



CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2016 AND 2015

CPAs / ADVISORS



UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Union Health System, Inc. and Subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

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

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

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 the System as of December 31, 2016 and 2015, and the changes in its net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

REPORT ON SUPPLEMENTARY INFORMATION

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating information as listed in the accompanying table of contents is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and changes in net assets of the individual entities, and is not a required part of the consolidated financial statements. The accompanying supplementary information shown on page 51 is presented for purposes of additional analysis as required by the Consolidated Audit Guide for Audits of HUD Programs issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General, and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations (CFR) Part 200, Uniform Administrative requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is also 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 audits 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.

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with Government Auditing Standards, we have also issued our report dated April 20, 2017 on our consideration of the System’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System’s internal control over financial reporting and compliance.

CHANGE IN ACCOUNTING PRINCIPLE

As discussed in Note 3 to the consolidated financial statements, the System adopted new accounting guidance, Accounting Standards Update 2015-03, *Interest – Imputation of Interest*, which simplifies the presentation of debt issue costs. Our opinion is not modified with respect to this matter.

Blue & Co., LLC

Indianapolis, Indiana
April 20, 2017

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2016 AND 2015

ASSETS		
	2016	2015 As Restated
Current assets		
Cash and cash equivalents	\$ 67,367,091	\$ 44,857,010
Funds held by trustee, current portion	-0-	6,162,514
Board designated funds, current portion	-0-	1,363,310
Patient accounts receivable, net	55,467,999	58,497,402
Inventories	5,315,627	5,127,559
Prepaid expenses and other current assets	12,171,704	7,369,083
Total current assets	140,322,421	123,376,878
Investments limited as to use, less current portion		
Funds held by trustee	1,568,237	24,344,185
Board designated funds	69,205,212	52,682,991
Permanently restricted	-0-	1,548,109
Total investments limited as to use	70,773,449	78,575,285
Property and equipment		
Land and improvements	37,876,725	38,516,464
Buildings and fixed equipment	364,903,986	362,732,925
Movable equipment	141,072,606	135,386,601
	543,853,317	536,635,990
Less allowances for depreciation	280,052,676	261,992,362
	263,800,641	274,643,628
Construction in progress	13,773,273	5,985,110
Total property and equipment, net	277,573,914	280,628,738
Other assets		
Due from Union Health Foundation, Inc.	2,693,583	2,950,678
Intangible assets, net	3,887,592	4,206,301
Investment in joint ventures	3,507,893	3,850,683
	10,089,068	11,007,662
Total assets	\$ 498,758,852	\$ 493,588,563

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2016 AND 2015

LIABILITIES AND NET ASSETS

	2016	2015 As Restated
Current liabilities		
Accounts payable and other current liabilities	\$ 36,413,271	\$ 22,940,135
Salaries, wages and related liabilities	32,735,578	28,304,394
Estimated third party settlements	4,960,974	4,695,484
Accrued interest	-0-	5,134,370
Due to related parties	4,346,949	4,042,533
Current portion of long-term debt	9,042,190	5,450,916
Total current liabilities	<u>87,498,962</u>	<u>70,567,832</u>
Long-term liabilities		
Long-term debt, less current portion	277,953,332	279,850,793
Pension liability and related obligations	9,964,251	7,609,122
Total long-term liabilities	<u>287,917,583</u>	<u>287,459,915</u>
Total liabilities	375,416,545	358,027,747
Net assets		
Unrestricted	119,596,488	130,165,606
Noncontrolling interests in UHT, LLC	548,149	436,746
Total unrestricted net assets	<u>120,144,637</u>	<u>130,602,352</u>
Temporarily restricted	3,197,670	3,410,355
Permanently restricted	-0-	1,548,109
Total net assets	<u>123,342,307</u>	<u>135,560,816</u>
Total liabilities and net assets	<u>\$ 498,758,852</u>	<u>\$ 493,588,563</u>

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015 As Restated
Operating revenue		
Net patient service revenue (net of contractual allowances and discounts including financial assistance provisions of \$22,518,116 and \$23,634,095 in 2016 and 2015, respectively)	\$ 525,174,122	\$ 503,468,964
Less provision for bad debts	27,878,146	33,881,533
Net patient service revenue net of provision for bad debts	497,295,976	469,587,431
Other revenue	15,686,495	12,606,060
Total operating revenue	512,982,471	482,193,491
Operating expenses		
Physician, mid-level, and other provider salaries and wages	57,607,603	59,518,449
Other salaries and wages	101,719,829	99,047,361
Employee benefits	36,245,456	28,384,159
Medical supplies and drugs	87,014,842	71,937,916
Physician services	12,363,247	5,940,891
Contract services - management service organization support staff	31,440,570	28,097,489
Contract services - other	60,174,646	73,006,449
Rent and leases	12,009,444	10,987,259
Utilities, supplies, and other	36,721,558	30,751,746
Hospital assessment fee	15,184,385	13,612,043
Depreciation and amortization	20,039,841	20,343,265
Interest	16,595,824	18,115,779
Total operating expenses	487,117,245	459,742,806
Income from operations before pension settlement	25,865,226	22,450,685
Pension settlement	-0-	(3,990,490)
Income form operations after pension settlement	25,865,226	18,460,195
Non-operating gains (losses)		
Investment income	1,462,303	1,718,782
Loss on refinancing debt with HUD 242 mortgage insurance program	(29,190,407)	-0-
Other	502,639	711,727
Total non-operating gains (losses)	(27,225,465)	2,430,509
Excess of revenue over (under) expenses	(1,360,239)	20,890,704
Other changes in unrestricted net assets		
Pension related changes other than net pension cost	(9,071,119)	(7,790,558)
Distribution to owners	(1,275,046)	(1,191,422)
Net unrealized gain (loss) on investments	1,243,599	(1,875,949)
Net assets released for property and equipment	5,090	45,092
Change in unrestricted net assets	(10,457,715)	10,077,867
Temporarily restricted net assets		
Other changes in receivable from Union Health Foundation, Inc.	(207,595)	561,411
Net assets released for property and equipment	(5,090)	(45,092)
Change in temporarily restricted net assets	(212,685)	516,319
Permanently restricted net assets		
Transfer of endowments to Union Health Foundation, Inc.	(1,520,937)	-0-
Net investment loss	(27,172)	(24,987)
Change in permanently restricted net assets	(1,548,109)	(24,987)
Change in net assets	(12,218,509)	10,569,199
Net assets		
Beginning of year	135,560,816	124,991,617
End of year	\$ 123,342,307	\$ 135,560,816

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Operating activities		
Change in net assets	\$ (12,218,509)	\$ 10,569,199
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	18,757,904	19,508,644
Amortization of intangible asset	1,281,937	834,621
Amortization of bond issuance costs	264,057	241,525
Provision for bad debts	27,878,146	33,881,533
Distribution to owners	1,275,046	1,191,422
Loss on property disposals	253,800	43,930
Loss on refinancing debt with HUD 242 mortgage insurance program	29,190,407	-0-
Net unrealized (gain) loss on investments	(1,243,599)	1,875,949
Changes in operating assets and liabilities		
Patient accounts receivable	(24,848,743)	(36,454,376)
Other current and noncurrent assets	(4,072,095)	(4,153,605)
Accounts payable and other current liabilities	9,483,553	5,231,941
Salaries, wages and related liabilities	4,431,184	(689,082)
Other long-term liabilities	1,577,816	2,638,900
Estimated third-party payor settlements	265,490	(316,387)
Accrued interest	(5,134,370)	(12,977)
Net cash flows from operating activities	47,142,024	34,391,237
Investing activities		
Purchases of property and equipment	(11,197,177)	(6,737,845)
Proceeds from sale of property and equipment	311,609	184,702
Purchase of investments	(27,190,547)	(25,499,618)
Proceeds from sale of investments	43,761,806	21,703,212
Net cash flows from investing activities	5,685,691	(10,349,549)
Financing activities		
Payments on long-term debt	(4,109,131)	(4,522,261)
Payments to refinance long-term debt	(258,620,900)	-0-
Proceeds from long-term debt	265,550,014	768,020
Cash paid for redemption of bonds prior to callable event	(24,594,295)	-0-
Cash paid for upfront mortgage insurance premium	(2,666,003)	-0-
Cash paid for deferred financing costs	(4,602,273)	-0-
Distribution to owners	(1,275,046)	(1,191,422)
Net cash flows from financing activities	(30,317,634)	(4,945,663)
Change in cash and cash equivalents	22,510,081	19,096,025
Cash and cash equivalents		
Beginning of year	44,857,010	25,760,985
End of year	\$ 67,367,091	\$ 44,857,010
Noncash investing activities		
Issuance of capital leases	\$ 1,081,729	\$ 295,152
Capital acquisitions included in accounts payable	\$ 3,989,583	\$ 221,111
Financed acquisition of medical practice service line	\$ -0-	\$ 4,600,000
Supplemental cash flow information		
Cash paid for interest	\$ 21,730,194	\$ 18,128,756

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

1. ORGANIZATION

Nature of Operations

Union Health System, Inc. (UHS), an Indiana nonprofit corporation, is the sole member of Union Hospital, Inc. (the Corporation). UHS and the Corporation are 50% members of Union Associated Physicians Clinic, LLC (UAPC). UHS, UAPC, and the Corporation are collectively referred to as the System. The System was formed in November 2009 to provide vision and strategic direction in the formation of a regional health care system to expand and improve the delivery of health care services in order to meet the health care needs of residents in the System's service area.

The Corporation is an Indiana not-for-profit corporation which owns and operates Union Hospital (the Hospital), a 258 staffed-beds and regional referral center hospital located in Terre Haute, Indiana. The Hospital is a full-service, acute-care hospital with medical-surgical, obstetric, pediatric, coronary care, post-coronary care, intensive care, maximum care, and medical rehabilitation units. Additionally, as the largest hospital in west central Indiana, the Hospital is a referral center for such services as its newborn intensive care unit (Level II), open heart surgery, cardiac rehabilitation clinic, radiology, cardiopulmonary services, and radiation therapy. The Hospital and its related consolidated entities provide comprehensive health care services to the residents of Terre Haute and the surrounding communities, west central Indiana, and east central Illinois through its acute and specialty care facilities and physician medical practices.

UAPC is an Indiana limited liability company which operates a multi-specialty physician clinic and is governed by a nine person Board of Managers. UAPC is comprised of approximately eighty physicians and allied health professionals.

The consolidated financial statements include the accounts of UHS, the Corporation, IPACS, Inc. (IPACS), Center for Occupational Health (COH), Union Hospital Therapy, LLC (UHT) and UAPC (collectively, the System). Union Hospital Clinton is a designated Medicare critical access hospital operating as a division of the Corporation. IPACS is a wholly owned, taxable subsidiary of the Corporation engaged in providing collection services to hospitals, hospital physicians, and other health care providers. COH provides work related injury care and other occupational medicine services and is also a wholly owned tax-exempt subsidiary of the Corporation. All material intercompany accounts and transactions have been eliminated.

