McLaren

HEALTH CARE

# Continuing Disclosure:

# Quarterly report for the period ended June 30, 2017

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**Statement of Operations:**

McLaren Health Care Corporation ("McLaren" or "the Corporation") recorded improved operating results for the nine-month period ended June 30, 2017 as compared to the same period in fiscal year 2016. Operating income totaled $113.7 million and $109.3 million for the nine-month period ended June 30, 2017 and 2016, respectively. Total operating revenue increased by $110 million or 4.0% for the period ended June 30, 2017 compared to the same period in in the prior year. Within this change, net patient service revenue increased by $110.7 million or 5.8%.

McLaren continues to experience patient volume growth with the exception of Emergency Room visits. Inpatient discharges increased by 2.2%, while hospital outpatient visits and observation stays increased by 6.2% and 7.9%, respectively, for the nine month period ended June 30, 2017 compared to the same period in fiscal year 2016. Emergency Room visits were down 1.7% over the same timeframe.

The State of Michigan unexpectedly reduced Medicaid premium rates to Health Plans effective October 1, 2016. This has resulted in revenue growth below expectations for McLaren Health Plan for the nine-month period ended June 30, 2017. Therefore, although membership has increased by 5.9%, premium revenue has increased by $15.94 million or 2.2% from the third quarter of fiscal year 2016 to 2017.

Total operating expenses for the period ended June 30, 2017 were approximately $2.7 billion, which represents an increase of $105.6 million or 4.0% compared to the third quarter of fiscal year 2016. Major contributors to the period-over-period change were inflationary and volume related increases in wage and supplies expenses. Depreciation and amortization accounts for $7.2 million of the period over period increase.

Non-operating income for the period ended June 30, 2017 was approximately $105 million, which is an increase of $72 million from the prior period ended June 30, 2016. This increase is mainly due to unrealized investment gains recognized in fiscal year 2017 as well as improvements in the fair value of interest rate swap agreements. The Excess of Revenue over Expenses for the period ended June 30, 2017 was $219.1 million, which is an increase of $76.7 million compared to the prior period ended June 30, 2016.

**Balance Sheet:**

During the period ended June 30, 2017, total cash and unrestricted investments increased by approximately $114.5 million to approximately $1.55 billion.

Total long-term debt has decreased by approximately $22.7 million from September 30, 2016 to June 30, 2017 due to payments of scheduled principal maturities. Net pension liabilities decreased by approximately $30.6 million from September 30, 2016 to June 30, 2017, primarily due to contributions and income recognition.

Unrestricted net assets improved by $219.4 million to approximately $1.5 billion from September 30, 2016 to June 30, 2017. This includes the excess of revenue over expenses of $219.4 million.

## Other:

During April 2017, McLaren Bay Special Care announced its achievement of accreditation from the Pharmacy Compounding Accreditation Board. At the same time, McLaren Bay Diagnostic Center was granted a three-year/full accreditation from the National Accreditation Program for Breast Centers (NAPBC). A breast center that achieves NAPBC accreditation has demonstrated a firm commitment to offer its patients every significant advantage in their battle against breast disease. In May, both McLaren Central Michigan and McLaren Lapeer Region, received the 2017 Governor's Award of Excellence. The awards are given to health care providers that "have achieved, maintained and continually improved in specific rigorous milestones related to the award they received." McLaren Bay Region earned a three-year accreditation by Commission on Accreditation of Rehabilitation Facilities (CARF) for its Comprehensive Inpatient Rehabilitation program for Adults and as a Stroke Specialty Program. This is the hospital's ninth consecutive three-year accreditation.

