <u>(96,000)</u> | <u>1,554,000</u> | <u>37,000</u> | <u>76,585,000</u> |
| Net assets at December 31, 2017 | <u>\$ 646,867,000</u> | <u>4,856,000</u> | <u>5,672,000</u> | <u>1,539,000</u> | <u>658,934,000</u> |

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2017 and 2016

| | <u>2017</u> | <u>2016</u> |
|---|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Increase in net assets | \$ 76,585,000 | 51,916,000 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Depreciation and amortization | 35,242,000 | 34,319,000 |
| Net gain on investments | (41,804,000) | (13,090,000) |
| Loss on sale of property and equipment | 652,000 | 331,000 |
| Amortization and accretion of debt obligation | (484,000) | 287,000 |
| Loss from extinguishment of debt | — | 3,214,000 |
| Restricted contributions | (2,933,000) | (506,000) |
| Distributions to noncontrolling interests | 8,499,000 | 6,869,000 |
| Changes in certain operating assets and liabilities: | | |
| Patient accounts receivable, net | 4,837,000 | (4,835,000) |
| Other receivables, net | (10,295,000) | 2,955,000 |
| Supplies inventory | (880,000) | (2,365,000) |
| Other assets | (2,146,000) | (489,000) |
| Accounts payable | 15,220,000 | 7,454,000 |
| Accrued liabilities | 3,531,000 | 3,216,000 |
| Estimated third-party payor settlements payable, net | 1,245,000 | 1,371,000 |
| Deferred revenue | 953,000 | 243,000 |
| Other liabilities | 2,807,000 | (53,000) |
| Net cash provided by operating activities | <u>91,029,000</u> | <u>90,837,000</u> |
| Cash flows from investing activities: | | |
| Purchases of investments | (41,379,000) | (155,682,000) |
| Proceeds from sales and maturities of investments | 30,377,000 | 47,126,000 |
| Distributions received from joint ventures | 4,357,000 | 4,366,000 |
| Investment in joint ventures | — | (1,399,000) |
| Purchases of property and equipment | (71,390,000) | (50,121,000) |
| Proceeds from sale of property and equipment | 11,000 | 695,000 |
| Net cash used in investing activities | <u>(78,024,000)</u> | <u>(155,015,000)</u> |
| Cash flows from financing activities: | | |
| Payments on long-term obligations | (6,258,000) | (50,632,000) |
| Proceeds from issuance of long-term obligations | 1,451,000 | 122,636,000 |
| Proceeds from restricted contributions | 2,933,000 | 506,000 |
| Distributions paid to noncontrolling interests | (8,499,000) | (6,869,000) |
| Net cash provided by (used in) financing activities | <u>(10,373,000)</u> | <u>65,641,000</u> |
| Net increase in cash and cash equivalents | 2,632,000 | 1,463,000 |
| Cash and cash equivalents at beginning of year | <u>57,259,000</u> | <u>55,796,000</u> |
| Cash and cash equivalents at end of year | \$ <u>59,891,000</u> | <u>57,259,000</u> |
| Supplemental disclosures: | | |
| Cash paid for interest, net of amounts capitalized | \$ 5,520,000 | 7,425,000 |
| Noncash change in property and equipment in accounts payable | (3,633,000) | (420,000) |

See accompanying notes to consolidated financial statements.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(1) Business, Organization, and Summary of Significant Accounting Policies

(a) Business and Organization

St. Charles Health System, Inc. (SCHS or the Corporation) is an Oregon nonprofit corporation that operates a healthcare delivery system, which includes four hospitals in Central Oregon: St. Charles Bend, St. Charles Redmond, St. Charles Madras, and St. Charles Prineville, as well as several other lines of healthcare-related businesses. SCHS provides healthcare and healthcare-related services primarily to residents in Central, Southeastern, and Eastern Oregon. The Corporation contributes actuarially determined amounts to a self-insurance trust (the Trust) established to fund estimated ultimate losses related to professional liability claims. SCHS is also the sole member of St. Charles Management Services Organization LLC (SCMSO), a limited liability company that previously provided billing services to physicians and medical clinics, but currently has no active business operations. These healthcare businesses and subsidiaries, along with the Corporation's home office, form the obligated group. The assets of any one are available for the satisfaction of debts of the others within the obligated group (subject to certain contractual limitations).

The St. Charles Foundation, Inc. (SCF), an Oregon nonprofit corporation, was established to engage in and conduct charitable, educational, and scientific activities and to raise funds in support of SCHS. The Corporation is the sole member of SCF, and SCF is included in the consolidated financial statements of SCHS but is not a member of the obligated group. The net assets of SCF are reported as unrestricted, temporarily restricted, or permanently restricted, according to donor or legal restrictions, in the accompanying consolidated financial statements.

SCHS also has a controlling interest in Cascade Medical Imaging, LLC (CMI). CMI is a limited liability corporation whose two members are SCHS (70% ownership interest) and Central Oregon Radiology Associates, P.C. (CORA) (30% ownership interest). CMI provides positron emission tomography (PET) scanning, computer-assisted tomography (CT) scanning, nuclear medicine, mammography, and picture archiving and communications system (PACS) services in Central, Southeastern, and Eastern Oregon. CMI has been consolidated into the financial statements of SCHS but is not part of the obligated group.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts and transactions of SCHS, the Trust, SCMSO, SCF, and CMI. All material intercompany accounts and transactions have been eliminated in consolidation.

(c) Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue, income, gains, expenses, and losses during the reporting period. Actual results could differ from those estimates. The significant estimates in the Corporation's consolidated financial statements include accounts receivable allowances, receivables for capitation risk withhold returns, and liabilities related to self-insurance programs.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(d) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and bank deposit money market accounts. Amounts held in demand bank accounts are often in excess of Federal Deposit Insurance Corporation (FDIC) coverage levels.

(e) Assets Limited as to Use

Assets limited as to use primarily consist of assets internally designated for future capital acquisitions and operating purposes (over which SCHS retains control and may, at its discretion, subsequently use for other purposes), assets held by a trustee under bond indenture agreements, assets held in the Trust, assets held in a 457B deferred contribution retirement plan, and temporarily and permanently restricted funds held by SCF. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices in the accompanying consolidated financial statements.

The investment in the Oregon Community Foundation (OCF) represents a beneficial interest in a recipient organization. The investments are used solely to support the endowments of SCHS, and are recorded as a beneficial interest by SCHS in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-20, *Not-for-Profit Entities – Financially Interrelated Entities*, regarding financially interrelated not-for-profit entities. The investments, which represent an endowment fund that is legally owned by the OCF, primarily include equity securities and fixed-income investments. SCHS' investment in the OCF is recorded based on its initial contribution to the OCF, adjusted for changes in the value of the investment portfolio using a method that is similar to the equity method of accounting for investments in common stock. All earnings of the investments held by the OCF, less investment management fees charged by the OCF, are allocated by the OCF and are recorded by SCHS as investment earnings in the consolidated statements of operations, within the appropriate category of net assets based on related donor restrictions. Earnings consist of interest, dividends, realized gains and losses, and changes in unrealized gains and losses. Funds held by the OCF may be distributed once per quarter, subject to approval by the OCF board of directors.

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

Investment income or loss (including interest, dividends, realized gains and losses, and unrealized gains and losses) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law.

