

Beaumont Health and Consolidated Subsidiaries

Consolidated Financial Statements as of and
for the Years Ended December 31, 2017 and 2016,
Supplemental Schedule of Expenditures of Federal
Awards for the Year Ended December 31, 2017 and
Independent Auditors' Report

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1-2
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016:	
Balance Sheets	3-4
Statements of Operations and Changes in Net Assets	5-6
Statements of Cash Flows	7-8
Notes to Consolidated Financial Statements	9-57
INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	58-59
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE AS REQUIRED BY THE UNIFORM GUIDANCE	60-61
SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED DECEMBER 31, 2017	62-64
NOTES TO SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED DECEMBER 31, 2017	65
SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED DECEMBER 31, 2017	66-67
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (DECEMBER 31, 2016) FOR THE YEAR ENDED DECEMBER 31, 2017	68

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Beaumont Health
Southfield, Michigan

We have audited the accompanying consolidated financial statements of Beaumont Health and consolidated 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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 consolidated financial position of the System as of December 31, 2017 and 2016, and the results of its operations and 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.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplemental schedule of expenditures of federal awards, as required by *Title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 1, 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 solely 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 the effectiveness of the 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.

Deloitte + Touche LLP

March 1, 2018, except for Note 16 and the Supplemental Schedule of Expenditures of Federal Awards and related notes for the year ended December 31, 2017, as to which the date is October 1, 2018.

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 390,465	\$ 429,928
Short-term investments		500
Accounts receivable:		
Patients and third-party payors—net of provision for bad debts of \$230,060 and \$107,836, respectively	552,931	511,120
Other	54,582	34,041
Estimated third-party payor settlements	30,211	21,708
Inventories, prepaid expenses, and other current assets	104,663	97,347
Current portion—cash, investments, and pledges whose use is limited or restricted	<u>133,078</u>	<u>172,384</u>
Total current assets	1,265,930	1,267,028
PROPERTY, PLANT, AND EQUIPMENT—Net	1,951,290	1,897,964
INVESTMENTS	1,609,367	1,408,106
INVESTMENTS IN NONCONSOLIDATED ENTITIES	28,616	26,226
GOODWILL	13,409	13,409
INTANGIBLES AND OTHER ASSETS—Intangible assets total \$16,449 for the years ended December 31, 2017 and 2016	66,274	63,069
CASH, INVESTMENTS, AND PLEDGES WHOSE USE IS LIMITED OR RESTRICTED (NET OF CURRENT PORTION):		
Board designated	553	563
Bond construction and reserve funds	53,415	111,344
Professional liability	74,661	94,266
Deferred compensation and other	87,470	61,746
Donor-restricted assets	<u>144,665</u>	<u>100,711</u>
Total cash, investments, and pledges whose use is limited or restricted (net of current portion)	<u>360,764</u>	<u>368,630</u>
TOTAL	<u>\$5,295,650</u>	<u>\$5,044,432</u>

(Continued)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Trade accounts payable	\$ <u>187,835</u>	\$ <u>245,662</u>
Accrued liabilities:		
Employee benefits and payroll-related liabilities	291,916	316,443
Other	<u>71,262</u>	<u>49,480</u>
Total accrued liabilities	<u>363,178</u>	<u>365,923</u>
Current portion of professional and general liability	38,978	44,142
Current portion of long-term debt	51,278	64,512
Estimated third-party payor settlements	<u>70,610</u>	<u>102,374</u>
Total current liabilities	<u>711,879</u>	<u>822,613</u>
LONG-TERM LIABILITIES (NET OF CURRENT PORTION):		
Long-term debt	1,572,286	1,561,529
Professional and general liability	154,975	153,290
Other long-term liabilities	143,610	115,640
Pension liability	258,717	328,954
Postretirement benefits other than pensions	<u>15,118</u>	<u>15,999</u>
Total long-term liabilities (net of current portion)	<u>2,144,706</u>	<u>2,175,412</u>
Total liabilities	<u>2,856,585</u>	<u>2,998,025</u>
NET ASSETS:		
Unrestricted:		
Beaumont Health	2,288,267	1,910,673
Noncontrolling interest	<u>5,251</u>	<u>3,621</u>
Total unrestricted	2,293,518	1,914,294
Temporarily restricted	103,567	94,652
Permanently restricted	<u>41,980</u>	<u>37,461</u>
Total net assets	<u>2,439,065</u>	<u>2,046,407</u>
TOTAL	<u>\$5,295,650</u>	<u>\$5,044,432</u>

See notes to consolidated financial statements.

(Concluded)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
REVENUES:		
Net patient service revenue	\$4,339,807	\$4,301,454
Provision for bad debts	<u>(165,938)</u>	<u>(156,169)</u>
Net patient service revenue—less provision for bad debts	4,173,869	4,145,285
Other operating revenue	246,441	208,140
Income from nonconsolidated entities	7,447	8,430
Net assets released from restrictions—operations	<u>10,863</u>	<u>11,291</u>
Total revenues	<u>4,438,620</u>	<u>4,373,146</u>
EXPENSES:		
Salaries, wages, and benefits	2,506,797	2,368,792
Supplies	802,272	805,990
Purchased services and other expenses	628,894	666,055
Professional liability and general insurance	22,560	28,154
Depreciation and amortization	255,101	254,964
Interest	<u>45,442</u>	<u>48,564</u>
Total expenses	<u>4,261,066</u>	<u>4,172,519</u>
OPERATING INCOME BEFORE OTHER ITEMS	<u>177,554</u>	<u>200,627</u>
OTHER ITEMS:		
Asset impairment charges		(5,067)
Pension expense settlement cost	<u>(25,684)</u>	<u> </u>
Total other items	<u>(25,684)</u>	<u>(5,067)</u>
OPERATING INCOME AFTER OTHER ITEMS	<u>151,870</u>	<u>195,560</u>
NONOPERATING:		
Investment income	183,514	95,711
Loss on extinguishment of debt		(903)
Other—net	<u>(9,892)</u>	<u>(3,677)</u>
Total nonoperating	<u>173,622</u>	<u>91,131</u>
EXCESS OF REVENUES OVER EXPENSES FROM CONSOLIDATED OPERATIONS	325,492	286,691
LOSS (INCOME) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	<u>(3,910)</u>	<u>9</u>
EXCESS OF REVENUES OVER EXPENSES ATTRIBUTABLE TO THE SYSTEM	<u>\$ 321,582</u>	<u>\$ 286,700</u>

(Continued)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
UNRESTRICTED NET ASSETS:		
Excess of revenues over expenses from consolidated operations	\$ 325,492	\$ 286,691
Net assets released from restrictions—capital acquisitions	11,681	12,587
Changes in noncontrolling interests	(2,280)	(7,295)
Other changes in unrestricted net assets	5,771	(3,543)
Pension and other postretirement liability adjustments	<u>38,560</u>	<u>(112,465)</u>
Increase in unrestricted net assets	<u>379,224</u>	<u>175,975</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions and pledges—net of allowance	23,602	32,889
Investment income	10,189	5,286
Change in value of split-interest agreements	6	(33)
Other changes in temporarily restricted net assets	(2,338)	
Net assets released from restrictions	<u>(22,544)</u>	<u>(23,878)</u>
Increase in temporarily restricted net assets	<u>8,915</u>	<u>14,264</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Contributions and pledges—net of allowance	1,451	672
Investment Income	32	
Other changes in permanently restricted net assets	<u>3,036</u>	<u> </u>
Increase in permanently restricted net assets	4,519	672
INCREASE IN NET ASSETS	392,658	190,911
NET ASSETS—Beginning of year	<u>2,046,407</u>	<u>1,855,496</u>
NET ASSETS—End of year	<u>\$2,439,065</u>	<u>\$2,046,407</u>

See notes to consolidated financial statements.

(Concluded)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 392,658	\$ 190,911
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Restricted contributions and investment income	(35,274)	(38,847)
Depreciation and amortization	244,150	243,782
Provision for bad debts	166,304	156,193
Net gains and losses on investments	(176,187)	(88,323)
Loss on sale of property, plant, and equipment	1,576	10,181
System's portion of income from nonconsolidated entities	(7,447)	(8,430)
Asset impairment charges		5,067
Loss on extinguishment of debt		903
Pension and other postretirement liability adjustments	(38,560)	112,465
Changes in noncontrolling interest		
(Increase) decrease in:		
Accounts receivable—net	(228,656)	(175,023)
Estimated third-party payor settlement receivables	(8,503)	(7,946)
Inventories, prepaid expenses, and other	(7,316)	949
Intangibles & Other Assets	(3,205)	2,187
(Decrease) increase in:		
Trade accounts payable, accrued liabilities, and other	(31,884)	125,712
Estimated third-party payor settlement payables	(31,764)	24,520
Professional and general liability	(3,479)	6,521
Other long-term liabilities	27,970	3,781
Pension and other postretirement benefits	(44,448)	(71,964)
Net cash provided by operating activities	<u>215,935</u>	<u>492,639</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property, plant, and equipment	(326,800)	(296,927)
Purchases of investments	(2,531,512)	(2,627,281)
Proceeds from sales of investments	2,481,178	2,430,745
Addition to (release of) bond reserve funds	87,929	(220,889)
Distributions from nonconsolidated entities	6,458	8,961
Other—net	(16,399)	(13,873)
Net cash used in investing activities	<u>(299,146)</u>	<u>(719,264)</u>

(Continued)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016 (In thousands)

	2017	2016
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted contributions and interest	\$ 35,274	\$ 38,847
Changes in noncontrolling interest		
Proceeds from issuance of long-term debt	73,105	389,774
Principal payments of long-term debt	(63,917)	(107,847)
Debt issuance cost and premium amortization		
Debt issuance and other	<u>(714)</u>	<u>(2,563)</u>
Net cash provided by financing activities	<u>43,748</u>	<u>318,211</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(39,463)	91,586
CASH AND CASH EQUIVALENTS—Beginning of year	<u>429,928</u>	<u>338,342</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 390,465</u>	<u>\$ 429,928</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest—net of amount capitalized in 2017 of \$13,823 and in 2016 of \$14,351	<u>\$ 49,593</u>	<u>\$ 54,087</u>
Cash paid for income taxes	<u>\$ 689</u>	<u>\$ 2,089</u>
(Decrease) increase in accounts payable related to property acquisitions	<u>\$ (16,798)</u>	<u>\$ 2,754</u>
Increase in restricted net assets related to donated beneficial interests in trusts	<u>\$ 1,350</u>	<u>\$ 383</u>
See notes to consolidated financial statements.		(Concluded)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016 (In thousands)

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—Beaumont Health (the “System”) is the sole member of Oakwood Healthcare, Inc. (OHI), William Beaumont Hospital (WBH), and Zieger Healthcare Corporation, the sole member of Botsford General Hospital (BGH), a Michigan nonprofit corporation headquartered in Southfield, Michigan. The System is a tax-exempt organization under Internal Revenue Code (IRC) Section 501(c)(3).

The System provides a continuum of care as an integrated health care delivery system, primarily to southeastern Michigan residents. The System’s services include inpatient and outpatient services, physician services, long-term care, senior and assisted living, rehabilitation services, home health care, and other health-related activities. The System owns and operates eight nonprofit acute care hospitals, nursing homes, including assisted and independent living centers, certified home health agencies, ambulatory care facilities, a for-profit company engaged in health-related businesses, and various other health care entities. All subsidiaries are governed and related through common control. Substantially, all expenses of the System are related to providing health care services.

Additionally, the System currently operates two captive insurance companies, one is offshore and one onshore. Both are wholly owned subsidiaries of the System and provide medical professional and general liability coverage to the System, its affiliates, and voluntary medical staff.

In 2017, the Beaumont Foundation Board of Directors, the Botsford Board of Directors and the Oakwood Healthcare Foundation Board of Trustees, agreed to reorganize the three founding legacy foundations of Beaumont Health and create a new Michigan nonprofit corporation, “Beaumont Health Foundation.” As part of the reorganization, the foundation worked with donors on pledge and asset transfers, reviewing donor intent and related restrictions, where applicable. The Beaumont Health Foundation began operations in July 2017.

Basis of Consolidated Financial Statements—The consolidated financial statements include the accounts of all wholly owned, majority-owned, and controlled organizations. Investments where the System holds less than 20% ownership interest and does not exercise significant influence are accounted for on either the equity or cost method of accounting. All other investments, whereby the System holds up to 50% ownership interest and exercises significant influence, are accounted for using the equity method of accounting. All intercompany transactions and account balances 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 (GAAP) requires management of the System to make assumptions, estimates, and judgments that affect the amounts reported in the consolidated financial statements, including the notes

thereto, and related disclosures of commitments and contingencies, if any. The System considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: recognition of net patient service revenues and patient accounts receivables, including contractual and charity care allowances and provisions for bad debts; valuation of investments, including alternative investments, assessment of goodwill, long-lived assets, and intangibles for impairment; liabilities for losses and expenses related to employee health care, professional, and general liabilities; and liabilities for pensions and other postretirement benefits. Management relies on historical experience and other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results may differ from those estimates.

Cash Equivalents—Cash equivalents are liquid investments carried at cost with a maturity of three months or less from the date of purchase.

Short-Term Investments—Short-term investments are certificate of deposits and commercial paper with maturities of 91 days to 365 days.

Accounts Receivable, Provision for Bad Debts, Estimated Third-Party Payor Settlements, and Net Patient Service Revenue—Patient and third-party payor accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Substantially, all the System's receivables are related to providing health care services to patients.

The System recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided, less an uninsured discount, which is applied to the patient account. Based on historical experience, a significant portion of the System's self-pay patients (which consists of patients without insurance coverage) will be unable or unwilling to pay for the services provided.

Patient accounts receivable is reduced by an allowance for amounts that could become uncollectible in the future. The System's estimate for its provision for bad debts is based on management's assessment of historical and expected net collection by payor. The System updates the historical collection rates quarterly for each of its major payor sources of revenue used to estimate the provision for bad debts and contractual allowances. Management performs an analysis on a quarterly basis to evaluate the sufficiency of the provision for bad debts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides a provision for bad debts (which includes uncollectible deductibles and co-payments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties). For receivables associated with self-pay and insured patients, the System records a significant provision for bad debts during the year of service based on experience. At December 31, 2017, the System fully reserved all accounts aged at greater than 365 days.

The System's provision for bad debts for self-pay patients is 79% and 78% of self-pay accounts receivable at December 31, 2017 and 2016, respectively. In addition, the System's insured and uninsured self-pay write-offs are \$33,497 and \$100,474 for 2017 and 2016, respectively. In 2017, there was a change in the collection policies for the System's accounts receivable related to the hospital line of business. Prior to May 2017,

acute care self-pay accounts receivable was written off to bad debt after 120 days from billing date. As of May 2017, these accounts remain on active accounts receivable for 365 days and are reserved for through the System's provision for bad debt. The System does not maintain a material provision for bad debts from third-party payors, nor did it have significant write-offs from third-party payors.