# Consolidated Balance Sheet
**June 30, 2017**
**(In Thousands)**

| | (Unaudited) June 30, 2017 | September 30, 2016 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 564,916 | $ 553,423 |
| Net patient accounts receivable | 207,121 | 186,629 |
| Other accounts receivable | 42,085 | 33,241 |
| Collateral from securities lending | 7,358 | 4,698 |
| Other current assets | 116,582 | 115,566 |
| Total current assets | 938,062 | 893,557 |
| **Other Assets** | | |
| Investments | 989,706 | 886,701 |
| Trustee held funds | 114,034 | 140,545 |
| Investment in unconsolidated subsidiaries | 24,478 | 31,971 |
| Limited as to use or restricted | 205,906 | 208,903 |
| Other assets | 101,479 | 83,957 |
| Total other assets | 1,435,603 | 1,352,077 |
| **Property and Equipment, Net** | 1,060,952 | 1,024,843 |
| Total Assets | $ 3,434,617 | $ 3,270,477 |
| **Liabilities and Net Assets** | | |
| **Current Liabilities** | | |
| Current portion of long-term debt | $ 24,004 | $ 25,681 |
| Accounts payable | 262,999 | 285,896 |
| Third party payor settlements | 59,728 | 44,883 |
| Obligations under securities lending | 7,529 | 4,853 |
| Salaries, wages and withholdings | 126,746 | 129,247 |
| Pension | 3,603 | 3,553 |
| Interest | 2,508 | 8,044 |
| Professional and other liability claims | 15,420 | 11,780 |
| Other | 35,115 | 29,306 |
| Total current liabilities | 537,652 | 543,243 |
| **Long-Term Debt** | 757,518 | 778,603 |
| **Fair Value of Interest Rate Swap Agreements** | 20,580 | 37,517 |
| **Other Liabilities** | | |
| Accrued pension cost | 322,373 | 352,989 |
| Accrued postretirement cost | 25,923 | 24,803 |
| Accrued professional and other liability claims | 81,546 | 79,716 |
| Other | 67,160 | 71,624 |
| Total liabilities | 1,812,752 | 1,888,495 |
| **Net Assets** | | |
| Unrestricted | 1,482,194 | 1,262,814 |
| Temporarily restricted | 61,831 | 49,173 |
| Permanently restricted | 77,840 | 69,995 |
| Total Net Assets | 1,621,865 | 1,381,982 |
| Total liabilities and net assets | $ 3,434,617 | $ 3,270,477 |

## McLaren Health Care Corporation and Subsidiaries

### Consolidated Statements of Operations and Changes in Net Assets (Unaudited)

**For the nine-month period ended June 30, 2017**
**(In Thousands)**

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| **Unrestricted Revenue, Gains, and Other Support** | | |
| Total patient service revenue | 5,820,379 | 5,381,695 |
| Revenue deductions | 3,745,890 | 3,409,980 |
| Net patient service revenue | 2,074,489 | 1,971,715 |
| Provision for bad debts | 70,220 | 78,172 |
| Net patient service revenue less provision for bad debts | 2,004,269 | 1,893,543 |
| Net assets released from restrictions | 6,316 | 8,730 |
| Premium revenue | 751,527 | 735,592 |
| Other revenue | 88,700 | 102,907 |
| Total unrestricted revenue, gains, and other support | 2,850,812 | 2,740,772 |
| **Expenses** | | |
| Salaries | 849,899 | 806,426 |
| Employee benefits and payroll taxes | 175,734 | 170,501 |
| Supplies | 433,992 | 414,674 |
| Other | 659,389 | 659,964 |
| Healthcare claims expense | 520,269 | 489,181 |
| Depreciation and amortization | 84,747 | 77,524 |
| Interest expense | 13,090 | 13,208 |
| Total expenses | 2,737,120 | 2,631,478 |
| **Operating Income** | 113,692 | 109,294 |
| **Nonoperating Income (Loss)** | | |
| Investment income | 40,117 | 14,448 |
| Change in interest swap agreements | 16,936 | (5,491) |
| Change in unrealized gains and losses on investments | 46,992 | 24,086 |
| Gain on sale of Anthelio Health Care Solutions, Inc. | 1,322 | - |
| Other | - | - |
| Total nonoperating income (loss) | 105,367 | 33,043 |
| **Excess of Revenue Over (Under) Expense** | 219,059 | 142,337 |
| Other Changes in Net Assets | 321 | 12,441 |
| **Increase (Decrease) in Unrestricted Net Assets** | $ 219,380 | $ 154,778 |

## Note 1 - Nature of Business and Significant Accounting Policies

### Unaudited Financial Statements

The accompanying financial statements of McLaren Health Care and McLaren Health Care Credit Group for the nine-month period ended June 30, 2017 are unaudited, and subject to audit and fiscal year-end adjustments, including but not limited to pension related changes other than net periodic benefit costs.

### Reporting Entity and Corporate Structure

McLaren Health Care Corporation and Subsidiaries (the "Corporation" or “MHC”), a not-for-profit corporation, is a major provider of healthcare services to residents of Southeast Michigan and the cities of Flint, Lansing, Bay City, Lapeer, Mt. Pleasant, Petoskey, and Port Huron, Michigan and surrounding communities.

