



CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2017 AND 2016

CPAs / ADVISORS



UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

TABLE OF CONTENTS DECEMBER 31, 2017 AND 2016

	Page
Report of Independent Auditors	1
Consolidated Financial Statements	
Consolidated Balance Sheets.....	4
Consolidated Statements of Operations and Changes in Net Assets.....	6
Consolidated Statements of Cash Flows.....	7
Notes to Consolidated Financial Statements.....	8
Supplementary Information	
Consolidating Balance Sheets – December 31, 2017.....	36
Consolidating Balance Sheets – December 31, 2016.....	38
Consolidating Statements of Operations and Changes in Net Assets – Year Ended December 31, 2017.....	40
Consolidating Statements of Operations and Changes in Net Assets – Year Ended December 31, 2016.....	42
Consolidating Statements of Operations (Union Hospital, Inc. and Subsidiaries) – Year Ended December 31, 2017.....	44
Consolidating Statements of Operations (Union Hospital, Inc. and Subsidiaries) – Year Ended December 31, 2016.....	45
Schedule of Property and Equipment of Mortgagor.....	46
Schedule of Expenditures of Federal Awards – Year Ended December 31, 2017.....	47
Report of Independent Auditors on Internal Control Over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	49

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

TABLE OF CONTENTS DECEMBER 31, 2017 AND 2016

Report of Independent Auditors on Compliance for For Each Major Federal Program and on Internal Control Over Compliance Required by Uniform Guidance	51
Schedule of Findings and Questioned Costs – Year Ended December 31, 2017.....	53



Blue & Co., LLC / 500 N. Meridian Street, Suite 200 / Indianapolis, IN 46204
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

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, 2017 and 2016, 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, 2017 and 2016, and the changes in its net assets and its 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 consolidating balance sheets, consolidating statements of operations and changes in net assets, and consolidating statements of operations (Union Hospital, Inc. and Subsidiaries) 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 schedule of property and equipment of mortgagor and 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*, are presented for purposes of additional analysis and are 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 19, 2018 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.

Blue & Co., LLC

Indianapolis, Indiana
April 19, 2018

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2017 AND 2016

ASSETS		
	2017	2016
Current assets		
Cash and cash equivalents	\$ 51,095,248	\$ 67,367,091
Patient accounts receivable, net	65,943,052	55,467,999
Inventories	5,890,533	5,315,627
Prepaid expenses and other current assets	15,255,289	12,175,520
Total current assets	138,184,122	140,326,237
Investments limited as to use		
Funds held by trustee	3,939,955	1,568,237
Board designated and donor-restricted funds	60,155,430	69,205,212
Total investments limited as to use	64,095,385	70,773,449
Property and equipment		
Land and improvements	37,685,526	37,876,725
Buildings and fixed equipment	369,366,453	364,903,986
Movable equipment	168,528,589	141,066,798
	575,580,568	543,847,509
Less allowances for depreciation	299,461,001	280,050,684
	276,119,567	263,796,825
Construction in progress	7,851,065	13,773,273
Total property and equipment, net	283,970,632	277,570,098
Other assets		
Due from Union Health Foundation, Inc.	3,187,376	2,693,583
Intangible assets, net and other	5,541,838	3,887,592
Investment in joint ventures	4,312,532	3,507,893
	13,041,746	10,089,068
Total assets	\$ 499,291,885	\$ 498,758,852

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2017 AND 2016

LIABILITIES AND NET ASSETS

	2017	2016
Current liabilities		
Accounts payable and other current liabilities	\$ 40,263,313	\$ 40,760,220
Salaries, wages and related liabilities	30,549,746	32,735,578
Estimated third party settlements	2,142,902	4,960,974
Current portion of long-term debt	10,600,023	9,042,190
Total current liabilities	<u>83,555,984</u>	<u>87,498,962</u>
Long-term liabilities		
Long-term debt, less current portion	271,670,593	277,953,332
Pension liability and related obligations	294,236	9,964,251
Total long-term liabilities	<u>271,964,829</u>	<u>287,917,583</u>
Total liabilities	355,520,813	375,416,545
Net assets		
Unrestricted	139,165,226	119,596,488
Noncontrolling interests in UHT, LLC	529,695	548,149
Total unrestricted net assets	<u>139,694,921</u>	<u>120,144,637</u>
Temporarily restricted	4,076,151	3,197,670
Total net assets	<u>143,771,072</u>	<u>123,342,307</u>
Total liabilities and net assets	<u>\$ 499,291,885</u>	<u>\$ 498,758,852</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, 2017 AND 2016

	2017	2016
Operating revenue		
Net patient service revenue (net of contractual allowances and discounts including financial assistance provisions of \$17,975,538 and \$22,252,171 in 2017 and 2016, respectively)	\$ 525,204,201	\$ 525,174,122
Less provision for bad debts	28,805,557	27,878,146
Net patient service revenue net of provision for bad debts	496,398,644	497,295,976
Other revenue	15,782,339	15,686,495
Total operating revenue	512,180,983	512,982,471
Operating expenses		
Physician, mid-level, and other provider salaries and wages	54,330,189	57,607,603
Other salaries and wages	101,541,697	101,719,829
Employee benefits	38,494,094	36,245,456
Medical supplies and drugs	89,553,730	87,014,842
Physician services	19,373,250	12,363,247
Contract services - management service organization support staff	28,938,173	31,440,570
Contract services - other	64,857,399	60,174,646
Rent and leases	11,109,134	12,009,443
Utilities, supplies, and other	35,523,217	36,721,558
Hospital assessment fee	16,853,726	15,184,385
Depreciation and amortization	21,519,114	20,039,841
Interest	13,737,220	16,595,824
Total operating expenses	495,830,943	487,117,244
Income from operations before pension termination	16,350,040	25,865,227
Pension termination	48,909,624	-0-
Income (loss) from operations after pension termination	(32,559,584)	25,865,227
Non-operating gains (losses)		
Investment income	5,460,047	1,462,303
Loss on refinancing debt with HUD 242 mortgage insurance program	-0-	(29,190,407)
Other	2,834,231	502,638
Total non-operating gains (losses)	8,294,278	(27,225,466)
Excess of revenue over (under) expenses	(24,265,306)	(1,360,239)
Other changes in unrestricted net assets		
Pension related changes other than net pension cost	44,826,541	(9,071,119)
Distribution to non-controlling interests	(1,505,038)	(1,275,046)
Net unrealized gain on investments	69,880	1,243,599
Net assets released for property and equipment	424,207	5,090
Change in unrestricted net assets	19,550,284	(10,457,715)
Temporarily restricted net assets		
Other changes in receivable from Union Health Foundation, Inc.	1,302,688	(207,595)
Net assets released for property and equipment	(424,207)	(5,090)
Change in temporarily restricted net assets	878,481	(212,685)
Permanently restricted net assets		
Transfer of endowments to Union Health Foundation, Inc.	-0-	(1,520,937)
Net investment loss	-0-	(27,172)
Change in permanently restricted net assets	-0-	(1,548,109)
Change in net assets	20,428,765	(12,218,509)
Net assets		
Beginning of year	123,342,307	135,560,816
End of year	\$ 143,771,072	\$ 123,342,307