Trading securities are debt and equity securities that are bought and held principally for the purpose of selling them in the near term. The Corporation classifies all of its investments in internally designated assets as trading securities, based on the nature of trading activity in its portfolio by the Corporation's investment manager.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

As of December 31, 2017, the Corporation had investments in equity and fixed-income mutual funds, corporate obligations, cash surrender value of life insurance, and an interest in the OCF. Management believes that the Corporation's credit risk with respect to these investments is minimal due to the diversity of the individual investments and the financial strength of the entities, which have issued the securities or instruments. However, due to changes in economic conditions, interest rates, and common stock prices, the fair value of the Corporation's investments can be volatile. Consequently, the fair value of the Corporation's investments can significantly change in the near term as a result of such volatility.

(f) *Patient Accounts Receivable, Reserves for Doubtful Accounts, and Other Receivables*

The collection of receivables from third-party payors and patients is SCHS' primary source of cash and is critical to its operating performance. When SCHS provides care to patients, it does not require collateral; however, it maintains an estimated allowance for doubtful accounts. Additionally, SCHS adjusts accounts receivable balances to estimated collectible balances based on the terms of contracts in place with third-party payors. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (generally, deductibles and copayments) remain outstanding. The allowance for doubtful accounts is estimated based upon SCHS' historical collection experience, the age of the patient's account, management's estimate of the patient's economic ability to pay, and the effectiveness of collection efforts. Patient accounts receivable balances are routinely reviewed in conjunction with historical collection rates and other economic conditions that might ultimately affect the collectibility of patient accounts when considering the adequacy of the amounts recorded in the allowance for doubtful accounts. Actual write-offs have historically been within management's expectations. Significant changes in payor mix, business office operations, economic conditions, or trends in federal and state governmental healthcare coverage could affect SCHS' collection of patient accounts receivable, cash flows, and results of operations.

Total bad debt expense, which is a reduction in deriving net patient service revenue, for the years ended December 31, 2017 and 2016 was \$5,874,000 and \$15,656,000, respectively. The Corporation also maintains an allowance for doubtful accounts for third-party payors, which has been determined based on historical bad debt write-offs on those account types.

(g) *Supplies Inventory*

Supplies inventory is recorded at the lower of cost (first-in, first-out method) or net realizable value.

(h) *Property and Equipment*

Property and equipment acquisitions are recorded at cost. Donated property and equipment items are recorded on the basis of estimated fair value at the date of donation. Improvements and replacements of property and equipment are capitalized. Maintenance and repairs are charged to expense as incurred.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Assets under capital lease obligations are amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation expense in the accompanying consolidated financial statements. Net interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Estimated useful lives are as follows:

| | |
|---------------------------------|------------|
| Land improvements | 5–25 years |
| Buildings and fixed equipment | 5–40 years |
| Furniture and movable equipment | 3–20 years |

Contributions of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports expirations of donor restrictions as support when the donated or acquired long-lived assets are placed in service.

(i) Long-Lived Assets

Management reviews property and equipment and other long-term assets, as appropriate, for possible impairment whenever events or circumstances indicate the carrying amount of such assets may not be recoverable. If there is an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposal. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value. In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over the remaining lives.

(j) Contributions and Grants

Unrestricted donations and grants are recorded as other operating revenue. Donor-restricted contributions and grants are recorded as additions to the appropriate class of restricted net assets. When capital expenditures are made consistent with the purpose intended by the donor, a transfer is made from temporarily restricted net assets to unrestricted net assets. If restricted amounts are expended for operations, the amounts are recorded as other revenue in the accompanying consolidated statements of operations.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(k) Other Assets

Other assets include SCHS' investments in various related entities, which are not consolidated. SCHS consolidates such investees if it owns a majority of the investee's stock, is the sole member of the investee, or controls a majority voting interest in the investee's board of directors and has an economic interest in such investee. If SCHS owns 50% or less of the voting stock of an investee and can exercise significant influence over the investee's operating and financial policies (generally presumed to be when SCHS owns more than 20% of the voting stock of the investee), SCHS accounts for such investments under the equity method of accounting, whereby SCHS records its proportionate share of the investee's income or loss in the consolidated statements of operations and records distributions received from the investee as a reduction in the related investment balance. If SCHS cannot exercise significant influence over the investee's operating and financial policies (generally presumed to be when SCHS owns less than 20% of the voting stock of the investee), SCHS accounts for such investments at cost and records dividends or distributions from the investee as other income when received.

(l) Unamortized Bond Premium and Discount

Unamortized bond premium and discount, a component of long-term obligations, is amortized to interest expense over the term of the related bonds using the effective-interest method.

(m) Net Patient Service Revenue and Premium Revenue

SCHS has agreements with third-party payors that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, outpatient case rates, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts due and determined to be collectible from patients, third-party payors, and others for services rendered and includes estimates for potential retroactive revenue adjustments under reimbursement agreements with third-party payors. Such estimates are adjusted in future periods, as final settlements are determined.

Significant concentrations of net patient service revenue prior to bad debt expense, excluding premium revenue, for the years ended December 31, 2017 and 2016 were approximately as follows:

| | <u>2017</u> | <u>2016</u> |
|--|--------------|--------------|
| Medicare and Medicare managed care contracts | 42 % | 40 % |
| Medicaid and Oregon Health Plan (OHP), excluding premium revenue | 9 | 10 |
| Commercial and managed care insurance | 48 | 48 |
| Self-pay | 1 | 2 |
| | <u>100 %</u> | <u>100 %</u> |

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

A significant portion of SCHS' services are provided to Medicare, Medicaid, and Oregon Health Plan (OHP) patients under contractual arrangements. Inpatient acute care services rendered by SCHS to Medicare, Medicaid, and OHP program beneficiaries are generally reimbursed at prospectively determined rates per discharge, except for those paid based on capitated per member per month payment arrangements. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors (i.e., Medicare severity diagnosis-related groups or MS-DRGs). Such payments include a capital cost component and may be greater or less than the actual charges for services. Most outpatient services related to Medicare beneficiaries are reimbursed prospectively under the ambulatory payment classifications methodology. Home health services related to Medicare beneficiaries are reimbursed under a prospective payment system methodology. OHP outpatient services are reimbursed based on a percentage of charges, except for those paid based on capitated per member per month payment arrangements. SCHS is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after audits of SCHS' annual cost reports by the Medicare fiscal intermediary and Medicaid. St. Charles Bend's cost reports have been audited and final settled by the Medicare fiscal intermediary and Medicaid through December 31, 2014. St. Charles Redmond's cost reports have been audited and final settled by the Medicare fiscal intermediary and Medicaid through December 31, 2013.

St. Charles Madras and St. Charles Prineville are "critical access hospitals" (CAH) for Medicare and Medicaid program purposes. As CAHs, St. Charles Madras and St. Charles Prineville cannot operate more than 25 beds, and the average length of stay for acute care patients cannot exceed 96 hours. As CAHs, St. Charles Madras and St. Charles Prineville are reimbursed for Medicare and Medicaid inpatient and outpatient services under a cost-reimbursement methodology. St. Charles Madras' and St. Charles Prineville's cost reports have been audited and final settled by the Medicare fiscal intermediary and Medicaid through December 31, 2015 and 2014 respectively.

The laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that estimated third-party payor settlements payable, net, will change by a material amount in the near term. Net patient service revenue increased by approximately \$1,262,000 and \$1,874,000 for the years ended December 31, 2017 and 2016, respectively, as a result of final settlements of prior years' cost reports and revisions of estimates for prior years' cost report settlements.