Under Blue Cross, Medicare, and Medicaid programs, estimated retroactive adjustments under reimbursement agreements are included in net patient service revenue and estimated third-party payor settlements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The System's other accounts receivable is reduced by an allowance for amounts that could become uncollectible in the future. The System's estimate for its provision for bad debts is based on management's assessment of historical and expected net collection. Other accounts receivable is reviewed at least annually to determine collectability.

Inventories—Inventories consist of drugs, supplies, and retail goods, and are stated at the lower of cost or net realizable value.

Property, Plant, and Equipment—Property, plant, and equipment are recorded at cost, less accumulated depreciation. Expenditures for renewals and betterments are capitalized. Maintenance and repairs are charged to current operations. Depreciation for financial reporting purposes is computed on a straight-line basis over the estimated useful lives of the assets ranging from three to fifty years. Internal-use software is also included in equipment and is recorded at cost, less accumulated amortization with useful lives ranging from three to ten years.

Investments and Investment Earnings—Investments, inclusive of assets limited or restricted as to use, include marketable debt, equity securities and mutual funds. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value and are classified as trading securities. Mutual funds are recorded at fair value based on observable quoted prices. Investments also include investments in commingled funds and hedge funds. Commingled funds that hold securities directly are stated at the fair value of the underlying securities, as determined by the administrator, based on readily determinable market values. Certain commingled funds, hedge funds, private capital, and real estate vehicles are stated at fair value based on their net asset value (NAV).

Investment earnings (including equity earnings, realized gains and losses on investments, holding gains and losses on trading securities, and interest and dividends) are included in nonoperating gains and losses, unless the income or loss is restricted by donor or law.

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

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

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

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

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

Fair values of trading securities are based on quoted market prices, where available. The System obtains pricing for each security from investment managers and the System's consultants or a third-party pricing service (the "pricing service"), which generally uses Level 1 or Level 2 inputs for the determination of fair value in accordance with the fair value hierarchy. Security prices are normally derived through recently reported trades for identical or similar securities, adjusting through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or discount cash flow analysis, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, nonbinding broker quotes, benchmark yields, credit spread, default rates, and prepayment spreads.

As the System is responsible for the determination of fair value, it performs analyses on the prices received from the pricing service relative to the prices expected by the investment managers to determine whether the prices are reasonable estimates of fair value. Because of these reviews, the System has not adjusted the prices obtained from the pricing service.

An instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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

Investments in Nonconsolidated Entities—These investments where the System does not have operational control are accounted for on the equity method or cost method. Investments in entities where the System owns less than 50% but has significant operational influence over the operating and financial policies are recorded using the equity method.

Goodwill—In accordance with FASB ASC 350-20, *Intangibles—Goodwill and Other*, goodwill is evaluated annually for impairment. If the carrying amount of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in the

amount equal to that excess. Estimates of fair value are based on appraisals, established market prices for comparable assets, or internal estimates of future net cash flows and presumes stable, improving, or, in some cases, declining results, depending on the circumstances. In 2017 and 2016, no impairments to goodwill were required. Goodwill, net of amortization, is \$13,409 as of December 31, 2017 and 2016.

Intangibles and Other Assets—Intangibles and other assets include bed licenses and naming rights. Bed licenses and the naming rights have an indefinite useful life and are evaluated annually for impairment in accordance with FASB ASC 350-20, *Intangibles—Goodwill and Other*. If the carrying amount of the intangible asset exceeds the implied fair value of the intangible asset, an impairment loss is recognized in the amount equal to that excess. Estimates of fair value are based on appraisals, established market prices for comparable assets, or internal estimates of future net cash flows and presumes stable, improving, or, in some cases, declining results, depending on the circumstances. Intangible assets in the consolidated balance sheets have an indefinite life with a carrying value of \$16,449 as of the years ended December 31, 2017 and 2016. In 2017 and 2016, no impairments to intangibles were required.

Cash and Investments Whose Use is Limited—Cash and investments whose use is limited include assets held by trustees under indenture agreements, deferred compensation funds, and self-insurance arrangements. The current portion of cash and investments whose use is limited includes the assets that are required for current liabilities for bond-financed construction, debt service, and professional liability.

Assets Whose Use is Restricted—Assets whose use is restricted include invested contributions, the beneficial interests in trusts, and pledges receivable from donors or grantors whose use is either temporarily or permanently restricted. Pledges that are expected to be collected in the next year are included in current assets. Contributions received with donor-imposed temporary restrictions are reported as contributions and pledges of temporarily restricted net assets. When a donor restriction expires, which is typically the result of the purpose of a restriction being accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions in the consolidated statements of operations and changes in net assets. This includes contributions for which the restrictions are met in the same reporting period as when received.

Pledges receivable for restricted contributions is recorded in temporarily restricted net assets, net of amounts estimated to be uncollectible. Pledges receivable, due to be collected beyond one year, is discounted to their net present value. Expenses incurred in soliciting pledges and contributions were \$10,945 and \$11,148 for 2017 and 2016, respectively, and are included in the accompanying consolidated financial statements.

Donations of property are reported as temporarily restricted net assets at their estimated fair value, at the time received, and are then transferred to unrestricted net assets as capital acquisitions when the assets are placed in service. Contributions received, which are restricted for additions to property, plant, and equipment, are transferred to unrestricted net assets when expenditures are incurred.

Other Long-Term Liabilities—Other long-term liabilities include workers' compensation, deferred compensation, asset retirement obligations, and nursing home support agreements.

Advertising Costs—Advertising costs are expensed as incurred. Advertising expenses were \$10,264 and \$6,428 for the years ended December 31, 2017 and 2016, respectively, and were included in purchased services and other expenses in the consolidated statements of operations and changes in net assets.

Operating and Nonoperating Activities—The System meets the needs of individuals and the communities in its service area through a complement of general and specialized health care services, including inpatient acute care, outpatient services, long-term care, home health care, and other health care services. Activities directly associated with the fulfillment of the mission are considered to be operating activities. Other activities not central to the System’s primary mission are nonoperating.

Other Items—During 2017 and 2016, the System recognized asset impairment charges of \$0 and \$5,067 related to the write-down of certain medical office buildings and real estate holdings, respectively.

Effective September 30, 2016, the System began the process to terminate its noncontributory single-employer defined benefit pension plan covering all eligible BGH employees. As of December 31, 2017, \$25,684 of settlement costs have been recorded related to this termination. All benefit obligations are expected to be settled in the coming year and an estimated \$44,000 of additional settlement costs are expected in 2018.

Borrowing Costs—Interest incurred on assets acquired with proceeds of tax-exempt borrowings is capitalized up to the date the asset is placed into service and is net of any interest earned on construction and debt service funds established with proceeds of the related tax-exempt borrowings. Interest costs are not capitalized on assets established with donor-restricted assets. Net interest capitalized was \$13,823 and \$14,351 during 2017 and 2016, respectively. Debt issue costs are deferred and amortized using the interest method over the life of the obligations to which they pertain, and netted against outstanding debt issuances.

Discounts and Premiums on Bonds—Discounts and premiums on bonds issued are amortized using the bonds outstanding method over the lives of the bonds.

Functional Expenses—FASB ASC 958-205-45, *Presentation of Financial Statements for Not-for-Profit Entities*, requires that the expenses reported in the consolidated statements of operations and changes in net assets also be shown by their functional classification. The functional classifications of such expenses for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Patient care	\$ 3,528,095	\$ 3,393,320
Support services	732,971	779,199
Other Items	<u>25,684</u>	<u>5,067</u>
Total	<u>\$ 4,286,750</u>	<u>\$ 4,177,586</u>

Excess Revenue over Expenses—For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Transactions that are not directly related to the delivery of health care services are excluded from operating results. Changes in net assets,

which are excluded from the excess of revenue over expenses, include permanent transfers of assets to and from affiliates for other than goods and services, contributions of property and equipment (including assets acquired using contributions that by donor restrictions were to be used for the purposes of acquiring such assets), net assets released from restrictions for capital, changes in ownership related to entities with a noncontrolling interest, and changes in the pension and postretirement obligations related to prior service cost and unrecognized gains and losses.

Income Taxes—The System has been recognized by the Internal Revenue Service as an organization exempt from income taxes under IRC Section 501(a) as an organization described in IRC Section 501(c)(3). Certain of the System’s subsidiaries and other operations of the System are subject to federal income taxes. Provisions for such taxes are included in operating expenses. The System has net income tax liability totaling \$2,268 and \$610 at December 31, 2017 and 2016, respectively.

Adopted Accounting Pronouncements

In March 2016, the FASB issued ASU No. 2016-07, *Investments—Equity Method and Joint Ventures: Simplifying the Transition to the Equity Method of Accounting*. This guidance eliminates the requirement to retrospectively apply the equity method to an investment that subsequently qualifies for such accounting as result of an increase in the level of ownership interest or degree of influence. This guidance was effective for the System beginning January 1, 2017. The adoption of this guidance did not have a material impact on the System’s consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory*. This guidance requires entities to measure most inventories at the lower of cost or net realizable value. This guidance was effective for the System beginning January 1, 2017. The adoption of this guidance did not have a material impact on the System’s consolidated financial statements.

In May 2015, the FASB issued ASU No. 2015-09, *Disclosures About Short-Duration Contracts*. This guidance expands the disclosures an insurance entity must provide about its short-duration insurance contracts. This guidance was effective for the System beginning January 1, 2017. The adoption of this guidance did not have a material impact on the System’s consolidated financial statement.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*. This guidance significantly changes the consolidation analysis required under GAAP. This guidance was effective for the System beginning January 1, 2017. The adoption of this guidance did not have a material impact on the System’s consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-02, *Not-for-Profit Entities-Consolidation (Subtopic 958-810)*. This guidance amends the consolidation guidance in Subtopic 958-810 to clarify when a not-for-profit entity that is a general or limited partner should consolidate a for-profit limited partnership or similar legal entity. This ASU was effective for the System in the reporting period beginning January 1, 2017. The adoption of this guidance did not have a material impact on the System’s consolidated financial statements.

Forthcoming Accounting Pronouncements

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*. This guidance simplifies and improves how not-for-profit entities classify net assets, as well as the information presented in financial statements and notes about liquidity, financial performance, and cash flows. This guidance is effective for the System beginning January 1, 2018. The System does not expect this guidance to have a material impact on its results of operations, however presentation within the consolidated financial statements will be updated for proper presentation and required disclosures will be added.

In May 2014, FASB issued ASU No. 2014-09, *Revenue From Contracts With Customers (Topic 606)* which outlines a single, comprehensive model for accounting for revenue from contracts with customers. This ASU replaces most previously issued revenue recognition guidance and provides guidance for any entity entering into contracts with customers to transfer goods or services or entering into contracts for the transfer of nonfinancial assets unless the contracts are within the scope of other standards (e.g., insurance contracts). Under the ASU, an entity should recognize revenue to reflect the transfer of goods or services to customers in an amount depicting the consideration to which the entity expects to be entitled in exchange for the goods or services. After the deferral of the original effective date, this guidance is effective for the System beginning January 1, 2018. The System does not expect this guidance to have a material impact on its results of operations, however presentation within the consolidated financial statements will be updated to reflect net revenue including bad debt (price concessions) as one line and adding required disclosures.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. This guidance adds or clarifies guidance on the classification of certain cash receipts and payments in the consolidated statements of cash flows. This guidance is effective for the System beginning January 1, 2019. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This guidance introduces a lessee model that brings substantially all leases on the consolidated balance sheets. This guidance is effective for the System beginning January 1, 2019. Retrospective application is required. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance revises accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with fair value of financial instruments. This guidance is effective for the System beginning January 1, 2019. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805)-Clarifying the Definition of a Business*, which provides a framework to use in determining when a set of assets and activities is a business. This ASU is effective for the System in the reporting period beginning January 1, 2019. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which amends the requirements related to the presentation of the components of net periodic benefit cost in the statement of operations for an entity's sponsored defined benefit pension and other postretirement plans. This guidance is effective for the System in the reporting period beginning January 1, 2019. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, *Premium Amortization on Purchased Callable Debt Securities* which shortens the amortization period for certain callable debt securities held at a premium to be amortized to the earliest call date. Under current GAAP, the premium is generally amortized to the maturity date. This guidance is effective for the System in the reporting period beginning January 1, 2020. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. This guidance eliminates Step 2 from the goodwill impairment test. Instead, an entity will test goodwill by comparing the fair value of a reporting unit with its carrying amount. This ASU is effective for the System in the reporting period beginning January 1, 2022. The System is still evaluating the impact this guidance may have on its consolidated financial statements.

2. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment at cost as of December 31, 2017 and 2016, consist of the following:

	2017	2016
Land and land improvements	\$ 283,614	\$ 275,634
Buildings and building improvements	3,499,148	3,281,513
Furniture and equipment	1,994,869	1,870,999
Property leased to others under operating leases	87,802	88,860
Construction in progress	<u>141,305</u>	<u>213,021</u>
Total property, plant, and equipment	6,006,738	5,730,027
Less accumulated depreciation and amortization	<u>(4,055,448)</u>	<u>(3,832,063)</u>
Property, plant, and equipment—net	<u>\$ 1,951,290</u>	<u>\$ 1,897,964</u>

At December 31, 2017 and 2016, equipment includes software costs that are approximated at \$388,536 and \$357,861 and accumulated amortization of \$339,319 and \$301,027, respectively. Commitments for costs related to the construction and remodeling of System facilities were approximately \$147,246 and \$111,597 at December 31, 2017 and 2016, respectively.

3. INVESTMENTS

Marketable Securities—The fair value amounts of marketable securities are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Other Investments—The System invests in various commingled funds, hedge funds, private capital, and real estate funds, which are included in investments and assets limited or restricted as to use in the consolidated balance sheets. These funds are recorded at fair value.

Hedge funds are designed to produce positive investment returns regardless of market activity. These investments utilize a “fund-of-one” approach resulting in diversified, multi-strategy, and multi-manager investments. Underlying investments include other hedge funds that may invest in equities, fixed-income, commodities, currencies, and derivatives. Audited information is only available annually based on the funds of one’s year-end. Carrying values are based on the NAV. Management obtains and considers the audited consolidated financial statements of the fund of one when evaluating the overall reasonableness of the fair value.