The consolidated financial statements include the corporations listed below, as well as their subsidiaries and related foundations, of which MHC is the sole member:

McLaren Flint (Flint)

McLaren Bay Region (Bay)

McLaren Lapeer Region (Lapeer)

McLaren Greater Lansing (Lansing)

McLaren Macomb (Macomb)

McLaren Oakland (Oakland)

McLaren Central Michigan (Central)

McLaren Northern Michigan (Northern)

McLaren Port Huron (Port Huron)

Barbara Ann Karmanos Cancer Institute (Karmanos)

McLaren Medical Group (MMG)

McLaren Homecare Group (MHG)

McLaren Health Plan (MHP)

McLaren Bay Special Care (BSC)

McLaren Insurance Company, LTD (MICOL)

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Significant accounting policies include the following:

### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of McLaren Health Care Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

### Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts limited as to use by board designation or other arrangements under trust agreements.

The Corporation routinely invests its surplus operating funds in money market mutual funds and in insured bank deposits. The money market mutual funds invest only in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by the U.S. government and agencies and instrumentalities. The bank deposits, backed by the full faith and credit of U.S. government, utilize a series of insured deposit accounts that are electronically linked and aggregated. Both investments aim to preserve capital, maintain liquidity, and provide a competitive yield.

### Accounts Receivable

Accounts receivable from patients, insurance companies, and governmental agencies are based on gross charges. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Corporation analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Corporation analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely).

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Accounts Receivable (Continued)

For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Corporation records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

### Investments

Investments include general investments held by the Corporation and assets set aside by the governing boards of various subsidiaries for future capital improvements, over which the boards retain control and may at their discretion subsequently use for other purposes. Investments in equity securities with readily determinable fair values and all investments in debt securities are stated at fair market value. Investments in other equity securities or privately held companies are recorded at cost. Investment income or loss (including interest and dividend income, realized gains or losses, and changes in unrealized gains or losses on investments) is included in excess of revenue over expenses, unless the income or loss is restricted by the donor.

The Corporation's investments are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in the value of investments in the near term could materially affect the amounts reported in the consolidated balance sheet and the consolidated statements of operations and changes in net assets.

### Securities Lending Arrangements

The Corporation engages in transactions whereby certain securities in its portfolio are loaned to other institutions, generally for a short period of time. The Corporation records the fair value of the collateral received as a current asset and a current liability since the Corporation is obligated to return the collateral upon the return of the borrowed securities.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Pooled Funds

The Corporation has authorized investment pools for flexibility in investing its assets and maximizing its rate of return. Realized and unrealized gains or losses and income on unallocated investments are allocated to the unrestricted and temporarily restricted net assets participating in the pool based upon the average balance of the respective net assets.

### Assets Limited as to Use

Assets limited as to use also include assets held by trustees under indenture agreements, funds held in trust by foundations, funds restricted by donors for specific purposes, funds held in trust for payment of employee benefits, and self-insurance trust arrangements.

### Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated property and equipment are recorded at the estimated fair market value at the time of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

### Impairment of Long-lived Assets

The Corporation evaluates the recoverability of long-lived assets and the related estimated remaining lives when indicators of impairment are present. For the purpose of impairment analysis, assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The Corporation records an impairment charge or changes the useful life if events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed.

### Goodwill

The recorded amounts of goodwill from prior business combinations are based on management's best estimates of the fair values of assets acquired and liabilities assumed at the date of acquisition. Annually, the Corporation assesses goodwill for impairment. No impairment charge was recognized for the period ended June 30, 2017 and 2016.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Intangible Assets

The recorded amount of intangible assets results primarily from the acquisition of plan members and provider networks related to MHP's acquisition of CareSource Michigan and the acquisition of various physician practices. Intangible assets are based on management's best estimates of the fair value of assets acquired at the date of acquisition. Certain components of the intangible assets are being amortized. The remainder is assessed for impairment on an annual basis. No impairment charge related to intangible assets was recognized for the period ended June 30, 2017 and 2016.

### Interest Rate Swaps

The Corporation has entered into interest rate swap agreements to manage its investments and capitalization, including risks associated with changes in interest rates. The Corporation records its interest rate swaps at fair value in the accompanying consolidated balance sheet as either assets or liabilities. None of the Corporation's current swaps are designated as a hedge. Accordingly, both the unrealized and realized gains or losses related to the interest rate swaps are included in nonoperating income (loss) on the consolidated statement of operations.