SCHS has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations to provide medical services to subscribing participants. The basis for payment to SCHS under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined fee schedules, and certain capitated per member per month payment arrangements. The capitated agreements are limited to services provided at SCHS facilities, and therefore, no unpaid claims liability is necessary. Amounts received under capitated agreements are shown in the consolidated statements of operations as premium revenue.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

The capitated agreement includes a risk withhold that is earned by meeting definitive process and outcome metrics. Certain aspects of these metrics require a claim run-out period and others can be determined before the claim run-out period. SCHS records risk withhold return in the period the unique metrics are realized. During the year ended December 31, 2017 and 2016, \$4,915,000 and \$3,316,000, respectively, were realized as adjustments to premium revenue for amounts withheld in 2016 and 2015, respectively. During 2017 and 2016, SCHS received \$6,047,000 and \$8,652,000, respectively, for risk share payments resulting from quality metric and global healthcare budget performance under the managed Medicaid contract for the premium years ended December 31, 2016 and 2015, respectively. These amounts are included in other revenue on the consolidated statements of operations.

(n) Charity Care

SCHS provides services without charge, or at amounts less than its established rates, to patients who meet the criteria of its charity care policy. SCHS' criteria for the determination of charity care include the patient's, or other responsible party's, annual household income, the number of people in the home and claimed for income tax purposes, assets, existing medical debt obligations, and other indicators of the patient's ability to pay. Generally, those individuals with an annual household income at or less than 300% of the Federal Poverty Guidelines (the Guidelines) qualify for charity care under SCHS' policy. In addition, SCHS provides discounts on a sliding scale to those individuals with an annual household income of between 301% and 400% of the Guidelines. When assistance available under SCHS's policy does not cover 100% of the gross charges for the services, the amounts charged to patients will not be more than amounts generally billed to patients having insurance with Medicare. Since SCHS does not pursue collection of amounts determined to qualify as charity care, those amounts are not reported as net patient service revenue. The cost of the services and supplies furnished under the charity care policy for the years ended December 31, 2017 and 2016, net of subsidies, was approximately \$12,034,000 and \$4,728,000, respectively. The Corporation uses a ratio of cost to charges based on the direct and indirect costs and gross charges of SCHS to estimate the cost of providing this charity care. The cost to charge ratio is developed separately for each facility by using certain analysis tools. The weighted average cost to charge ratio used in this determination was 47.8% and 45.4% for the years ended December 31, 2017 and 2016, respectively. The amount of subsidies received by SCHS for providing charity care for the years ended December 31, 2017 and 2016 was approximately \$523,000 and \$262,000, respectively.

(o) Consolidated Statements of Operations

For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenue and expenses. SCHS' income from investments in healthcare-related joint ventures recorded on the equity method of accounting is reported as other revenue. Peripheral or incidental transactions are reported as other income (loss).

The performance indicator for the accompanying consolidated statements of operations is excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses, consistent with industry practice, include the change in net assets released from restrictions used for purchases of property and equipment, contributions for property and equipment, distributions to noncontrolling interests, and net asset transfers.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(p) State of Oregon Provider Tax

Effective July 1, 2004, the State of Oregon instituted a provider tax on certain qualifying hospitals. SCHS recorded provider taxes of approximately \$27,490,000 and \$26,625,000 for the years ended December 31, 2017 and 2016, respectively, which are included in medical supplies, drugs, and other expense in the accompanying consolidated statements of operations. In addition, SCHS has entered into an agreement with the Oregon Association of Hospitals and Health Systems (OAHHS), which provides that all payments owed to SCHS related to beneficiaries of the Oregon Department of Medical Assistance Program (DMAP) are to be remitted directly to OAHHS. OAHHS aggregates these payments, returning a portion to SCHS. The remaining funds are pooled by OAHHS with like amounts received on behalf of other hospitals subject to the provider tax, and OAHHS redistributes such funds to qualifying hospitals on a quarterly basis. The estimate of the amount of receipts via the quarterly redistribution process from OAHHS for the years ended December 31, 2017 and 2016 matches the annual amounts of taxes paid, which is reflected as a component of net patient service revenue in the accompanying consolidated statements of operations.

(q) Income Taxes

The Corporation has received a determination letter from the Internal Revenue Service (IRS) stating that it is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. It is management's belief that none of its activities have produced material unrelated business income, and that SCHS continues to be operated in a manner that qualifies it for tax-exempt status.

Accounting principles generally accepted in the United States of America require SCHS' management to evaluate tax positions taken by the Corporation and recognize a tax liability (or asset) if the Corporation has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed tax positions taken by the Corporation and has concluded that as of December 31, 2017, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the consolidated financial statements. The Corporation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Corporation's management believes it is no longer subject to income tax examinations for years prior to 2014.

(r) Healthcare Transformation Performance Program (HTPP)

The State of Oregon established a Healthcare Transformation Performance Program (HTPP) in 2013 to advance health system transformation, reduce hospital costs, and improve patient safety. The first year of the program, all diagnosis-related group (DRG) hospitals in Oregon were eligible to earn HTPP payments based on reporting of key quality measures during the year ended September 30, 2014. In 2016 and 2017, payment was determined by improvements in performance against quality measures for the years ended September 30, 2015 and September 30, 2016, respectively. SCHS recorded \$2,470,000 and \$5,836,000 in HTPP revenue in 2017 and 2016, respectively, which were recognized in other revenue in the consolidated statements of operations.

(2) Assets Limited as to Use

The composition of assets limited as to use as of December 31, 2017 and 2016 is set forth in the following table. The following breakout indicates management's methodology for managing its various investment

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

portfolios, which does not necessarily directly follow net asset classification. Investments are carried at fair value.

| | <u>2017</u> | <u>2016</u> |
|--|-----------------------|--------------------|
| Internally designated for capital acquisitions: | | |
| Equity mutual funds | \$ 303,260,000 | 246,894,000 |
| Fixed-income mutual funds | <u>168,020,000</u> | <u>145,757,000</u> |
| Total internally designated for capital acquisitions | <u>471,280,000</u> | <u>392,651,000</u> |
| Internally designated for operating purposes: | | |
| Cash and cash equivalents | 747,000 | 740,000 |
| Equity mutual funds | 6,619,000 | 4,888,000 |
| Fixed-income mutual funds | 1,839,000 | 1,394,000 |
| Cash surrender value of life insurance | <u>363,000</u> | <u>343,000</u> |
| Total internally designated for operating purposes | <u>9,568,000</u> | <u>7,365,000</u> |
| Total internally designated | <u>480,848,000</u> | <u>400,016,000</u> |
| Held by trustee: | | |
| Cash and cash equivalents | 51,327,000 | 80,355,000 |
| Equity mutual funds | 3,376,000 | 2,971,000 |
| Corporate obligations | <u>3,140,000</u> | <u>2,808,000</u> |
| Total held by trustee | 57,843,000 | 86,134,000 |
| Board-designated endowment: | | |
| Investment in Oregon Community Foundation | 2,681,000 | 2,430,000 |
| Donor restricted – temporarily: | | |
| Equity mutual funds | 2,162,000 | 2,238,000 |
| Fixed-income mutual funds | 1,305,000 | 1,334,000 |
| Donor restricted – permanently: | | |
| Investment in Oregon Community Foundation | 879,000 | 797,000 |
| Cash and cash equivalents | 9,000 | 11,000 |
| Equity mutual funds | 431,000 | 374,000 |
| Fixed-income mutual funds | <u>323,000</u> | <u>341,000</u> |
| Total assets limited as to use | 546,481,000 | 493,675,000 |
| Less current portion | <u>(4,302,000)</u> | <u>(3,321,000)</u> |
| Total assets limited as to use, net of current portion | <u>\$ 542,179,000</u> | <u>490,354,000</u> |

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Investment income, net, consisted of the following for the years ended December 31, 2017 and 2016:

| | <u>2017</u> | <u>2016</u> |
|---|----------------------|-------------------|
| Interest and dividend income | \$ 14,603,000 | 11,403,000 |
| Realized gains on sales of securities, net | 242,000 | 33,000 |
| Unrealized gains on trading securities, net | <u>41,562,000</u> | <u>13,057,000</u> |
| Investment income, net | <u>\$ 56,407,000</u> | <u>24,493,000</u> |