The System has elected the fair value option for valuation of private capital investments. These investments are structured as limited partnerships and are designed to produce stable investment returns regardless of market activity. Audited information is only available annually based on the limited partnerships or funds’ year-end.

For hedge funds and private capital investments, there is a review of external information and the use of an investment consultant in addition to management’s internal procedures. These procedures include a review of returns against benchmarks and discussions with the fund manager on performance, changes in personnel, changes in process, and evaluations of current market conditions. The fund of one administrator and underlying managers meet with the System’s management and the investment committee of the Board of Directors on a periodic basis.

Because of the inherent uncertainty of valuations of the hedge funds, private capital, real estate and beneficial interests in trusts, values may differ materially from the values that would have been used had a ready market existed. Investments as of December 31, 2017 and 2016, are as follows:

	2017	2016
Cash and cash equivalents	\$ 203,403	\$ 305,215
Certificates of deposit	17,000	17,000
Equities and exchange traded funds	491,742	416,247
Mutual funds	126,258	62,507
Government securities and obligations	181,040	261,255
Asset-backed securities	49,594	34,267
Mortgage-backed securities	65,524	82,824
Corporate obligations	155,386	88,726
Derivatives—Swaps, Options, Futures	684	
	<hr/>	<hr/>
Total marketable securities	1,290,631	1,268,041
Commingled funds	359,007	311,342
Beneficial interests in trusts	10,838	9,105
Hedge funds	348,322	273,878
Private capital	23,073	7,437
Real estate	40,889	38,652
	<hr/>	<hr/>
Total investments	<u>\$ 2,072,760</u>	<u>\$ 1,908,455</u>

Investments are reported in the consolidated balance sheets as of December 31, 2017 and 2016, in the following captions:

	2017	2016
Current portion, cash and investments whose use is limited or restricted	\$ 133,078	\$ 172,384
Less pledges receivable	(11,961)	(12,442)
Short-term investments		500
Investments	1,609,367	1,408,106
Cash and investments whose use is limited or restricted	360,764	368,630
Less pledges receivable	<u>(18,488)</u>	<u>(28,723)</u>
Total	<u>\$ 2,072,760</u>	<u>\$ 1,908,455</u>

Investment activity for the years ended December 31, 2017 and 2016, is composed of the following:

	2017	2016
Nonoperating:		
Interest and dividend income	\$ 17,548	\$ 12,674
Net realized gains on investments sold	68,576	7,474
Net recognized gains on trading securities held at year-end	<u>97,390</u>	<u>75,563</u>
Investment income, realized gains, and recognized losses on trading securities held at year-end	183,514	95,711
Temporarily restricted investment income	10,189	5,286
Permanently restricted investment income	<u>32</u>	<u> </u>
Total	<u>\$ 193,735</u>	<u>\$ 100,997</u>

Investments in Nonconsolidated Entities—These investments are accounted for using the equity method except for two investments totaling \$375 accounted for using the cost method for the years ended December 31, 2017 and 2016.

The System has 50% limited partnership interests in six real estate partnerships and six joint venture arrangements to own and operate a 93-unit assisted living facility and five nursing and convalescent centers, with 1,052 beds (see Note 12). During 2017 and 2016, the System recorded revenues of approximately \$227 and \$270 from these related parties for medical management services, respectively.

The System has a 10.9% and 10.8% interest in a joint venture limited liability company for the years ended December 31, 2017 and 2016, respectively. It was established to own and operate mobile and fixed equipment used in the treatment of kidney stones using shockwave lithotripsy. Individual physicians and other hospitals hold the remaining interests. During 2017 and 2016, the System recorded lease expenses of approximately \$878 and \$963 to this related party, respectively.

The System has a 10.4% interest in a joint venture limited liability company established to own and operate a gamma knife used for advanced radiation treatments for brain tumors and neurological conditions. Individual physicians hold the remaining interests. During 2017 and 2016, the System incurred lease expenses of approximately \$2,556 and \$2,552 to this related party, respectively.

The System has a 20% interest in a real estate joint venture limited liability company established to own and operate a 40,000 square-foot medical office building in Warren, Michigan. Currently, a private development company holds the remaining 80%. During 2017 and 2016, the System incurred lease expenses of \$0 to this related party for the years ended December 31, 2017 and 2016.

The System has a 19% interest in a real estate joint venture limited liability company established to own and operate a 171,000 square-foot medical office building in West Bloomfield, Michigan. The System's interest in this entity was acquired in October 2006, in conjunction with a sale of the medical office building, which was expanded in 2007 to add an additional 87,500 square feet. A private development company holds the remaining 81%.

The System has an 18.2% interest in a real estate joint venture limited liability company established to own and operate a 100,490 square-foot medical office building in Sterling Heights, Michigan. Individual physicians and physician groups own the remaining interest. The System's interest in the entity was acquired in April 2011. The System currently leases approximately 36,566 square feet of space to provide ambulatory infusion services. During 2017 and 2016, the System incurred lease expenses of approximately \$1,720 and \$1,436 to this related party, respectively.

The System has a 0% and 50% interest at December 31, 2017 and 2016, respectively in a diagnostic and imaging service joint venture. The System's 50% interest was sold in July 2017.

The System has a 1.5% limited partnership interest in a limited partnership established to realize long-term appreciation through venture capital investments in equity and equity-related securities in the medical device industry. Two high-worth individuals hold a majority and others hold the remaining interest. The System has made a \$1,000 total investment commitment. During 2017 and 2016, the System contributed \$100 and \$186 of capital to the partnership, respectively.

The System has a 33% interest in a clinical integration network established during 2016 to meet the health care needs of the communities served by its members and participating physicians. An affiliated accountable care organization and an affiliated physician organization hold the remaining 67% interest. During 2017 and 2016, the System contributed \$400 and \$400 of capital to the partnership. The System is committed to another \$400 capital contribution, payable during 2018.

The System has a 49.38% and 50% interest at December 31, 2017 and 2016, respectively, in a joint venture established to own an outpatient surgical center located in Dearborn, Michigan. A physicians group holds the remaining 50.62% and 50% interest at December 31, 2017 and 2016, respectively. During 2017 and 2016, the System incurred expenses of approximately \$0 and \$2,658 to this related party, respectively.

The System has a 49% membership interest at December 31, 2017 and 2016 in a long-term acute care entity to provide long-term acute care and rehabilitation services. A private health care corporation holds the remaining 51% interest for the years ended December 31, 2017 and 2016. During 2017 and 2016, the System incurred expenses of approximately \$0 and \$27 to this related party, respectively.

The System has a 25% membership interest in an entity that provides dialysis and other health care related services to Dearborn and other Wayne County communities. A public health care organization holds the remaining 75% interest.

The System has a 40% interest in a joint venture limited liability company established to provide mobile MRI, x-ray, and ultrasound services. Physician groups hold the remaining 60% interest. During 2017 and 2016, the System recorded lease expenses of approximately \$1,908 and \$3,215 to this related party, respectively.

The System has 25%–50% and 20%-50% interest in seven and eight joint venture ambulance companies as of December 31, 2017 and 2018, respectively. The companies were established to provide emergency and nonemergency medical transportation to the general public and health care providers in multiple states. Various hospital systems hold the remaining interests. During 2017 and 2016, the System recorded revenues of approximately \$7,130 and \$7,522 from these related parties for management, dispatch, vehicle repair, and other services, respectively. In addition, the System recorded expenses of approximately \$45 and \$25 during 2017 and 2016, respectively.

The System’s portion of investees’ income is reflected on a separate line in the consolidated statements of operations and changes in net assets for 2017 and 2016. The System received distributions from these investees of \$6,458 and \$8,961 in 2017 and 2016, respectively.

The unaudited summarized financial position and results of operations for the entities accounted for under the equity method as of and for the year ended December 31, 2017, are as follows:

	Office Buildings	and Diagnostic	Homes and Assisted Living	Other	Total
Total assets	\$ 55,755	\$ 46,878	\$ 85,800	\$ 20,448	\$ 208,881
Total liabilities	74,921	13,298	117,480	9,234	214,933
(Deficit) equity	(19,166)	33,580	(31,680)	11,214	(6,052)
Revenue—net	17,373	77,660	60,408	40,352	195,793
Excess of revenue over expenses	6,908	11,658	2,764	3,842	25,172

The unaudited summarized financial position and results of operations for the entities accounted for under the equity method as of and for the year ended December 31, 2016, are as follows:

	Medical Office Buildings	Outpatient and Diagnostic	Nursing Homes and Assisted Living	Other	Total
Total assets	\$ 57,227	\$ 42,620	\$ 83,887	\$ 21,404	\$ 205,138
Total liabilities	75,489	12,088	120,444	11,069	219,090
(Deficit) equity	(18,262)	30,532	(36,557)	10,335	(13,952)
Revenue—net	17,282	67,266	61,805	41,211	187,564
Excess of revenue over expenses	6,759	11,603	3,780	82	22,224

4. PLEDGES RECEIVABLE

The maturity schedule for pledges receivable, net of the provision for bad debts of \$6,834 and \$7,427, and a present value discount of \$1,534 and \$2,552 (determined using 0.35%–0.6% for less than one year, 1.06%–6% for two years, 1.31%–6% for three and four years, 1.76%–6% for five and six years, 2.09%–6% for seven thru nine years, and 2.27%–6% for greater than 10 years), as of December 31, 2017 and 2016, respectively, is as follows:

	2017	2016
Less than one year	\$11,961	\$12,442
One to five years	18,362	28,334
Greater than five years	<u>126</u>	<u>389</u>
Total (included in current and noncurrent cash, investments, and pledges whose use is limited or restricted)	<u>\$30,449</u>	<u>\$41,165</u>

5. LONG-TERM DEBT AND OTHER FINANCING AGREEMENTS

The composition of long-term debt and capital lease obligations at December 31, 2017 and 2016, is as follows:

	2017	2016
Series 2007A; interest of 5.00%; partially refunded 2015; due through 2017—gross of bond issue premium and issuance costs of \$0—2017 and \$39—2016	\$ -	\$ 5,069
Series 2012A; interest of 3.00% to 5.00%; due through 2042—gross of bond issue premium and issuance costs of \$6,380—2017 and \$7,029—2016	133,530	138,824
Series 2012Z; indexed floating interest rate bonds 1.65% and 1.13% at December 31, 2017 and 2016, respectively; mature in 2035—net of bond issuance costs of \$84—2017 and \$89—2016	49,916	49,911
Series 2013A; interest of 5.00%; due through 2031—gross of bond issue premium and issuance costs of \$3,708—2017 and \$4,044—2016	51,853	52,189
Series 2014D; interest of 2.00% to 5.00%; due through 2039—gross of bond issue premium and issuance costs of \$16,793—2017 and \$19,570—2016	416,723	429,500
Series 2015A; interest of 4.00% to 5.00%; due through 2033—gross of bond issue premium and issuance costs of \$48,036—2017 and \$54,378—2016	443,917	452,813
Series 2016A; interest of 4.00% to 5.00%; due through 2046—gross of bond issue premium and issuance costs of \$19,469—2017 and \$20,264—2016	319,469	320,264
Series 2016B; interest of 1.82%; due through 2022—net of bond issuance costs of \$164—2017 and \$41—2016	60,502	64,959
Series 2017A; interest of 3.56%; due through 2027—net of bond issuance costs of \$558—2017	71,442	
Mortgage payable; interest rate of 7.38%; collateralized by land and a medical building with a net book value of \$20,585	24,344	25,534
Mortgage payable; interest rate of 6.52%; collateralized by master tenant lease—net of bond issuance costs of \$1,164—2017 and \$1,254—2016	40,936	42,174
Mortgage payable; variable interest rate (2.74% at October 31, 2017) and (2.16% at December 31, 2016); collateralized by property with a net book value of \$14,389—gross of bond issuance costs of \$221—2017 and net of bond issuance costs of \$20—2016	221	11,550
Mortgage payable; interest rate of 6.52%; collateralized by a medical building with a net book value of \$8,225		13,884
Fixed-rate installment note; interest of 2.6%; due through 2018	6,215	12,115
Other installment notes payable; interest ranging from 1.15% to 12.41%; collateralized by assets with a net book value of \$3,737 in 2017 and \$3,754 in 2016; including accreted interest of \$0—2017 and \$51—2016	<u>4,496</u>	<u>7,255</u>
Total	1,623,564	1,626,041
Less current portion	<u>(51,278)</u>	<u>(64,512)</u>
Long-term debt—net	<u>\$1,572,286</u>	<u>\$1,561,529</u>

Obligated Group—Under the Master Indenture, the System Obligated Group consists of the System; BGH; WBH; OHI; Oakwood United Hospitals, Inc.; and Oakwood Health Promotions. The System entities not included in the obligated group consist primarily of foundation, ambulance, and home care service companies along with for-profit business units.

Bonds—Series 2007A, 2012A, and 2013A were issued through the Michigan Finance Authority or the Michigan State Hospital Finance Authority (MSHFA). The loans are secured by the accounts receivable and general intangibles of the Obligated Group members pursuant to the Master Indenture.

The Series 2007A bonds were issued to refund previously issued Revenue and Refunding Bonds and to fund certain capital projects. The 2007A bonds were partially refunded with proceeds from the 2015A bond issuance. The remaining Series 2007A bonds matured in 2017.

The Series 2012A bonds were issued to refund certain portions of previously issued Revenue and Refunding Bonds and to fund certain capital projects. The Series 2012A bonds mature in annual amounts ranging from \$3,770 in 2018 to \$5,370 in 2042.

The Series 2013A bonds were issued to refund certain portions of previously issued Revenue and Refunding Bonds. The Series 2013A bonds mature in annual amounts ranging from \$11,170 in 2028 to \$12,930 in 2031.

Series 2012Z and 2014D were issued through the City of Royal Oak Hospital Finance Authority.

Series 2012Z bonds bear interest at an indexed floating interest rate adjusted weekly. This rate is based upon a percentage of the current London InterBank Offered Rate (LIBOR), plus 0.70%, and interest is payable monthly. The Series 2012Z bonds mature in 2035.

The Series 2014D bonds mature in annual amounts ranging from \$10,000 in 2018 to \$17,925 in 2039.

In January 2015, the System issued fixed-rate bond Series 2015A in the amount of \$398,435 to advance refund existing bonds. Premium on issuance of the Series 2015A bonds was \$70,824. The System incurred a nonoperating noncash loss on this advance refunding of \$46,143. The Series 2015A bonds mature in annual amounts ranging from \$12,225 in 2018 to \$30,330 in 2033.

In February 2016, the System issued fixed-rate bond Series 2016A in the amount of \$300,000 for approved capital projects. Premium on issuance of the Series 2016A bonds was \$23,514. The Series 2016A bonds mature in annual amounts ranging from \$11,545 in 2039 to \$49,605 in 2046.