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Operating activities		
Change in net assets	\$ 20,428,765	\$ (12,218,509)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	20,029,052	18,757,904
Amortization of intangible asset	1,490,062	1,281,937
Amortization of bond issuance costs	315,968	264,057
Provision for bad debts	28,805,557	27,878,146
Distribution to non-controlling interests	1,505,038	1,275,046
Loss on property disposals	(566,343)	253,800
Loss on refinancing debt with HUD 242 mortgage insurance program	-0-	29,190,407
Net unrealized gain on investments	(69,880)	(1,243,599)
Changes in operating assets and liabilities		
Patient accounts receivable	(39,280,610)	(24,848,743)
Other current and noncurrent assets	(4,767,415)	(4,072,095)
Accounts payable and other current liabilities	(528,154)	9,483,553
Salaries, wages and related liabilities	(2,185,832)	4,431,184
Other long-term liabilities	(9,670,015)	1,577,816
Estimated third-party payor settlements	(2,818,072)	265,490
Accrued interest	-0-	(5,134,370)
Net cash flows from operating activities	12,688,121	47,142,024
Investing activities		
Purchases of property and equipment	(27,316,633)	(11,197,177)
Proceeds from sale of property and equipment	1,484,637	311,609
Purchase of investments	(48,159,073)	(27,190,547)
Proceeds from sale of investments	54,907,017	43,761,806
Net cash flows from investing activities	(19,084,052)	5,685,691
Financing activities		
Payments on long-term debt	(8,402,317)	(4,109,131)
Payments to refinance long-term debt	-0-	(258,620,900)
Proceeds from long-term debt	31,443	265,550,014
Cash paid for redemption of bonds prior to callable event	-0-	(24,594,295)
Cash paid for upfront mortgage insurance premium	-0-	(2,666,003)
Cash paid for deferred financing costs	-0-	(4,602,273)
Distribution to non-controlling interests	(1,505,038)	(1,275,046)
Net cash flows from financing activities	(9,875,912)	(30,317,634)
Change in cash and cash equivalents	(16,271,843)	22,510,081
Cash and cash equivalents		
Beginning of year	67,367,091	44,857,010
End of year	\$ 51,095,248	\$ 67,367,091
Noncash investing activities		
Issuance of capital leases	\$ -0-	\$ 1,081,729
Capital acquisitions included in accounts payable	\$ 31,247	\$ 3,989,583
Financed acquisition of medical practice service line	\$ 3,330,000	\$ -0-
Supplemental cash flow information		
Cash paid for interest	\$ 13,421,252	\$ 21,466,137

See accompanying notes to consolidated financial statements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

1. ORGANIZATION

Nature of Operations

Union Health System, Inc. (UHS), an Indiana nonprofit corporation, is the sole member of Union Hospital, Inc. (the Corporation) and 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, non-invasive cardiology services, 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, 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 110 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, 2017 AND 2016

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, 2017 AND 2016

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:

	2017	2016
Inpatient revenue	\$ 517,272,164	\$ 523,912,644
Outpatient revenue	910,455,690	849,397,879
Physician revenue	128,986,555	145,664,867
Gross patient revenue	1,556,714,409	1,518,975,390
Financial assistance revenue foregone	18,363,848	22,518,116
Contractual adjustments	1,013,146,360	971,283,152
Total adjustments	1,031,510,208	993,801,268
Net patient service revenue	525,204,201	525,174,122
Less provision for bad debts	28,805,557	27,878,146
	\$ 496,398,644	\$ 497,295,976

A summary of gross patient service revenue at established rates by payor source for 2017 and 2016, respectively, is as follows:

	2017	2016
Medicare	50%	49%
Medicaid	19%	20%
Managed care and commercial insurance	28%	28%
Self-pay and other	3%	3%
	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, 2017 and 2016.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 2017, the System's allowance for uncollectible accounts for patient and physician services increased approximately \$6,300,000 from approximately \$24,200,000 to approximately \$30,500,000. 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, 2017, the allowance for uncollectible accounts of \$30,500,000 was comprised of approximately \$15,500,000 reserved for self-pay balances and approximately \$15,000,000 reserved for third-party payor balances. 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. As of December 31, 2016, the allowance for doubtful accounts of approximately \$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.

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, health maintenance organizations, and commercial insurance policies). The System has not changed its financial assistance or uninsured discount policies during 2017 or 2016.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

At December 31, 2017 and 2016, gross accounts receivable from patients and third party were comprised of the following:

	2017	2016
Medicare	33%	35%
Medicaid	21%	21%
Managed care and commercial insurance	33%	33%
Self-pay and other	13%	11%
	<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, 2017 AND 2016

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 2017 and 2016.

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 \$5,855,000 and \$7,228,000 arose from providing services to patients requiring financial assistance during the years ended December 31, 2017 and 2016, 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, 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, 2017 AND 2016

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, 2017 and 2016, the System recognized HAF Program expense of approximately \$16,900,000 and \$15,200,000, respectively, which resulted in increased Medicaid reimbursement. The HAF Program expense is included in the consolidated statements of operations and changes in net assets as an operating expense. The Medicaid rate increases under the HAF Program are included in net patient service revenue in the consolidated statements of operations and changes in net assets.

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, common stocks, and commingled funds.

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; and 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, 2017 AND 2016

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. During 2017 and 2016, the System purchased targeted service lines for approximately \$3,300,000 and \$-0-, respectively. As of December 31, 2017 and 2016, intangible assets approximated \$4,764,000 and \$2,924,000, respectively, and recorded within intangible assets, net and other on the consolidated balance sheets. The System expects future amortization as follows:

Year Ending December 31,	
2018	\$ 2,060,424
2019	1,241,808
2020	832,500
2021	629,570
	<u>\$ 4,764,302</u>

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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.

Medical Malpractice Insurance

The System has a self-insurance plan for professional liability insurance. A third-party claims administrator has been retained to process all benefit claims. Claims are processed and presented for payment upon occurrence. The System makes periodic deposits into a trust fund for the proper administration and protection of the fund.