(3) Property and Equipment

Property and equipment consisted of the following at December 31, 2017 and 2016:

| | <u>2017</u> | <u>2016</u> |
|---------------------------------|-----------------------|----------------------|
| Land and improvements | \$ 31,148,000 | 26,238,000 |
| Buildings and fixed equipment | 372,619,000 | 356,161,000 |
| Furniture and movable equipment | <u>205,697,000</u> | <u>202,824,000</u> |
| | 609,464,000 | 585,223,000 |
| Less accumulated depreciation | <u>(312,032,000)</u> | <u>(304,863,000)</u> |
| | 297,432,000 | 280,360,000 |
| Construction in progress | <u>36,763,000</u> | <u>21,983,000</u> |
| Property and equipment, net | <u>\$ 334,195,000</u> | <u>302,343,000</u> |

Construction in progress includes costs incurred in connection with various construction projects and costs incurred related to the acquisition and implementation of various software applications. As of December 31, 2017, management estimates that the remaining cost to complete the construction projects is approximately \$59,825,000 and the remaining cost to complete the software acquisitions and implementations is approximately \$23,563,000.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of acquiring those assets. In 2017 and 2016, SCHS capitalized \$4,349,000 and \$2,543,000, respectively, of interest expense.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(4) Restricted Net Assets

Restricted net assets are held by SCF and are those whose use has been limited by donor-imposed restrictions to a specific time period and/or purpose. SCF also holds funds that are not donor restricted for a specific purpose and are distributed to SCHS in amounts and in periods determined by SCF's board of directors, which are included in unrestricted net assets. SCF's temporarily restricted net assets are distributed to SCHS or other recipients for the purposes specified by the donors. SCF's permanently restricted net assets consist of the principal amount of contributions accepted by SCF with the stipulation from donors that the principal be maintained in perpetuity and only the income from investments thereof be expended to support SCF's general activities or restricted purposes, as stipulated by the respective donors.

During 2017 and 2016, net assets were released from donor restrictions by SCHS incurring operating expenses satisfying the restricted purpose of approximately \$611,000 and \$750,000, respectively, and are included in other revenue. Further, approximately \$948,000 and \$873,000 were released from restriction to SCHS for capital expenditures made during 2017 and 2016, respectively.

Temporarily and permanently restricted net assets are available for the following purposes at December 31, 2017 and 2016:

| | <u>2017</u> | <u>2016</u> |
|------------------------------------|---------------------|------------------|
| Temporarily restricted: | | |
| Education and research | \$ 465,000 | 434,000 |
| Indigent care | 277,000 | 306,000 |
| Patient care activities | 2,541,000 | 3,018,000 |
| Purchase of property and equipment | 554,000 | 360,000 |
| Regional healthcare services | 1,835,000 | — |
| Net assets, temporarily restricted | <u>\$ 5,672,000</u> | <u>4,118,000</u> |
| Permanently restricted: | | |
| Education and research | \$ 497,000 | 497,000 |
| Indigent care | 1,017,000 | 980,000 |
| Patient care activities | 25,000 | 25,000 |
| Net assets, permanently restricted | <u>\$ 1,539,000</u> | <u>1,502,000</u> |

SCF has adopted investment and spending policies for endowment assets to provide a predictable stream of funding to programs supported by its endowment and to maintain the value of the endowment assets. Asset allocation is reviewed annually with respect to i) SCF's tolerance for risk based on its financial condition and need for cash from investments to support operations; ii) expected asset class return, risk, and correlation characteristics; and iii) changes in accounting guidance, tax law, or other restrictions.

SCF's spending practices are intended to comply with donor's wishes and meet all applicable laws and regulations. Spending must be for a purpose that is consistent with the documented intent of the donor, and may not exceed the amounts annually determined by the SCF's board of directors. Factors that are considered in addressing the annual spending allocation are i) market value of the fund relative to the principal of the gift and ii) the level of spending in prior years.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires SCF to retain as a fund of perpetual duration. Deficiencies of this nature are reported as a reduction to unrestricted net assets and are excluded from the performance indicator.

SCF follows the guidance in UPMIFA in determining the net asset classification of all donor-restricted endowment funds. In accordance with board policy, assets classified as permanent endowments in accordance with donor intent are only utilized for current period expenditures to the extent that earnings on the endowment exceed the original fair value of the donation. To the extent earnings on endowment funds exceed identified expenditures on which to apply those earnings, the earnings are classified as temporarily restricted net assets. As of December 31, 2017 and 2016, unspent earnings on endowment funds totaling \$375,000 and \$361,000, respectively, were included in temporarily restricted net assets.

(5) Debt Agreements

Long-term obligations consisted of the following at December 31, 2017 and 2016:

| | <u>2017</u> | <u>2016</u> |
|---|------------------------------|------------------------------|
| Hospital Facility Authority of Deschutes County, Oregon (The Authority) Hospital Revenue Bonds Series 2016A (the 2016A Bonds) | \$ 99,915,000 | 101,265,000 |
| The Authority Hospital Revenue Bonds Series 2016B (the 2016B Bonds) | 6,080,000 | 7,035,000 |
| 2015 Senior Notes | 103,240,000 | 106,440,000 |
| The Authority Hospital Revenue Bonds Series 2014A (the 2014A Bonds) | 37,500,000 | 37,500,000 |
| The Authority Hospital Revenue Bonds Series 2014B (the 2014B Bonds) | 37,500,000 | 37,500,000 |
| First Interstate Note Payable | 3,000,000 | 1,549,000 |
| First Interstate Secured Loan | 632,000 | 910,000 |
| Wells Fargo Bank and Wells Equipment Finance Notes Payable | 317,000 | 713,000 |
| Siemens Financial Services Equipment leases | — | 52,000 |
| Other | 131,000 | 158,000 |
| Unamortized cost of issuance | (1,630,000) | (1,759,000) |
| Unamortized premium on bonds, net | <u>11,725,000</u> | <u>12,338,000</u> |
| Total long-term obligations | 298,410,000 | 303,701,000 |
| Less current portion | <u>(3,188,000)</u> | <u>(4,596,000)</u> |
| Long-term obligations, net of current portion | \$ <u><u>295,222,000</u></u> | \$ <u><u>299,105,000</u></u> |

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

In October 2016, The Authority issued the 2016A Bonds (2016A Bonds) in the amount of \$101,265,000. The proceeds of the 2016A Bonds were primarily used to advance refund the 2005B Bonds and finance capital construction, remodeling, and equipping of facilities used to provide healthcare at or near St. Charles Bend. The 2016A Bonds bear interest at rates ranging from 3.000% to 5.000% payable semiannually each January 1 and July 1 and require annual principal payments each January 1, 2024 through 2048 (including mandatory redemptions) ranging from \$225,000 to \$15,510,000.

In October 2016, The Authority issued the 2016B Bonds (2016B Bonds) in the amount of \$7,035,000. The proceeds of the 2016B Bonds were primarily used to finance capital costs of refurbishing a medical office building and equipping the facility to provide healthcare services near St. Charles Bend. The 2016B Bonds bear interest at rates ranging from 1.375% to 2.740% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 ranging from \$945,000 to \$1,070,000 through 2023.

In June 2015, the Corporation issued the 2015 Senior Notes (2015 Notes) in the amount of \$111,750,000. The proceeds of the 2015 Notes were used to advance refund the 2008 Bonds which were legally defeased in 2015. The 2015 Notes bear interest at a fixed rate of 4.420% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 (including mandatory redemptions) with a final payment in 2038. The principal payments range from \$1,730,000 to \$10,755,000.