In December 2016, the System issued fixed-rate bond Series 2016B in the amount of \$65,000 at a fixed interest rate of 1.82%, payable monthly, to advance refund Bond 2012C. The System incurred a nonoperating noncash loss on this advance refunding of \$903. The Series 2016B bonds mature in 2022.

In December 2017, the System issued fixed-rate bond Series 2017A in the amount of \$72,000 for the Beaumont Service Center. The Series 2017A bonds mature in 2027.

The current portion of the long-term debt includes \$11,183 of net original issue premium that will be amortized in 2018.

Mortgages Payable—The System has an ambulatory care center, with an original mortgage of \$31,517 with a fixed interest rate of 7.38% that matures in 2027. The balance at December 31, 2017 and 2016, was \$24,344 and \$25,534, respectively.

The System has a mortgage note payable of \$42,100 and \$43,428 at December 31, 2017 and 2016, respectively, which is secured by a master tenant lease of a medical office building. The mortgage note is payable in annual principal amounts ranging from \$1,523 in 2018 to \$5,486 in 2030.

The System has two other mortgage notes payable of \$0 and \$25,454 at December 31, 2017 and 2016, respectively, which are secured by the assets of various medical office buildings, respectively. Early pay-off of both mortgage notes payable occurred during 2017.

The System has agreed to a mortgage lien on the Beaumont Hospital—Royal Oak hospital building site and improvements constructed thereon and a mortgage lien on the Beaumont Hospital-Troy hospital building site and improvements constructed thereon to the Bank of New York Mellon. The mortgages secure all outstanding obligations on a parity basis, and the supplemental indenture requires such mortgages to remain in place so long as the bonds (Series 2012Z, 2014D, 2015A, 2016A, and 2016B) are outstanding.

Term and Installment Loan—The System entered into a fixed-rate installment note of \$34,350 in 2012, which bears interest at 2.6% annually. The proceeds from the note were used to refund certain portions of the prior bonds. The loan has a balance of \$6,215 and \$12,115 as of December 31, 2017 and 2016, respectively. This remaining balance is due in 2018.

Other Installment Notes Payable—In 2015, the Oakland University William Beaumont School of Medicine received full accreditation from the Liaison Council for Medical Education. As part of this partnership with Oakland University, students will take part in clinical training and applied research at the hospital. As a result, the System has recognized \$0 and \$1,929 of long-term obligation to Oakland University for naming rights installment payments at December 31, 2017 and 2016, respectively. Final naming rights installment payment occurred on July 31, 2017.

The remaining other installment notes relate to term loans with lenders and property lessors for purchases of equipment and leasehold improvements, with terms of repayment ranging from three to ten years. 2017 debt incurred includes \$78 of cash received from a vendor for capital equipment and improvements to be repaid over 10 years based on the terms of the vendor agreement and \$1,027 of capital lease obligations for other capital equipment and software paid over four years.

Annual principal payments on long-term debt as of December 31, 2017, are due as follows:

**Years Ending
December 31**

2018	\$ 40,961
2019	42,689
2020	44,760
2021	46,992
2022	89,081
Thereafter	<u>1,266,444</u>
Subtotal	1,530,927
Plus net unamortized original issue premium	103,884
Less net unamortized issuance costs	<u>(11,247)</u>
Total	<u>\$ 1,623,564</u>

Lines of Credit—The System has availed a \$50,000 secured line of credit with US Bank. The secured line of credit expires on October 1, 2018. The unused fee for the line of credit is \$50 per year. There were no outstanding balances on the lines of credit at December 31, 2017 and 2016.

6. OTHER LONG-TERM LIABILITIES

The composition of other long-term liabilities as of December 31, 2017 and 2016, is as follows:

	2017	2016
Workers' compensation liability	\$ 14,901	\$ 16,234
Deferred compensation plan liability (Note 11)	85,968	60,201
Asset retirement obligation	8,214	8,358
Nursing home support agreements (Note 12)	16,814	19,160
Other	<u>17,713</u>	<u>11,687</u>
Total	<u>\$143,610</u>	<u>\$115,640</u>

Asset Retirement Obligation—Asset retirement obligations represent legal or contractual obligations associated with the retirement of tangible long-lived assets that are incurred upon the acquisition, construction, development, or normal operation of that long-lived asset. The guidance requires the System to recognize asset retirement obligations in the period in which they are incurred, if a reasonable estimate of fair value can be made. The asset retirement obligations are accreted to their present value at the end of each reporting period. The associated estimated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over its useful life.

The System annually evaluates its leased and owned properties for potential asset retirement obligations. Based on these reviews, the System has identified obligations primarily related to the removal of certain materials previously utilized in the construction process and storage tanks. The changes in the total liability for asset retirement obligations for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Liability—beginning of year	\$8,528	\$7,968
Accretion expense	184	594
Future remediation assumption changes	<u>(348)</u>	<u>(34)</u>
Liability—end of year	<u>\$8,364</u>	<u>\$8,528</u>
Current portion	\$ 150	\$ 170
Long-term portion	<u>8,214</u>	<u>8,358</u>
Total	<u>\$8,364</u>	<u>\$8,528</u>

7. PENSIONS AND OTHER POSTRETIREMENT BENEFIT PLANS

Hospital Employees’ Retirement Plans—The System has a defined benefit pension plan (“Employees’ Retirement Plan”) that covers substantially all of the WBH employees. Prior to 2008, benefits under the plan were based generally on an employee’s highest five consecutive years of earnings out of the 10 years preceding retirement. Effective January 1, 2008, the System changed the benefit calculation of the Employees’ Retirement Plan to be based on a cash balance formula for 2008 and future years of service. Pension benefits earned prior to January 1, 2008, were not reduced or eliminated, but will be increased to reflect credited years of service earned prior to 2008 and final average pay. Under the amended plan, eligible employees are credited with 5% of base pay earned for each year after 2007. Credited account balances are increased through an interest credit each December 31, based on the 30-year US Treasury rate as of August 1 of the prior plan year. Effective February 1, 2013, the System amended the plan to allow current employees who terminate employment after January 1, 2013, to take a lump-sum payout if the value of the benefit is less than \$100. Effective December 31, 2013, the System amended the plan to freeze compensation used to determine the final average pay benefit for benefit service provided prior to January 1, 2008.

The System has two cash balance pension plans covering substantially all the OHI employees. The plans are noncontributory for employees, and OHI contributions are based on years of service and compensation. OHI’s funding policy is to contribute amounts based on the terms of the respective plans and the recommendations of an actuary considering minimum funding requirements determined in accordance with the Pension Protection Act. Plan assets, principally cash and cash equivalents, equity, and fixed-income investments, are invested in a master trust. Contributions to the plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants. The assets of the plans are available to pay the benefits of eligible participants. Effective July 1, 2013, the Plan was closed to new participants. OHI employees hired after January 1, 2010, not eligible to participate in the cash balance plan.

The System has a noncontributory single-employer pension plan (the "Plan"), covering all eligible BGH employees. The Plan is a defined benefit plan that is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Normal retirement benefits, coordinated with Social Security, are principally based on years of service and annual compensation. BGH makes annual contributions to the Plan equal to an amount necessary to meet or exceed the minimum funding requirements of ERISA. Contributions are intended to provide for benefits earned through the date the Plan was frozen. On November 26, 2002, BGH's board of trustees approved a resolution to freeze the defined benefit plan effective December 31, 2002. No additional benefits were earned after that date, and all eligible participants were vested. Effective September 30, 2016, the plan is in the process of being terminated and all benefit obligations are expected to be settled by 2018. As of December 31, 2017, \$25,683 of settlement costs have been recorded related to this termination; an estimated \$44,000 of additional settlement costs are expected in 2018.

Supplemental Pension Plans—The System has a nonqualified supplemental pension plan covering certain employees, as designated by the Organization and Compensation Committee of the Board of Directors. The plan provides for lump-sum benefit payments from the System's general assets so that total payments are the same or more than the payments that would have been payable from the System's principal defined benefit pension plan if it were not for limitations imposed by income tax regulations. The System has accrued liabilities based on actuarial valuations. These supplemental pension plans are unfunded. Effective December 31, 2016, the plan is in the process of being terminated and all benefit obligations were settled in February 2018.

403(b) and 401(a) Plans—The System has a matching 403(b) plan and a 401(a) plan for employees. Those employees who do not participate in a cash balance plan receive an employer contribution of 3% of compensation. Additionally, all employees may make elective deferrals to the plan up to the limits contained in IRC Section 402(g) and are eligible to receive a discretionary match. During 2017, the System announced its intent to make a matching contribution for active participants that would be funded in 2018. The expenses included in the 2017 and 2016 consolidated financial statements related to these transactions for the system amounted to \$23,682 and \$29,062, respectively.

Deferred Compensation Plan—The System has a deferred compensation plan that was established for eligible participants from 1982–1986. The plan was closed in 1986 to new participants due to the 1986 tax laws. Deferred compensations in the amount of \$8,832 and \$8,803 as of December 31, 2017 and 2016, respectively, are included in deferred compensation in long-term liabilities.

457(b) Plans—The System has a plan that allows certain employees to participate in the deferred compensation plan under code section 457(b). Such assets are held in a rabbi trust; however, these assets belong to the System and are subject to the claims of general creditors. Deferred compensations in the amount of \$69,531 and \$44,418 as of December 31, 2017 and 2016, respectively, are included in deferred compensation and other in cash, investments, and pledges, whose use is limited or restricted.

457 (f) Plans—The System has an additional plan that allows certain eligible employees of WBH to participate in a deferred compensation plan under code section 457(f). This is an unfunded “top hat” plan. Deferred compensation in the amount of \$4,689 and \$4,707 as of December 31, 2017 and 2016, respectively, is included in deferred compensation and other in cash, investments, and pledges whose use is limited or restricted. Effective December 31, 2016, the plan is in the process of being terminated and all benefit obligations were settled in January 2018.

The System has a plan that allows certain eligible employees to participate in a deferred compensation plan under code section 457(f). This is an unfunded “top hat” plan. Deferred compensations in the amount of \$2,916 and \$2,273 as of December 31, 2017 and 2016, respectively, are included in deferred compensation and other in cash, investments, and pledges whose use is limited or restricted.

Postretirement Benefits—The System has a plan that provides health and certain other postretirement benefits to eligible OHI employees who meet certain eligibility requirements. A segment of employees who retired prior to 1993 currently receives a subsidy equal to most of the cost of retiree medical benefits. All other retirees contribute toward the cost of their medical costs and receive a fixed subsidy from OHI. The postretirement health care plan requires retiree contributions, which are adjusted annually. OHI does not prefund these plans and has the right to modify or terminate any of these plans in the future. The OHI’s board of trustees approved a change to the postretirement benefit plan, which resulted in elimination of the annual subsidy for employees who had not retired as of December 31, 2008.

The System has a postretirement health care plan that covers certain WBH employees and their covered dependents. WBH employees meeting certain eligibility criteria and retiring before January 1, 2007, are eligible for subsidized medical benefits capped at the 2006 hospital subsidy indexed no more than 5% per year. Effective January 1, 2012, subsidies for medical coverage past age 65 were eliminated for all current and future WBH retirees. WBH employees meeting certain eligibility criteria and retiring on or after January 1, 2007, are eligible for a retiree medical account providing a defined dollar subsidy based on years of service at retirement.

The following tables set forth the changes in projected benefit obligations, accumulated postretirement obligations, changes in plan assets, and liability of the plans for both the pension plans and the postretirement healthcare plan reconciled with the amounts included in the System's consolidated financial statements as of December 31, 2017 and 2016, as follows:

2017	Pension Plans	Postretirement Plan
Change in benefit obligation:		
Benefit obligation—beginning of year	\$ 1,916,727	\$ 17,381
Service cost	47,340	376
Interest cost	79,566	721
Amendments		
Actuarial gain	79,969	(709)
Benefits paid	(152,629)	(1,435)
Annuities purchased	<u> </u>	<u> </u>
Benefit obligation—end of year	<u>1,970,973</u>	<u>16,334</u>
Change in plan assets:		
Fair value of plan assets—beginning of year	1,547,752	
Actual return of plan assets	181,341	
Employer contributions	107,493	
Benefits paid	(152,627)	
Annuities purchased	<u> </u>	<u> </u>
Fair value of plan assets—end of year	<u>1,683,959</u>	<u>-</u>
Accrued liability	<u>\$ (287,014)</u>	<u>\$(16,334)</u>
Included in current liabilities	\$ (28,297)	\$ (1,216)
Liability—long term	<u>(258,717)</u>	<u>(15,118)</u>
Accrued liability	<u>\$ (287,014)</u>	<u>\$(16,334)</u>
Components of net periodic benefit cost:		
Service cost	\$ 47,340	\$ 376
Interest cost	79,566	721
Expected return on plan assets	(116,405)	
Settlement cost	26,181	
Amortization of prior service credit	(3,601)	(2,232)
Amortization of unrecognized net loss	<u>32,374</u>	<u>160</u>
Net periodic benefit cost	<u>\$ 65,455</u>	<u>\$(975)</u>

2016	Pension Plans	Postretirement Plan
Change in benefit obligation:		
Benefit obligation—beginning of year	\$ 1,738,911	\$ 18,188
Service cost	45,016	401
Interest cost	80,082	823
Amendments	(260)	
Actuarial gain	134,698	(262)
Benefits paid	(81,720)	(1,769)
Annuities purchased	<u> </u>	<u> </u>
Benefit obligation—end of year	<u>1,916,727</u>	<u>17,381</u>
Change in plan assets:		
Fair value of plan assets—beginning of year	1,411,245	
Actual return of plan assets	111,103	
Purchase of JLL		
Employer contributions	107,126	
Benefits paid	(81,722)	
Annuities purchased	<u> </u>	<u> </u>
Fair value of plan assets—end of year	<u>1,547,752</u>	<u>-</u>
Accrued liability	<u>\$ (368,975)</u>	<u>\$ (17,381)</u>
Included in current liabilities	\$ (40,021)	\$ (1,382)
Liability—long term	<u>(328,954)</u>	<u>(15,999)</u>
Accrued liability	<u>\$ (368,975)</u>	<u>\$ (17,381)</u>
Components of net periodic benefit cost:		
Service cost	\$ 45,016	\$ 401
Interest cost	80,082	823
Expected return on plan assets	(108,501)	
Settlement cost	1,242	
Amortization of prior service credit	(2,692)	(2,232)
Amortization of unrecognized net loss	<u>22,503</u>	<u>290</u>
Net periodic benefit cost	<u>\$ 37,650</u>	<u>\$ (718)</u>