The Indiana Medical Malpractice Act, IC 34-18 (the Act) provides a maximum recovery of \$1,650,000 for an occurrence of malpractice until June 30, 2019, and \$1,800,000 thereafter. The Act requires the System to maintain medical malpractice liability insurance in the amount of at least \$400,000 per occurrence and \$12,000,000 in the annual aggregate until June 30, 2019. Starting July 1, 2019, the Act will require the System to maintain medical malpractice liability insurance in the amount of at least \$500,000 per occurrence and \$15,000,000 in the annual aggregate. The Act also requires the System to pay a surcharge to the State Patient's Compensation Fund (Fund). The Fund is used to pay medical malpractice claims in excess of per occurrence and the annual aggregate amounts as noted above, under certain terms and conditions. No accrual for possible losses attributable to incidents that may have occurred but that have not been identified has been made because the amount, if any, is not reasonably estimable. The Fund is on a claims-made basis and as long as this coverage is continuous or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be insured.

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the System's claim experience, an accrual for estimated malpractice claims costs was approximately \$1,497,000 and \$1,897,000 as of December 31, 2017 and 2016, respectively. It is reasonably possible that this estimate could change materially in the near term.

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.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 10 for additional details on the System's pension plans.

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 \$3,187,000 and \$2,694,000 of funds held by the Foundation for the benefit of the System at December 31, 2017 and 2016, respectively. These amounts represent planned contributions of property and equipment 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 in the approximate amounts of \$913,000 and \$504,000 as of December 31, 2017 and 2016, respectively, and held for future capital improvements.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 lifetime maximum on claims. The maximum annual aggregate reimbursement under the policy is \$1,000,000 per year.

Functional Expenses

The Corporation provides general health care services to patients. Health care services expenses related to providing these services were approximately \$469,845,000 and \$423,505,000 for the years ended December 31, 2017 and 2016, respectively. Administrative expenses (consisting of support services, employee benefits, patient billing and other) amounted to approximately \$74,895,000 and \$63,613,000 for the years ended December 31, 2017 and 2016, respectively.

Income Taxes

UHS and the Corporation are organized as not-for-profit corporations under Section 501(c) (3) of the United States Internal Revenue Code. As such, UHS and the Corporation are generally exempt from income taxes. However, UHS and the Corporation are 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 UHS and the Corporation and recognize a tax liability if UHS and the Corporation have 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 UHS and the Corporation, and has concluded that as of December 31, 2017 and 2016, 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. UHS and the Corporation are subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Filings are current through 2016. 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.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Operating Indicator

The System's operating indicator, income from operations after pension termination, 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.

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.

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 2016 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 19, 2018.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

3. 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 \$28,938,000 and \$31,440,000 for the years ended December 31, 2017 and 2016, 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, 2017 and 2016, a net payable is owed from the System to AP&S Clinic in the amount of approximately \$4,402,000 and \$4,788,000, respectively, and is reflected in accounts payable and other current liabilities in the consolidated balance sheets. UAPC paid approximately \$2,947,000 and \$2,665,000 during 2017 and 2016, 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, 2017 and 2016 totaled approximately \$1,900,000, respectively.

UAPC is related to AP&S Clinic, AP&S II, and AP&S III as some physicians employed by UAPC have ownership interests in AP&S Clinic, AP&S II, and AP&S III.

The Corporation provided management and other services for the Foundation and other related organizations for the years ended December 31, 2017 and 2016. These amounts are immaterial to the financial statements as a whole.

The Corporation received approximately \$419,000 and \$5,000 in contributions from the Foundation for the years ended December 31, 2017 and 2016, respectively. These amounts are recorded within other revenue in the consolidated statements of operations and changes in net assets.

4. CONSTRUCTION-IN-PROGRESS

A summary of the construction-in-progress projects at December 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Cerner Project (including Sorian software)	\$ -0-	\$ 12,469,201
Non-Invasive Cardio Project	4,363,588	-0-
Nuclear Med Project	2,048,296	-0-
Other renovations and upgrades	1,439,181	1,304,072
	<u>\$ 7,851,065</u>	<u>\$ 13,773,273</u>

At December 31, 2017, the System has outstanding commitments related to property and equipment of approximately \$5,660,000.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

5. 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:

	2017	2016
Money market deposit accounts and certificates of deposit	\$ 956,640	\$ 6,944,255
US Government obligations	7,459,170	12,396,904
Mutual funds	32,415,132	26,285,975
Common stocks	8,613,379	12,724,060
Corporate obligations	3,616,499	12,422,255
Commingled funds	11,034,565	-0-
	\$ 64,095,385	\$ 70,773,449

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.

	2017	2016
Investment income included within non-operating gains (losses) and net investment income on permanently restricted net assets:		
Investment income	\$ 5,460,047	\$ 1,435,131
Other changes in net assets:		
Unrealized gain on investments	69,880	1,243,599
	\$ 5,529,927	\$ 2,678,730

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, 2017 and 2016. The schedule further segregates the securities that have been in a gross unrealized position as of December 31, 2017 and 2016, 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, 2017 AND 2016

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, 2017 and 2016:

Description of securities	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stocks	\$ 1,608,039	\$ 140,256	\$ -0-	\$ -0-	\$ 1,608,039	\$ 140,256
Mutual funds	137,625	1,310	17,107,301	572,105	17,244,926	573,415
Government obligations	6,429,444	54,384	-0-	-0-	6,429,444	54,384
Corporate obligations	3,568,220	30,732	-0-	-0-	3,568,220	30,732
Total temporarily impaired securities	<u>\$ 11,743,328</u>	<u>\$ 226,682</u>	<u>\$ 17,107,301</u>	<u>\$ 572,105</u>	<u>\$ 28,850,629</u>	<u>\$ 798,787</u>

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 stocks	\$ 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>

6. 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, 2017 AND 2016

- 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, 2017 and 2016.

- *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.
- *Commingled funds*: Valued at the NAV of units as reported by the fund. 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 NAV of the fund and, consequently, the fair value of the System'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 NAV. It is therefore reasonably possible that if the System were to sell these investments in the secondary market, a buyer may require a discount to the reported NAV, and the discount could be significant.
- *Money market mutual funds*: Valued based at the subscription and redemption activity at a \$1 stable NAV. However, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

Assets measured at fair value on a recurring basis as of December 31, 2017 and 2016 are as follows:

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Investments limited as to use				
Common stocks				
Consumer	\$ 1,350,247	\$ 1,350,247	\$ -0-	\$ -0-
Energy	1,099,678	1,099,678	-0-	-0-
Financial	1,986,968	1,986,968	-0-	-0-
Healthcare	1,142,671	1,142,671	-0-	-0-
Industrials	1,166,448	1,166,448	-0-	-0-
Information technology	931,798	931,798	-0-	-0-
Materials	935,569	935,569	-0-	-0-
Total common stocks	8,613,379	8,613,379	-0-	-0-
Mutual funds				
Fixed income funds	17,244,926	17,244,926	-0-	-0-
Large cap funds	10,938,356	10,938,356	-0-	-0-
International funds	4,198,617	4,198,617	-0-	-0-
Index funds	33,233	33,233	-0-	-0-
Total mutual funds	32,415,132	32,415,132	-0-	-0-
US Government obligations	7,459,170	7,459,170	-0-	-0-
Corporate obligations				
Mid yield	3,616,499	-0-	3,616,499	-0-
Total corporate obligations	3,616,499	-0-	3,616,499	-0-
	52,104,180	\$ 48,487,681	\$ 3,616,499	\$ -0-
Money market deposit accounts	956,640			
Commingled funds *	11,034,565			
Total investments limited as to use	\$ 64,095,385			

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

	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	<u>12,724,060</u>	<u>12,724,060</u>	-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	<u>26,285,975</u>	<u>26,285,975</u>	-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	<u>12,422,255</u>	<u>-0-</u>	<u>12,422,255</u>	<u>-0-</u>
	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 **	<u>4,015,818</u>			
Total investments limited as to use	<u>\$ 70,773,449</u>			

* In accordance with Subtopic 820-10, certain investments that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts present in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented at fair value in the balance sheets.