In April 2014, The Authority issued the 2014 Bonds in the amount of \$75,000,000. The proceeds from the 2014 Bonds are being used to finance certain capital additions and improvements at St. Charles Bend and St. Charles Madras, and to build a replacement hospital facility in Prineville, Oregon. In September 2016, the terms of the 2014 Bonds were amended and restated, resulting in the 2014A Bonds (2014A Bonds) in the amount of \$37,500,000 and the 2014B Bonds (2014B Bonds) in the amount of \$37,500,000. The 2014A Bonds bear interest at a fixed rate of 1.930% payable monthly, until September 21, 2023, at which time the 2014A Bonds will be remarketed into another interest rate period. Principal payments will be subject to mandatory redemption on January 1, 2034 and 2035 and each January 1 beginning in 2039 with a final payment in 2044. The principal payments range from \$265,000 to \$6,595,000. The 2014B Bonds bear interest at a fixed rate of 2.030% payable monthly, until September 21, 2026, at which time the 2014B Bonds will be remarketed into another interest rate period. Principal payments will be subject to mandatory redemption on January 1, 2034 and 2035 and each January 1 beginning in 2039 with a final payment in 2044. The principal payments range from \$265,000 to \$6,595,000. Effective January 1, 2018, the interest rates increased to 2.346% and 2.467% for the 2014A Bonds and 2014B Bonds, respectively, as a result of the change in the maximum federal corporate tax rate, under the recently adopted "Tax Cuts and Jobs Act."

In December 2005, The Authority issued the 2005B Bonds in the amount of \$51,800,000. The proceeds from the 2005B Bonds were primarily used to finance certain capital additions and improvements at St. Charles Bend and St. Charles Redmond. The 2005B Bonds bear interest at rates ranging from 4.000% to 5.375% payable semiannually each January 1 and July 1 and require annual principal payments each January 1 (including mandatory redemptions) ranging from \$1,050,000 in 2016 to \$7,150,000 in 2035. The 2005B Bonds were defeased in October 2016, with a resulting loss on extinguishment of \$3,214,000.

The above-described debt instruments are secured by gross receivables of SCHS and carry various financial covenants that the Corporation is required to measure on an annual basis.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

As of December 31, 2016, CMI had a \$3,000,000 line-of-credit agreement with First Interstate. As of December 31, 2016, \$1,549,000 was outstanding under this agreement and was used to purchase equipment. Effective January 27, 2017, the total borrowings increased to \$3,000,000 and were converted to a promissory note that bears interest based on a variable rate set at the Wall Street Journal Prime Rate and matures in 2022.

During 2015, CMI entered into a loan with First Interstate, which is secured by the equipment purchased with the loan proceeds. The loan is payable in monthly installments of \$25,000, bears interest at a rate of 3.400%, and matures February 2020.

Notes and leases payable to Wells Fargo Bank, Wells Equipment Finance, Bank of the Cascades, and Siemens Financial Services represent various equipment financing arrangements, generally at CMI. The notes bear interest ranging from 3.400% to 3.941%, mature at various times from 2016 to 2019, and are secured by equipment.

Scheduled principal repayments on long-term obligations are as follows:

| | Long-term obligations |
|------------|----------------------------------|
| 2018 | \$ 3,188,000 |
| 2019 | 6,374,000 |
| 2020 | 6,347,000 |
| 2021 | 6,553,000 |
| 2022 | 6,781,000 |
| Thereafter | <u>259,072,000</u> |
| | <u>\$ 288,315,000</u> |

As of December 31, 2017, SCHS did not have any capital lease obligations.

As of December 31, 2017 and 2016, SCHS had a \$30,000,000 line-of-credit agreement with U.S. Bank. There were no amounts outstanding under this line-of-credit agreement at December 31, 2017 or 2016. Borrowings outstanding under this line-of-credit agreement bear interest at LIBOR plus 0.650%. The line of credit expires on December 27, 2018.

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

(6) Commitments and Contingencies

(a) Operating Leases

SCHS leases office space and equipment under operating lease agreements, which expire at various dates through 2035. Certain of these lease agreements contain renewal options. A portion of the leased office space has been subleased to unrelated third parties. As of December 31, 2017, future minimum rental commitments for the five years subsequent to and thereafter, under noncancelable operating lease agreements, that have initial or remaining lease terms in excess of a year were as follows:

| | | |
|-------------------------------------|----|----------------------|
| 2018 | \$ | 6,128,000 |
| 2019 | | 5,021,000 |
| 2020 | | 4,412,000 |
| 2021 | | 3,805,000 |
| 2022 | | 2,919,000 |
| Thereafter | | <u>11,865,000</u> |
| Total minimum lease payments | | 34,150,000 |
| Less total minimum sublease rentals | | <u>(251,000)</u> |
| | | <u>\$ 33,899,000</u> |

Certain of the leases above are with related entities. As of December 31, 2017, the total future minimum rental commitments expected to be paid on these related entity leases aggregate approximately \$10,386,000.

Rent expense totaled \$8,845,000 and \$7,476,000 for the years ended December 31, 2017 and 2016, respectively, and is included in medical supplies, drugs, and other in the accompanying consolidated statements of operations.

(b) Medical Malpractice Insurance

SCHS maintains a self-insurance program for malpractice and other general liability claims under which the Corporation contributes actuarially determined amounts to the Trust to fund estimated ultimate losses. SCHS purchases excess insurance for claims exceeding \$500,000 per occurrence, with a \$500,000 annual buffer and \$3,000,000 annual in aggregate.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Based on an actuarial valuation, the Corporation has recorded estimated liabilities for incurred but not reported (IBNR) medical malpractice claims, which, along with deductibles on reported claims, aggregated \$7,801,000 and \$6,425,000 as of December 31, 2017 and 2016, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. These amounts are prior to expected insurance recoveries. Management believes that these estimated liabilities are adequate to cover actual ultimate expenses; however, the establishment of estimated liabilities for medical malpractice claims is an inherently uncertain process, and there can be no assurance that currently established liabilities will prove adequate. Subsequent actual experience could result in liabilities being too high or too low, which could positively or negatively impact the Corporation's consolidated results of operations in future periods.

(c) Self-Insurance

SCHS is self-insured for medical, dental, and vision benefits provided to its employees for claims up to \$400,000 per employee. SCHS is also self-insured for state unemployment claims. SCHS recognizes self-insurance costs based on claims filed with its third-party administrators and estimates for IBNR claims. Management believes that the amounts accrued in the accompanying consolidated financial statements for the years ended December 31, 2017 and 2016 of \$9,739,000 and \$9,142,000, respectively, are adequate to cover any related potential losses.

(d) Risk Management

In the ordinary course of business, the Corporation is exposed to various risks of loss from theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. However, management believes that adequate commercial insurance coverage has been purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage for the years ended December 31, 2017 and 2016.