The amounts included in unrestricted net assets, including amounts arising during the year and amounts reclassified into net periodic benefit cost, as of December 31, 2017 and 2016, are as follows:

2017	Pension Plans Net Gain (Loss)	Prior Service Credit	Total
Included in net assets—January 1, 2017	\$ 590,063	\$(21,380)	\$ 568,683
Reclassified to net periodic benefit cost	(32,374)	3,601	(28,773)
Curtailment/Settlement	(26,181)		(26,181)
Arising during the year	<u>15,031</u>	<u> </u>	<u>15,031</u>
Included in net assets—December 31, 2017	<u>\$ 546,539</u>	<u>\$(17,779)</u>	<u>\$ 528,760</u>
	Postretirement Plan Net Gain (Loss)	Prior Service Credit	Total
Included in net assets—January 1, 2017	\$ (501)	\$ (2,552)	\$ (3,053)
Reclassified to net periodic benefit cost	(160)	2,232	2,072
Arising during the year	<u>(709)</u>	<u> </u>	<u>(709)</u>
Included in net assets—December 31, 2017	<u>\$ (1,370)</u>	<u>\$ (320)</u>	<u>\$ (1,690)</u>
2016	Pension Plans Net Gain (Loss)	Prior Service Credit	Total
Included in net assets—January 1, 2016	\$ 480,904	\$(23,006)	\$ 457,898
Reclassified to net periodic benefit cost	(22,503)	2,692	(19,811)
Curtailment/Settlement	(436)	(806)	(1,242)
Arising during the year	<u>132,098</u>	<u>(260)</u>	<u>131,838</u>
Included in net assets—December 31, 2016	<u>\$ 590,063</u>	<u>\$(21,380)</u>	<u>\$ 568,683</u>
	Postretirement Plan Net Gain (Loss)	Prior Service Credit	Total
Included in net assets—January 1, 2016	\$ 50	\$ (4,756)	\$ (4,706)
Reclassified to net periodic benefit cost	(290)	2,232	1,942
Arising during the year	<u>(262)</u>	<u> </u>	<u>(262)</u>
Included in net assets—December 31, 2016	<u>\$ (502)</u>	<u>\$(2,524)</u>	<u>\$ (3,026)</u>

Amounts included in unrestricted net assets and not yet recognized in operations as of December 31, 2017 and 2016, consist of:

	Pension Plans	Postretirement Plan
2017		
Unrecognized prior service credit	\$ (17,779)	\$ (293)
Actuarial losses	<u>546,539</u>	<u>(1,370)</u>
Total amount not yet recognized in operations	<u>\$528,760</u>	<u>\$ (1,663)</u>
2016		
Unrecognized prior service credit	\$ (21,380)	\$ (2,525)
Actuarial losses	<u>590,063</u>	<u>(501)</u>
Total amount not yet recognized in operations	<u>\$568,683</u>	<u>\$ (3,026)</u>

The estimated amounts to be amortized from unrecognized net assets into net periodic benefit cost during 2018 are as follows:

	Pension Plans	Postretirement Plan
2018		
Amortization of prior service credits	\$ (3,341)	\$ (293)
Amortization of net actuarial loss	<u>31,436</u>	<u> </u>
Net amount to be recognized in 2018	<u>\$28,095</u>	<u>\$ (293)</u>

The System's plan assets and accumulated benefit obligations measured as of December 31, 2017 and 2016, are as follows (in thousands):

	2017	2016
Fair value of plan assets	\$ 1,683,959	\$ 1,547,754
Accumulated benefit obligation	<u>1,940,785</u>	<u>1,889,160</u>
Unfunded status	<u>\$ (256,826)</u>	<u>\$ (341,406)</u>

Plan Assets—Plan assets are recorded at their fair value and consist of various securities. The various types of securities are as follows:

Cash and cash equivalents, equities, and mutual funds are recorded at fair value based on observable quoted prices for identical assets in active markets. As a result, these financial assets have been classified as Level 1 investments

Government securities, asset-backed securities, mortgage-backed securities, and corporate obligations are recorded at fair value based on observable inputs derived from quoted prices for similar assets in active markets. As a result, these securities have been classified as Level 2 investments.

Derivatives are recorded at fair value based on observable inputs derived from quoted prices for similar assets in active markets. As a result, these securities have been classified as Level 2 investments.

Commingled funds are recorded at fair value based on the underlying investments in the funds, which consist primarily of securities with quoted prices in active markets. Commingled funds' fair values are based on the NAV per share calculated by the investment manager and administrator. As investments in commingled funds are measured at NAV, they are measured separately from the fair value hierarchy in the following tables.

Hedge funds and real estate do not have a readily determinable market value. Fair values are based on the NAV per share provided by the fund managers along with audited financial information. As investments in hedge funds are measured at NAV, they are measured separately from the fair value hierarchy in the following tables.

Private capital, which may include private equity, private credit and private real assets, does not have a readily determinable market. Fair values are based on information provided by the fund managers along with audited financial information using either a market approach or an income approach, each of which requires a significant degree of judgment. There is no active trading market for these investments, and they are for the most part illiquid. Due to the significant unobservable inputs, the fair value measurements used to estimate their fair value are a Level 3 input.

The System has elected the fair value option for valuation of private capital investments. These investments are structured as limited partnerships and are designed to produce stable investment returns regardless of market activity. Audited information is only available annually based on the limited partnerships or funds' year-end.

For hedge funds and private capital investments, there is a review of external information and the use of an investment consultant in addition to management's internal procedures. These procedures include a review of returns against benchmarks and discussions with the fund manager on performance, changes in personnel, changes in process, and evaluations of current market conditions. The fund of one administrator and underlying managers meet with the System's management and the investment committee of the Board of Directors on a periodic basis.

Other, which represents unsettled transactions relating primarily to purchases and sales of plan assets, accrued income, and derivatives. Due to the short maturity of these assets and liabilities, the fair value approximates the carrying amounts. The fair value of the derivatives is estimated utilizing the terms of the derivative instruments and publicly available market yield curves. Derivatives are used to manage the portfolio's duration and not for speculative purposes, which is prohibited in the Pension Plans' investment policies.

The System had no transfers between Level 1 and level 2 assets at December 31, 2017 and 2016. The total pension plans' asset portfolio by asset category as of December 31, is as follows:

2017	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total
Asset category:				
Cash and cash equivalents	\$ 83,307	\$ -	\$ -	\$ 83,307
Equities and exchange traded funds	406,186			406,186
Mutual funds	40,795			40,795
Government securities		171,379		171,379
Asset-backed securities		6,571		6,571
Mortgage-backed securities		12,631		12,631
Corporate obligations		281,561		281,561
Private capital			165,365	165,365
Derivatives—swaps, options, and futures		4,143		4,143
Other	<u>(15,436)</u>	<u> </u>	<u> </u>	<u>(15,436)</u>
Total marketable investments	<u>\$514,852</u>	<u>\$476,285</u>	<u>\$165,365</u>	<u>1,156,502</u>
Investments measured at NAV:				
Commingled funds				285,326
Hedge funds				<u>242,131</u>
Total investments measured at NAV				<u>527,457</u>
Total plan assets				<u>\$1,683,959</u>
			Level 3 Investments Private Equity Funds	
2017				
January 1, 2017—balance				\$154,515
Purchases				15,864
Redemptions/distributions				(24,530)
Net gain on assets held at December 31, 2017				9,514
Net gain on assets sold in 2017				<u>10,002</u>
December 31, 2017—balance				<u>\$165,365</u>

Total unfunded private capital commitments were \$64,652 and \$47,625 as of December 31, 2017 and 2016, respectively.

2016	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total
Asset category:				
Cash and cash equivalents	\$ 139,770	\$ -	\$ -	\$ 139,770
Equities	375,237			375,237
Government securities		176,879		176,879
Asset-backed securities		4,640		4,640
Mortgage-backed securities		30,994		30,994
Corporate obligations		207,642		207,642
Private capital			154,515	154,515
Derivatives—swaps, options, and futures		2,608		2,608
Other	<u>(32,486)</u>	<u> </u>	<u> </u>	<u>(32,486)</u>
Total marketable investments	<u>\$482,521</u>	<u>\$422,763</u>	<u>\$154,515</u>	<u>1,059,799</u>
Investments measured at NAV:				
Commingled funds				286,316
Hedge funds				<u>201,639</u>
Total investments measured at NAV				<u>487,955</u>
Total plan assets				<u>\$1,547,754</u>
				<u>Level 3 Investments Private Equity Funds</u>
2016				
January 1, 2016—balance				\$145,760
Purchases				15,652
Redemptions/distributions				(17,040)
Net gain on assets held at December 31, 2016				(38)
Net gain on assets sold in 2016				<u>10,181</u>
December 31, 2016—balance				<u>\$154,515</u>

The tables below disclose the nature and risks of investments on which fair value is measured by NAV per share as of December 31, 2017 and 2016, are as follows:

	Fair Value 2017	Redemption Frequency	Redemption Notice Period	Unfunded Commitments
Multistrategy hedge funds ^(a)	\$ -	Annually, May 31	185 days	N/A
Multistrategy hedge funds ^(b)		Quarterly	100 days	N/A
Emerging Market Equity ^(c)	23,894	Quarterly	92 days	N/A
Real Estate ^(d)		Quarterly	90 days	38000
Multistrategy hedge funds ^(e)	240,651	Quarterly	60 Days	13,673
Opportunistic credit fund ^(f)	54,201	Quarterly	60 days	N/A
Multistrategy hedge funds ^(g)	1,480	Quarterly	60 days	13500
Unconstrained Global Fixed Income ^(h)	50,552	Monthly	10 days	N/A
Emerging Market Equity ⁽ⁱ⁾	32,224	Monthly	10 days	N/A
Emerging Market Equity ^(j)	77,906	Monthly	5 days	N/A
Master Limited Partnership ^(k)	41,197	Weekly	5 days	N/A
US fixed income ^(l)	2,141	Daily	N/A	N/A
US fixed income ^(m)	3,211	Daily	N/A	N/A
Replication ⁽ⁿ⁾		Daily	N/A	N/A
	<u>\$527,457</u>			

(a) This category invested in hedge funds that pursued multiple strategies to diversify risks and reduce volatility. This fund was liquidated as the firm, The Carlyle Group, closed the strategy.

(b) This category invested in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. This strategy was liquidated in the first half of 2017.

(c) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

(d) This category's investment strategy is to create a high-quality and low-risk portfolio of stabilized and income-producing real estate assets diversified by property type and economic exposure. Property sector exposure includes apartments, office, retail, self-storage, and industrial. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

(e) This category invests in a hedge fund of one strategy that includes investments in underlying hedge funds. The total mandate is split between two distinct strategies of diversified strategies and long/short equity. Quantitative inputs for the underlying portfolio funds are based on valuations supplied by the investment managers or fund administrators of the underlying funds and not by the system. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.

(f) This commingled fund invests in many different sub strategies within corporate credit. The composite portfolio's strategies include investments in approximately high yield, bank debt, and distressed credit. Quantitative inputs for these securities are developed by the investment manager and fund administrator. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

- (g) This commingled invests in the public or structured equity, fixed income, and alternative investment markets across the globe. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.
- (h) This commingled fund features an unconstrained fixed-income approach that allows it to invest across the spectrum of bonds and currencies. Quantitative inputs for these securities are developed by the investment manager and fund administrator. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (i) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (j) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (k) This commingled fund invests in investment grade securities of any maturity. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (l) This commingled fund invests in investment grade securities of any maturity. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (m) This commingled fund invests in US government and investment-grade fixed-income securities of a long duration nature. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (n) This commingled fund was a fund of one portfolio that invested in a target asset allocation strategy to replicate the overall asset allocation of the total portfolio. This strategy was closed in early 2017 and was transferred to a separate account strategy.

	Fair Value 2016	Redemption Frequency	Redemption Notice Period	Unfunded Commitments
Multistrategy hedge funds ^(a)	\$ 2,733	Annually, May 31	185 days	N/A
Multistrategy hedge funds ^(b)	40,715	Quarterly	100 days	N/A
Emerging Market Equity ^(c)	17,939	Quarterly	92 days	N/A
Multistrategy hedge funds ^(d)	158,191	Quarterly	60 Days	55,000
Opportunistic credit fund ^(e)	60,994	Quarterly	60 days	N/A
Emerging Market Equity ^(f)	25,745	Monthly	10 days	N/A
Emerging Market Equity ^(g)	54,511	Monthly	5 days	N/A
Replication ^(h)	36,198	Daily	N/A	N/A
US fixed income ⁽ⁱ⁾	<u>90,929</u>	Daily	N/A	N/A
	<u>\$487,955</u>			

- (a) This category invested in hedge funds that pursued multiple strategies to diversify risks and reduce volatility. This fund is currently in liquidation mode as the firm, The Carlyle Group, is closing down the strategy. The proceeds will be used to fund the hedge fund of one strategy in description (d) below.
- (b) This category invests in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The composite portfolio's strategies include investments in approximately 30% long/short equities, 27% distressed debt, 17% asset-backed securities, 13% special situations, and 13% global macro. Quantitative inputs for these securities are developed by the funds of hedge funds manager and not by the System. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator. A full redemption request of this strategy has been submitted and the proceeds will be used to fund the hedge fund of one strategy in description (d) below.
- (c) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (d) This category invests in a hedge fund of one strategy that includes investments in underlying hedge funds. The total mandate is split between two distinct strategies of approximately 87% diversified strategies and 13% long/short equity. Quantitative inputs for the underlying portfolio funds are based on valuations supplied by the investment managers or fund administrators of the underlying funds and not by the system. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.
- (e) This commingled fund invests in many different sub strategies within corporate credit. The composite portfolio's strategies include investments in approximately 59% high yield, 29% bank debt, 7% cash/other, and 3% distressed credit. The allocations stated above represent the levered exposure and will not add to 100%. Quantitative inputs for these securities are developed by the investment manager and fund administrator, and not by the System. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

- (f) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (g) This commingled fund invests in equities of emerging market countries. The strategy is composed of marketable equity securities that are listed on global stock exchanges. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (h) This commingled fund is a fund of one portfolio that invests in a target asset allocation strategy to replicate the overall asset allocation of the total portfolio. The composite portfolio gains access to the required target exposure via derivative instruments. The fair values of the investments in this category have been calculated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (i) This commingled fund invests in US government and investment-grade fixed-income securities of a long duration nature. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

Disclosures about Investment Policies and Strategies—The System makes investment allocation decisions in order to achieve returns in excess of the plan’s actuarial return assumption, while remaining consistent with the plan’s risk posture and long-term investment horizon. The System establishes objectives, policies, and guidelines; allocates assets in an appropriate and prudent fashion in accordance with fiduciary requirements of ERISA; and ensures that plan assets are sufficient to meet the obligations of the plans as they come due.