During 2014, UHT was formed for the purpose of providing physical, occupational, and speech therapy, and related rehabilitation services. The Corporation ownership interest in UHT is 51%. The Corporation maintains substantial participation in the operations of UHT in addition to an economic interest in UHT's financial position. The 49% non-controlling interest is owned by Clinical Management Solutions, LLC. All material intercompany accounts and transactions have been eliminated.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The System is also related to various organizations principally through overlapping board membership which does not constitute control. These organizations include Union Hospital Foundation, Inc., Union Hospital Health Services, Inc., and Visiting Nurse Association of the Wabash Valley, Inc. The majority of all fund-raising activities are conducted by Union Health Foundation, Inc. (the Foundation).

Accordingly, unrestricted gifts and bequests received directly by the System are recorded as nonoperating gains, and restricted gifts and bequests received by the Foundation for the benefit of the Corporation are recorded by the Corporation as temporarily restricted net assets until expended by the System for their intended purpose.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Use of Estimates

The preparation of the 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, including the allowance for estimated uncollectible accounts and estimated third-party payor settlements, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period and could differ from actual results.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less when purchased, excluding investments limited as to use. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate fair value.

Patient Accounts Receivable, Estimated Third Party Settlements, and Net Patient Service Revenue

Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered. Net patient service revenue includes estimated retroactive adjustments under reimbursement agreements with certain third-party payors (principally for the Medicare program). Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, adjusted in future periods as final settlements are determined, and are included with estimated receivables from third-party payors.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets follows:

	2016	2015
Inpatient revenue	\$ 523,912,644	\$ 487,506,041
Outpatient revenue	849,397,879	735,019,006
Physician revenue	145,664,867	173,198,159
Gross patient revenue	1,518,975,390	1,395,723,206
Financial assistance revenue foregone	22,518,116	23,634,095
Contractual adjustments	971,283,152	868,620,147
Total adjustments	993,801,268	892,254,242
Net patient service revenue	525,174,122	503,468,964
Less provision for bad debts	27,878,146	33,881,533
	\$ 497,295,976	\$ 469,587,431

A summary of gross patient service revenue at established rates by payor source for 2016 and 2015, respectively, is as follows:

	2016	2015
Medicare	49%	49%
Medicaid	20%	18%
Managed care and commercial	28%	29%
Self-pay and other	3%	4%
	100%	100%

There is a single insurance and managed care provider that constituted 17% of patient service revenue at established rates for the years ended December 31, 2016 and 2015.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the System analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

During 2016, the System's allowance for uncollectible accounts for patient and physician services increased approximately \$6,000,000 from approximately \$18,200,000 to approximately \$24,200,000. This increase is due to continued shift in accounts receivable payor mix and an overall increase in age of accounts receivable. As of December 31, 2016, the allowance for uncollectible accounts of \$24,200,000 was comprised of approximately \$11,000,000 reserved for self-pay balances and approximately \$13,200,000 reserved for third-party payor balances. During 2015, the System's allowance for uncollectible accounts for patient and physician services decreased approximately \$500,000 from approximately \$18,700,000 to approximately \$18,200,000. As of December 31, 2015, the allowance for doubtful accounts of approximately \$18,200,000 was comprised of approximately \$11,200,000 reserved for self-pay balances and approximately \$7,000,000 reserved for third-party payor balances.

The System grants credit to patients, substantially all of whom are local residents of the communities served. The System does not generally require credit or other collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, HMOs, and commercial insurance policies). The System has not changed its financial assistance or uninsured discount policies during 2016 or 2015.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

At December 31, 2016 and 2015, gross accounts receivable from patients and third party were comprised of the following:

	2016	2015
Medicare	35%	34%
Medicaid	21%	22%
Managed care and commercial	33%	31%
Self-pay and other	11%	13%
	<u>100%</u>	<u>100%</u>

The allowance for doubtful accounts is based on management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy for uncollectible receivables based upon the payor composition and aging of receivables as of the reporting date with consideration of the historical write-off experience by payor category. The results of these reviews are then used to make any modifications to the provision for uncollectible receivables to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the System follows established guidelines for placing past-due patient accounts with collection agencies.

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. A summary of the significant payment arrangements with third-party payors follows:

Medicare: Physician services, inpatient acute care services, and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Critical access hospital services are reimbursed based on cost reimbursement methodologies. Cost reimbursable services are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary.

Medicaid: Reimbursement for services rendered to Medicaid program beneficiaries are at prospectively determined rates per discharge for inpatient hospital services. Other services are reimbursed based on a combination of cost reimbursement methodologies and prospectively determined rates.

Other: Reimbursement for services to certain patients is received from commercial insurance carriers, health maintenance organizations, preferred provider organizations, and other payors, based on prospectively determined rates per discharge or discount of charges for inpatient hospital services and discount of charges for outpatient services.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated settlements could change by a material amount in the near term.

Management believes that adequate provisions have been made for any adjustments which may result from such final settlements. Differences between prior estimates and subsequent actual settlements are immaterial to these financial statements for 2016 and 2015.

Financial Assistance and Community Benefit

Patients are provided care regardless of their ability to pay in accordance with financial assistance policies of the System. These policies define financial assistance services as those services for which no or reduced payment is anticipated and are based on federal poverty income levels and certain other factors. Because collection of amounts determined to qualify as financial assistance is not pursued, such amounts are not reported as revenue. The System's financial assistance policies also extend to services provided by physicians, although records are not maintained for such services provided by the physicians.

Of the System's total expenses reported, an estimated \$7,228,000 and \$7,794,000 arose from providing services to patients requiring financial assistance during the years ended December 31, 2016 and 2015, respectively. The estimated costs of providing patient assistance services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to patients requiring financial assistance. The ratio of cost to charges is calculated based on the System's total expenses divided by gross patient service revenue.

The System also provides programs and services to address the needs of the communities it serves, generally at no, or low, cost to those being served. Specific community needs being addressed by the System include, among others, low-weight births and infant mortality, high incidence of, and deaths from, certain diseases and chronic illnesses, underserved populations, adequacy of the supply of physicians and other health care providers, and certain behavioral risk factors. The System's programs and services include, among others, services to low-income women in need of prenatal care, health screenings for underserved women, wellness and injury prevention programs, chronic disease management assistance, educational programs, rural health care access and availability initiatives, transportation services for elderly and low-income patients, and access to support groups for critically and chronically ill patients and their families. Assistance is also provided to senior citizens and other patients and their families for the submission of forms for insurance, financial counseling, and application to the Medicare and Medicaid programs for health service coverage. The System periodically reviews, modifies, and reports on its Community Health Assessment and Plan of Action for the communities served.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Hospital Assessment Fee (HAF) Program

The purpose of the HAF Program is to fund the State share of enhanced Medicaid payments and Medicaid Disproportionate Share (DSH) payments for Indiana inpatient providers. Previously, the State share was funded by governmental entities through intergovernmental transfers. The Medicaid enhanced payments relate to both fee for service and managed care claims. The Medicaid enhanced payments are designed to follow the patients and result in increased Medicaid rates.

During the years ended December 31, 2016 and 2015, the System recognized HAF Program expense of approximately \$15,200,000 and \$13,600,000, respectively, which resulted in increased Medicaid reimbursement. The HAF Program was approved for extension in March 2014 by CMS for the period July 1, 2013 through June 30, 2017.

Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost or market and principally valued using the average cost method.

Investments Limited as to Use

Investments limited as to use are stated at fair value. The fair value of assets is based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The cost of securities sold is based on the specific identification method. Dividends and interest income and realized gains and losses on sales of investments are recorded as investment income within non-operating gains (losses) in the consolidated statements of operations and changes in net assets. Unrealized gains (losses) and temporary appreciation (temporary losses) of investments are reported as other changes in unrestricted net assets in the consolidated statements of operations and changes in net assets.

Investments are generally commingled for investment purposes and consist of short-term investments (principally money market deposit accounts), certificates of deposit, U.S. government obligations, mutual funds, corporate obligations, and common stocks.

Investments limited as to use include investments set aside by the Board of Directors for future capital improvements and retirement of debt over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes; investments held by trustees under bond indenture agreements; and donor-restricted funds. Amounts that are required for obligations classified as current liabilities, and other amounts previously paid from operating cash that are to be reimbursed by the applicable funds, are reported in current assets.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows: land improvements 3 to 30 years, buildings 5 to 40 years, and equipment 3 to 25 years. The System's policy is to designate certain available unrestricted net assets for expansion and renovation.

Equipment under capital lease obligations is amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs are capitalized as a component of the cost of constructing the assets. Repair and maintenance costs are expensed when incurred.

The System periodically evaluates whether circumstances have occurred that would indicate whether the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, an estimate is made of the undiscounted cash flows over the remaining life of the assets in measuring whether the asset is recoverable in accordance with accounting standards.

Intangible Assets

Intangible assets arising from the purchase of physician practices (primarily non-compete provisions) and service lines are carried at cost. Amortization is computed using the straight-line method based on the assets' estimated useful lives.

Unamortized Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt are amortized using the bonds outstanding method, which approximates the amortization under the effective interest rate method, and are included in interest expense in the accompanying consolidated statements of operations and changes in net assets. The unamortized debt issuance costs are included in the consolidated balance sheets as a reduction in related long-term debt.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Medical Malpractice Insurance

The System and its employed physicians with active Indiana medical licenses are qualified as health providers under the Indiana Medical Malpractice Act (the Medical Malpractice Act). The Medical Malpractice Act limits liability for malpractice claims against qualified health care providers such as the System. The law provides for a mandatory State Patient's Compensation Fund (the Compensation Fund) to which qualified health care providers contribute a surcharge. The amount of the surcharge is established by the Indiana Department of Insurance on an actuarial basis. The amount contributed by each hospital must be sufficient to cover, but may not exceed, the actuarial risk posed to the Compensation Fund by such hospital and its employed physicians with active Indiana medical licenses. For malpractice incidents occurring after December 31, 1989, and before July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of \$750,000 per claim (\$3,000,000 annual aggregate); the related health care provider is liable for up to \$100,000 of the recovery. For malpractice incidents occurring on or after July 1, 1999, the Medical Malpractice Act provides for a maximum recovery of \$1,250,000 per claim (\$7,500,000 annual aggregate); the related health care provider is liable for up to \$250,000 of the recovery.

Effective December 31, 2003, the Corporation became a member in a Vermont captive insurance company, Indiana Healthcare Reciprocal Risk Retention Group, Inc., to fund the System's required portion of the insurance coverage pursuant to the Medical Malpractice Act, as well as its general liability insurance.

The System also provides medical malpractice insurance for its employed physicians who practice in the state of Illinois with limits of \$1,000,000 per occurrence and \$3,000,000 in the aggregate.

Malpractice insurance coverage provided through the Compensation Fund and the captive insurance company is provided on a claims-made basis. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be uninsured.

Pension Plans

A noncontributory, defined-benefit pension plan covers substantially all employees. Plan benefits are based on years of service and the employee's compensation. During 2010, the Corporation froze the defined benefit plan and initiated a discretionary match component to the 403b defined contribution plan. UAPC has established an employer match, safe harbor 401k and profit sharing plan for certain employees based on eligibility requirements including annual hours of service and designated plan entry dates. See footnote 11 for additional details on the System's pension plans.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Financial Statement Presentation

The System is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets) based upon the existence or absence of donor imposed restrictions.