### Classification of Net Assets

Net assets of the Corporation are classified as permanently restricted, temporarily restricted, or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the Corporation's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Permanently restricted net assets result from donor-imposed restrictions that limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

### Temporarily Restricted Net Assets

Temporarily restricted net assets reflect assets contributed or pledged to the Corporation and its subsidiaries, the use of which is restricted by the donor. Temporarily restricted net assets are restricted for medical education, research, clinical and outreach programs, indigent care, and property and equipment purchases. Investment earnings on temporarily restricted investments are restricted by donors for specific purposes.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the estimated present value of the future cash receipts from certain trust assets and restricted investments held in perpetuity for research, clinical, and outreach programs. The present value of the future receipts from the trusts is recorded at the fair value of the assets of the trusts, net of liabilities.

### Excess of Revenue Over (Under) Expenses

The consolidated statement of operations includes excess of revenue over (under) expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over (under) expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets, pension-related changes other than net periodic benefit cost, net assets transferred to (from) affiliates, and other.

### Net Patient Service Revenue

The Corporation 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 Corporation recognizes revenue on the basis of its discounted rates, provided by policy. On the basis of historical experience, a significant portion of the Corporation’s uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Violations may result in significant regulatory action including fines, penalties, or exclusions from the Medicare and/or Medicaid programs. Management is not aware of any potential non-compliance with laws and regulations that they believe will be material to the financial statements.

**Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

**Contributions**

The Corporation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of operations and the consolidated statement of changes in net assets as net assets released from restrictions. The Corporation reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Corporation reports the expiration of donor restrictions when the assets are placed in service.

**Premium Revenue**

MHP recognizes premium revenue in the period the subscribers are entitled to related healthcare services. Premium revenue is reported in other revenue in the consolidated statement of operations and was approximately $751.5 million and $735.6 million for the periods ended June 30, 2017 and 2016, respectively.

**Healthcare Claims Expense**

MHP contracts with various healthcare providers for the provision of certain medical services to its members. Healthcare claims expense includes all amounts incurred under capitation payment agreements and services rendered under fee-for-service arrangements, including an estimate of costs incurred but not reported at each year end.

**Professional and Other Liability Insurance**

All subsidiaries of the Corporation and qualifying medical staff are insured for professional liability on a claims-made basis by MICOL, a multiprovider, offshore captive insurance company which is wholly owned by the Corporation. The Corporation and its subsidiaries accrue an estimate of the ultimate expense, including litigation and settlement expense, for incidents of potential improper professional service and other liability claims occurring during the year as well as for those claims that have not been reported at year end, which is based on estimates provided by an independent actuary. The expected amount of insurance recoveries is recorded as a receivable, net of allowance for uncollectible receivables.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Charity Care

Subsidiaries of the Corporation provide care to patients who meet certain criteria under charity care policies without charge or at amounts less than established rates. Because the Corporation and its subsidiaries do not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

### Tax Status

The Corporation and substantially all of its subsidiaries are nonprofit, tax-exempt organizations. Some subsidiaries are for-profit corporations. Income tax provisions are not material to the consolidated financial statements.

The accounting standard that refers to accounting for uncertainty in income taxes addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded on the consolidated financial statements. Companies must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The standard also provides guidance on derecognition, classification, interest and penalties on income taxes, and accounting in interim periods, and requires increased disclosures. The evaluated potential exposure related to uncertain tax positions was found to be immaterial. Management believes the Corporation is not subject to federal tax examinations for years prior to September 30, 2012.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

### Electronic Health Records Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) established funding in order to provide incentive payments to hospitals and physicians that implement the use of electronic health record (EHR) technology by 2014. The Corporation has received incentive payments, which may continue for up to four years, provided the Corporation demonstrates meaningful use of certified EHR technology during the EHR reporting period. The revenue from the incentive payments is recognized ratably over the EHR reporting period when there is reasonable assurance that the Corporation will comply with eligibility requirements during the EHR reporting period and an incentive payment will be received. The amounts are recorded within other operating revenue, as the incentive payments are related to the Corporation's ongoing and central activities, yet not directly linked to the delivery of patient service. McLaren Health Care remains eligible for incentive payments, provided the Corporation demonstrates meaningful use of certified EHR technology during the EHR reporting period. The Corporation recorded incentive payments totaling $5.0 million and $10.9 million for the period ended June 30, 2017 and 2016, respectively. The incentive payments received during 2017 and 2016 were the result of meeting specific requirements related to its meaningful use of EHR technology.