Investment management of the plans is delegated to professional investment management firms that must adhere to policy guidelines and objectives. An independent investment consultant is used to measure and report on investment performance; to perform asset/liability modeling studies and recommend changes to objectives, guidelines, manager, or asset class structure; and to keep the System informed of current investment trends and issues.

Based on consideration of the plans’ projected benefit obligation and long-term investment horizon, the plan’s ability to tolerate risk is in the moderate-to-aggressive range. Asset allocation is consistent with this level of risk, with assets diversified among multiple asset classes. Minimum and maximum ranges are established for each asset class to control risk and maximize the effectiveness of the plan’s asset allocation strategy. Asset allocation is reviewed and rebalanced quarterly. Derivative instruments may only be utilized when consistent with the manager’s stated style and objectives, and may not be used for speculative purposes. Margin purchases are prohibited. Investment is also prohibited in antiques, stamps, gold, silver, commodities, and companies that manufacture tobacco products. Specific investment guidelines, restrictions, and investment return objectives exist for each asset class and corresponding investment manager. Certain investment strategies (swaps, puts, and calls) are deployed to extend duration of the plan’s assets to achieve a closer match with the duration of the plan’s liabilities or to reduce exposure during swings in interest rates. These techniques are designed to reduce the volatility in the plan asset/liability ratios.

The target and actual allocations for the pension plans' assets as of December 31, 2017 and 2016, are as follows:

	2017		2016	
	Target %	Actual %	Target %	Actual %
Small cap equities	7.0 %	7.0 %	7.0 %	7.9 %
Large cap equities	5.0	4.9	5.0	3.2
Global equities	11.0	11.2	11.0	11.4
Developed non-US equities	5.0	5.4	5.0	5.2
Emerging market equities	7.0	8.4	7.0	6.9
Hedged equity	5.0	4.9	5.0	4.3
Private capital	10.0	10.3	10.0	10.9
Intermediate/core fixed income	3.0	2.6	3.0	2.8
Liability-driven investing	25.0	22.6	25.0	22.6
Return focused fixed income	7.0	7.1	7.0	4.3
Real assets	5.0	2.6	5.0	
Diversifying strategies	10.0	9.7	10.0	9.9
Replication		2.2		8.4
Cash		1.1		2.2
	<u>100 %</u>	<u>100 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

The expected long-term rate of return on plan assets assumption is based on modeling studies completed with the assistance of the System's actuaries and investment consultants. The models take into account asset class allocation, asset class returns, inflation, and bond yields for both domestic and foreign markets. They are also calibrated to take into consideration historical experience, including a random variable to reflect real-life uncertainty of the future and to project many future economic scenarios. The consequences of adopting various investment policies on the future financial health of the plans under each of the scenarios are then evaluated. These studies, along with the historical 0.6% above-market returns that the plans have generated, indicated that expected future returns, weighted by asset allocation, support an expected long-term asset return assumption of 7.5% for the years ended December 31, 2017 and 2016.

The weighted-average assumptions used to determine benefit obligations for the pension plans as of December 31, 2017 and 2016, are as follows:

	2017	2016
Discount rate—Employees' Retirement Plans	2.6%–3.9%	3.4%–4.4%
Discount rate—Supplemental Pension Plans		1.9
Discount rate—Postretirement Benefit Plan	3.9	4.2–4.4
Rate of compensation increase—Employees' Retirement Plan and Supplemental Executive Retirement Plan (SERP)	3.0	
Expected return on plan assets	5.5–7.5	5.3–7.5

The weighted-average discount rate for the pension plans is 3.81% and 4.26% as of December 31, 2017 and 2016, and 4.26% and 4.74% as of January 1, 2017 and 2016, respectively. The weighted-average discount rate for the retiree medical plans is 3.90% and 4.32% as of December 31, 2017 and 2016, and 4.32% and 4.71% as of January 1, 2017 and 2016, respectively.

The average assumptions used to determine benefit expense for the pension plans for the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Discount rate—Employees’ Retirement Plans	3.4%–4.4%	4.6%–4.8%
Discount rate—Supplemental Pension Plans	1.9	3.2
Discount rate—Postretirement Benefit Plan	4.2-4.4	4.6–4.8
Rate of compensation increase—Employees’ Retirement Plan and Supplemental Executive Retirement Plan (SERP)	3.0	2.6–3.0
Expected return on plan assets	5.5–7.5	5.3–7.5

The System’s funding policy is to contribute annually, not less than the minimum required by applicable laws and regulations. The System contributed \$104,200 and \$107,126 to the Employees’ Retirement Plan in 2017 and 2016, respectively. Pension contributions are expected to be \$91,500 in 2018.

For the years ended December 31, 2017 and 2016, the health care trend rate on covered benefits is assumed to be 6.67%, decreasing gradually to 5.00% by 2022 and all years thereafter.

The System expects to pay the following for pension benefits and expected postretirement benefits:

	Pension Plans	Postretirement Plans
2018	\$213,132	\$1,239
2019	92,710	1,228
2020	97,477	1,215
2021	100,420	1,159
2022	105,901	1,143
2023–2027	567,215	5,541

8. RESTRICTED NET ASSETS

Restricted net assets as of December 31, 2017 and 2016, are available for the following activities:

	2017	2016
Patient care	\$ 64,216	\$ 47,648
Education, training, and research	9,799	14,945
Property, plant, and equipment	<u>29,552</u>	<u>32,059</u>
Total temporarily restricted net assets	103,567	94,652
Permanently restricted net assets	<u>41,980</u>	<u>37,461</u>
Total restricted net assets	<u>\$145,547</u>	<u>\$132,113</u>

The System's restricted net assets (funds) consisted of approximately 726 funds in 2017, and 815 in 2016, whose use was restricted by explicit donor-imposed stipulations. There were 128 funds in 2017, and 130 in 2016, that were permanently restricted; as well as 562 funds in 2017, and 646 in 2016, that were temporarily restricted, none of which were term endowments. There were 9 unrestricted funds in 2017, and 17 in 2016, that were designated by the Board of Directors to function as a restricted fund. There were 27 unrestricted funds without a board designation in 2017, and 22 of this type in 2016. As required by GAAP, net assets associated with restricted funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Uniform Prudent Management of Institutional Funds Act (UPMIFA), along with other relevant state laws, guides the System's investment policies for restricted funds.

UPMIFA requires the System to exercise ordinary and prudent care in good faith in its discretion to invest and appropriate some or all the net appreciation or depreciation of investments. In absence of a relevant law or donor stipulations, fiduciary responsibility to exercise ordinary care and prudence does not extend donor stipulations to the earnings and losses on investments.

The System utilizes investment and spending policies for restricted net assets with the intent to preserve assets and provide a reliable stream of funding to support donor intentions. These policies are in place to ensure prudent investment, a moderate level of investment risk, and to achieve returns in excess of the rate of inflation and commensurate with the funds' time horizon. An independent investment consultant is used to measure and report on investment performance. A reconciliation of net assets is included in the consolidated statements of operations and changes in net assets.

Recognized gains and losses on securities held are reflected in the nonoperating unrestricted activity. Investment income and realized gains and losses from the investment of permanently restricted funds not directed by donor stipulations to be retained in the endowment principal are immediately appropriated to an accompanying temporarily restricted fund that meets the donor-imposed stipulations. Permanently restricted net assets are not reduced by losses, which are charged to the accompanying temporarily restricted fund to the extent an unexpended balance is remaining in the temporarily restricted fund. In the event a temporarily restricted fund has been depleted, losses are charged to unrestricted net assets. No restricted funds are maintained in a deficit status.

The System has remainder interests in certain trusts held by third-party trustees. At the time of initial recognition, interests in charitable remainder trusts are recorded as contributions. Subsequent revaluations are reported as changes in value of interests in trusts.

9. NET PATIENT SERVICE REVENUE AND PATIENT RECEIVABLES AND SETTLEMENTS

Net patient service revenues paid by third parties are based upon contractual agreements, which generally include a fixed rate adjusted for acuity for each inpatient admission according to its diagnosis. Outpatient services are generally paid based on a fee-for-service schedule or a percentage of charges. Based upon these agreements, the System has reduced gross charges and the resulting net patient service revenue has been reflected in the accompanying consolidated financial statements using the most current information available. The percentages of revenue for Medicare and Blue Cross were 41% and 25%, respectively, for 2017. The percentages of revenue for Medicare and Blue Cross were 41% and 23%, respectively, for 2016.

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized for the years ended December 31, 2017 and 2016, from these major payor sources is as follows:

	2017	2016
Medicare	\$ 1,782,740	\$ 1,758,084
Blue Cross	1,078,450	999,292
Managed care	460,528	544,224
Medicaid	565,218	555,210
Commercial	326,268	277,498
Self-pay	68,934	71,288
Other	<u>57,669</u>	<u>95,858</u>
Total	<u>\$ 4,339,807</u>	<u>\$ 4,301,454</u>

Net patient receivables and settlements from major third-party payors as of December 31, 2017 and 2016, are as follows:

	2017	2016
Medicare	\$ 181,095	\$ 162,185
Blue Cross	23,061	37,840
Medicaid	<u>34,810</u>	<u>26,822</u>
Total	<u>\$ 238,966</u>	<u>\$ 226,847</u>

Third-party payor settlements are generally subject to audit of reimbursable costs and medical necessity. At December 31, 2017, Medicare 2014 through 2017, Medicaid 2015 through 2017, and Blue Cross 2016 and 2017 cost reports were not final settled. The estimated third-party payor settlements receivable or payable are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as settlements and other information become available.

In 2016, the System settled a prior-year coding issue with Blue Cross and received Medicaid hospital tax program distributions, increasing net patient revenue by \$42,529.

10. UNCOMPENSATED CARE

The following uncompensated care and community benefit information is reported consistent with the American Hospital Association Guidance on Reporting of Community Benefits.

The System follows the policy of providing health care service to all patients regardless of their ability to pay. Consequently, the System provides health care services free of charge or at amounts less than its full costs of providing care to certain categories of patients. The unreimbursed cost of this uncompensated care as of December 31, 2017 and 2016, was as follows:

	2017	2016
Medicare	\$ 95,391	\$ 66,599
Medicaid	100,572	110,317
Other charity care	<u>11,624</u>	<u>14,593</u>
Total	207,587	191,509
Bad debts at cost	<u>47,061</u>	<u>42,969</u>
Total cost of uncompensated care	<u>\$254,648</u>	<u>\$234,478</u>

The method used to estimate the cost of providing uncompensated care was determined by calculating the System's overall direct and indirect cost using the System's cost accounting system and multiplying that ratio to the cost of uncompensated charges.

11. DEFERRED COMPENSATION

The deferred compensation plans cover eligible employees electing to defer payments for part of their compensation. Amounts due under the plans are fully vested. Investments are reported at fair value, with an equal outstanding deferred compensation liability.

12. COMMITMENTS AND CONTINGENCIES

Professional and General Liability—The System self-insures primary medical professional and general liability claims. Coverage is purchased on a claims-made basis from its wholly-owned captive insurance company for claims more than \$1 million per claim inclusive of defense costs. The captive limits its liability through the purchase of reinsurance from unrelated reinsurance companies.

The System recorded expenses of \$15,885 and \$22,308 in 2017 and 2016, respectively, for the estimated costs of medical professional claims, their associated defense, and excess insurance costs. These amounts are included in the Professional liability and general insurance financial statement line.

The liability for self-insurance represents the undiscounted ultimate net losses and loss adjustment expenses for incurred claims. Loss reserves are determined based on assumptions that are reviewed and adjusted as necessary.

Workers' Compensation Liability—The System is a qualified self-insurer within the State of Michigan. Excess coverage is purchased on a statutory limits basis for an unrelated commercial insurer.

The liability for this self-insurance represents the ultimate net losses and loss adjustment expenses for incurred claims, and is discounted at 2% for both years 2017 and 2016. Loss reserves are determined based on assumptions that are reviewed and adjusted as necessary.

Nursing Homes—In 2008, the nursing home joint venture incurred indebtedness of \$15,413 in conjunction with the purchase of a 50% interest in a nursing home and assisted-living facility, reducing the System's ownership to 50%.

Under certain conditions, the System has agreed to make loans or capital contributions to its nursing home joint venture arrangements for them to maintain certain Debt Service Coverage Ratios relating to aggregate bank financing of \$89,698 in outstanding mortgage balances and \$10,903 in line of credit draws for as long as these debts remain outstanding. Current analysis of the nursing homes and the assisted-living facility indicates that the Debt Service Coverage Ratios are adequate, and as such, all covenants are currently met. The maximum potential future amount of payments that could be required under the guarantees associated with this debt is \$100,600.

The System has reported its share of the obligation as of December 31, 2017, of \$16,814 as a long-term liability, which represents approximately 50% of the negative equity in such nursing homes (see Note 6). These agreements are secured by all assets of the nursing home joint ventures. Any recoveries stemming from liquidation proceedings would be allocated on par with the ownership percentages stipulated in the joint venture agreement.

Legal—The System is party to lawsuits (including alleged medical professional liability claims) incidental to the operation of the hospitals. Management believes that the ultimate disposition of such litigation will not result in liabilities that are materially in excess of amounts currently accrued in the consolidated balance sheets of the System.

In 2015, a Wayne County Michigan jury returned a verdict against the System in the amount of \$20 million in *Nayyar v Oakwood*. The Michigan Court of Appeals reversed the verdict and ordered that a judgment be entered for defendant. Plaintiff has filed an application for leave to appeal to the Michigan Supreme Court, which was denied on February 7, 2018. The System's reserve for this claim is still recorded at management's reasonable estimate of anticipated losses in the event that plaintiff counsel pursues other possible state or federal remedies.

There is currently a case pending in Wayne County Michigan Circuit Court in which former patients of Dr. Awaad, claim they were misdiagnosed. This case and companion cases have been pending for over ten years and have been subject to numerous appeals and discovery stays. Discovery is currently ongoing. The System's reserve for this claim is recorded at management's estimate of the low end of the range of anticipated losses. The System believes that further discovery will need to be completed to properly assess its potential

exposure. The plaintiffs have filed approximately 360 notices of intent to sue and have alleged that the former patients who were misdiagnosed constitute a class for class action purposes. The court's ruling on this issue could potentially have an impact on the System's exposure and anticipated losses.

In April 2011, the System's subsidiary, WBH, received a Civil Investigative Demand from the United States Attorney's office requiring production of a large number of documents. Management has been informed that the thrust of the investigation concerns allegations of relationships between WBH and its physicians to determine whether there exists a violation of the Stark or Federal Anti-Fraud laws as a civil false claim. Management understands that, at this time, the investigation is a civil investigation only. Management continues to communicate with the Government's attorneys and is actively working to resolve the matter. WBH intends to defend any demand if or when proffered.