Net Assets

Unrestricted net assets represent the part of the net assets of the System that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations. Temporarily restricted net assets are those assets whose use by the System has been limited by donors primarily for a specified time period or purpose. When a donor restriction expires or is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released for property and equipment. Property and equipment donated to the Hospital are recorded as additions to temporarily restricted net assets at their fair value at the date of receipt and as a transfer to unrestricted net assets when the assets are placed in service. Temporarily restricted net assets include approximately \$2,694,000 and \$2,951,000 of funds held by the Foundation for the benefit of the System at December 31, 2016 and 2015, respectively. These amounts represent contributions received on behalf of the System by the Foundation and other amounts the Foundation has granted to the System and are included within Due from Union Health Foundation Inc. on the consolidated balance sheets. Other miscellaneous funds are held as temporarily restricted net assets. Permanently restricted net assets are those that the donor has requested to be held in perpetuity. In accordance with donor stipulations, certain investment income earned on permanently restricted net assets is unrestricted. Accordingly, such income is recorded in the unrestricted net asset class as it is earned.

Health Insurance

The System's employee health care insurance is provided through a combination of self-insurance and purchased re-insurance coverage from a commercial carrier. The System maintains an estimated liability for the amount of claims incurred but not reported. Substantially all employees are covered for major medical benefits. For the Corporation, the specific annual attachment point for an individual is \$325,000 with no policy period maximum. There is no aggregate limit on claims for the Corporation. For UAPC, the specific annual attachment point for an individual is \$300,000 with no life-time maximum on claims. The maximum annual aggregate reimbursement under the policy is \$1,000,000 per year.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately \$423,505,000 and \$399,509,000 for the years ended December 31, 2016 and 2015, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing, and other) amounted to approximately \$63,613,000 and \$64,224,000 for the years ended December 31, 2016 and 2015, respectively. These totals include the pension settlement expense of approximately \$3,990,000 for the year ended December 31, 2015.

Income Taxes

The System is organized as a not-for-profit corporation under Section 501(c) (3) of the United States Internal Revenue Code. As such, the System is generally exempt from income taxes. However, the System is required to file Federal Form 990 – Return of Organization Exempt from Income Tax, which is an informational return only.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System and recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the System, and has concluded that as of December 31, 2016 and 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Filings are current through 2015. The impact of the subsidiaries tax consequences is immaterial to these consolidated financial statements.

UAPC is a limited liability company with the System serving as the sole member and is regarded as a pass-through entity.

Operating Indicator

The System's operating indicator, income from operations, includes all unrestricted net income, gains and support, and expenses from System operations directly related to recurring and ongoing health care operations during the reporting period. The operating indicator excludes interest, dividend, and realized gains and losses on sales of investments, contributions, loss on refinancing debt, and gains and losses deemed by management not to be directly related to providing health care services.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Performance Indicator

The System's performance indicator, excess of revenues over (under) expenses, includes all changes in unrestricted net assets other than net unrealized gain (loss) and temporary gains (losses) on investments, investment returns restricted by donors, changes in pension plan funded status, transfers of endowments, distributions to non-controlling owners, and contributions of property and equipment.

Pension Settlement

In response to employee benefit cost control, the Corporation, with the approvals of the Pension Committee and Board of Directors, elected to distribute lump sum payments to qualified individuals participating in the pension plan creating recognition of an operating expense. Qualified individuals included all participating employees age 62 and older, any terminated and fully vested participants, and any new retirees. Settlement costs associated with the lump sum payments amounted to approximately \$3,991,000 for the year ended December 31, 2015.

Going Concern Evaluation

Management evaluates whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year from the date the financial statements are available to be issued.

Reclassifications

Certain amounts from the 2015 financial statements were reclassified to the current year presentation. There were no changes to net assets, as previously reported.

Subsequent Events

The System has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are available to be issued which is April 20, 2017.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

3. CHANGE IN ACCOUNTING PRINCIPLE

During 2016, the System adopted Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements – Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. ASU No. 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year from the date the financial statements are available to be issued. When conditions or events that raise substantial doubt exist, additional disclosures will be required to enable financial statement users to understand those conditions or events, management's evaluation of them and management's plans that either alleviated substantial doubt, or are intended to mitigate the conditions or events that raise substantial doubt. The adoption of ASU No. 2014-15 did not have a material effect on the accompanying consolidated financial statements.

During 2016, the System adopted Accounting Standards Update 2015-03, *Interest – Imputation of Interest*, which simplifies the presentation of debt issue costs by presenting them as direct deduction from face amount of the related debt payable. Previously, debt issue costs were aggregated and presented as a deferred charge within the other assets section on the consolidated balance sheets. Debt issue costs will continue to be amortized over the term of the related debt, but are now are presented as a component of interest expense in the statements of operations and changes in net assets.

The 2015 financial statements have been retroactively restated to adopt this new guidance as detailed in the following table:

	As previously reported	Effects of implementation	As restated
<u>Consolidated balance sheets</u>			
Deferred financing costs, net	\$ 2,696,320	\$ (2,696,320)	\$ -0-
Long-term debt, less current portion	\$ 282,547,113	\$ (2,696,320)	\$ 279,850,793
 <u>Consolidated statements of operations and changes in net assets</u>			
Depreciation and amortization	\$ 20,584,790	\$ (241,525)	\$ 20,343,265
Interest expense	\$ 17,874,254	\$ 241,525	\$ 18,115,779

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

4. AFFILIATED ENTITY AND RELATED PARTY TRANSACTIONS

The System contracts with AP&S Clinic for management services, which are provided to UAPC and the Corporation. Management expenses totaled approximately \$31,440,000 and \$28,100,000 for the years ended December 31, 2016 and 2015, respectively, and are included in contract services – management service organization support staff in the consolidated statements of operations and changes in net assets. At December 31, 2016 and 2015, a payable is owed to AP&S Clinic in the amount of approximately \$4,347,000 and \$4,043,000, respectively. UAPC paid approximately \$2,665,000 and \$2,289,000 during 2016 and 2015, respectively, in rental expense to AP&S II, a related real estate entity. UAPC entered into a capital lease arrangement during 2013 with AP&S III, a related real estate entity where total payments from UAPC to AP&S III during the years ended December 31, 2016 and 2015 totaled approximately \$1,900,000, respectively.

The Corporation provided management and other services for the Foundation and other related organizations for the years ended December 31, 2016 and 2015. These amounts are immaterial to the financial statements as a whole.

The Corporation received approximately \$5,000 and \$45,000 in contributions from the Foundation for the years ended December 31, 2016 and 2015, respectively. These amounts are recorded within other revenue in the consolidated statements of operations and changes in net assets.

The Corporation collaborates with physicians and physician groups including UAPC, to improve the quality of services, eliminate duplication of services, and to improve standards of care by entering into certain contractual agreements. While certain of the agreements are amended and/or terminated from time to time, the Corporation has had agreements for chemotherapy, ambulatory surgery, cardiac catheterization, and radiation oncology therapy services. The costs for these services are included in contract services in the consolidated statements of operations and changes in net assets totaling approximately \$44,045,000 and \$52,768,000 for the years ended December 31, 2016 and 2015, respectively.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

5. PROPERTY AND EQUIPMENT

A summary of the construction-in-progress projects at December 31, 2016 and 2015 is as follows:

	2016	2015
Cerner Project (including Sorian software)	\$ 12,469,201	\$ 5,230,175
Other renovations and upgrades	1,304,072	754,935
	<u>\$ 13,773,273</u>	<u>\$ 5,985,110</u>

At December 31, 2016 the Corporation has outstanding commitments of \$13,500,000. Approximately \$6,200,000 of the commitments are earmarked for implementation of a new information system with expected completion in phases through 2018. Commitments for all other remaining construction project costs total approximately \$7,300,000 at December 31, 2016 and are expected to be expended through 2017.

6. INVESTMENTS

The Corporation does not engage in trading activities for investment purposes. The composition of investments, at fair value, is set forth in the following table:

	2016	2015
Money market deposit accounts and certificates of deposit	\$ 6,944,255	\$ 39,186,778
US Government obligations	12,396,904	7,922,194
Mutual funds	26,285,975	3,220,783
Common stocks	12,724,060	11,184,353
Corporate obligations	12,422,255	24,587,001
	<u>70,773,449</u>	<u>86,101,109</u>
Less current portion of:		
Debt service	-0-	6,162,514
Board designated	-0-	1,363,310
	<u>\$ 70,773,449</u>	<u>\$ 78,575,285</u>

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Investment income included in the consolidated statements of operations and changes in net assets is primarily comprised of interest, dividends and realized gains and losses on sale of investments.

	<u>2016</u>	<u>2015</u>
Investment income included within non-operating gains (losses) and net investment income on permanently restricted net assets:		
Investment income	\$ 1,435,131	\$ 1,693,795
Other changes in net assets:		
Unrealized gain (loss) on investments	<u>1,243,599</u>	<u>(1,875,949)</u>
	<u>\$ 2,678,730</u>	<u>\$ (182,154)</u>

The following schedule summarizes the fair value of securities included in investments by board designated and held by trustee that have gross unrealized losses (the amount by which historical cost exceeds the fair value) as of December 31, 2016 and 2015. The schedule further segregates the securities that have been in a gross unrealized position as of December 31, 2016 and 2015, for less than twelve months and those for twelve months or more. The gross unrealized losses of less than twelve months are a reflection of the normal fluctuations of the market and are therefore considered temporary.

The gross unrealized losses of twelve months or longer are reflective of current market fluctuations. The majority of the decline is attributable to several securities which industry experts expect recovery in the short-term future.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The decline in value is determined by management to be temporary, and unrealized losses have not been reclassified to realized losses as of December 31, 2016 and 2015:

Description of securities	December 31, 2016					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 497,062	\$ 52,290	\$ 1,141,793	\$ 71,826	\$ 1,638,855	\$ 124,116
Mutual funds	17,479,427	486,879	272,568	432	17,751,995	487,311
Government obligations	526,601	1,739	7,392,106	159,657	7,918,707	161,396
Corporate obligations	14,868,646	546,044	2,085,331	61,936	16,953,977	607,980
Total temporarily impaired securities	<u>\$ 33,371,736</u>	<u>\$ 1,086,952</u>	<u>\$ 10,891,798</u>	<u>\$ 293,851</u>	<u>\$ 44,263,534</u>	<u>\$ 1,380,803</u>

Description of securities	December 31, 2015					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock	\$ 741,164	\$ 203,979	\$ 2,239,521	\$ 293,877	\$ 2,980,685	\$ 497,856
Mutual funds	781,858	25,889	358,743	9,655	1,140,601	35,544
Government obligations	1,099,133	4,100	2,659,373	10,052	3,758,506	14,152
Corporate obligations	21,819,363	990,766	2,520,102	174,699	24,339,465	1,165,465
Total temporarily impaired securities	<u>\$ 24,441,518</u>	<u>\$ 1,224,734</u>	<u>\$ 7,777,739</u>	<u>\$ 488,283</u>	<u>\$ 32,219,257</u>	<u>\$ 1,713,017</u>

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The framework for measuring fair value provides 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) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the System has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of December 31, 2016 and 2015.