** Certificates of deposit are recorded 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 2017 and 2016.

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, 2017 AND 2016

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, 2017. There were no investments measured on NAVs per share as of December 31, 2016. The following methods and assumptions were used by the System in estimating the fair value of its financial instruments:

<u>December 31, 2017</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Commingled funds	11,034,565	None	Daily	Daily
	<u>\$ 11,034,565</u>			

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

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 fixed rate service line loans, and variable rate debt (2010 loan) approximates the carrying value based on the incremental borrowing rate of the System of as of December 31, 2017 and 2016, respectively.

7. 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, 2017 AND 2016

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. During 2016, the Corporation transferred their endowment funds to Union Health Foundation, Inc.

For 2017 and 2016, the Corporation had the following endowment-related activities:

	Permanently restricted	
	2017	2016
Endowment net assets, beginning of year	\$ -0-	\$ 1,548,109
Transfer of endowments to Union Health Foundation, Inc.	-0-	(1,520,937)
Net investment income	-0-	(27,172)
Endowment net assets, end of year	\$ -0-	\$ -0-

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

8. LONG-TERM DEBT AND LEASES

The following is a summary of long-term debt as of December 31, 2017 and 2016:

	2017	2016
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, collateralized by property and equipment with a net book value of approximately \$280,607,000 as of December 31, 2017.	\$ 257,872,031	\$ 264,308,121
Loan payable in monthly principal and interests installments of approximately \$40,000 commencing in fiscal 2010 through fiscal 2026. Fixed term with variable interest rate set monthly (payable monthly) at 5.01% in 2017. Secured by net revenues and receivables of the Corporation with a net book value of approximately \$60,000,000.	3,141,700	3,439,000
Loans payable for purchases of medical group service lines in June 2015 and October 2017, due April 2019 and September 2021, respectively, with monthly installments of approximately \$102,000 and \$69,000, respectively, and fixed interest rates of 3.25% and 4.25%, respectively. The loans are unsecured.	4,825,088	2,850,230
Capital leases and other	20,590,620	20,872,962
Total long-term debt	286,429,439	291,470,313
Less current portion	10,600,023	9,042,190
Less unamortized debt issue costs	4,158,823	4,474,791
	\$ 271,670,593	\$ 277,953,332

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

Year Ending December 31,	
2018	\$ 10,600,023
2019	9,284,596
2020	9,155,545
2021	9,314,838
2022	8,837,465
Thereafter	239,236,972
	\$ 286,429,439

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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.

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 June 2015 and October 2017, the Corporation financed the purchase of a medical group's Cardiac Cath Lab and Non-Invasive Cardiology service lines for approximately \$4,600,000 and \$3,330,000, respectively. The terms of the loans used to finance the purchases are shown in the summary table above. Payments made during the years ended December 31, 2017 and 2016 totaled approximately \$1,355,000 and \$1,116,000, respectively. The related intangible assets, reflecting primarily of the fair value of medical records and a non-compete contracts, are a component of intangible assets at net value within the consolidated balance sheets.

The System is also required to meet certain financial covenants. The System believes it is in compliance with all covenants as of December 31, 2017 and 2016.

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 \$20,300,000 and \$20,700,000, respectively, and \$2,700,000 and \$2,600,000, respectively, at December 31, 2017 and 2016.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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

Year Ending December 31,	
2018	\$ 2,002,444
2019	1,998,069
2020	1,965,570
2021	1,935,660
2022	1,935,660
Thereafter	78,878,396
	<u>88,715,799</u>
Less imputed interest	68,125,179
	<u>\$ 20,590,620</u>

The System has operating leases for medical equipment and office space. Total rent and lease expense for the years ended December 31, 2017 and 2016 was approximately \$11,100,000 and \$12,009,000, respectively. Future minimum lease payments under noncancelable operating leases as of December 31, 2017 that have initial or remaining lease terms in excess of one year are as follows:

Year Ending December 31,	
2018	\$ 4,602,690
2019	3,332,475
2020	2,387,473
2021	1,974,990
2022	808,654
Thereafter	35,212
	<u>\$ 13,141,494</u>

9. 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).

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

	Controlling Interest	Noncontrolling Interest	Total
Balance December 31, 2015	\$ 130,165,606	\$ 436,746	\$ 130,602,352
Excess of revenue over (under) expenses	(2,746,688)	1,386,449	(1,360,239)
Other changes in unrestricted net assets	(7,822,430)	(1,275,046)	(9,097,476)
Change in net assets	(10,569,118)	111,403	(10,457,715)
Balance December 31, 2016	\$ 119,596,488	\$ 548,149	\$ 120,144,637
Excess of revenue over (under) expenses	(25,751,890)	1,486,584	(24,265,306)
Other changes in unrestricted net assets	45,320,628	(1,505,038)	43,815,590
Change in net assets	19,568,738	(18,454)	19,550,284
Balance December 31, 2017	\$ 139,165,226	\$ 529,695	\$ 139,694,921

10. PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

The Corporation had a noncontributory, defined-benefit plan (the Plan) covering substantially all of its employees who were at least 21 years old and had completed one year of service, and certain employees meeting those requirements of affiliated organizations. The Plan provided for retirement, survivor, and severance benefits. Employees with five or more years of service were 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 produced the highest total. The Corporation agreed to contribute such amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members. Contributions included normal cost, interest on unfunded prior service cost, and amortization of prior service cost over a period not exceeding 30 years. The Plan met the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

During 2017, the Corporation terminated the defined-benefit plan, resulting in pension termination costs of approximately \$48,910,000 for the year. Lump sum payments to participants amounted to approximately \$68,029,000 and annuities purchased from the insurance company set up for participants amounted to approximately \$42,979,000 for the year ended December 31, 2017.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 \$-0- and \$44,827,000 have been included in the unrestricted net assets at December 31, 2017 and 2016, 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, 2017 and 2016.