13. LEASES

The System leases certain buildings and equipment under noncancelable operating lease agreements. Total rental expense for operating leases was approximately \$56,251 and \$77,873 in 2017 and 2016, respectively. Future minimum lease payments under these leases are as follows: 2018—\$41,685; 2019—\$35,896; 2020—\$31,211; 2021—\$26,405; 2022—\$18,518; and thereafter—\$49,467.

The System also leases available space in its medical office buildings and certain other facilities to third parties with lease terms ranging from one to 50 years. Rental income for 2017 and 2016 was approximately \$22,379 and \$36,606. Minimum future rental income under these agreements is as follows: 2018—\$12,432; 2019—\$10,331; 2020—\$8,079; 2021—\$6,296; 2022—\$5,568; and thereafter—\$39,304.

14. FAIR VALUES OF FINANCIAL INSTRUMENTS

Investments are recorded at their fair value and consist of various securities. The various types of securities are as follows:

Cash and cash equivalents, equities and exchange traded funds, and mutual funds are recorded at fair value based on observable quoted prices for identical assets in active markets. As a result, these financial assets have been classified as Level 1 investments.

Government securities, asset-backed securities, mortgage-backed securities, and corporate obligations are recorded at fair value based on observable inputs derived from quoted prices for similar assets in active markets. As a result, these securities have been classified as Level 2 investments.

Derivatives are recorded at fair value based on observable inputs derived from quoted prices for similar assets in active markets. As a result, these securities have been classified as Level 2 investments.

Commingled funds are recorded at fair value based on the underlying investments in the funds, which consist primarily of securities with quoted prices in active markets. Commingled funds fair values are based on the NAV per share calculated by the investment manager and administrator. As investments in commingled funds are measured at NAV, they are measured separately from the fair value hierarchy in the following tables.

Beneficial interest in trust funds are recorded at fair value based on the underlying investments in the funds, which consist primarily of securities with quoted prices in active markets. As a result, these funds have been classified as Level 3 investments.

Hedge funds and real estate do not have a readily determinable market value. Fair values are based on the NAV per share provided by the fund managers along with audited financial information. As investments in hedge funds are measured at NAV, they are measured separately from the fair value hierarchy in the following tables.

Private capital (i.e. equity, credit and real assets) does not have a readily determinable market value. Fair values are based on information provided by the fund managers along with audited financial information using either a market approach or an income approach, each of which requires a significant degree of judgment. There is no active trading market for these investments, and they are for the most part illiquid. Due to the significant unobservable inputs, the fair value measurements used to estimate their fair value are a Level 3 input.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest-level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including consideration of inputs specific to the asset. The System's policy is to record transfers at the end of the year. The System had no transfers between Level 1 and Level 2 assets at December 31, 2017 and 2016.

The following is a summary of assets and liabilities recorded at fair value on a recurring basis (no assets or liabilities were assessed on a nonrecurring basis) at December 31, 2017.

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	2017 Total
Cash and cash equivalents	\$203,403	\$ -	\$ -	\$ 203,403
Certificates of deposit	17,000			17,000
Equities and exchange traded funds	491,742			491,742
Mutual funds	126,258			126,258
Government securities		181,040		181,040
Asset-backed securities		49,594		49,594
Mortgage-backed securities		65,524		65,524
Corporate obligations		155,386		155,386
Derivatives—Swaps, Options, Futures		684		684
Beneficial interest in trusts			10,838	10,838
Private capital	<u> </u>	<u> </u>	<u>23,073</u>	<u>23,073</u>
 Total marketable investments	 <u>\$838,403</u>	 <u>\$452,228</u>	 <u>\$33,911</u>	 <u>1,324,542</u>
 Investments measured at NAV:				
Commingled funds				359,007
Hedge funds				348,322
Real estate				<u>40,889</u>
 Total investments measured at NAV				 <u>748,218</u>
 Total assets at fair value				 <u>\$2,072,760</u>

The following is a summary of assets and liabilities recorded at fair value on a recurring basis (no assets or liabilities were assessed on a nonrecurring basis) at December 31, 2016.

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	2016 Total
Cash and cash equivalents	\$ 240,035	\$ 65,180	\$ -	\$ 305,215
Certificates of deposit	17,000			17,000
Equities and exchange traded funds	416,247			416,247
Mutual funds	62,507			62,507
Government securities		261,255		261,255
Asset-backed securities		34,267		34,267
Mortgage-backed securities		82,824		82,824
Corporate obligations		88,726		88,726
Beneficial interest in trusts			9,105	9,105
Private capital			7,437	7,437
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total marketable investments	<u>\$ 735,789</u>	<u>\$ 532,252</u>	<u>\$ 16,542</u>	<u>1,284,583</u>
Investments measured at NAV:				
Commingled funds				311,342
Hedge funds				273,878
Real estate				<u>38,652</u>
				<u> </u>
Total investments measured at NAV				<u>623,872</u>
Total assets at fair value				<u>\$ 1,908,455</u>

Information about the System’s financial assets and liabilities recorded at fair value and measured on a recurring basis as of December 31, 2017 and 2016, according to the valuation techniques the System used to determine their fair values (there were no assets or liabilities measured on a nonrecurring basis as of December 31, 2017 and 2016), is as follows:

	Level 3 Investments		
	Private Equity	Trust Interest	Total
Balance—January 1, 2016	\$ -	\$ 9,105	\$ 9,105
Purchases	6,959		6,959
Redemptions			-
Net gain on assets sold in 2016			-
Net gain (loss) on assets held at December 31, 2016	<u>478</u>	<u> </u>	<u>478</u>
Balance—December 31, 2016	7,437	9,105	16,542
Purchases	14,551		14,551
Redemptions	(1,242)		(1,242)
Net gain on assets sold in 2017	72		72
Net gain (loss) on assets held at December 31, 2017	<u>2,255</u>	<u>1,733</u>	<u>3,988</u>
Balance—December 31, 2017	<u>\$ 23,073</u>	<u>\$ 10,838</u>	<u>\$ 33,911</u>

Total unfunded private capital commitments are \$73,485 and \$34,391 as of December 31, 2017 and 2016, respectively.

The table below discloses the nature and risks of investments on which fair value is measured by NAV per share as of December 31, 2017:

	Fair Value 2017	Redemption Frequency	Redemption Notice Period	Unfunded Commitments
Multistrategy hedge funds ^(a)	\$ -	Annually, May 31	185 days	N/A
Multistrategy hedge funds ^(b)		Quarterly	100 days	N/A
Emerging Market Equity ^(c)	33,685	Quarterly	92 days	N/A
Real estate ^(d)	40,889	Quarterly	90 days	N/A
Multistrategy hedge funds ^(e)	346,645	Quarterly	60 days	16,711
Opportunistic credit fund ^(f)	64,169	Quarterly	60 Days	N/A
Multistrategy hedge funds ^(g)	1,677	Quarterly	60 Days	15,300
Unconstrained global fixed income ^(h)	62,850	Monthly	15 days	N/A
Emerging Market Equity ⁽ⁱ⁾	40,522	Monthly	10 days	N/A
Emerging Market Equity ^(j)	84,862	Monthly	5 days	N/A
Master Limited Partnership ^(k)	45,422	Weekly	5 days	N/A
Global equity ^(l)	26,183	Daily	N/A	N/A
US fixed income ^(m)	1,298	Daily	N/A	N/A
Balanced Fund ⁽ⁿ⁾	16	Daily	N/A	N/A
Replication Portfolio ^(o)	_____	Daily	N/A	N/A
	<u>\$ 748,218</u>			

(a) This category invested in hedge funds that pursued multiple strategies to diversify risks and reduce volatility. This fund was liquidated as the firm, The Carlyle Group, closed the strategy.

(b) This category invested in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. This strategy was liquidated in the first half of 2017.

(c) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

(d) This category's investment strategy is to create a high-quality and low-risk portfolio of stabilized and income-producing real estate assets diversified by property type and economic exposure. Property sector exposure includes apartments, office, retail, self-storage, and industrial. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

(e) This category invests in a hedge fund of one strategy that includes investments in underlying hedge funds. The total mandate is split between two distinct strategies of diversified strategies and long/short equity. Quantitative inputs for the underlying portfolio funds are based on valuations supplied by the investment managers or fund administrators of the underlying funds and not by the system. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.

- (f) This commingled fund invests in many different sub strategies within corporate credit. The composite portfolio's strategies include investments in approximately high yield, bank debt, and distressed credit. Quantitative inputs for these securities are developed by the investment manager and fund administrator. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (g) This commingled invests in the public or structured equity, fixed income, and alternative investment markets across the globe. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.
- (h) This commingled fund features an unconstrained fixed-income approach that allows it to invest across the spectrum of bonds and currencies. Quantitative inputs for these securities are developed by the investment manager and fund administrator. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (i) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (j) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (k) This commingled fund invests in a diversified portfolio of Master Limited Partnerships and other high yield energy equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (l) This commingled fund invests in equities that mimic the MSCI World index. The MSCI World Index captures large and mid-cap representation across 23 developed markets countries. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (m) This commingled fund invests in investment grade securities of any maturity. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (n) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (o) This commingled fund was a fund of one portfolio that invested in a target asset allocation strategy to replicate the overall asset allocation of the total portfolio. This strategy was closed in early 2017 and was transferred to a separate account strategy.

The table below discloses the nature and risks of investments on which fair value is measured by NAV per share as of December 31, 2016:

	Fair Value 2016	Redemption Frequency	Redemption Notice Period	Unfunded Commitments
Multistrategy hedge funds ^(a)	\$ 3,579	Annually, May 31	185 days	N/A
Multistrategy hedge funds ^(b)	53,635	Quarterly	100 days	N/A
Emerging Market Equity ^(c)	18,599	Quarterly	92 days	N/A
Private real estate ^(d)	38,652	Quarterly	90 days	N/A
Opportunistic credit fund ^(e)	79,413	Quarterly	60 days	N/A
Multistrategy hedge funds ^(f)	216,664	Quarterly	60 Days	77,000
Unconstrained global fixed income ^(g)	92,650	Monthly	15 days	N/A
Emerging Market Equity ^(h)	25,744	Monthly	10 days	N/A
Emerging Market Equity ⁽ⁱ⁾	55,671	Monthly	5 days	N/A
Replication Portfolio ^(j)	30,328	Daily	N/A	N/A
Global equity ^(k)	8,923	Daily	N/A	N/A
Balanced Fund ^(l)	<u>14</u>	Daily	N/A	N/A
	<u>\$ 623,872</u>			

- (a) This category invested in hedge funds that pursued multiple strategies to diversify risks and reduce volatility. This fund is currently in liquidation mode as the firm, The Carlyle Group, is closing down the strategy. The proceeds will be used to fund the hedge fund of one strategy in description (f) below.
- (b) This category invests in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The composite portfolio's strategies include investments in approximately 30% long/short equities, 27% distressed debt, 17% asset-backed securities, 13% special situations, and 13% global macro. Quantitative inputs for these securities are developed by the funds of hedge funds manager and not by the System. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator. A full redemption request of this strategy has been submitted and the proceeds will be used to fund the hedge fund of one strategy in description (f) below.
- (c) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (d) This category's investment strategy is to create a high-quality and low-risk portfolio of stabilized and income-producing real estate assets diversified by property type and economic exposure. Property sector exposure includes apartments, office, retail, self-storage, and industrial. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (e) This commingled fund invests in many different sub strategies within corporate credit. The composite portfolio's strategies include investments in approximately 59% high yield, 29% bank debt, 7% cash/other, and 3% distressed credit. The allocations stated above represent the levered exposure and will not add to 100%. Quantitative inputs for these securities are developed by the investment manager and fund administrator, and not by the System. The fair

values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

- (f) This category invests in a hedge fund of one strategy that includes investments in underlying hedge funds. The total mandate is split between two distinct strategies of approximately 87% diversified strategies and 13% long/short equity. Quantitative inputs for the underlying portfolio funds are based on valuations supplied by the investment managers or fund administrators of the underlying funds and not by the system. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the fund administrator.
- (g) This commingled fund features an unconstrained fixed-income approach that allows it to invest across the spectrum of bonds and currencies. The following allocation percentages are the allocation for each individual asset class and do not represent a net exposure for the overall portfolio. The composite portfolio's exposure to bonds includes approximately 78% to international government/agency bonds, 12% in sovereign bonds, and 6% in cash. Currency exposure includes 84% to the US dollar, 45% to Asia (non-Japan), 37% non-US America, and 9% periphery Europe; short currency positions include (47%) to the euro and (31%) to the Japanese yen. Quantitative inputs for these securities are developed by the investment manager and fund administrator and not by the System. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (h) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (i) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (j) This commingled fund is a fund of one portfolio that invests in a target asset allocation strategy to replicate the overall asset allocation of the total portfolio. The composite portfolio gains access to the required target exposure via derivative instruments. The fair values of the investments in this category have been calculated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (k) This commingled fund invests in equities that mimic the MSCI World index. The MSCI World Index captures large and mid-cap representation across 23 developed markets countries. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.
- (l) This commingled fund invests in US-listed equity securities. The fair values of the investments in this category have been estimated using the NAV per share of the investments, which are determined by the investment manager and fund administrator.

The estimated fair value amounts have been determined by the System using available market information and appropriate valuation methodologies. These estimates are subjective in nature and involve uncertainties and matters of considerable judgment. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the System could realize in a current market exchange. The use of different assumptions, judgments, and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Patient Accounts Receivable, Estimated Third-Party Payor Settlements, and Current Liabilities—The carrying amounts reported in the consolidated balance sheets approximate the fair value.

Long-Term Debt—The fair values of the System’s variable-rate debt approximate their carrying values. The fair value of the System’s fixed-rate long-term debt is estimated using discounted cash flow analysis based on the System’s current incremental borrowing rates for similar types of borrowing arrangements. A significant portion of the inputs used to calculate the fair values of the System’s long-term debt is unobservable and cannot be corroborated by observable market data. As a result, all long-term debt would be classified as Level 3.