- *Common stocks:* Valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds:* Valued at the daily closing price as reported by the fund. Mutual funds held by the System are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily (NAV) and to transact at that price. The mutual funds held by the System are deemed to be actively traded.
- *US Government obligations:* Valued based upon the active market on which the individual securities are traded.
- *Corporate obligations:* Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015 are as follows:

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
Investments limited as to use				
Common stocks				
Consumer	\$ 3,330,650	\$ 3,330,650	\$ -0-	\$ -0-
Energy	2,056,578	2,056,578	-0-	-0-
Financial	2,122,083	2,122,083	-0-	-0-
Healthcare	1,079,828	1,079,828	-0-	-0-
Industrials	2,034,885	2,034,885	-0-	-0-
Information technology	1,619,680	1,619,680	-0-	-0-
Materials	480,356	480,356	-0-	-0-
Total common stocks	12,724,060	12,724,060	-0-	-0-
Mutual funds				
Fixed income funds	22,850,128	22,850,128	-0-	-0-
International funds	1,868,819	1,868,819	-0-	-0-
Index funds	1,567,028	1,567,028	-0-	-0-
Total mutual funds	26,285,975	26,285,975	-0-	-0-
US Government obligations	12,396,904	12,396,904	-0-	-0-
Corporate obligations				
Mid yield	12,422,255	-0-	12,422,255	-0-
Total corporate obligations	12,422,255	-0-	12,422,255	-0-
	63,829,194	<u>\$ 51,406,939</u>	<u>\$ 12,422,255</u>	<u>\$ -0-</u>
Money market deposit accounts	2,928,437			
Certificates of deposit*	4,015,818			
Total investments limited as to use	\$ 70,773,449			

* Certificates of deposit are reported at contract value

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

	December 31, 2015			
	Total	Level 1	Level 2	Level 3
Investments limited as to use				
Common stocks				
Consumer	\$ 2,887,765	\$ 2,887,765	\$ -0-	\$ -0-
Energy	1,715,925	1,715,925	-0-	-0-
Financial	2,075,851	2,075,851	-0-	-0-
Healthcare	1,217,437	1,217,437	-0-	-0-
Industrials	1,556,503	1,556,503	-0-	-0-
Information technology	1,537,717	1,537,717	-0-	-0-
Materials	193,155	193,155	-0-	-0-
Total common stocks	11,184,353	11,184,353	-0-	-0-
Mutual funds				
Fixed income funds	1,510,001	1,510,001	-0-	-0-
Large cap funds	214,081	214,081	-0-	-0-
Mid cap funds	80,683	80,683	-0-	-0-
Small cap funds	24,919	24,919	-0-	-0-
International funds	326,696	326,696	-0-	-0-
Index funds	1,064,403	1,064,403	-0-	-0-
Total mutual funds	3,220,783	3,220,783	-0-	-0-
US Government obligations	7,922,194	7,922,194	-0-	-0-
Corporate obligations				
Low yield	6,551,711	-0-	6,551,711	-0-
Mid yield	12,757,460	-0-	12,757,460	-0-
High yield	5,277,830	-0-	5,277,830	-0-
Total corporate obligations	24,587,001	-0-	24,587,001	-0-
	46,914,331	<u>\$ 22,327,330</u>	<u>\$ 24,587,001</u>	<u>\$ -0-</u>
Money market deposit accounts	32,910,311			
Certificates of deposit*	6,276,467			
Total investments limited as to use	<u>\$ 86,101,109</u>			

* Certificates of deposit are reported at contract value

The System's policy is to recognize transfers between levels as of the end of the reporting period. There were no transfers during 2016 and 2015.

The System holds investments which are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

Fair Value of Investments in Entities that Use Net Asset Value

The following table summarizes investments measured at fair value based on net asset value (NAVs) per share as of December 31, 2016 and 2015, respectively. The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

<u>December 31, 2016</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Mutual funds	\$ 26,285,975	Not applicable	Daily	Daily

<u>December 31, 2015</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Mutual funds	\$ 3,220,783	Not applicable	Daily	Daily

The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

Cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements approximate fair value based on short term maturity.

Long-term debt: The fair value of the Corporation's long-term debt for the mortgage payable insured by the United States Department of Housing and Urban Development (HUD) and 2015 fixed rate service line loan approximates the carrying value of \$267,158,000 as of December 31, 2016. For the Series 2011, 2007, and 1993 fixed rate tax exempt bonds and 2015 fixed rate service line loan approximated \$267,520,000 as of December 31, 2015. The fair value of variable rate debt (2010 loan) approximates its carrying value of \$3,439,000 as of December 31, 2016. The fair value of variable rate debt (2010 loan and 2014 bonds) approximated its carrying value of \$15,387,000 as of December 31, 2015.

8. ENDOWMENT FUNDS

The Corporation's endowment consists of individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The objective is to meet or exceed the market index, or blended market index, selected and agreed upon by the Corporation or provide an acceptable return with lower volatility or credit risk. In order to meet its needs, the investment strategy of the Corporation is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income. As shown below, none of the net investment income reflected is unrestricted income as that income has been earned and shown in non-operating gains (losses) on the consolidated statements of operations and changes in net assets. Specifically, the primary objective in the investment management for endowment fund assets shall be long-term growth of capital and to emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated in as much as it is consistent with the volatility of a comparable market index. Endowment fund assets may be invested only in investment grade bonds rated BBB (or equivalent) or better. The board of directors has interpreted the relevant law as requiring prudent preservation of the fund and evaluates the amounts of unrestricted income and the unrealized gains and losses periodically. During 2016, upon receiving related trustee consent, the Corporation's Board of Directors mutually approved to transfer ownership of all endowment funds to Union Health Foundation, Inc. for more appropriate oversight and investment return maximization.

The Corporation has a policy of appropriating for distribution the earned income.

The endowment net assets by type of fund as of December 31, 2016 and 2015:

	2016	2015
Donor-restricted endowment funds		
Permanently restricted	\$ -0-	\$ 1,548,109
Total endowment funds	\$ -0-	\$ 1,548,109

For 2016 and 2015, the Corporation had the following endowment-related activities:

	Permanently restricted	
	2016	2015
Endowment net assets, beginning of year	\$ 1,548,109	\$ 1,573,096
Transfer of endowments to Union Health Foundation, Inc.	(1,520,937)	-0-
Net investment income	(27,172)	(24,987)
Endowment net assets, end of year	\$ -0-	\$ 1,548,109

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

9. LONG-TERM DEBT

The following is a summary of long-term debt as of December 31, 2016 and 2015:

	2016	2015
Indiana Health and Educational Facility Financing Authority or Hospital Authority of Vigo County (Indiana):		
Series 2011, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2015 through 2041. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 7.5% to 8% and averages 7.82%. Includes bond discount of approximately \$782,000 as of December 31, 2015. Paid in full during 2016.	\$ -0-	\$ 53,273,124
Series 2007, tax-exempt demand revenue bonds payable in annual installments commencing in fiscal 2027 through 2047. Interest rate is fixed (payable semiannually) during the term the bonds are outstanding and ranges from 5.50% to 5.80% and averages 5.74%. Includes bond discount of approximately \$330,000 as of December 31, 2015. Refinanced with HUD mortgage loan during 2016.	-0-	176,169,586
Series 1993, tax-exempt fixed rate serial and term bonds, payable in annual principal installments through fiscal 2024. Interest (payable semiannually) ranges from 5.125% to 5.250% and averages 5.20% in fiscal 2015. Refinanced with HUD mortgage loan during 2016.	-0-	17,475,000
Series 2014A, taxable variable rate demand revenue bonds, payable in annual principal installments through fiscal 2036. Interest rate is set weekly (payable monthly) and averages 2.56% in fiscal 2015. Refinanced with HUD mortgage loan during 2016.	-0-	11,660,000
Mortgage note payable (project 073-22274) in the original amount of approximately \$266,600,000 bearing fixed interest on the unpaid balance at 3.33%, payable in monthly installments of principal and interest of approximately \$1,310,000, maturing on September 1, 2041.	264,308,121	-0-
Loan payable in monthly principal installments commencing in fiscal 2010 through fiscal 2026. Fixed term with variable interest rate set monthly (payable monthly) using LIBOR based rates and averages 4.13% in 2016.	3,439,000	3,726,600
Loan payable for purchase of a medical group service line in June 2015, due April 2019, with monthly installments of approximately \$102,000. A fixed interest rate is set at 3.25%.	2,850,230	3,965,785
Note payable to bank in monthly principal installments commencing in fiscal year 2011 through fiscal year 2016. Fixed term with interest rate of 4.25%. Paid in full during 2016	-0-	65,604
Capital leases and other	20,872,962	21,662,330
Total long-term debt	291,470,313	287,998,029
Less current portion	9,042,190	5,450,916
Less unamortized debt issue costs	4,474,791	2,696,320
	\$ 277,953,332	\$ 279,850,793

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The scheduled maturities and mandatory redemptions of long-term debt are as follows:

Year Ending December 31,	
2017	\$ 9,042,190
2018	9,034,513
2019	8,561,809
2020	8,300,279
2021	8,548,407
Thereafter	247,983,115
	<u>\$ 291,470,313</u>

During August 2016, the System refinanced outstanding debt (Series 2011, 2007, 1993, and 2014A bonds) with an approximate \$266,600,000 mortgage loan insured by the U.S. Department of Housing and Urban Development (HUD), authorized pursuant to Section 242 of the National Housing Act and the corresponding Regulations issued thereunder. The lender of this mortgage is Jones Lang LaSalle Multifamily, LLC. The agreement has monthly principal and interest payments of approximately \$1,310,000 from September 2016 through September 2041. This loan is secured by substantially all current and future properties and revenues of the System with the exception of identified excluded assets and subsidiaries in the terms of the Regulatory Agreement.

As noted below, the 2011 and 2007 bonds were not callable until 2021 and 2017, respectively. The future, semi-annual interest payments required until the callable event and the removal of prior debt issuance costs caused the Corporation to recognize a loss on refinancing of approximately \$29,000,000, reflected as a component of non-operating gains (losses) on the consolidated statement of operations and changes in net assets.

In February 2011, the Corporation issued, through the Hospital Authority of Vigo County (Indiana), Hospital Revenue Bonds, Series 2011 (tax-exempt bonds) in the aggregate amount of \$55 million, net of bond discount, principally to finance, or reimburse the Corporation for, the costs of constructing, acquiring, equipping, or renovating certain capital assets of the Corporation, and to refund the Indiana Health Facility Financing Authority Variable Rate Demand Bonds, Series 2002 and the Indiana Health and Educational Facility Financing Authority Variable Rate Demand Revenue Bonds, Series 2006A, and for bond issuance cost, debt service reserve fund, and capitalized interest during the construction period. The interest rate is fixed and ranges from 7.5 to 8%. Term bonds expire in 2022 (\$10.4 million), 2031 (\$20.7 million), and 2041 (\$24.0 million) with principal payments beginning in 2015. In conjunction with the HUD Section 242 mortgage, the bonds were put into escrow until the first call date in 2021.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

During July 2007, the Corporation issued, through the Hospital Authority of Vigo County (Indiana), Hospital Revenue Bonds, Series 2007 (tax-exempt bonds) in the aggregate amount of \$176.5 million principally to finance, or reimburse the Corporation for, the costs of acquisition, construction, furnishing, and equipping of a new 500,000 square-foot hospital building, and certain renovations of the existing hospital facility, bond issuance cost, debt service reserve fund, and capitalized interest during the construction period. The interest rate is fixed and ranges from 5.50% to 5.80%. Term bonds expire in 2027 (\$7.4 million), 2037 (\$52.2 million), 2042 (\$50.3 million), and 2047 (\$66.6 million) with principal payments beginning in 2024. In conjunction with the HUD Section 242 mortgage, the bonds were put into escrow until the first call date in 2017.