### Recent Accounting Pronouncements

**New Accounting Pronouncement** - In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs. The accounting guidance requires that debt issuance costs related to a recognized debt liability be reported in the balance sheet as a direct deduction from the carrying amount of that debt liability. The updated guidance was adopted by the Corporation for the fiscal year ended September 30, 2016, and has been applied on a retrospective basis for the fiscal year ended September 30, 2015. As a result of implementing this guidance, the other assets and long-term debt balances were reduced by $4,123,000 for the year ended September 30, 2015.

**Upcoming Accounting Pronouncements** - In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which will supersede the current revenue recognition requirements in Topic 605, Revenue Recognition. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for the Corporation's year ending September 30, 2019. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. The Corporation has not yet determined which application method it will use or the potential effects of the new standard, if any.

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, Leases, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Corporation’s year ending September 30, 2020, and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The effect of applying the new lease guidance on the financial statements has not yet been determined.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, in August 2016. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations who follow FASB not-for-profit rules, including changing from three classes of net assets to two classes, net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by the Corporation, including required disclosures about the liquidity and availability of resources. The new standard is effective for the Corporation's fiscal year ending September 30, 2019 and thereafter, and must be applied on a retrospective basis. The Corporation is currently evaluating the impact this standard will have on the financial statements.

## Note 2 – Cash and Cash Equivalents, Investments and Assets Whose Use Is Limited

Cash and investments are reported in the accompanying consolidated balance sheets as presented in the following table as of June 30, 2017 and September 30, 2016 (in thousands):

| | 6/30/2017 | 9/30/2016 |
|---|---|---|
| Cash and cash equivalents | $ 564,916 | $ 553,423 |
| Collateral from securities lending | 7,358 | 4,698 |
| Investments | 989,706 | 886,701 |
| Trustee held funds | 114,034 | 140,545 |
| Limited as to use or restricted | 205,906 | 178,731 |
| Obligations under securities lending | (7,529) | (4,853) |
| **Total** | **$ 1,874,391** | **$ 1,759,245** |

**Note 3 - Pension and Other Postretirement Benefit Plans**

MHC, Flint, MHP, MHG, Northern and MMG participate in a single defined benefit pension plan. Bay, Lapeer, Oakland, Macomb and Port Huron have separate noncontributory defined benefit pension plans covering certain employees. The Corporation intends to annually contribute amounts deemed necessary, if any, to maintain the plans on a sound actuarial basis.

Effective May 1, 2015, the Lansing plan merged into the consolidated plan noted above. Effective September 1, 2016, the Northern plan also merged into the consolidated plan noted above. As of the effective date of the mergers, it was determined that a remeasurement was not necessary.

The various defined benefit pension plans have taken steps to freeze accrual of future benefits or participation in the plans by new hires. Essentially all the defined benefit plans have been frozen for future benefit accruals.

Substantially all employees of the Corporation also participate in defined contribution pension plans that provide benefits to eligible participants as determined according to the provisions of the plan agreements.

MHC, Flint, Lansing, Macomb, and Bay also sponsor defined benefit postretirement plans that provide postretirement medical benefits summarized as follows:

**MHC and Flint** - The plan includes substantially all employees who have a minimum of 10 years of service after the age of 45. Employees who elect for early retirement can purchase benefits at the group rate through the plan. MHC and Flint currently fund the cost of these benefits as they are incurred. The retiree healthcare plan requires participant contributions and deductibles. Effective November 1, 2015 certain employees will no longer receive an employer subsidy for post-65 benefits under the plan. Additional plan changes occurred during the period ended September 30, 2016, which eliminated pre-65 subsidies for many current retirees.

**Lansing** - The plan allows retirees to purchase health insurance coverage at group rates through Lansing. Individuals who retired before December 31, 1993 also receive a maximum monthly contribution for the purchase of health insurance coverage. Individuals who retire after January 1, 1994 and have attained the age of 65 do not receive postretirement medical benefits under this plan. Lansing does not prefund the plan and has the right to modify or terminate the plan in the future.

**Bay** - The plan provides certain health care and prescription drugs for employees who retired prior to October 1994. Bay funds the cost of these benefits as they are incurred. During 2014, benefits were frozen for certain employee groups under this plan.

**Macomb -** The plan provides medical savings account plan benefits to substantially all employees who are subject to certain collective bargaining unit agreements.