Actuarial losses included in unrestricted net assets at December 31, 2017 and 2016, and expected to be amortized in net periodic benefit costs in future periods are approximately \$-0- and \$3,853,000, respectively.

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, 2017 and 2016:

	2017	2016
Change in benefit obligation		
Benefit obligation, beginning of year	\$ 101,492,815	\$ 95,037,622
Interest cost	3,951,628	4,466,036
Benefits paid	(111,008,307)	(8,723,562)
Actuarial loss	5,563,864	10,712,719
Benefit obligation, ending of year	\$ -0-	\$ 101,492,815
Changes in plan assets		
Fair value of plan assets, beginning of year	\$ 91,822,800	\$ 87,927,316
Actual return on plan assets	(521,827)	3,379,046
Employer contributions	19,707,334	9,240,000
Benefits paid	(111,008,307)	(8,723,562)
Fair value of plan assets, end of year	\$ -0-	\$ 91,822,800
Unfunded status		
Unfunded status of the plan, end of year	\$ -0-	\$ (9,670,015)

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

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

During 2017, a lump sum payment was offered in lieu of annuities to all participating employees in the Plan as part of the termination. Approximately \$42,979,000 of lump sum payments were made during 2017 and are included as a component of benefits paid in the table above.

During 2016, 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 of lump sum payments were made during 2016 and are 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, 2017 and 2016.

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

	2017	2016
Components of net benefit cost		
Interest cost	\$ 3,951,628	\$ 4,466,036
Expected return on plan assets	(1,850,421)	(4,654,297)
Actuarial loss	3,853,029	2,916,851
Net periodic benefit cost	5,954,236	2,728,590
Settlement cost related to plan termination	48,909,624	-0-
Net periodic benefit cost	\$ 54,863,860	\$ 2,728,590

The Corporation recognized a settlement loss due to the plan termination of approximately \$48,910,000 during 2017, which relates to the plan termination and related settlement payments. The losses represent a proportion of previously unrecognized losses included in unrestricted net assets. The settlement losses are included in the pension termination line in the 2017 consolidated statements of operations and changes in net assets.

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, 2017 and 2016, are as follows:

	2017	2016
Discount rate	4.1%	4.1%
Expected return on plan assets	2.0%	2.0%
Rate of compensation increase - NPBC	Not Applicable	Not Applicable

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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, 2017 and 2016, by asset category, are as follows:

	2017	2016
Mutual funds - equity funds	0%	0%
Mutual funds - bond funds	0%	96%
Other	0%	4%
	<u>0%</u>	<u>100%</u>

The following is an analysis of fair value of the major classes of plan assets as of December 31, 2017 and 2016:

	Fair Value	
	2017	2016
Money market mutual funds	\$ -0-	\$ 3,299,348
Mutual funds - bond funds	-0-	88,523,452
Total	<u>\$ -0-</u>	<u>\$ 91,822,800</u>

See footnote 6 for information on valuation techniques for money market mutual funds and mutual funds.

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.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017 AND 2016

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 \$451,000 as of December 31, 2017 and 2016. Of these amounts, approximately \$215,000 and \$214,000 were recorded as salaries, wages, and related liabilities and approximately \$294,000 were recorded as pension liability and related obligations on the consolidated balance sheets as of December 31, 2017 and 2016.

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, 2017 and 2016. The related contributions for the plan approximated \$3,372,000 and \$3,829,000 for the years ended December 31, 2017 and 2016, respectively.

UAPC also has a 401(k) discretionary defined contribution plan for which contributions during the years ended December 31, 2017 and 2016 were approximately \$1,721,000 and \$1,715,000, respectively.

11. INVESTMENTS IN JOINT VENTURES

The Corporation is a member of a Vermont insurance company, Tecumseh Health Reciprocal Risk Retention Group (THRRRG), as means to comply with the Corporation's required portion of the insurance coverage pursuant to the Act, as well as its liability insurance. Membership in THRRRG includes 14 hospitals as of December 31, 2017. The Corporation's investment in THRRRG amounts to approximately \$3,384,000 and \$3,016,000 as of December 31, 2017 and 2016, respectively. The interest is recorded in investments in joint ventures on the consolidated balance sheets and the Corporation's gain on its investment in THRRRG 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.

12. 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.

SUPPLEMENTARY INFORMATION

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2017

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Eliminations	Union Health System
Assets				
Current assets				
Cash and cash equivalents	\$ 49,826,085	\$ 1,269,163	\$ -0-	\$ 51,095,248
Patient accounts receivable, net	59,552,107	6,390,945	-0-	65,943,052
Inventories	5,325,620	564,913	-0-	5,890,533
Due from related parties	-0-	752,145	(752,145)	-0-
Prepaid expenses and other current assets	13,919,940	1,747,002	(411,653)	15,255,289
Total current assets	<u>128,623,752</u>	<u>10,724,168</u>	<u>(1,163,798)</u>	<u>138,184,122</u>
Investments limited as to use				
Funds held by trustee	3,939,955	-0-	-0-	3,939,955
Board designated and donor-restricted funds	60,155,430	-0-	-0-	60,155,430
Total investments limited as to use	<u>64,095,385</u>	<u>-0-</u>	<u>-0-</u>	<u>64,095,385</u>
Property and equipment				
Land and improvements	37,685,526	-0-	-0-	37,685,526
Buildings and fixed equipment	349,809,901	19,556,552	-0-	369,366,453
Movable equipment	160,371,108	8,157,481	-0-	168,528,589
	<u>547,866,535</u>	<u>27,714,033</u>	<u>-0-</u>	<u>575,580,568</u>
Less allowances for depreciation	294,495,876	4,965,125	-0-	299,461,001
	<u>253,370,659</u>	<u>22,748,908</u>	<u>-0-</u>	<u>276,119,567</u>
Construction in progress	7,847,106	3,959	-0-	7,851,065
Total property and equipment, net	<u>261,217,765</u>	<u>22,752,867</u>	<u>-0-</u>	<u>283,970,632</u>
Other assets				
Due from Union Health Foundation, Inc.	3,187,376	-0-	-0-	3,187,376
Intangible assets, net and other	5,514,074	27,764	-0-	5,541,838
Investment in joint ventures	3,383,980	928,552	-0-	4,312,532
	<u>12,085,430</u>	<u>956,316</u>	<u>-0-</u>	<u>13,041,746</u>
Total assets	<u>\$ 466,022,332</u>	<u>\$ 34,433,351</u>	<u>\$ (1,163,798)</u>	<u>\$ 499,291,885</u>

See Report of Independent Auditors on Pages 1 - 3.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2017