On April 25, 2014, the Corporation issued through the Hospital Authority of Vigo County (the Authority), Hospital Revenue Bonds, Series 2014A (taxable bonds) in the aggregate amount of \$12,105,000, principally to finance, or reimburse the Corporation to refund the Indiana Health Facility Financing Authority Variable Rate Demand Bonds, Series 2006B. The interest rate is variable and averages 2.56%. The term bonds expire in 2036 with principal payments beginning in 2015. During 2014, the Corporation, the Authority, and JP Morgan Chase entered into Bond Purchase Contracts (Contracts) whereby JP Morgan Chase purchased from the Authority all of the series 2014A bonds in a private placement.

Under the terms of the Contracts, JP Morgan Chase agreed to hold the Series 2014A bonds through April 23, 2021. At the end of the initial bank purchase date for the Series 2014A bonds, these bonds could be remarketed to the original holders or to new investors at interest rate options as provided in the bond documents. If the Series 2014A bonds cannot be remarketed at the end of the initial bank purchase date, the Corporation would be subject to payment of the remaining principal. The bonds were paid in full in 2016 with the HUD Section 242 mortgage refinancing

The Series 1993 tax-exempt Bonds are secured by a security interest in unrestricted receivables (as defined in the bond agreements) of the Corporation. Payment of principal and interest on the Series 1993 Bonds is guaranteed under a municipal bond insurance policy. In February 2004, the Corporation made a tender offer to existing 1993 Bondholders for a 103% tender price, which was accepted. A bank purchased the tendered bonds for par value. The bonds were paid in full in 2016 with the HUD Section 242 mortgage refinancing

In June 2015, the Corporation financed the purchase of a medical group's Cardiac Cath Lab service line for approximately \$4,600,000. The terms of the loan used to finance the purchase are shown in the summary table above. Payments made during the years ended December 31, 2016 and 2015 totaled approximately \$1,116,000 and \$634,000, respectively. The related intangible asset, reflecting the fair value of medical records and a non-compete contract, is a component of intangible assets at net value within the consolidated balance sheets.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The System leases, buildings, medical equipment and software under capital leases with various expiration dates. Cost and accumulated depreciation of the buildings and equipment under capital leases was approximately \$20,700,000 and \$20,900,000, respectively, and \$2,600,000 and \$2,000,000, respectively, at December 31, 2016 and 2015.

The following is a schedule by year of future minimum lease payments under capital leases as of December 31, 2016, that have initial or remaining lease terms in excess of one year.

Year Ending December 31,	
2017	\$ 2,110,259
2018	2,007,193
2019	2,000,410
2020	1,965,804
2021	1,935,660
Thereafter	79,845,975
	<u>89,865,301</u>
Less imputed interest	70,075,845
	<u>\$ 19,789,456</u>

The System has operating leases for medical equipment and office space. Total rent and lease expense for the years ended December 31, 2016 and 2015 was \$12,400,000 and \$11,000,000, respectively. Future minimum lease payments under noncancelable operating leases as of December 31, 2016 that have initial or remaining lease terms in excess of one year are as follows:

Year Ending December 31,	
2017	\$ 4,394,282
2018	3,306,428
2019	2,122,367
2020	1,259,143
2021	1,010,067
Thereafter	270,220
	<u>\$ 12,362,507</u>

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

10. NONCONTROLLING INTEREST

The following table depicts the changes in consolidated net assets attributable to the controlling financial interest of the Corporation and the 49% non-controlling interest Clinical Management Solutions, LLC holds in Union Hospital Therapy, LLC (UHT).

	Controlling Interest	Noncontrolling Interest	Total
Balance December 31, 2014	\$ 124,557,791	\$ 433,826	\$ 124,991,617
Change in net assets, before distribution to owners	11,806,330	1,194,342	13,000,672
Distribution to owners	(1,240,051)	(1,191,422)	(2,431,473)
Change in net assets, after distribution to owners	10,566,279	2,920	10,569,199
Balance December 31, 2015	135,124,070	436,746	135,560,816
Change in net assets, before distribution to owners	(11,002,823)	1,386,449	(9,616,374)
Distribution to owners	(1,327,089)	(1,275,046)	(2,602,135)
Change in net assets, after distribution to owners	(12,329,912)	111,403	(12,218,509)
Balance December 31, 2016	\$ 122,794,158	\$ 548,149	\$ 123,342,307

11. PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

The Corporation has a noncontributory, defined-benefit plan (the Plan) covering substantially all of its employees who are at least 21 years old and have completed one year of service, and certain employees meeting those requirements of affiliated organizations. The Plan provides for retirement, survivor, and severance benefits. Employees with five or more years of service are entitled to monthly pension benefits beginning at normal retirement age (65) equal to their credited service multiplied by 1/60th of 1% of the total of their annual compensation for the five consecutive plan years which produce the highest total. The Corporation has agreed to contribute such amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members. Contributions include normal cost, interest on unfunded prior service cost, and amortization of prior service cost over a period not exceeding 30 years. The Plan has met the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The Corporation instituted a special voluntary early-retirement pension and health insurance benefit for eligible employees between the ages of 55 to 60 and above through multiple phases throughout 2011. Employees who applied and qualified under the program received monthly annuities based upon the value of their pension, as well as COBRA health benefits for up to 18 months at the current employee costs. Upon the 19th month and until reaching the age of 65, the Corporation will deposit \$500 a month into a benefits account per qualifying retiree to be used for the health benefits.

The liability outstanding for the estimated cost for those in the program is approximately \$509,000 and \$758,000 as of December 31, 2016 and 2015. Of these amounts, approximately \$215,000 and \$316,000 were recorded as salaries, wages, and related liabilities and approximately \$294,000 and \$442,000 were recorded as pension liability and related obligations on the consolidated balance sheets as of December 31, 2016 and 2015, respectively.

The Corporation recognizes the unfunded status of its defined-benefit pension plan in its consolidated balance sheets and the changes therein within its consolidated statements of operations and changes in net assets. Unfunded status is defined as the difference between the projected benefit obligation and the fair value of plan assets. Prior unrecognized net actuarial losses of approximately \$44,827,000 and \$35,755,000 have been included in the unrestricted net assets at December 31, 2016 and 2015, respectively, and have not yet been recognized in net periodic pension cost. The adjustment to unrestricted net assets consisted primarily of the change in cumulative losses on the retirement plan and changes in the funded status for the years ended December 31, 2016 and 2015.

Actuarial losses included in unrestricted net assets at December 31, 2016 and 2015, and expected to be amortized in net periodic benefit cost were approximately \$3,853,000 and \$2,001,000.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The following table sets forth the defined-benefit pension plan's benefit obligations, fair value of the Plan's assets, and unfunded status at December 31, 2016 and 2015:

	2016	2015
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 95,037,622	\$ 99,595,005
Interest cost	4,466,036	4,778,740
Benefits paid	(8,723,562)	(15,093,199)
Actuarial loss	10,712,719	4,428,784
Effect of settlement/curtailment	-0-	1,328,292
Benefit obligation, ending of year	\$ 101,492,815	\$ 95,037,622
Changes in plan assets		
Fair value of plan assets, beginning of year	\$ 87,927,316	\$ 95,555,020
Actual return on plan assets	3,379,046	(1,774,505)
Employer contributions	9,240,000	9,240,000
Benefits paid	(8,723,562)	(15,093,199)
Fair value of plan assets, end of year	\$ 91,822,800	\$ 87,927,316
Unfunded status		
Unfunded status of the plan, end of year	\$ (9,670,015)	\$ (7,110,306)

The unfunded obligation is recorded as a component of pension liability and related obligations on the consolidated balance sheets.

During 2016 and 2015, a lump sum payment was offered in lieu of annuities to all participating employees age 62 and older, any terminated and fully vested participants, and any new retirees. Approximately \$4,405,000 and \$10,605,000 of lump sum payments were made during 2016 and 2015, respectively, and included as a component of benefits paid in the table above.

The liability recorded to account for the unfunded status of the plan at year end is recognized within the pension liability and related obligations on the consolidated balance sheet as of December 31, 2016 and 2015.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The following is a summary of the components of net periodic pension costs:

	2016	2015
Components of net benefit cost		
Interest cost	\$ 3,951,628	\$ 4,778,740
Expected return on plan assets	(1,850,421)	(6,250,093)
Actuarial loss	3,853,029	2,000,596
Net periodic benefit cost	5,954,236	529,243
Settlement cost	-0-	3,990,490
Net benefit cost	\$ 5,954,236	\$ 4,519,733

The Corporation recognized a settlement loss of approximately \$3,990,000 during 2015, which relates to the settlement payments made during 2015. The losses represent a proportion of previously unrecognized losses included in unrestricted net assets. The settlement losses are included in the pension settlement line in the 2015 consolidated statements of operations and changes in net assets.

The following is a schedule, by year, of expected benefit payments, which reflect expected future service.

Year Ending December 31,	
2017	\$ 7,843,499
2018	7,092,004
2019	7,130,664
2020	7,611,904
2021	7,130,353
2022-2026	30,288,368
	\$ 67,096,792

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The weighted-average assumptions used to determine the Plan's projected benefit obligation (PBO) and net periodic benefit costs (NPBC) for the years ended December 31, 2016 and 2015, are as follows:

	2016	2015
Discount rate	4.1%	4.9%
Expected return on plan assets	2.0%	5.3%
Rate of compensation increase - NPBC	Not Applicable	Not Applicable

The principal long-term determinant of a portfolio's investment return is its asset allocation. In addition, active management strategies have added value relative to passive benchmark returns. The expected long-term rate of return assumption is based on the mix of assets in the Plan, the long-term earnings expected to be associated with each asset class, and the additional return expected through active management.

The Plan's weighted-average asset allocations at December 31, 2016 and 2015, by asset category, are as follows:

	2016	2015
Mutual funds - equity funds	0%	57%
Mutual funds - bond funds	96%	41%
Other	4%	2%
	100%	100%

The following is an analysis of fair value of the major classes of plan assets as of December 31, 2016 and 2015:

	Fair Value	
	2016	2015
Money market mutual funds	\$ 3,299,348	\$ 1,669,279
Mutual funds - equity funds	-0-	49,412,765
Mutual funds - bond funds	88,523,452	35,631,026
Private equity funds	-0-	1,214,246
Total	\$ 91,822,800	\$ 87,927,316

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

See footnote 7 for information on valuation techniques for money market mutual funds and mutual funds. The private equity funds are considered level 3 assets in the fair value hierarchy, as the inputs to the valuation methodology are unobservable and significant to the fair value measurement. The fair value of the private equity funds are valued at the NAV of units of the funds. The NAV, as provided by the investment manager, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. Due to the nature of the investments held by the fund, changes in market conditions and the economic environment may significantly impact the net asset value of the fund and, consequently, the fair value of the Corporation's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is therefore reasonably possible that if the Corporation were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.