**Note 3 - Pension and Other Postretirement Benefit Plans (Continued)**

Components of net periodic benefit cost (benefit) and other changes in plan assets and benefit obligations are as follows for the nine-month period ended June 30, 2017 and June 30, 2016 (in thousands):

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 6/30/2017 | 6/30/2016 | 6/30/2017 | 6/30/2016 |
| **Net Periodic Benefit Cost** | | | | |
| Service cost | $ 175 | $ 187 | $ 248 | $ 467 |
| Interest cost | 38,012 | 41,213 | 687 | 966 |
| Expected return on plan assets | (60,057) | (59,942) | - | - |
| Amortization of prior service cost (credits) | 11,985 | 9,146 | (2,149) | (2,064) |
| Settlement and curtailment change | - | - | - | - |
| Total net periodic benefit cost (benefit) | **$ (9,885)** | **$ (9,396)** | **$ (1,214)** | **$ (631)** |

## Cash Flow

### Contributions

The Corporation expects to contribute approximately $29.8 million to its pension plans and $1.4 million to its other postretirement benefit plans in 2017.

## Composition of the Credit Group

McLaren Health Care Corporation

McLaren Flint Hospital

McLaren Bay Region Hospital

McLaren Lapeer Region Hospital

McLaren Greater Lansing Hospital

McLaren Macomb Hospital

McLaren Oakland Hospital

McLaren Central Michigan Hospital

McLaren Northern Michigan Hospital

McLaren Port Huron Hospital

Barbara Ann Karmanos Cancer Institute (Karmanos)

McLaren Foundation (Flint)

McLaren Lapeer Region Foundation

McLaren Macomb Hospital Foundation

## Consolidating Balance Sheet (Unaudited)

**June 30, 2017**
**(In Thousands)**

| | McLaren Credit Group | Non-Credit Group Members | Elimination | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current Assets** | | | | |
| Cash and cash equivalents | $ 319,409 | $ 245,507 | $ - | $ 564,916 |
| Net patient accounts receivable | 175,207 | 35,796 | (3,882) | 207,121 |
| Other accounts receivable | 21,774 | 20,311 | - | 42,085 |
| Collateral from securities lending | 7,358 | - | - | 7,358 |
| Other current assets | 141,703 | 25,610 | (50,731) | 116,582 |
| Total current assets | 665,451 | 327,224 | (54,613) | 938,062 |
| **Other Assets** | | | | |
| Investments | 876,642 | 110,029 | 3,035 | 989,706 |
| Trustee held funds | 114,016 | 18 | - | 114,034 |
| Investment in unconsolidated subsidiaries | 40,562 | 145 | (16,229) | 24,478 |
| Limited as to use or restricted | 106,519 | 106,489 | (7,102) | 205,906 |
| Other assets | 297 | 49,587 | 51,595 | 101,479 |
| Total other assets | 1,138,036 | 266,268 | 31,299 | 1,435,603 |
| **Property and Equipment - Net** | 987,078 | 73,874 | - | 1,060,952 |
| Total Assets | $ 2,790,565 | $ 667,366 | $ (23,314) | $ 3,434,617 |
| **Liabilities and Net Assets** | | | | |
| **Current Liabilities** | | | | |
| Current portion of long-term debt | $ 22,736 | $ 1,268 | $ - | $ 24,004 |
| Accounts payable | 148,643 | 158,311 | (43,955) | 262,999 |
| Cost report settlements payable | 58,250 | 1,478 | - | 59,728 |
| Obligations under securities lending | 7,529 | - | - | 7,529 |
| Salaries, wages and withholdings | 94,669 | 32,154 | (77) | 126,746 |
| Pension | 3,552 | 51 | - | 3,603 |
| Interest | 2,508 | - | - | 2,508 |
| Professional and other liability claims | 14,997 | 423 | - | 15,420 |
| Other | 12,336 | 33,361 | (10,582) | 35,115 |
| Total current liabilities | 365,220 | 227,046 | (54,614) | 537,652 |
| **Long-Term Debt** | 751,339 | 6,179 | - | 757,518 |
| **Fair Value of Interest Rate Swap Agreements** | 20,580 | - | - | 20,580 |
| **Other Liabilities** | | | | |
| Accrued pension cost | 309,959 | 12,414 | - | 322,373 |
| Accrued postretirement cost | 25,923 | - | - | 25,923 |
| Accrued professional and other liability claims | 21,222 | 60,324 | - | 81,546 |
| Other | (8,207) | 23,771 | 51,596 | 67,160 |
| Total liabilities | 1,486,036 | 329,734 | (3,018) | 1,812,752 |
| **Net Assets** | | | | |
| Unrestricted | 1,201,232 | 294,156 | (13,194) | 1,482,194 |
| Temporarily restricted | 37,230 | 31,703 | (7,102) | 61,831 |
| Permanently restricted | 66,067 | 11,773 | - | 77,840 |
| Total Net Assets | 1,304,529 | 337,632 | (20,296) | 1,621,865 |
| Total liabilities and net assets | $ 2,790,565 | $ 667,366 | $ (23,314) | $ 3,434,617 |