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Eliminations	Union Health System
Liabilities and net assets				
Current liabilities				
Accounts payable and other current liabilities	\$ 30,725,380	\$ 9,537,933	\$ -0-	\$ 40,263,313
Salaries, wages and related liabilities	23,273,329	7,688,070	(411,653)	30,549,746
Estimated third party settlements	2,142,902	-0-	-0-	2,142,902
Current portion of long-term debt	10,575,204	24,819	-0-	10,600,023
Total current liabilities	<u>66,716,815</u>	<u>17,250,822</u>	<u>(411,653)</u>	<u>83,555,984</u>
Long-term liabilities				
Long-term debt, less current portion	252,327,628	19,342,965	-0-	271,670,593
Pension liability and related obligations	294,236	-0-	-0-	294,236
Other long-term liabilities	752,145	-0-	(752,145)	-0-
Total long-term liabilities	<u>253,374,009</u>	<u>19,342,965</u>	<u>(752,145)</u>	<u>271,964,829</u>
Total liabilities	320,090,824	36,593,787	(1,163,798)	355,520,813
Net assets				
Unrestricted	141,325,662	(2,160,436)	-0-	139,165,226
Noncontrolling interests in UHT, LLC	529,695	-0-	-0-	529,695
Total unrestricted net assets	<u>141,855,357</u>	<u>(2,160,436)</u>	<u>-0-</u>	<u>139,694,921</u>
Temporarily restricted	4,076,151	-0-	-0-	4,076,151
Total net assets	<u>145,931,508</u>	<u>(2,160,436)</u>	<u>-0-</u>	<u>143,771,072</u>
Total liabilities and net assets	<u>\$ 466,022,332</u>	<u>\$ 34,433,351</u>	<u>\$ (1,163,798)</u>	<u>\$ 499,291,885</u>

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	Eliminations	Union Health System
Assets				
Current assets				
Cash and cash equivalents	\$ 66,419,631	\$ 947,460	\$ -0-	\$ 67,367,091
Patient accounts receivable, net	51,760,295	3,707,704	-0-	55,467,999
Inventories	4,765,820	549,807	-0-	5,315,627
Due from related parties	-0-	1,091,781	(1,091,781)	-0-
Prepaid expenses and other current assets	11,354,990	816,714	3,816	12,175,520
Total current assets	134,300,736	7,113,466	(1,087,965)	140,326,237
Investments limited as to use				
Funds held by trustee	1,568,237	-0-	-0-	1,568,237
Board designated and donor-restricted funds	69,205,212	-0-	-0-	69,205,212
Total investments limited as to use	70,773,449	-0-	-0-	70,773,449
Property and equipment				
Land and improvements	37,876,725	-0-	-0-	37,876,725
Buildings and fixed equipment	345,347,434	19,556,552	-0-	364,903,986
Movable equipment	137,854,386	3,212,412	-0-	141,066,798
	521,078,545	22,768,964	-0-	543,847,509
Less allowances for depreciation	276,243,160	3,807,524	-0-	280,050,684
	244,835,385	18,961,440	-0-	263,796,825
Construction in progress	13,699,629	73,644	-0-	13,773,273
Total property and equipment, net	258,535,014	19,035,084	-0-	277,570,098
Other assets				
Due from Union Health Foundation, Inc.	2,693,583	-0-	-0-	2,693,583
Intangible assets, net and other	3,847,805	39,787	-0-	3,887,592
Investment in joint ventures	3,016,227	491,666	-0-	3,507,893
	9,557,615	531,453	-0-	10,089,068
Total assets	\$ 473,166,814	\$ 26,680,003	\$ (1,087,965)	\$ 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	Eliminations	Union Health System
Liabilities and net assets				
Current liabilities				
Accounts payable and other current liabilities	\$ 35,317,875	\$ 5,229,385	\$ 212,960	\$ 40,760,220
Salaries, wages and related liabilities	22,824,499	9,911,010	69	32,735,578
Estimated third party settlements	4,960,974	-0-	-0-	4,960,974
Current portion of long-term debt	9,005,430	36,760	-0-	9,042,190
Total current liabilities	<u>72,108,778</u>	<u>15,177,155</u>	<u>213,029</u>	<u>87,498,962</u>
Long-term liabilities				
Long-term debt, less current portion	258,586,616	19,366,716	-0-	277,953,332
Pension liability and related obligations	9,964,251	-0-	-0-	9,964,251
Other long-term liabilities	1,300,994	-0-	(1,300,994)	-0-
Total long-term liabilities	<u>269,851,861</u>	<u>19,366,716</u>	<u>(1,300,994)</u>	<u>287,917,583</u>
Total liabilities	341,960,639	34,543,871	(1,087,965)	375,416,545
Net assets				
Unrestricted	127,460,356	(7,863,868)	-0-	119,596,488
Noncontrolling interests in UHT, LLC	548,149	-0-	-0-	548,149
Total unrestricted net assets	<u>128,008,505</u>	<u>(7,863,868)</u>	<u>-0-</u>	<u>120,144,637</u>
Temporarily restricted	3,197,670	-0-	-0-	3,197,670
Total net assets	<u>131,206,175</u>	<u>(7,863,868)</u>	<u>-0-</u>	<u>123,342,307</u>
Total liabilities and net assets	<u>\$ 473,166,814</u>	<u>\$ 26,680,003</u>	<u>\$ (1,087,965)</u>	<u>\$ 498,758,852</u>

See Report of Independent Auditors on Pages 1 - 3.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2017

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Eliminations	Union Health System
Operating revenue				
Net patient service revenue	\$ 473,332,301	\$ 51,871,900	\$ -0-	\$ 525,204,201
Less provision for bad debts	26,227,684	2,577,873	-0-	28,805,557
Net patient service revenue net of provision for bad debts	447,104,617	49,294,027	-0-	496,398,644
Other revenue	12,994,178	6,039,956	(3,251,795)	15,782,339
Total operating revenue	460,098,795	55,333,983	(3,251,795)	512,180,983
Operating expenses				
Physician, Mid-level, and other provider salaries and wages	19,403,497	34,926,692	-0-	54,330,189
Other salaries and wages	101,384,908	156,789	-0-	101,541,697
Employee benefits	31,352,860	7,141,234	-0-	38,494,094
Medical supplies and drugs	81,399,317	8,154,413	-0-	89,553,730
Physician services	19,373,250	-0-	-0-	19,373,250
Contract services - management service organization support staff	7,182,394	24,386,695	(2,630,916)	28,938,173
Contract services - other	64,126,994	745,084	(14,679)	64,857,399
Rent and leases	7,341,254	4,366,755	(598,875)	11,109,134
Utilities, supplies, and other	30,282,804	5,247,738	(7,325)	35,523,217
Hospital assessment fee	16,853,726	-0-	-0-	16,853,726
Depreciation and amortization	20,361,514	1,157,600	-0-	21,519,114
Interest	11,671,271	2,065,949	-0-	13,737,220
Total operating expenses	410,733,789	88,348,949	(3,251,795)	495,830,943
Income (loss) from operations before pension termination	49,365,006	(33,014,966)	-0-	16,350,040
Pension termination	48,909,624	-0-	-0-	48,909,624
Income (loss) from operations after pension termination	455,382	(33,014,966)	-0-	(32,559,584)
Non-operating gains (losses)				
Investment income	5,459,181	866	-0-	5,460,047
Other	514,979	2,319,252	-0-	2,834,231
Total non-operating gains (losses)	5,974,160	2,320,118	-0-	8,294,278
Excess of revenue over (under) expenses	\$ 6,429,542	\$ (30,694,848)	\$ -0-	\$ (24,265,306)