The carrying and fair values of the System’s debt as of December 31, 2017 and 2016, are as follows:

	2017	2016
Carrying value (excluding bond issue costs)	\$ 1,634,811	\$ 1,637,771
Fair value	1,677,361	1,622,173

15. NET ASSETS

Unrestricted Net Assets—Changes in consolidated unrestricted net assets attributable to the System and the noncontrolling interest in consolidated subsidiary for the years ended December 31, 2017 and 2016, are as follows:

	Beaumont Health	Noncontrolling Interests in Consolidated Subsidiary	Total
Unrestricted net assets—January 1, 2016	<u>\$1,727,394</u>	<u>\$10,925</u>	<u>\$1,738,319</u>
Excess of revenues over expenses	286,700	(9)	286,691
Other changes in unrestricted net assets:			
Pension and other postretirement adjustments	(112,465)		(112,465)
Changes in noncontrolling interests		(7,295)	(7,295)
Net assets released from restrictions— capital acquisitions	12,587		12,587
Other changes in unrestricted net assets	<u>(3,543)</u>	<u> </u>	<u>(3,543)</u>
Increase in unrestricted net assets	<u>183,279</u>	<u>(7,304)</u>	<u>175,975</u>
Unrestricted net assets—December 31, 2016	<u>1,910,673</u>	<u>3,621</u>	<u>1,914,294</u>
Excess of revenues over expenses	321,582	3,910	325,492
Other changes in unrestricted net assets:			
Pension and other postretirement adjustments	38,560		38,560
Changes in noncontrolling interests		(2,280)	(2,280)
Net assets released from restrictions— capital acquisitions	11,681		11,681
Other changes in unrestricted net assets	<u>5,771</u>	<u> </u>	<u>5,771</u>
Increase in unrestricted net assets	<u>377,594</u>	<u>1,630</u>	<u>379,224</u>
Unrestricted net assets—December 31, 2017	<u>\$2,288,267</u>	<u>\$ 5,251</u>	<u>\$2,293,518</u>

16. SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 1, 2018, the date the consolidated financial statements were issued. The following subsequent event was noted that requires disclosure under FASB ASC 855, *Subsequent Events*.

In July 2018, the System's subsidiary, WBH, executed and paid a settlement related to a federal investigation stemming from four lawsuits filed in 2010-2011 in the amount of \$84.5 million, plus interest.

* * * * *

INDEPENDENT AUDITORS' REPORT 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*

To the Board of Directors of
Beaumont Health
Southfield, Michigan

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, the consolidated financial statements of Beaumont Health and consolidated subsidiaries (the "System"), which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated March 1, 2018, except for Note 16 and the supplemental schedule of expenditures of federal awards and related notes, as to which the date is October 1, 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.

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 or significant deficiencies.

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.

Deloitte + Touche LLP

March 1, 2018



Deloitte & Touche LLP
200 Renaissance Center
Suite 3900
Detroit, MI 48243-1313
USA

Tel: +1 313 396 3000
Fax: +1 313 396 3618
www.deloitte.com

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

To the Board of Directors of
Beaumont Health
Southfield, Michigan

Report on Compliance for Each Major Federal Program

We have audited Beaumont Health and consolidated subsidiaries' (the "System") compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (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 terms and conditions of its federal awards.

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.

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.

Deloitte + Touche LLP

October 1, 2018

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

**SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2017**

Federal Grantor/Pass-Through

Grantor/Program Title	CFDA #	Pass-Through Entity Identifying Number	Passed through to Subrecipients	Expenditure
RESEARCH & DEVELOPMENT CLUSTER:				
U.S. Department of Health and Human Services—National Institutes of Health (NIH): Research Related to Deafness and Other Communication Disorders Passed through Regents of the University of Michigan-Early audiology referral in primary care	93.173	3003386548		\$ 76,876
U.S. Department of Health and Human Services—Agency for Healthcare Research and Quality Center for Quality Improvement and Patient Safety Screening to Prophylax against C. Difficile infection (STOP CDI)	93.226		8,809	240,982
U.S. Department of Health and Human Services—National Institutes of Mental Health Passed through The University of North Carolina at Chapel Hill- A longitudinal Assessment of Post Traumatic Syndrom	93.242	5106106		1,119
U.S. Department of Health and Human Services—National Institutes of Health Office of the Director Passed through The University of North Carolina at Chapel Hill- Environment, Epigenetics, Neurodevelopment and Health of Extremely Pre-term Children	93.310	5106183		56,930
U.S. Department of Health and Human Services—National Institute of Nursing Research Grant Passed through Regents of the University of Michigan - Family Routines: Healthy Routines	93.361	3004123445		8,663
Passed through Wayne State University - An Algorithmic Approach to Ventilator Withdrawal at the End of Life	93.361	WSU18003		<u>2,030</u>
Total Nursing Research				<u>10,693</u>
National Cancer Institute—Cancer Treatment Research:				
Passed through ECOG/ACRIN - ECOG/ACRIN Cancer Research Group	93.395			45,000
Passed through NSABP-NRG Oncology Studies	93.395			4,000
Beaumont NCI Community Oncology Research Program	93.395			792,087
Passed Through Wake Forest NCORP Research Base	93.395			9,350
Passed Through University of Colorado at Denver-Clinical trial personalizing radiation therapy through a novel lung function imaging modality	93.395	FY16.803.002		131,683
Passed through Southwest Oncology Group-Southwest Oncology Group Trials	93.395	N/A		<u>8,100</u>
Total Cancer Treatment Research				<u>990,221</u>
National Cancer Institute-Cancer Centers Support Grants				
Passed through The Trustees of Indiana University— AMPATH oncology institute HPV & Cervical Cancer in Kenya Women with HPV/AIDS	93.397	5141		20,940
Trans-NIH Recovery Act Research:				
ARRA- National Institute of Neurological Disorders And Stroke through the University Of California San Francisco	93.701	WSU10079-A7 & WSU12050-A2		12,450
National Heart Lung And Blood Institute—Cardiovascular Diseases Research:				
Passed Through University of Rochester-Ranolazine ICD Trial (RAID) Cardiac Defibrillators—Phase III	93.837	415574-G		4,408
Passed through Brigham and Woman’s Hospital, Inc.— Cardiovascular Inflammation Reduction Trial (CIRT)	93.837	PS#107223		7,250
Passed through Oregon Health & Science University— Improving Syncope Risk Stratification in Older Adults	93.837	1002459-WBH		14,100
Passed Through Beth Israel Deaconess Medical Center— Neuromuscular Blockage for Post-Cardiac Arrest Care - Biomarkers	93.837	01028492		1,500
Passed Through Wake Forest University Health Science CMR-IMPACT		WFUHS113029 Beaumont		14,500
Passed through The Board of Trustees of the University of Alabama for the University of Alabama at Birmingham-Chronic Hypertension and Pregnancy Project	93.837	000503570-033-A01		<u>5,092</u>
Total Cardiovascular Diseases Research				<u>46,850</u>
National Institute of Diabetes And Digestive And Kidney Diseases—Extramural Research:				
Passed through Lipella Pharmaceuticals, Inc. -A Single-Center, Double-Blind, Randomized, Dose-Ranging, Placebo Controlled Trial Comparing the Safety, Tolerability and Efficacy of LP-08 with Placebo in Subjects with Interstitial Cystitis/Bladder Pain Syndrome (IC/BPS)	93.847	N/A		33,999
Passed through University of South Florida-Trial NET	93.847	Site#3735		<u>1,395</u>
Total Diabetes And Digestive And Kidney Diseases Extramural Research				<u>35,394</u>

(Continued)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

**SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2017**

Federal Grantor/Pass-Through

Grantor/Program Title	CFDA #	Pass-Through Entity Identifying Number	Passed through to Subrecipients	Expenditure
National Institute of Neurological Disorders And Stroke—Extramural Research Programs in the Neurosciences and Neurological Disorders: Passed Through Mayo Clinic Jacksonville-Carotid Revascularization and Medical Management For Asymptomatic Carotid Stenosis Trial	93.853	WIL-187276-02		13,345
National Cancer Institute-Extramural Research Programs in the Neurosciences and Neurological Disorders:	93.853			<u>149,810</u>
Total Neurological Disorders and Stroke Research				<u>163,155</u>
Eunice Kennedy Shriver National Institute of Child Health & Human Development Passed through University of Florida Board of Trustees- Placental microvasculature, environmental influences and FGR	93.865	6122-1020-00-A		205,854
National Institute on Aging—Aging Research: Group Learning Achieves Decreased Incidents of Lower Urinary Symptoms (GLADIOLUS)	93.866		136,465	236,888
First Congress of Urologic Research and Education on Aging UnderActive Bladder	93.866			105,108
Translation Science Award-K12 Scholars Program Passed through University of North Carolina	93.866	5037932		<u>600</u>
Persistent Pain and Associated Physical Function Decline Among Elderly Individual				
Total Aging Research				<u>342,596</u>
National Eye Institute—Vision Research: Passed Through Oregon Health & Science University— Clinical and Genetic Analysis of Retinopathy of Prematurity	93.867	1005935_BEAUMONT		27,279
National Institute of Allergy and Infectious Diseases Passed through Wayne State University- Randomized Controlled Trial for Treatment of Extensively Drug-Resistant Gram-Negative Bacilli	N/A	3004219080		26,818
National Institute of Child Health-Passed Through Duke University-A multi-centered, randomized, open-label, comparative study to assess the safety and efficacy of a treatment algorithm to reduce the use of vancomycin in patients with blood stream infections due to staphylococci	N/A	213803		28,000
National Institute of Child Health-Passed Through Baylor College of Medicine- Fetal body composition and volumes study	N/A	1021166761		30,506
National Institute of Allergy and Infectious Diseases- Passed Through Social and Scientific Systems- A Randomized Double-Blind Phase 3 Study Comparing the Efficacy and Safety of High Titer versus Low-Titer Anti-Influenza Immune Plasma for the Treatment of Severe Influenza A	N/A			66,700
National Cancer Institute -Clinical Proteomic Tumor Analysis Consortium	N/A			<u>54,908</u>
Total US Department of Health and Human Services				<u>2,438,271</u>
Military Medical Research and Development Combating Post-Traumatic Osteoarthritis via Enhanced Intra-Articular Recruitment of Stem Cells and Targeted Delivery of a Chondrogenic Agent	12.420		12,514	168,667
Passed through Baylor College of Medicine OnaBoNT-T Study Specimen Analysis	12.420	7000000161		15,284
Vision Research Program Comparison of Bladder Directed and Pelvic Floor Therapy in Women with Interstitial Cystitis/Bladder Pain Syndrome	12.420		13,292	<u>295,231</u>
Total Military Medical Research and Development				<u>479,182</u>
Total Research and Development Cluster Grant				<u>2,917,453</u>
Food Stamp Program -Supplemental Nutrition Assistance Program—Education Passed through Michigan Department of Community Health	10.561	FY18 OHCF; FY17 OHCF		51,611
ACA-Personal Responsibility Education Program Passed through Michigan Department of Community Health	93.092	20180263-01		20,408
	93.092	20170153-00		<u>73,018</u>
Total ACA				<u>93,426</u>
Family Planning Services Passed through Michigan Department of Community Health	93.217	E20180393-00; E20172433-001		50,789

(Continued)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

**SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2017**

Federal Grantor/Pass-Through

Grantor/Program Title	CFDA #	Pass-Through Entity Identifying Number	Passed through to Subrecipients	Expenditure
U.S. Department of Health and Human Services—Centers for Disease Control and Prevention (CDC): CDC Investigations and Technical Assistance: Passed through the Michigan Department of Health and Human Services Genomic Applications in Practice and Prevention (GAPP): Passed through the Michigan Department of Community Health-Breast Cancer Genomics Best Practices and Tribal Organizations	93.283	20172510-00		6
U.S. Department of Health And Human Services: Passed Through Region 2 North Healthcare Coalition—National Bioterrorism Hospital Preparedness Program	93.889	N/A		2,983
U.S. Department of Health & Human Services: Human Resources and Service Administration Passed Through City of Detroit Department of Health and Wellness Promotion Passed through Southeastern Michigan Health Association Passed Through Matrix Human Services Ryan White HIV/AIDS Treatment Extension Act HIV Emergency Relief Project Grants/Ryan White HIV/AIDS Treatment Modernization Act	93.914 93.914	N/A N/A		1,250 <u>159,672</u>
Total Passed Through Southeastern Michigan Health Association				<u>160,922</u>
Block Grants for Prevention and Treatment of Substance Abuse Passed through from the Detroit Wayne Mental Health Authority Department of Health and Human Services: Substance Abuse and	93.959	20170097-00		7,139
Maternal and Child Health Services Block Grant Passed through from the Michigan Department of Community Health	93.994	BO4MC30620; B1MIMCHS		31,761
Passed through from the Detroit Wayne Mental Health Authority Partnership for Success II Program	93.243	20140097-00		<u>70,477</u>
TOTAL FEDERAL AWARDS				<u>\$ 3,386,567</u>

See notes to supplemental schedule of expenditure of Federal Awards.

(Concluded)

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

NOTES TO SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED DECEMBER 31, 2017

1. BASIS OF ACCOUNTING

The accompanying supplemental schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Beaumont Health and consolidated subsidiaries (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 Schedule 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule 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. Pass-through entity identifying numbers are presented where available. The System does not elect to use the de minimis indirect cost rate allowed under the Uniform Guidance.

3. PROGRAMS

The System's programs are primarily research and development.

Research and development programs include those awards that are for basic and applied research and development activities. The Uniform Guidance defines research and development as follows: research is a systematic study directed towards fuller scientific knowledge or understanding of the subject studied; development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

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BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED DECEMBER 31, 2017

SECTION I—SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified? Yes No

Significant deficiency(ies) identified? Yes None Reported

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over financial reporting:

Material weakness(es) identified? Yes No

Significant deficiency(ies) identified? Yes None Reported

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

Any audit findings disclosed that are required to be reported in accordance with Section 200.516 of the Grant Guidance Yes No

Identification of major programs:

Name of Federal Program or Cluster

CFDA Numbers(s)/GRANT DOC

Research and development cluster:

U.S. Department of Health and Human Services

93.173; 93.226; 93.242; 93.310;
93.361; 93.395; 93.397; 93.701;
93.837; 93.847; 93.853; 93.865;
93.866; 93.867;
HSN272202000039C;
HHSN272200900023C;
HHSN275201500002C;
HHSN26100009I; HHSN26100002;
16-I-0022

Military Medical Research and Development

12.420

Dollar Threshold used to Distinguish between
type A and type B programs:

\$750,000

Auditee qualified as low-risk auditee?

Yes No

SECTION II—FINANCIAL STATEMENT FINDINGS

There were no audit findings.

SECTION III—FEDERAL AWARD FINDINGS AND QUESTIONED COST SECTION

There were no audit findings.

BEAUMONT HEALTH AND CONSOLIDATED SUBSIDIARIES

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (DECEMBER 31, 2016) FOR THE YEAR ENDED DECEMBER 31, 2017

There were no prior audit findings for Beaumont Health and consolidated subsidiaries for the year ended December 31, 2016.