## Consolidating Statement of Operations (Unaudited)

**For the nine-month period ended June 30, 2017**
**(In Thousands)**

| | McLaren Credit Group | Non-Credit Group Members | Elimination | Total |
|---|---|---|---|---|
| **Unrestricted Revenue, Gains, and Other Support** | | | | |
| Total patient service revenue | 5,858,594 | 214,812 | (253,027) | 5,820,379 |
| Revenue deductions | 3,901,866 | 65,296 | (221,272) | 3,745,890 |
| Net patient service revenue | 1,956,728 | 149,516 | (31,755) | 2,074,489 |
| Provision for bad debts | 68,473 | 1,747 | - | 70,220 |
| Net patient service revenue less provision for bad debts | 1,888,255 | 147,769 | (31,755) | 2,004,269 |
| Net assets released from restrictions | 5,193 | 1,865 | (742) | 6,316 |
| Premium revenue | - | 751,527 | - | 751,527 |
| Other revenue | 104,602 | 24,917 | (40,819) | 88,700 |
| Total unrestricted revenue, gains, and other support | 1,998,050 | 926,078 | (73,316) | 2,850,812 |
| **Expenses** | | | | |
| Salaries | 748,293 | 105,216 | (3,610) | 849,899 |
| Employee benefits and payroll taxes | 158,881 | 22,728 | (5,875) | 175,734 |
| Supplies | 396,744 | 37,395 | (147) | 433,992 |
| Other | 482,640 | 238,715 | (61,966) | 659,389 |
| Healthcare claims expense | - | 520,269 | - | 520,269 |
| Depreciation and amortization | 78,283 | 8,142 | (1,678) | 84,747 |
| Interest expense | 12,936 | 194 | (40) | 13,090 |
| Total expenses | 1,877,777 | 932,659 | (73,316) | 2,737,120 |
| **Operating Income** | 120,273 | (6,581) | - | 113,692 |
| **Nonoperating Income (Loss)** | | | | |
| Investment income | 35,358 | 4,759 | - | 40,117 |
| Change in interest swap agreements | 16,936 | - | - | 16,936 |
| Change in unrealized gains and losses on investments | 37,400 | 9,592 | - | 46,992 |
| Gain on sale of Anthelio Health Care Solutions, Inc. | 1,322 | - | - | 1,322 |
| Other | - | - | - | - |
| Total nonoperating income (loss) | 91,016 | 14,351 | - | 105,367 |
| **Excess of Revenue Over (Under) Expense** | 211,289 | 7,770 | - | 219,059 |

## Maximum Annual Debt Service Coverage Ratio – Consolidated and Credit Group

The following tables are calculations of the maximum annual debt service coverage ratio for the Corporation and Credit Group for fiscal quarter ending June 30, 2017.

| McLaren Credit Group | FYE 9/30/2016 | Less 10/1/2015 6/30/2016 | Plus 10/1/2016 6/30/2017 | 7/1/2016 6/30/2017 |
|---|---|---|---|---|
| **Required** | **1.10** | | | **1.10** |
| Credit group excess of revenue over expenses | $ 217,644 | $ 132,341 | $ 211,289 | $ 296,592 |
| Plus: | | | | |
| Depreciation and Amortization | 114,318 | 67,681 | 78,283 | 124,920 |
| Interest | 17,708 | 12,687 | 12,936 | 17,957 |
| Change in interest swap agreements | 5,544 | 5,491 | (16,936) | (16,883) |
| Change in unrealized gains and losses on investments | (48,264) | (18,881) | (37,400) | (66,783) |
| Available for debt service | $ 306,950 | $ 199,319 | $ 248,172 | $ 355,803 |
| Maximum Annual Debt Service | $ 50,563 | | | $ 50,563 |
| **Maximum Annual Debt Service Coverage Ratio** | **6.07** | | | **7.04** |