The following is a reconciliation of the fair value of plan assets as of December 31, 2016 and 2015 determined on the basis of level 3 valuation techniques:

	Private Equity Funds	
	2016	2015
Balance, beginning of year	\$ 1,214,246	\$ 1,214,728
Return on plan assets:		
Assets held at the end of the year	-0-	(482)
Sales	(1,214,246)	-0-
Balance, end of year	<u>\$ -0-</u>	<u>\$ 1,214,246</u>

The Plan employs an investment advisor to monitor the Plan's investment managers and make investment recommendations to the Corporation. The Corporation invests fund balances in a structured portfolio of equity and bond mutual funds and alternative investments. The target allocation strategy for the Plan is to have its investment portfolio comprise approximately 95% debt instruments, and 5% in other investments.

Projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category.

The Corporation expects to contribute approximately \$9,240,000 to the pension plan in calendar year 2017 and will meet the required funding amounts for 2016. The Corporation elected to freeze the Plan in 2010, but will continue to fund the plan as required.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2016 AND 2015

The Corporation also has a 403b defined contribution plan which includes a 50% employer match up to 6% of employee deferrals in addition to an employer discretionary add-on of 1.67% for the years ended December 31, 2016 and 2015. The related contributions for the plan approximated \$3,829,000 and \$3,316,000 for the years ended December 31, 2016 and 2015, respectively.

UAPC also has a 401(k) discretionary defined contribution plan for which contributions during the years ended December 31, 2016 and 2015 were approximately \$1,715,000 and \$1,200,000, respectively.

12. INVESTMENTS IN JOINT VENTURES

The Corporation owns approximately 18% of the Indiana Healthcare Reciprocal Risk Retention Group (IHRRRG). The Corporation accounted for the investment under the equity method of accounting, as the governance structure is such that the Corporation cannot exercise control. The Corporation's 18% interest in IHRRRG amounts to approximately \$3,016,000 and \$3,016,000 as of December 31, 2016 and 2015, respectively. The interest is recorded in investments in joint ventures on the consolidated balance sheets and the Corporation's gain on its investment in IHRRRG is recorded in other non-operating gains (losses) on the consolidated statements of operations and changes in net assets.

The Corporation has ownership interest in other joint ventures accounted for under the equity method, the effects of which are immaterial to the consolidated financial statements as a whole.

13. COMMITMENTS AND CONTINGENCIES

The System is involved in other litigation arising in the normal course of business. After consultation with legal counsel, it is management's opinion that these matters will be resolved without a material adverse effect on the System's financial position or consolidated results of operations, changes in net assets, and cash flows.

14. SUBSEQUENT EVENT

In January 2017, the Board of Directors and Pension Committee of the Corporation approved to terminate the defined-benefit plan with an anticipated effective date in 2017.

SUPPLEMENTARY INFORMATION

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2016

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit
Assets					
Current assets					
Cash and cash equivalents	\$ 66,419,631	\$ 947,460	\$ -0-	\$ -0-	\$ 67,367,091
Funds held by trustee, current portion	-0-	-0-	-0-	-0-	-0-
Board designated funds, current portion	-0-	-0-	-0-	-0-	-0-
Patient accounts receivable, net	51,760,295	3,707,704	-0-	-0-	55,467,999
Inventories	4,765,820	549,807	-0-	-0-	5,315,627
Due from related parties	-0-	1,091,781	3,116,589	(4,208,370)	-0-
Prepaid expenses and other current assets	11,354,990	816,714	-0-	-0-	12,171,704
Total current assets	134,300,736	7,113,466	3,116,589	(4,208,370)	140,322,421
Investments limited as to use, less current portion					
Funds held by trustee	1,568,237	-0-	-0-	-0-	1,568,237
Board designated funds	69,205,212	-0-	-0-	-0-	69,205,212
Total investments limited as to use	70,773,449	-0-	-0-	-0-	70,773,449
Property and equipment					
Land and improvements	37,876,725	-0-	-0-	-0-	37,876,725
Buildings and fixed equipment	345,347,434	19,556,552	-0-	-0-	364,903,986
Movable equipment	137,854,386	3,212,412	5,808	-0-	141,072,606
	521,078,545	22,768,964	5,808	-0-	543,853,317
Less allowances for depreciation	276,243,160	3,807,524	1,992	-0-	280,052,676
	244,835,385	18,961,440	3,816	-0-	263,800,641
Construction in progress	13,699,629	73,644	-0-	-0-	13,773,273
Total property and equipment, net	258,535,014	19,035,084	3,816	-0-	277,573,914
Other assets					
Due from Union Health Foundation, Inc.	2,693,583	-0-	-0-	-0-	2,693,583
Intangible assets, net and other assets	3,847,805	39,787	-0-	-0-	3,887,592
Investment in joint ventures	(915,707)	491,666	(3,931,934)	7,863,868	3,507,893
	5,625,681	531,453	(3,931,934)	7,863,868	10,089,068
Total assets	\$ 469,234,880	\$ 26,680,003	\$ (811,529)	\$ 3,655,498	\$ 498,758,852

See Report of Independent Auditors on Pages 1 - 3.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2016

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit
Liabilities and net assets					
Current liabilities					
Accounts payable and other current liabilities	\$ 35,317,875	\$ 1,095,396	\$ -0-	\$ -0-	\$ 36,413,271
Salaries, wages and related liabilities	22,824,499	9,911,010	69	-0-	32,735,578
Estimated third party settlements	4,960,974	-0-	-0-	-0-	4,960,974
Due to related entities	-0-	4,133,989	3,120,336	(2,907,376)	4,346,949
Current portion of long-term debt	9,005,430	36,760	-0-	-0-	9,042,190
Total current liabilities	<u>72,108,778</u>	<u>15,177,155</u>	<u>3,120,405</u>	<u>(2,907,376)</u>	<u>87,498,962</u>
Long-term liabilities					
Long-term debt, less current portion	258,586,616	19,366,716	-0-	-0-	277,953,332
Pension liability and related obligations	9,964,251	-0-	-0-	-0-	9,964,251
Other long-term liabilities	1,300,994	-0-	-0-	(1,300,994)	-0-
Total long-term liabilities	<u>269,851,861</u>	<u>19,366,716</u>	<u>-0-</u>	<u>(1,300,994)</u>	<u>287,917,583</u>
Total liabilities	341,960,639	34,543,871	3,120,405	(4,208,370)	375,416,545
Net assets					
Unrestricted	123,528,422	(7,863,868)	(3,931,934)	7,863,868	119,596,488
Noncontrolling interests in UHT, LLC	548,149	-0-	-0-	-0-	548,149
Total unrestricted net assets	<u>124,076,571</u>	<u>(7,863,868)</u>	<u>(3,931,934)</u>	<u>7,863,868</u>	<u>120,144,637</u>
Temporarily restricted	3,197,670	-0-	-0-	-0-	3,197,670
Total net assets	<u>127,274,241</u>	<u>(7,863,868)</u>	<u>(3,931,934)</u>	<u>7,863,868</u>	<u>123,342,307</u>
Total liabilities and net assets	<u>\$ 469,234,880</u>	<u>\$ 26,680,003</u>	<u>\$ (811,529)</u>	<u>\$ 3,655,498</u>	<u>\$ 498,758,852</u>

See Report of Independent Auditors on Pages 1 - 3.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2015

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit - As Restated
Assets					
Current assets					
Cash and cash equivalents	\$ 42,055,967	\$ 2,801,043	\$ -0-	\$ -0-	\$ 44,857,010
Funds held by trustee, current portion	6,162,514	-0-	-0-	-0-	6,162,514
Board designated funds, current portion	1,363,310	-0-	-0-	-0-	1,363,310
Patient accounts receivable, net	53,770,430	4,726,972	-0-	-0-	58,497,402
Inventories	4,550,182	577,377	-0-	-0-	5,127,559
Due from related parties	-0-	3,742,738	3,116,589	(6,859,327)	-0-
Prepaid expenses and other current assets	6,032,607	1,336,476	-0-	-0-	7,369,083
Total current assets	113,935,010	13,184,606	3,116,589	(6,859,327)	123,376,878
Investments limited as to use, less current portion					
Funds held by trustee	24,344,185	-0-	-0-	-0-	24,344,185
Board designated	52,682,991	-0-	-0-	-0-	52,682,991
Permanently restricted	1,548,109	-0-	-0-	-0-	1,548,109
Total investments limited as to use	78,575,285	-0-	-0-	-0-	78,575,285
Property and equipment					
Land and improvements	38,516,464	-0-	-0-	-0-	38,516,464
Buildings and fixed equipment	343,176,373	19,556,552	-0-	-0-	362,732,925
Movable equipment	132,580,686	2,800,107	5,808	-0-	135,386,601
	514,273,523	22,356,659	5,808	-0-	536,635,990
Less allowances for depreciation	259,053,753	2,936,617	1,992	-0-	261,992,362
	255,219,770	19,420,042	3,816	-0-	274,643,628
Construction in progress	5,985,110	-0-	-0-	-0-	5,985,110
Total property and equipment, net	261,204,880	19,420,042	3,816	-0-	280,628,738
Other assets					
Due from Union Health Foundation, Inc.	2,950,678	-0-	-0-	-0-	2,950,678
Intangible assets, net	4,206,301	-0-	-0-	-0-	4,206,301
Investment in joint ventures	3,043,627	834,456	27,399	(54,799)	3,850,683
	10,200,606	834,456	27,399	(54,799)	11,007,662
Total assets	\$ 463,915,781	\$ 33,439,104	\$ 3,147,804	\$ (6,914,126)	\$ 493,588,563

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2015

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit - As Restated
Liabilities and net assets					
Current liabilities					
Accounts payable and other current liabilities	\$ 23,809,716	\$ 1,053,397	\$ -0-	\$ (1,922,978)	\$ 22,940,135
Salaries, wages and related liabilities	19,955,536	8,348,858	-0-	-0-	28,304,394
Estimated third party settlements	4,695,484	-0-	-0-	-0-	4,695,484
Accrued interest	5,134,370	-0-	-0-	-0-	5,134,370
Due to related parties	-0-	4,163,526	3,120,405	(3,241,398)	4,042,533
Current portion of long-term debt	5,020,634	430,282	-0-	-0-	5,450,916
Total current liabilities	<u>58,615,740</u>	<u>13,996,063</u>	<u>3,120,405</u>	<u>(5,164,376)</u>	<u>70,567,832</u>
Long-term liabilities					
Long-term debt, less current portion	260,462,551	19,388,242	-0-	-0-	279,850,793
Pension liability and related obligations	7,609,122	-0-	-0-	-0-	7,609,122
Other long-term liabilities	1,694,951	-0-	-0-	(1,694,951)	-0-
Total long-term liabilities	<u>269,766,624</u>	<u>19,388,242</u>	<u>-0-</u>	<u>(1,694,951)</u>	<u>287,459,915</u>
Total liabilities	328,382,364	33,384,305	3,120,405	(6,859,327)	358,027,747
Net assets					
Unrestricted	130,138,207	54,799	27,399	(54,799)	130,165,606
Noncontrolling interests in UHT, LLC	436,746	-0-	-0-	-0-	436,746
Total unrestricted net assets	<u>130,574,953</u>	<u>54,799</u>	<u>27,399</u>	<u>(54,799)</u>	<u>130,602,352</u>
Temporarily restricted	3,410,355	-0-	-0-	-0-	3,410,355
Permanently restricted	1,548,109	-0-	-0-	-0-	1,548,109
Total net assets	<u>135,533,417</u>	<u>54,799</u>	<u>27,399</u>	<u>(54,799)</u>	<u>135,560,816</u>
Total liabilities and net assets	<u>\$ 463,915,781</u>	<u>\$ 33,439,104</u>	<u>\$ 3,147,804</u>	<u>\$ (6,914,126)</u>	<u>\$ 493,588,563</u>