See Report of Independent Auditors on Pages 1 - 3.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2017

	Union Hospital, Inc. and Subsidiaries	Union Associated Physician's Clinic	Eliminations	Total Reporting Unit
Other changes in unrestricted net assets				
Pension related changes other than net pension cost	\$ 44,826,541	\$ -0-	\$ -0-	\$ 44,826,541
Distribution to non-controlling interests	(1,505,038)	-0-	-0-	(1,505,038)
Net unrealized gain on investments	69,880	-0-	-0-	69,880
Transfers for property and equipment additions	424,207	-0-	-0-	424,207
Transfers between Union Hospital, Inc. UAPC	(36,398,280)	36,398,280	-0-	-0-
Change in unrestricted net assets	<u>13,846,852</u>	<u>5,703,432</u>	-0-	<u>19,550,284</u>
Temporarily restricted net assets				
Other changes in receivable from Union Health Foundation, Inc.	1,302,688	-0-	-0-	1,302,688
Net assets released for property and equipment	(424,207)	-0-	-0-	(424,207)
Change in temporarily restricted net assets	<u>878,481</u>	<u>-0-</u>	-0-	<u>878,481</u>
Change in net assets	14,725,333	5,703,432	-0-	20,428,765
Net assets				
Beginning of year	131,206,175	(7,863,868)	-0-	123,342,307
End of year	<u>\$ 145,931,508</u>	<u>\$ (2,160,436)</u>	<u>\$ -0-</u>	<u>\$ 143,771,072</u>

See Report of Independent Auditors on Pages 1 - 3.

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	Eliminations	Union Health System
Operating revenue				
Net patient service revenue	\$ 466,973,604	\$ 58,277,127	\$ (76,609)	\$ 525,174,122
Less provision for bad debts	25,226,391	2,651,755	-0-	27,878,146
Net patient service revenue net of provision for bad debts	441,747,213	55,625,372	(76,609)	497,295,976
Other revenue	11,067,875	6,237,880	(1,619,260)	15,686,495
Total operating revenue	452,815,088	61,863,252	(1,695,869)	512,982,471
Operating expenses				
Physician, Mid-level, and other provider salaries and wages	20,710,479	36,897,124	-0-	57,607,603
Other salaries and wages	101,719,829	-0-	-0-	101,719,829
Employee benefits	32,400,193	3,845,263	-0-	36,245,456
Supplies and drugs	77,138,068	9,876,774	-0-	87,014,842
Physician services	12,363,247	-0-	-0-	12,363,247
Contract services - management service organization support staff	6,939,580	24,500,990	-0-	31,440,570
Contract services - other	60,363,875	1,067,927	(1,257,156)	60,174,646
Rent and leases	7,685,581	4,762,575	(438,713)	12,009,443
Utilities, supplies, and other	31,545,301	5,176,257	-0-	36,721,558
Hospital assessment fee	15,184,385	-0-	-0-	15,184,385
Depreciation and amortization	19,168,933	870,908	-0-	20,039,841
Interest	14,538,245	2,057,579	-0-	16,595,824
Total operating expenses	399,757,716	89,055,397	(1,695,869)	487,117,244
Income (loss) from operations	53,057,372	(27,192,145)	-0-	25,865,227
Nonoperating gains (losses)				
Investment income	1,445,263	17,040	-0-	1,462,303
Loss on refinancing debt with HUD 242 mortgage insurance program	(29,190,407)	-0-	-0-	(29,190,407)
Other	(253,800)	756,438	-0-	502,638
Total nonoperating gains (losses)	(27,998,944)	773,478	-0-	(27,225,466)
Excess of revenue over (under) expenses	\$ 25,058,428	\$ (26,418,667)	\$ -0-	\$ (1,360,239)

See Report of Independent Auditors on Pages 1 - 3.

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	Eliminations	Total Reporting Unit
Other changes in unrestricted net assets				
Pension related changes other than net pension cost	\$ (9,071,119)	\$ -0-	\$ -0-	\$ (9,071,119)
Distribution to non-controlling interests	(1,275,046)	-0-	-0-	(1,275,046)
Net unrealized gain on investments	1,243,599	-0-	-0-	1,243,599
Transfers for property and equipment additions	5,090	-0-	-0-	5,090
Transfers between Union Hospital, Inc. and UAPC	(18,500,000)	18,500,000	-0-	-0-
Change in unrestricted net assets	(2,539,048)	(7,918,667)	-0-	(10,457,715)
Temporarily restricted net assets				
Other changes in receivable from Union Health Foundation, Inc.	(207,595)	-0-	-0-	(207,595)
Net assets released for property and equipment	(5,090)	-0-	-0-	(5,090)
Change in temporarily restricted net assets	(212,685)	-0-	-0-	(212,685)
Permanently restricted net assets				
Transfer of endowments to Union Health Foundation, Inc.	(1,520,937)			(1,520,937)
Net investment income	(27,172)	-0-	-0-	(27,172)
Change in permanently restricted net assets	(1,548,109)	-0-	-0-	(1,548,109)
Change in net assets	(4,299,842)	(7,918,667)	-0-	(12,218,509)
Net assets				
Beginning of year	135,506,017	54,799	-0-	135,560,816
End of year	\$ 131,206,175	\$ (7,863,868)	\$ -0-	\$ 123,342,307

See Report of Independent Auditors on Pages 1 - 3.