**1.10**

| McLaren Health Care Corporation | FYE 9/30/2016 | Less 10/1/2015 6/30/2016 | Plus 10/1/2016 6/30/2017 | 7/1/2016 6/30/2017 |
|---|---|---|---|---|
| **Required** | **1.10** | | | **1.10** |
| Corporation excess of revenue over expenses | $ 225,909 | $ 142,337 | $ 219,059 | $ 302,631 |
| Plus: | | | | |
| Depreciation and Amortization | 108,690 | 77,524 | 84,747 | 115,913 |
| Interest | 17,772 | 13,208 | 13,090 | 17,654 |
| Change in interest swap agreements | 5,544 | 5,491 | (16,936) | (16,883) |
| Change in unrealized gains and losses on investments | (58,297) | (24,086) | (46,992) | (81,203) |
| Available for debt service | $ 299,618 | $ 214,474 | $ 252,968 | $ 338,112 |
| Maximum Annual Debt Service | $ 50,563 | | | $ 50,563 |
| **Maximum Annual Debt Service Coverage Ratio** | **5.93** | | | **6.69** |

### Days Cash on Hand – Consolidated and Credit Group

The following table is the days cash on hand calculation for the Corporation and Credit Group as of June 30, 2017 and September 30, 2016.

| **McLaren Credit Group** | **6/30/2017** | **9/30/2016** |
|---|---|---|
| Cash and cash equivalents | $319,409 | $341,391 |
| General fund investments including funded depreciation | 876,642 | 789,284 |
| | $1,196,051 | 1,130,675 |
| Annual Expense | $2,503,703 | $2,530,277 |
| Depreciation and amortization | 104,377 | 114,318 |
| Annual cash expenses | $2,399,325 | $2,415,959 |
| Days cash on hand | 182 | 171 |

| **McLaren Health Care Corporation** | **6/30/2017** | **9/30/2016** |
|---|---|---|
| Cash and cash equivalents | $564,916 | $553,423 |
| General fund investments including funded depreciation | 989,706 | 886,701 |
| | $1,554,622 | $1,440,124 |
| Annual Expense | $3,649,493 | $3,566,248 |
| Depreciation and amortization | 112,996 | 108,690 |
| Annual cash expenses | $3,536,497 | $3,457,558 |
| Less: | | |
| McLaren Health Plan Passthrough Expenses | $229,776 | $224,343 |
| Days cash on hand | 172 | 163 |

## Historical Utilization Statistics – Consolidated and Credit Group

The following table summarizes certain historical utilization information for the Corporation and Credit Group collectively for periods ended June 30, 2015 through 2017.

| | McLaren Health Care Corporation Nine Months Ended June 30, | | | Credit Group Nine Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2017 | 2016 | 2015 |
| Licensed Beds * | 3,097 | 3,097 | 3,097 | 3,069 | 3,069 | 3,065 |
| Staffed Beds * | 2,509 | 2,510 | 2,433 | 2,483 | 2,484 | 2,502 |
| Discharges | 77,344 | 75,660 | 77,052 | 77,344 | 73,203 | 74,400 |
| Patient Days | 427,828 | 341,350 | 348,209 | 353,037 | 323,065 | 329,969 |
| Average length of Stay | 5.5 | 4.5 | 4.5 | 4.6 | 4.4 | 4.4 |
| Outpatient Visits | 2,798,480 | 2,698,177 | 2,416,448 | 2,505,411 | 2,359,418 | 2,252,636 |
| Emergency Room Visits | 308,981 | 314,214 | 298,604 | 308,981 | 314,214 | 298,604 |
| Surgical Procedures** | 60,489 | 61,501 | 60,169 | 60,489 | 59,216 | 57,898 |
| Observation Stays | 20,273 | 18,786 | 18,096 | 20,273 | 18,571 | 17,881 |

* Skilled beds are included in the statistics.
** Surgical procedures exclude volumes from ASC joint ventures.
2015 and 2016 Credit Group data includes Karmanos for comparative purposes.

## Sources of Patient Service Revenue

The following table provides the percentage of patient services revenue by payor source for the Corporation and Credit Group for periods ended June 30, 2015 through 2017.

| | McLaren Health Care Corporation Nine Months Ended June 30, | | | Credit Group Nine Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| **Payor** | **2017** | **2016** | **2015** | **2017** | **2016** | **2015** |
| Medicare | 51% | 50% | 50% | 51% | 50% | 50% |
| Medicaid | 17% | 17% | 16% | 17% | 17% | 16% |
| Blue Cross | 17% | 17% | 18% | 17% | 17% | 18% |
| Commercial | 9% | 9% | 10% | 9% | 9% | 10% |
| Managed Care | 5% | 6% | 5% | 5% | 6% | 5% |
| Self Pay | 1% | 1% | 1% | 1% | 1% | 1% |
| **Total** | **100%** | **100%** | **100%** | **100%** | **100%** | **100%** |