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2016

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit
Operating revenue					
Net patient service revenue	\$ 466,973,604	\$ 58,277,127	\$ -0-	\$ (76,609)	\$ 525,174,122
Less provision for bad debts	25,226,391	2,651,755	-0-	-0-	27,878,146
Net patient service revenue net of provision for bad debts	441,747,213	55,625,372	-0-	(76,609)	497,295,976
Other revenue	11,067,875	6,237,880	28,172,138	(29,791,398)	15,686,495
Total operating revenue	452,815,088	61,863,252	28,172,138	(29,868,007)	512,982,471
Operating expenses					
Physician, Mid-level, and other provider salaries and wages	20,710,479	36,897,124	-0-	-0-	57,607,603
Other salaries and wages	101,719,829	0	27,152	(27,152)	101,719,829
Employee benefits	32,400,193	3,845,263	2,496	(2,496)	36,245,456
Medical supplies and drugs	77,138,068	9,876,774	-0-	-0-	87,014,842
Physician services	12,363,247	-0-	-0-	-0-	12,363,247
Contract services - management service organization support staff	6,939,580	24,500,990	25,490,101	(25,490,101)	31,440,570
Contract services - other	60,363,875	1,067,927	2,607,397	(3,864,553)	60,174,646
Rent and leases	7,685,582	4,762,575	2,512	(441,225)	12,009,444
Utilities, supplies, and other	31,545,301	5,176,257	42,480	(42,480)	36,721,558
Hospital assessment fee	15,184,385	-0-	-0-	-0-	15,184,385
Depreciation and amortization	19,168,933	870,908	-0-	-0-	20,039,841
Interest	14,538,245	2,057,579	-0-	-0-	16,595,824
Total operating expenses	399,757,717	89,055,397	28,172,138	(29,868,007)	487,117,245
Income (loss) from operations	53,057,371	(27,192,145)	-0-	-0-	25,865,226
Non-operating gains (losses)					
Investment income	1,445,263	17,040	-0-	-0-	1,462,303
Loss on investment in UAPC	(7,659,333)	-0-	(3,959,334)	11,618,667	-0-
Loss on refinancing debt with HUD 242 mortgage insurance program	(29,190,407)	-0-	-0-	-0-	(29,190,407)
Other	(253,800)	756,438	1	-0-	502,639
Total non-operating gains (losses)	(35,658,277)	773,478	(3,959,333)	11,618,667	(27,225,465)
Excess of revenue over (under) expenses	\$ 17,399,094	\$ (26,418,667)	\$ (3,959,333)	\$ 11,618,667	\$ (1,360,239)

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2016

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit
Other changes in unrestricted net assets					
Pension related changes other than net pension cost	\$ (9,071,119)	\$ -0-	\$ -0-	\$ -0-	\$ (9,071,119)
Distribution to owners	(1,275,046)	-0-	-0-	-0-	(1,275,046)
Net unrealized loss on investments	1,243,599	-0-	-0-	-0-	1,243,599
Transfers for property and equipment additions	5,090	-0-	-0-	-0-	5,090
Transfers between Union Hospital, Inc. and UHS	(14,800,000)	-0-	14,800,000	-0-	-0-
Transfers between UHS and UAPC	-0-	14,800,000	(14,800,000)	-0-	-0-
Capital contributions	-0-	3,700,000	-0-	(3,700,000)	-0-
Change in unrestricted net assets	<u>(6,498,382)</u>	<u>(7,918,667)</u>	<u>(3,959,333)</u>	<u>7,918,667</u>	<u>(10,457,715)</u>
Temporarily restricted net assets					
Other changes in receivable from Union Health Foundation, Inc.	(207,595)	-0-	-0-	-0-	(207,595)
Net assets released for property and equipment	(5,090)	-0-	-0-	-0-	(5,090)
Change in temporarily restricted net assets	<u>(212,685)</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>(212,685)</u>
Permanently restricted net assets					
Transfer of endowments to Union Health Foundation, Inc.	(1,520,937)	-0-	-0-	-0-	(1,520,937)
Net investment income	(27,172)	-0-	-0-	-0-	(27,172)
Change in permanently restricted net assets	<u>(1,548,109)</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>(1,548,109)</u>
Change in net assets	(8,259,176)	(7,918,667)	(3,959,333)	7,918,667	(12,218,509)
Net assets					
Beginning of year	135,533,417	54,799	27,399	(54,799)	135,560,816
End of year	<u>\$ 127,274,241</u>	<u>\$ (7,863,868)</u>	<u>\$ (3,931,934)</u>	<u>\$ 7,863,868</u>	<u>\$ 123,342,307</u>

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2015

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit - As Restated
Operating revenue					
Net patient service revenue	\$ 441,530,792	\$ 61,938,172	\$ -0-	\$ -0-	\$ 503,468,964
Less provision for bad debts	30,970,409	2,911,124	-0-	-0-	33,881,533
Net patient service revenue net of provision for bad debts	410,560,383	59,027,048	-0-	-0-	469,587,431
Other revenue	8,812,683	3,793,023	28,172,140	(28,171,786)	12,606,060
Total operating revenue	419,373,066	62,820,071	28,172,140	(28,171,786)	482,193,491
Operating expenses					
Physician, Mid-level, and other provider salaries and wages	30,564,633	28,953,816	-0-	-0-	59,518,449
Other salaries and wages	99,047,361	-0-	27,152	(27,152)	99,047,361
Employee benefits	26,008,435	2,375,724	1,483,214	(1,483,214)	28,384,159
Supplies and drugs	59,647,028	12,290,888	-0-	-0-	71,937,916
Physician services	5,940,891	-0-	-0-	-0-	5,940,891
Contract services - management service organization support staff	6,544,846	21,552,643	21,274,344	(21,274,344)	28,097,489
Contract services - other	67,271,274	5,735,175	5,341,567	(5,341,567)	73,006,449
Rent and leases	8,609,211	2,378,048	2,514	(2,514)	10,987,259
Utilities, supplies, and other	26,545,712	4,206,034	43,349	(43,349)	30,751,746
Hospital assessment fee	13,612,043	-0-	-0-	-0-	13,612,043
Depreciation and amortization	19,415,666	927,599	-0-	-0-	20,343,265
Interest	16,123,546	1,992,233	-0-	-0-	18,115,779
Total operating expenses	379,330,646	80,412,160	28,172,140	(28,172,140)	459,742,806
Income (loss) from operations before pension settlement	40,042,420	(17,592,089)	-0-	354	22,450,685
Pension settlement					
	(3,990,490)	-0-	-0-	-0-	(3,990,490)
Income (loss) from operations after pension settlement	36,051,930	(17,592,089)	-0-	354	18,460,195
Nonoperating gains (losses)					
Investment income	1,716,476	2,306	-0-	-0-	1,718,782
Loss on investment in UAPC	(5,256,471)	-0-	(545,626)	5,802,097	-0-
Other	299,940	411,787	-0-	-0-	711,727
Total nonoperating gains (losses)	(3,240,055)	414,093	(545,626)	5,802,097	2,430,509
Excess of revenue over (under) expenses	\$ 32,811,875	\$ (17,177,996)	\$ (545,626)	\$ 5,802,451	\$ 20,890,704

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UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2015

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Union Health System	Eliminations	Total Reporting Unit
Other changes in unrestricted net assets					
Pension related changes other than net pension cost	\$ (7,790,558)	\$ -0-	\$ -0-	\$ -0-	\$ (7,790,558)
Distribution to owners	(1,191,422)	-0-	-0-	-0-	(1,191,422)
Net unrealized loss on investments	(1,875,949)	-0-	-0-	-0-	(1,875,949)
Transfers for property and equipment additions	45,092	-0-	-0-	-0-	45,092
Transfers between Union Hospital, Inc. and UHS	(11,375,545)	-0-	11,375,545	-0-	-0-
Transfers between UHS and UAPC	-0-	11,375,545	(11,375,545)	-0-	-0-
Capital contributions	-0-	4,711,200	-	(4,711,200)	-0-
Change in unrestricted net assets	10,623,493	(1,091,251)	(545,626)	1,091,251	10,077,867
Temporarily restricted net assets					
Other changes in receivable from Union Health Foundation, Inc.	561,411	-0-	-0-	-0-	561,411
Net assets released for property and equipment	(45,092)	-0-	-0-	-0-	(45,092)
Change in temporarily restricted net assets	516,319	-0-	-0-	-0-	516,319
Permanently restricted net assets					
Net investment income	(24,987)	-0-	-0-	-0-	(24,987)
Change in net assets	11,114,825	(1,091,251)	(545,626)	1,091,251	10,569,199
Net assets					
Beginning of year	124,418,592	1,146,050	573,025	(1,146,050)	124,991,617
End of year	\$ 135,533,417	\$ 54,799	\$ 27,399	\$ (54,799)	\$ 135,560,816

UNION HOSPITAL, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2016

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Total Union Hospital, Inc. and Subsidiaries
Operating revenue								
Net patient service revenue	\$ 439,041,993	\$ 26,393,755	\$ 465,435,748	\$ -0-	\$ 1,537,856	\$ -0-	\$ -0-	\$ 466,973,604
Less provision for bad debts	22,707,070	2,519,321	25,226,391	-0-	-0-	-0-	-0-	25,226,391
Net patient service revenue net of provision for bad debts	416,334,923	23,874,434	440,209,357	-0-	1,537,856	-0-	-0-	441,747,213
Other revenue	11,966,039	386,312	12,352,351	1,264,367	-0-	9,177,320	(11,726,163)	11,067,875
Total operating revenue	428,300,962	24,260,746	452,561,708	1,264,367	1,537,856	9,177,320	(11,726,163)	452,815,088
Operating expenses								
Physician, Mid-level, and other provider salaries and wages	15,098,952	327,330	15,426,282	515,008	-0-	4,769,189	-0-	20,710,479
Other salaries and wages	93,967,109	7,752,720	101,719,829	-0-	-0-	-0-	-0-	101,719,829
Employee benefits	29,173,266	2,298,672	31,471,938	76,795	-0-	851,460	-0-	32,400,193
Medical supplies and drugs	74,698,247	2,188,776	76,887,023	-0-	251,045	-0-	-0-	77,138,068
Physician services	12,287,290	75,957	12,363,247	-0-	-0-	-0-	-0-	12,363,247
Contract services - management service organization support staff	6,763,386	176,194	6,939,580	-0-	-0-	-0-	-0-	6,939,580
Contract services - other	57,104,758	3,239,197	60,343,955	51,700	1,340,875	-0-	(1,372,655)	60,363,875
Rent and leases	7,166,829	512,834	7,679,663	18,775	4,174	-0-	(17,030)	7,685,582
Utilities, supplies, and other	37,397,930	2,709,026	40,106,956	643,230	405,458	726,135	(10,336,478)	31,545,301
Hospital assessment fee	14,401,002	783,383	15,184,385	-0-	-0-	-0-	-0-	15,184,385
Depreciation and amortization	18,144,652	1,011,641	19,156,293	9,051	3,589	-0-	-0-	19,168,933
Interest	14,535,835	1,362	14,537,197	-0-	-0-	1,048	-0-	14,538,245
Total operating expenses	380,739,256	21,077,092	401,816,348	1,314,559	2,005,141	6,347,832	(11,726,163)	399,757,717
Income (loss) from operations	47,561,706	3,183,654	50,745,360	(50,192)	(467,285)	2,829,488	-0-	53,057,371
Non-operating gains (losses)								
Investment income	1,346,115	847	1,346,962	98,301	-0-	-0-	-0-	1,445,263
Loss on investment in UAPC	(7,659,333)	-0-	(7,659,333)	-0-	-0-	-0-	-0-	(7,659,333)
Loss on refinancing debt with HUD 242 mortgage insurance program	(29,190,407)	-0-	(29,190,407)	-0-	-0-	-0-	-0-	(29,190,407)
Other	770,896	(833)	770,063	-0-	-0-	-0-	(1,023,863)	(253,800)
Total non-operating gains (losses)	(34,732,729)	14	(34,732,715)	98,301	-0-	-0-	(1,023,863)	(35,658,277)
Excess of revenue over (under) expenses	\$ 12,828,977	\$ 3,183,668	\$ 16,012,645	\$ 48,109	\$ (467,285)	\$ 2,829,488	\$ (1,023,863)	\$ 17,399,094