(e) Guaranties

As of December 31, 2017, SCHS is a guarantor of the following loans of certain related entities:

| Entity | Loan balances outstanding at December 31, 2017 | SCHS' guaranties | Loan expiration dates |
|-----------------------------------|---|-----------------------------|--------------------------------------|
| Cascade Medical Buildings, LLC | \$ 20,964,000 | 10,482,000 | March 2025 |
| Heart Center of the Cascades, LLC | 8,288,000 | 4,144,000 | April 2025 |

In the opinion of management, the likelihood that SCHS will be required to make any payments under the guaranties is remote, and the estimated fair value of such guaranties is not significant to the accompanying consolidated financial statements; accordingly, no liability related to these guaranties has been recorded in the accompanying consolidated balance sheets.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(f) Regulations and Litigation

The healthcare industry is subject to various laws and regulations from federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has remained high with respect to investigations and allegations concerning possible violations by healthcare providers of regulations, which could result in the expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments of patient services previously billed and collected. Management believes that the Corporation is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations; however, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

In addition, the Corporation becomes involved in litigation and other regulatory investigations arising in the ordinary course of business. After consultation with legal counsel, management believes that these matters will be resolved without causing a material adverse effect on the Corporation's future consolidated financial position or results of operations.

(g) Collective Bargaining Agreements

Approximately 21% of SCHS employees were covered under collective bargaining agreements at December 31, 2017 that will expire in 2018. An additional 5% are covered under contracts expiring beyond 2018.

(7) Retirement Plan

Substantially all employees of SCHS are eligible to participate in SCHS' defined-contribution retirement plan (the Plan). Under the Plan, SCHS matches each participant's contributions up to 6% of his or her salary. Employees are eligible to receive SCHS' matching contributions once they achieve at least 21 years of age, work 1,000 hours or more during the year, and have been continuously employed by SCHS for one year or more. SCHS' expense relating to the Plan during the years ended December 31, 2017 and 2016 was \$13,661,000 and \$12,187,000, respectively, and is included in employee benefits in the accompanying consolidated statements of operations.

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

(8) Other Related-Party Transactions

The following is a summary of SCHS' primary unconsolidated related-party investments at December 31, 2017 and 2016:

| Entity | Basis of accounting | Ownership as of December 31, 2017 | Investment balance included in the accompanying consolidated balance sheets | | SCHS' share of income (loss) included in the accompanying consolidated statements of operations | |
|--------|---------------------|-----------------------------------|---|-------------|---|-------------|
| | | | December 31 | | 2017 | 2016 |
| | | | 2017 | 2016 | | |
| CMB | Equity method | 50 % | \$ (2,640,000) | (2,653,000) | 689,000 | 537,000 |
| HCC | Equity method | 50 | (1,858,000) | (1,796,000) | 148,000 | 95,000 |
| CS | Equity method | 50 | 1,105,000 | 718,000 | 2,412,000 | 2,110,000 |
| SCAS | Equity method | 49 | — | — | — | — |
| COMRI | Equity method | 33 | 1,009,000 | 1,118,000 | 1,311,000 | 1,494,000 |
| SOLS | Equity method | 28 | 862,000 | 872,000 | 17,000 | 205,000 |
| PH | Equity method | 14 | — | — | — | (2,895,000) |
| IOC | Cost method | 50 | 20,000 | 20,000 | — | — |
| HF | Cost method | 14 | 54,000 | 54,000 | — | — |

In addition to SCF, the Trust, SCMSO, and CMI, SCHS has investments in the following related entities:

(a) Cascade Medical Buildings, LLC (CMB)

CMB is a limited liability company whose two members are SCHS (50% ownership interest) and Deschutes Medical Buildings, LLC (50% ownership interest). CMB was formed to build, own, and manage a medical office building on land leased from SCHS. SCHS rents approximately 12,967 square feet in this building. During the years ended December 31, 2017 and 2016, SCHS received member distributions of \$675,000 and \$830,000, respectively, from CMB. During the years ended December 31, 2017 and 2016, SCHS earned rental income from CMB of approximately \$220,000, under the land lease. During the years ended December 31, 2017 and 2016, SCHS incurred rent expense for facilities owned by CMB of \$291,000 and \$252,000, respectively.

(b) Heart Center of the Cascades, LLC (HCC)

HCC is a limited liability company whose two members are SCHS (50% ownership interest) and four physicians with equal direct ownership interests (collectively, a 50% ownership interest). Three of the physicians are also employees of the Corporation. HCC was formed to build, own, and manage a medical building on land leased from SCHS. During the years ended December 31, 2017 and 2016, SCHS received member distributions of \$210,000 and \$180,000 from HCC, respectively. During the years ended December 31, 2017 and 2016, SCHS earned income from HCC of \$148,000 and \$95,000, respectively, under the land lease and from the provision of certain facility services. During the years ended December 31, 2017 and 2016, SCHS incurred rent expense related to a lease with HCC of \$1,543,000 and \$1,523,000, respectively. SCHS made member contributions of \$0 and \$2,000 during the years ended December 31, 2017 and 2016, respectively.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(c) Cascade Surgicenter, LLC (CS)

CS is a limited liability company whose two members are SCHS (50% ownership interest) and Deschutes Surgicenter, LLC (50% ownership interest). CS was formed to own, operate, and manage an outpatient surgery center located in facilities owned by CMB. SCHS received member distributions of \$2,025,000 and \$2,078,000, from CS during the years ended December 31, 2017 and 2016, respectively. During the years ended December 31, 2017 and 2016, CS incurred rent expense for facilities owned by CMB of \$824,000 and \$808,000, respectively.

(d) St. Charles/AmSurg ASC Partners LLC (SCAS)

SCAS is a limited liability company, created in July 2013, whose two members are SCHS (49% ownership interest) and AmSurg Holdings, Inc. (51% ownership interest). SCAS was formed to acquire, develop, own, and/or operate ambulatory surgery centers or other facilities in Central Oregon. SCAS had no operating activities for the years ended December 31, 2017 and 2016.

(e) Central Oregon Magnetic Resonance Imaging, LLC (COMRI)

COMRI is a limited liability company, which is owned by SCHS, CORA, and certain physicians. SCHS owns a one-third interest in COMRI. COMRI operates six magnetic resonance imaging machines located in central Oregon. During the years ended December 31, 2017 and 2016, SCHS received member distributions of \$1,420,000 and \$1,260,000, respectively, from COMRI. During the years ended December 31, 2017 and 2016, SCHS charged COMRI \$608,000 and \$361,000, respectively, for certain staffing services, rent, and supplies. In addition, during the years ended December 31, 2017 and 2016, SCHS incurred professional fees expense of \$4,762,000 and \$3,490,000, respectively, for services rendered by COMRI. Included in accounts payable in the accompanying consolidated balance sheets are amounts due to COMRI for these services of \$427,000 and \$326,000, as of December 31, 2017 and 2016, respectively.

(f) Southern Oregon Linen Service (SOLS)

SOLS is an Oregon cooperative corporation that provides laundry, linen, and uniform services to members of the cooperative. SCHS owns 28% of the outstanding common stock of SOLS, and St. Charles Bend, St. Charles Redmond, St. Charles Madras, and St. Charles Prineville utilize the laundry and linen services provided by this cooperative. SCHS received member distributions of \$27,000 and \$18,000, from SOLS during the years ended December 31, 2017 and 2016, respectively. SCHS incurred laundry and linen expense with SOLS of \$1,910,000 and \$1,620,000, for the years ended December 31, 2017 and 2016, respectively.

(g) Propel Health (PH)

PH is a limited liability company formed to further the charitable and statutory mission of the eight member nonprofit corporations. PH's purpose is to deliver the tools, methods, and support necessary for optimal health management in the communities served by the participating organizations. SCHS owned approximately 14% of PH and invested \$1,396,000 during the year ended December 31, 2016. SCHS withdrew from PH on December 31, 2016. SCHS recorded a nonoperating loss from the withdrawal of \$2,344,000, included in other, net in the consolidated statements of operations during the year ended December 31, 2016.

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(h) Institute of the Cascades (IOC)

IOC is a limited liability company whose two members are SCHS (50% ownership interest) and The Neuromusculoskeletal Center of the Cascades PC (NCC) (50% ownership interest). IOC provides administration and marketing to promote CMB, CS, NCC, and SCHS.