UNION HOSPITAL, INC. AND SUBSIDIARIES

CONSOLIDATING STATEMENTS OF OPERATIONS YEAR ENDED DECEMBER 31, 2017

	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	\$ 446,878,806	\$ 24,955,727	\$ 471,834,533	\$ -0-	\$ 1,497,768	\$ -0-	\$ -0-	\$ 473,332,301
Less provision for bad debts	23,646,333	2,581,351	26,227,684	-0-	-0-	-0-	-0-	26,227,684
Net patient service revenue net of provision for bad debts	423,232,473	22,374,376	445,606,849	-0-	1,497,768	-0-	-0-	447,104,617
Other revenue	13,913,394	400,773	14,314,167	1,168,344	-0-	9,746,881	(12,235,214)	12,994,178
Total operating revenue	437,145,867	22,775,149	459,921,016	1,168,344	1,497,768	9,746,881	(12,235,214)	460,098,795
Operating expenses								
Physician, Mid-level, and other provider salaries and wages	13,854,668	145,432	14,000,100	400,245	-0-	5,003,152	-0-	19,403,497
Other salaries and wages	93,758,020	7,626,888	101,384,908	-0-	-0-	-0-	-0-	101,384,908
Employee benefits	28,180,934	2,152,437	30,333,371	77,995	-0-	941,494	-0-	31,352,860
Medical supplies and drugs	79,229,651	2,019,044	81,248,695	-0-	150,622	-0-	-0-	81,399,317
Physician services	17,461,567	1,911,683	19,373,250	-0-	-0-	-0-	-0-	19,373,250
Contract services - management service organization support staff	7,049,733	132,661	7,182,394	-0-	-0-	-0-	-0-	7,182,394
Contract services - other	61,078,285	2,997,135	64,075,420	75,906	1,378,449	-0-	(1,402,781)	64,126,994
Rent and leases	6,855,385	479,958	7,335,343	19,202	4,154	-0-	(17,445)	7,341,254
Utilities, supplies, and other	36,506,531	2,783,511	39,290,042	562,059	478,616	767,075	(10,814,988)	30,282,804
Hospital assessment fee	15,798,150	1,055,576	16,853,726	-0-	-0-	-0-	-0-	16,853,726
Depreciation and amortization	19,325,807	1,028,766	20,354,573	3,090	3,851	-0-	-0-	20,361,514
Interest	11,669,159	799	11,669,958	-0-	-0-	1,313	-0-	11,671,271
Total operating expenses	390,767,890	22,333,890	413,101,780	1,138,497	2,015,692	6,713,034	(12,235,214)	410,733,789
Income (loss) from operations before pension termination	46,377,977	441,259	46,819,236	29,847	(517,924)	3,033,847	-0-	49,365,006
Pension Termination	48,909,624	-0-	48,909,624	-0-	-0-	-0-	-0-	48,909,624
Income (loss) from operations after pension termination	(2,531,647)	441,259	(2,090,388)	29,847	(517,924)	3,033,847	-0-	455,382
Non-operating gains (losses)								
Investment income	5,374,470	3,005	5,377,475	81,706	-0-	-0-	-0-	5,459,181
Other	1,650,870	5,000	1,655,870	-0-	-0-	-0-	(1,140,891)	514,979
Total non-operating gains (losses)	7,025,340	8,005	7,033,345	81,706	-0-	-0-	(1,140,891)	5,974,160
Excess of revenue over (under) expenses	\$ 4,493,693	\$ 449,264	\$ 4,942,957	\$ 111,553	\$ (517,924)	\$ 3,033,847	\$ (1,140,891)	\$ 6,429,542

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.
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
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	7,166,828	512,834	7,679,662	18,775	4,174	-0-	(17,030)	7,685,581
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	380,739,255	21,077,092	401,816,347	1,314,559	2,005,141	6,347,832	(11,726,163)	399,757,716
Income (loss) from operations	47,561,707	3,183,654	50,745,361	(50,192)	(467,285)	2,829,488	-0-	53,057,372
Nonoperating gains (losses)								
Investment income	1,346,115	847	1,346,962	98,301	-0-	-0-	-0-	1,445,263
Loss on refinancing debt with HUD 242 mortgage insurance premium	(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 nonoperating gains (losses)	(27,073,396)	14	(27,073,382)	98,301	-0-	-0-	(1,023,863)	(27,998,944)
Excess of revenue over (under) expenses	\$ 20,488,311	\$ 3,183,668	\$ 23,671,979	\$ 48,109	\$ (467,285)	\$ 2,829,488	\$ (1,023,863)	\$ 25,058,428

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES
SCHEDULE OF PROPERTY AND EQUIPMENT OF MORTGAGOR
YEAR ENDED DECEMBER 31, 2017

	Mortgagor	Other Activities	Consolidated System
Land and improvements	\$ 34,671,264	\$ 3,014,262	\$ 37,685,526
Buildings and fixed equipment	363,633,738	5,732,715	369,366,453
Movable equipment	168,528,589	-0-	168,528,589
	566,833,591	8,746,977	575,580,568
Less allowances for depreciation	294,077,721	5,383,280	299,461,001
Construction in progress	7,851,065	-0-	7,851,065
Total property and equipment, net	\$ 280,606,935	\$ 3,363,697	\$ 283,970,632

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2017

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	\$ 257,872,031
Non-major programs			
U.S. Department of Health and Human Services			
Pass through Health Resources and Services Administration (HRSA)			
Bureau of Health Workforce			
Primary Care Training and Enhancement	TOBHP28564-02	93.884	102,228
Primary Care Training and Enhancement	TOBHP28564-03	93.884	136,116
Total for CFDA 93.884			<u>238,344</u>
U.S. Department of Health and Human Services			
Pass through HRSA Office of Advancement of Telehealth			
Substance Abuse Treatment Network Grant Program	1H1WRH31447-01	93.211	22,599
	G01RH27871-03	93.211	373,842
Evidence-Based Tele-emergency Network Grant Program	G01RH27871-04	93.211	132,951
Total for CFDA 93.211			<u>529,392</u>
Pass through Indiana State Department of Health			
Community Health Center Grant	14077	93.913	41,077
Pass through Indiana State Department of Health			
Assistance Programs for Chronic Disease Prevention and Control	22779	93.945	400
Pass through Indiana State Department of Health			
Assistance Programs for Chronic Disease Prevention and Control	22779	93.757	3,600
Pass through Indiana State University			
Indiana Area Health Education Centers Network	EDS A70-3-079997	93.107	15,000
Pass through Indiana State Department of Health			
Small Rural Hospital Improvement Program Grant (SHIP)	16784	93.301	8,929
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	33,181
Pass through District 7 Hospital Corporation			
National Bioterrorism Hospital Preparedness Program	U90TP000521	93.074	22,000
Total non-major programs			<u>891,923</u>
Total federal expenditures			<u>\$ 258,763,954</u>

* The U.S. Department of Housing and Urban Development – Mortgage Insurance for Hospital’s loan program continues to have compliance requirements. The amount noted as federal expenditures represents the remaining outstanding loan balance at the end of the year.

There were no entities that received pass-through federal awards from the Union Health System, Inc. and Subsidiaries (the System) during the year ended December 31, 2017.

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2017

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, 2017. 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.



Blue & Co., LLC / 500 N. Meridian Street, Suite 200 / Indianapolis, IN 46204
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

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, 2017 and the related consolidated statement of operations and changes in net assets, and consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 19, 2018.

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 19, 2018



Blue & Co., LLC / 500 N. Meridian Street, Suite 200 / Indianapolis, IN 46204
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

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, 2017. 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, 2017.

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, Indiana
April 19, 2018

UNION HEALTH SYSTEM, INC. AND SUBSIDIARIES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2017

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:

No matters reported