UNION HOSPITAL, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2015

	Union Hospital	Union Hospital Clinton	Total Union Hospital, Inc.	IPACS, Inc.	COH	UHT, LLC	Eliminations	Total Union Hospital, Inc. As Restated
Operating revenue								
Net patient service revenue	\$ 412,703,317	\$ 27,259,059	\$ 439,962,376	\$ -0-	\$ 1,568,416	\$ -0-	\$ -0-	\$ 441,530,792
Less provision for bad debts	27,731,084	3,239,325	30,970,409	-0-	-0-	-0-	-0-	30,970,409
Net patient service revenue net of provision for bad debts	384,972,233	24,019,734	408,991,967	-0-	1,568,416	-0-	-0-	410,560,383
Other revenue	9,437,724	391,635	9,829,359	1,289,064	-0-	8,232,484	(10,538,224)	8,812,683
Total operating revenue	394,409,957	24,411,369	418,821,326	1,289,064	1,568,416	8,232,484	(10,538,224)	419,373,066
Operating expenses								
Physician, Mid-level, and other provider salaries and wages	25,296,053	514,464	25,810,517	405,846	-0-	4,348,270	-0-	30,564,633
Other salaries and wages	91,370,543	7,676,818	99,047,361	-0-	-0-	-0-	-0-	99,047,361
Employee benefits	23,342,587	1,846,021	25,188,608	73,439	-0-	746,388	-0-	26,008,435
Supplies and drugs	57,317,668	2,165,068	59,482,736	-0-	164,292	-0-	-0-	59,647,028
Physician services	5,890,704	50,187	5,940,891	-0-	-0-	-0-	-0-	5,940,891
Contract services - management service organization support staff	6,376,123	168,723	6,544,846	-0-	-0-	-0-	-0-	6,544,846
Contract services - other	64,256,564	2,963,037	67,219,601	72,272	1,129,952	-0-	(1,150,551)	67,271,274
Rent and leases	8,061,992	541,286	8,603,278	18,433	4,176	-0-	(16,676)	8,609,211
Utilities, supplies, and other	31,560,675	2,645,795	34,206,470	690,666	319,621	699,952	(9,370,997)	26,545,712
Hospital assessment fee	13,107,733	504,310	13,612,043	-0-	-0-	-0-	-0-	13,612,043
Depreciation and amortization	18,324,443	1,078,040	19,402,483	9,676	3,507	-0-	-0-	19,415,666
Interest	16,122,307	797	16,123,104	-0-	-0-	442	-0-	16,123,546
Total operating expenses	361,027,392	20,154,546	381,181,938	1,270,332	1,621,548	5,795,052	(10,538,224)	379,330,646
Income (loss) from operations before pension settlement	33,382,565	4,256,823	37,639,388	18,732	(53,132)	2,437,432	-0-	40,042,420
Pension settlement								
	(3,990,490)	-0-	(3,990,490)	-0-	-0-	-0-	-0-	(3,990,490)
Income (loss) from operations after pension settlement	29,392,075	4,256,823	33,648,898	18,732	(53,132)	2,437,432	-0-	36,051,930
Nonoperating gains (losses)								
Investment income	1,612,880	759	1,613,639	102,837	-0-	-0-	-0-	1,716,476
Loss on investment in UAPC	(5,256,471)	-0-	(5,256,471)	-0-	-0-	-0-	-0-	(5,256,471)
Other	1,614,374	(2,908)	1,611,466	-0-	-0-	-0-	(1,311,526)	299,940
Total nonoperating gains (losses)	(2,029,217)	(2,149)	(2,031,366)	102,837	-0-	-0-	(1,311,526)	(3,240,055)
Excess of revenue over (under) expenses	\$ 27,362,858	\$ 4,254,674	\$ 31,617,532	\$ 121,569	\$ (53,132)	\$ 2,437,432	\$ (1,311,526)	\$ 32,811,875

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES
SCHEDULE OF PROPERTY AND EQUIPMENT OF MORTGAGOR
YEAR ENDED DECEMBER 31, 2016

	Mortgagor	Other Activities	Consolidated System
Land and improvements	\$ 34,881,648	\$ 2,995,077	\$ 37,876,725
Buildings and fixed equipment	359,766,194	5,137,792	364,903,986
Movable equipment	141,072,606	-0-	141,072,606
	535,720,448	8,132,869	543,853,317
Less allowances for depreciation	274,487,145	5,565,531	280,052,676
Construction in progress	13,773,273	-0-	13,773,273
Total property and equipment, net	\$ 275,006,576	\$ 2,567,338	\$ 277,573,914

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2016

Grantor/Pass-through Grantor/Program	Grant ID #	CFDA Number	Federal Expenditures
Major program			
U.S. Department of Housing and Urban Development			
Mortgage Insurance - Hospitals Section 242	073-22274	14.128	\$ 266,600,300
Non-major programs			
U.S. Department of Health and Human Services			
Pass through Health Resources and Services Administration (HRSA)			
Bureau of Health Professions			
Primary Care Training and Enhancement	D58HP23232	93.884	115,497
Pass through HRSA Bureau of Health Workforce			
Primary Care Training and Enhancement	TOBHP28564-01	93.884	132,797
Primary Care Training and Enhancement	TOBHP28564-02	93.884	110,517
Total for CFDA 93.884			<u>358,811</u>
U.S. Department of Health and Human Services			
Pass through HRSA Office of Advancement of Telehealth			
Evidence-Based Tele-emergency Network Grant Program	G01RH27871-02	93.211	103,226
	G01RH27871-03	93.211	409,083
Total for CFDA 93.211			<u>512,309</u>
Pass through Indiana State Department of Health			
Community Health Center Grant	14077	93.913	90,449
Pass through Indiana State Department of Health			
Assistance Programs for Chronic Disease Prevention and Control	'U58DP004806	93.945	1,194
Pass through HRSA Office of Rural Health Policy			
Rural Access to Emergency Devices	H3DRH26506-03	93.259	117,923
Pass through Indiana State University			
Indiana Area Health Education Centers Network	U77HP23068	93.107	20,000
Pass through Indiana State Department of Health			
Small Rural Hospital Improvement Program Grant (SHIP)	14142	93.301	9,000
Pass through Indiana State Department of Health			
Substance Abuse Prevention and Treatment Block Grant			
Quit for Baby of the Wabash Valley Project	13583	93.959	46,814
Pass through Indiana State Department of Health			
Hospital Preparedness Program (HPP) Ebola Preparedness and			
Response Activities	14924	93.817	22,666
Pass through the Indiana State Department of Health			
Pass through District 7 Hospital Corporation			
National Bioterrorism Hospital Preparedness Program	A70-5-0532519	93.074	22,000
Total non-major programs			<u>1,201,166</u>
Total federal expenditures			<u>\$ 267,801,466</u>

There were no entities that received pass-through federal awards from Union Health System, Inc. during the year ended December 31, 2016.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2016

Note A - Basis of Presentation – The accompanying schedule of expenditures of federal awards (SEFA) includes the federal award activity of the System under programs of the federal government for the year ended December 31, 2016. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

Because the SEFA presents only a selected portion of the operations of the System, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the System.

Note B- Summary of Significant Accounting Policies - Expenditures reported on the SEFA are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. The System has elected not to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance.



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REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

Report on the Consolidated Financial Statements

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Guideline for examination of Entities Receiving Financial Assistance from Governmental Sources, issued by the Indiana State Board of Accounts, the consolidated financial statements of Union Health System, Inc. (the System), which comprise the consolidated balance sheet as of December 31, 2016 and the related consolidated statement of operations, changes in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 20, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the System's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose

Blue & Co., LLC

Indianapolis, Indiana
April 20, 2017



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REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

Report on Compliance for Each Major Federal Program

We have audited Union Health System, Inc.'s (the System) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the System's major federal programs for the year ended December 31, 2016. The System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the System's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the System's compliance.

Board of Directors
Union Health System, Inc.
Terre Haute, Indiana

Opinion on Each Major Federal Program

In our opinion, the System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2016.

Report on Internal Control over Compliance

Management of the System is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the System's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Blue & Co., LLC

Indianapolis, IN
April 20, 2017

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2016

Summary of Auditor's Results

Consolidated Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified? yes none reported

Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none reported

Noncompliance material to financial statements noted? yes none reported

Federal Awards

Internal controls over major programs:

Material weakness(es) identified? yes none reported

Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none noted

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported as defined by Uniform Guidance [2 CFR 200.516(a)]? yes no

Identification of major program:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
14.128	U.S. Department of Housing and Urban Development Mortgage Insurance - Hospitals Section 242

Dollar threshold used to distinguish between type A and B programs: \$750,000

Auditee qualified as low-risk auditee? yes no

Section II – Findings related to financial statements reported in accordance with Government Auditing Standards:

No matters reported

Section III – Findings and questioned costs relating to Federal awards:

No matters reported

Section IV – Summary schedule of prior audit findings:

See Schedule of Prior Audit Findings

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

SCHEDULE OF PRIOR AUDIT FINDINGS

YEAR ENDED DECEMBER 31, 2016

2015-001 Monitoring of Accounts Receivable Balances and Allowance Methodology – Significant Deficiency

Condition: At December 31, 2015, certain uncollectible and contractual allowance on gross physician patient accounts receivable balances obtained during auditing procedures were not being maintained or adjusted to the net realizable value. Of the total gross patient accounts receivable, those not being maintained related to two physician practices, which were on separate accounts receivable systems than the Hospital.

Recommendation: We recommend the System perform a quarterly allowance analysis using gross account receivables, insurance contractual adjustments, and collection and bad debt experience in order to recognize and report net realizable value.

Current Status: The finding does not warrant further action. The System's management and finance personnel incorporated an allowance analysis for the related gross patient accounts receivable balances and adjusted these appropriately during the year.