(i) Health Futures (HF)

HF is a limited liability company whose members participate in centralized administrative services in Oregon. SCHS owns approximately 14% of HF. Primarily, SCHS benefits from group purchasing agreements. SCHS receives distributions from time to time that are treated as a reduction to purchases and not a return of capital, as they are the result of group purchasing agreements.

(j) Caravan Health ACO 17, LLC (CHACO)

CHACO is a limited liability company whose two members are SCHS (50% ownership interest) and Central Oregon Independent Practice Association, Inc. (COIPA) (50% ownership interest). CHACO is a clinically integrated network of providers that will participate in coordination of care, active management of chronic diseases and other quality improvement initiatives to support population health management. In order to coincide with SCHS's participation in an accountable care organization CHACO was established on January 1, 2018 to fulfill both parties' long-standing missions of service to their communities and a desire to continue to meet the lifelong health care needs of patients with high quality and high value.

(9) Functional Classification of Expenses

Expenses on a functional basis for the years ended December 31, 2017 and 2016 were as follows:

| | <u>2017</u> | <u>2016</u> |
|----------------------------|-----------------------|--------------------|
| Healthcare services | \$ 582,786,000 | 553,465,000 |
| General and administrative | 142,188,000 | 133,122,000 |
| | <u>\$ 724,974,000</u> | <u>686,587,000</u> |

(10) Fair Value Measurements

The Corporation applies the provisions of FASB ASC Topic 820, *Fair Value Measurement* (ASC 820) for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

The following table presents assets that are measured at fair value on a recurring basis at December 31, 2017:

| | Fair value measurements at reporting date | | | |
|--|--|-----------------------|------------------|----------------|
| | December 31, 2017 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | \$ 52,083,000 | 52,083,000 | — | — |
| Equity mutual funds: | | | | |
| Small cap blend | 24,000 | 24,000 | — | — |
| Small cap value | 66,000 | 66,000 | — | — |
| Small cap growth | 11,251,000 | 11,251,000 | — | — |
| Medium cap blend | 11,204,000 | 11,204,000 | — | — |
| Medium cap value | 24,000 | 24,000 | — | — |
| Medium cap growth | 13,000 | 13,000 | — | — |
| Large cap growth | 27,740,000 | 27,740,000 | — | — |
| Large cap balanced | 73,241,000 | 73,241,000 | — | — |
| Large cap value | 24,774,000 | 24,774,000 | — | — |
| Large cap blend | 5,964,000 | 5,964,000 | — | — |
| International growth | 27,041,000 | 27,041,000 | — | — |
| International value | 24,585,000 | 24,585,000 | — | — |
| International large cap | 83,000 | 83,000 | — | — |
| International balance | 50,477,000 | 50,477,000 | — | — |
| Market neutral | 22,594,000 | 22,594,000 | — | — |
| REIT sector | 36,767,000 | 36,767,000 | — | — |
| Fixed-income mutual funds: | | | | |
| Treasury intermediate | 65,558,000 | 65,558,000 | — | — |
| Inv grade corp interim | 36,995,000 | 36,995,000 | — | — |
| Inv grade corp short | 46,087,000 | 46,087,000 | — | — |
| International bond | 22,847,000 | 22,847,000 | — | — |
| Corporate obligations | 3,140,000 | — | 3,140,000 | — |
| Cash surrender value of life insurance | 363,000 | — | 363,000 | — |
| | <u>542,921,000</u> | <u>\$ 539,418,000</u> | <u>3,503,000</u> | <u>—</u> |
| Investment in Oregon | | | | |
| Community Foundation | <u>3,560,000</u> | | | |
| Total investments | <u>\$ 546,481,000</u> | | | |

ST. CHARLES HEALTH SYSTEM, INC.
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

The following table presents assets that are measured at fair value on a recurring basis at December 31, 2016:

| | Fair value measurements at reporting date | | | |
|--|--|-----------------------|------------------|----------------|
| | December 31, 2016 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Assets limited as to use: | | | | |
| Cash and cash equivalents | \$ 81,107,000 | 81,107,000 | — | — |
| Equity mutual funds: | | | | |
| Small cap blend | 180,000 | 180,000 | — | — |
| Small cap value | 59,000 | 59,000 | — | — |
| Small cap growth | 9,115,000 | 9,115,000 | — | — |
| Medium cap blend | 9,852,000 | 9,852,000 | — | — |
| Medium cap value | 22,000 | 22,000 | — | — |
| Medium cap growth | 10,000 | 10,000 | — | — |
| Large cap growth | 21,292,000 | 21,292,000 | — | — |
| Large cap balanced | 61,094,000 | 61,094,000 | — | — |
| Large cap value | 21,137,000 | 21,137,000 | — | — |
| Large cap blend | 4,079,000 | 4,079,000 | — | — |
| International growth | 19,244,000 | 19,244,000 | — | — |
| International value | 19,836,000 | 19,836,000 | — | — |
| International large cap | 61,000 | 61,000 | — | — |
| International balance | 38,720,000 | 38,720,000 | — | — |
| Market neutral | 19,677,000 | 19,677,000 | — | — |
| REIT sector | 32,787,000 | 32,787,000 | — | — |
| Fixed-income mutual funds: | | | | |
| Treasury intermediate | 56,111,000 | 56,111,000 | — | — |
| Inv grade corp interim | 33,264,000 | 33,264,000 | — | — |
| Inv grade corp short | 39,776,000 | 39,776,000 | — | — |
| International bond | 19,874,000 | 19,874,000 | — | — |
| Corporate obligations | 2,808,000 | — | 2,808,000 | — |
| Cash surrender value of life insurance | 343,000 | — | 343,000 | — |
| | <u>490,448,000</u> | <u>\$ 487,297,000</u> | <u>3,151,000</u> | <u>—</u> |
| Investment in Oregon | | | | |
| Community Foundation | <u>3,227,000</u> | | | |
| Total investments | <u>\$ 493,675,000</u> | | | |

ST. CHARLES HEALTH SYSTEM, INC.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(11) Recent Accounting Pronouncements

On May 28, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles, including industry-specific guidance, when it becomes effective. Topic 606 requires significantly expanded disclosures about revenue recognition. The standard permits the use of either the retrospective or cumulative-effect-transition method. The new standard also requires additional disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. The new standard is effective for SCHS on January 1, 2018. As part of adopting the standard, the Corporation will identify revenue streams of like contracts to allow for ease of implementation. The Corporation will use primarily a portfolio approach to apply the new model to classes of customers with similar characteristics. Management expects the impact of the new pronouncement to be primarily related to disclosures. The new accounting for the estimate of variable consideration will not result in materially different results compared to current practice. The Corporation will include new disclosures in 2018 in accordance with Topic 606.

In August 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. This ASU simplifies the classification of net assets and improves the disclosure of information a not-for-profit entity presents about its liquidity, financial performance, and cash flows. The provisions of this ASU are effective for year-end December 31, 2018. This ASU requires a modified retrospective application of its provisions upon adoption. SCHS is evaluating the effects this standard will have on its consolidated financial statements and accompanying disclosures.

On February 25, 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires that lease arrangements longer than 12 months result in an entity recognizing an asset and liability. The new guidance is effective for SCHS on January 1, 2019. Early adoption of the update is permitted. The Corporation is evaluating the impact of the adoption of this update on the consolidated financial statements and related disclosures.

In November of 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230)*. ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The new guidance is effective for SCHS on January 1, 2019. Early adoption of the update is permitted. The Corporation is evaluating the impact of the adoption of this update on the consolidated financial statements and related disclosures.

(12) Subsequent Events

The Corporation has performed an evaluation of subsequent events through March 28, 2018, which is the date these consolidated financial statements were issued.

SUPPLEMENTARY SCHEDULES

ST. CHARLES HEALTH SYSTEM, INC.

Supplementary Schedule – Balance Sheet Information

December 31, 2017 and 2016

| Assets | Obligated group | Nonobligated group excluding St. Charles Foundation, Inc. | St. Charles Foundation, Inc. | Eliminating and reclassifying entries | 2017 | 2016 |
|--|--------------------|--|------------------------------------|--|---------------|-------------|
| Current assets: | | | | | | |
| Cash and cash equivalents | \$ 55,102,000 | 1,776,000 | 3,013,000 | — | 59,891,000 | 57,259,000 |
| Assets limited as to use, current portion | 4,302,000 | — | — | — | 4,302,000 | 3,321,000 |
| Patient accounts receivable, net of allowance | 82,524,000 | 4,708,000 | — | — | 87,232,000 | 92,069,000 |
| Other receivables, net | 24,645,000 | 35,000 | 1,142,000 | (493,000) | 25,329,000 | 15,034,000 |
| Supplies inventory | 14,709,000 | — | — | — | 14,709,000 | 13,829,000 |
| Prepaid expenses and other current assets | 8,466,000 | 294,000 | — | — | 8,760,000 | 10,350,000 |
| Total current assets | 189,748,000 | 6,813,000 | 4,155,000 | (493,000) | 200,223,000 | 191,862,000 |
| Assets limited as to use, net of current portion | 531,625,000 | 728,000 | 9,826,000 | — | 542,179,000 | 490,354,000 |
| Property and equipment, net | 328,089,000 | 6,106,000 | — | — | 334,195,000 | 302,343,000 |
| Other assets | 27,855,000 | 9,214,000 | — | (34,029,000) | 3,040,000 | 3,661,000 |
| Total assets | \$ 1,077,317,000 | 22,861,000 | 13,981,000 | (34,522,000) | 1,079,637,000 | 988,220,000 |
| Liabilities and Net Assets | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | \$ 44,745,000 | 468,000 | — | — | 45,213,000 | 33,626,000 |
| Accrued liabilities | 57,432,000 | 12,000 | — | — | 57,444,000 | 53,913,000 |
| Estimated third-party payor settlements, net | 3,627,000 | — | — | — | 3,627,000 | 2,382,000 |
| Deferred revenue | 1,844,000 | — | — | (493,000) | 1,351,000 | 398,000 |
| Current portion of long-term obligations | 2,057,000 | 1,131,000 | — | — | 3,188,000 | 4,596,000 |
| Total current liabilities | 109,705,000 | 1,611,000 | — | (493,000) | 110,823,000 | 94,915,000 |
| Long-term obligations, net of current portion | 292,404,000 | 2,818,000 | — | — | 295,222,000 | 299,105,000 |
| Other liabilities | 14,602,000 | — | 56,000 | — | 14,658,000 | 11,851,000 |
| Total liabilities | 416,711,000 | 4,429,000 | 56,000 | (493,000) | 420,703,000 | 405,871,000 |
| Net assets: | | | | | | |
| Unrestricted, SCHS | 653,394,000 | 13,576,000 | 3,727,000 | (23,830,000) | 646,867,000 | 571,777,000 |
| Unrestricted, noncontrolling interests | — | 4,856,000 | — | — | 4,856,000 | 4,952,000 |
| Temporarily restricted | 5,673,000 | — | 6,257,000 | (6,258,000) | 5,672,000 | 4,118,000 |
| Permanently restricted | 1,539,000 | — | 3,941,000 | (3,941,000) | 1,539,000 | 1,502,000 |
| Total net assets | 660,606,000 | 18,432,000 | 13,925,000 | (34,029,000) | 658,934,000 | 582,349,000 |
| Total liabilities and net assets | \$ 1,077,317,000 | 22,861,000 | 13,981,000 | (34,522,000) | 1,079,637,000 | 988,220,000 |

See accompanying independent auditors' report.

ST. CHARLES HEALTH SYSTEM, INC.

Supplementary Schedule – Statement of Operations Information

Years ended December 31, 2017 and 2016

| | Obligated group | Nonobligated group excluding St. Charles Foundation, Inc. | St. Charles Foundation, Inc. | Eliminating and reclassifying entries | 2017 | 2016 |
|--|--------------------|--|------------------------------------|--|-------------|-------------|
| Operating revenues: | | | | | | |
| Net patient service revenue prior to provision for bad debts | \$ 639,732,000 | 47,630,000 | — | (32,241,000) | 655,121,000 | 640,492,000 |
| Provision for bad debts | 5,874,000 | — | — | — | 5,874,000 | 15,656,000 |
| Net patient service revenue | 633,858,000 | 47,630,000 | — | (32,241,000) | 649,247,000 | 624,836,000 |
| Premium revenue | 57,278,000 | — | — | — | 57,278,000 | 60,903,000 |
| Other revenue | 65,093,000 | — | 1,695,000 | (24,414,000) | 42,374,000 | 38,342,000 |
| Total operating revenues | 756,229,000 | 47,630,000 | 1,695,000 | (56,655,000) | 748,899,000 | 724,081,000 |
| Expenses: | | | | | | |
| Salaries and wages | 326,272,000 | 7,897,000 | 431,000 | (431,000) | 334,169,000 | 312,678,000 |
| Employee benefits | 93,597,000 | — | 138,000 | (754,000) | 92,981,000 | 84,752,000 |
| Professional fees and assessments | 76,873,000 | — | 90,000 | (32,306,000) | 44,657,000 | 43,471,000 |
| Depreciation and amortization | 33,909,000 | 1,333,000 | — | — | 35,242,000 | 34,319,000 |
| Interest | 6,654,000 | 138,000 | — | — | 6,792,000 | 7,242,000 |
| Medical supplies, drugs, and other | 203,802,000 | 10,252,000 | 597,000 | (3,518,000) | 211,133,000 | 204,125,000 |
| Total expenses | 741,107,000 | 19,620,000 | 1,256,000 | (37,009,000) | 724,974,000 | 686,587,000 |
| Excess of revenues over expenses from operations | 15,122,000 | 28,010,000 | 439,000 | (19,646,000) | 23,925,000 | 37,494,000 |
| Other income: | | | | | | |
| Investment income, net | 55,438,000 | — | 606,000 | 363,000 | 56,407,000 | 24,493,000 |
| Loss on extinguishment of debt | — | — | — | — | — | (3,214,000) |
| Other, net | 2,218,000 | — | — | — | 2,218,000 | (740,000) |
| Total other income, net | 57,656,000 | — | 606,000 | 363,000 | 58,625,000 | 20,539,000 |
| Excess of revenue over expenses | 72,778,000 | 28,010,000 | 1,045,000 | (19,283,000) | 82,550,000 | 58,033,000 |
| Increase (decrease) in interest in net assets of St. Charles Foundation, Inc. | | | | | | |
| Foundation, Inc. | 822,000 | — | — | (822,000) | — | — |
| Net assets released from restriction for capital | 948,000 | — | — | — | 948,000 | 873,000 |
| Other transfers | 762,000 | — | (223,000) | (544,000) | (5,000) | (14,000) |
| Distributions | — | (28,330,000) | — | 19,831,000 | (8,499,000) | (6,869,000) |
| Increase (decrease) in unrestricted net assets | \$ 75,310,000 | (320,000) | 822,000 | (818,000) | 74,994,000 | 52,023,000 |

See accompanying independent auditors' report.