

# **North Country Health Systems, Inc.**

## **Independent Auditor's Report and Consolidated Financial Statements**

**September 30, 2017 and 2016**

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# North Country Health Systems, Inc.

September 30, 2017 and 2016

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## Independent Auditor's Report

Board of Trustees  
North Country Health Systems, Inc.  
Newport, Vermont

We have audited the accompanying consolidated financial statements of North Country Health Systems, Inc., which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Country Health Systems, Inc. as of September 30, 2017 and 2016, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

*BKD, LLP*

Springfield, Missouri  
December 15, 2017

**North Country Health Systems, Inc.**  
**Consolidated Balance Sheets**  
**September 30, 2017 and 2016**

**Assets**

|  | <b>2017</b>   | <b>2016</b>   |
|--|---------------|---------------|
| <b>Current Assets</b>  |               |               |
| Cash and cash equivalents  | \$ 2,139,045  | \$ 3,239,093  |
| Patient accounts receivable, net of allowance;<br>2017 – \$5,000,000, 2016 – \$5,500,000 | 7,253,308     | 7,191,886     |
| Other receivables  | 463,314       | 967,826       |
| Supplies   | 2,433,240     | 2,531,046     |
| Estimated amounts due from third-party payers  | 100,955       | 363,316       |
| Prepaid expenses and other   | 1,201,045     | 1,004,235     |
| Total current assets   | 13,590,907    | 15,297,402    |
| <b>Assets Limited As To Use</b>  |               |               |
| Internally designated  | 39,075,746    | 31,500,429    |
| Externally restricted by donors  | 4,245,448     | 3,837,161     |
| Held by trustee  |               |               |
| Under deferred compensation arrangements   | 3,049,789     | 2,692,148     |
|  | 46,370,983    | 38,029,738    |
| <b>Property and Equipment, At Cost</b>   |               |               |
|  | 76,870,423    | 75,451,855    |
| Less accumulated depreciation  | 51,636,817    | 48,077,575    |
|  | 25,233,606    | 27,374,280    |
| <b>Other Assets</b>  |               |               |
|  | 30,267        | 704,620       |
| Total assets   | \$ 85,225,763 | \$ 81,406,040 |

## Liabilities and Net Assets

|   | <u>2017</u>          | <u>2016</u>          |
|---|----------------------|----------------------|
| <b>Current Liabilities</b>                                      |                      |                      |
| Current maturities of long-term debt                            | \$ 1,099,637         | \$ 1,154,258         |
| Accounts payable  | 2,630,733            | 1,845,004            |
| Accrued expenses  | 4,261,427            | 4,140,931            |
| Resident personal funds payable                                 | 599                  | 892                  |
| Due to affiliate  | 13,047               | 90,710               |
| Estimated amounts due to third-party payers                     | 1,791,945            | 487,116              |
|   | <hr/>                | <hr/>                |
| Total current liabilities                                       | 9,797,388            | 7,718,911            |
| <b>Deferred Compensation and Other</b>                          | 3,136,839            | 2,769,621            |
| <b>Long-Term Debt</b>   | 17,968,122           | 18,929,762           |
| <b>Interest Rate Swap Agreements</b>                            | 1,445,525            | 2,479,832            |
|   | <hr/>                | <hr/>                |
| Total liabilities   | 32,347,874           | 31,898,126           |
| <b>Net Assets</b>   |                      |                      |
| Unrestricted net assets attributable to the Health System       | 48,573,554           | 45,605,822           |
| Unrestricted net assets attributable to noncontrolling interest | 174,168              | 134,028              |
|   | <hr/>                | <hr/>                |
| Total unrestricted net assets                                   | 48,747,722           | 45,739,850           |
| Temporarily restricted  | 3,335,308            | 2,973,355            |
| Permanently restricted  | 794,859              | 794,709              |
|   | <hr/>                | <hr/>                |
| Total net assets  | 52,877,889           | 49,507,914           |
|   | <hr/>                | <hr/>                |
| Total liabilities and net assets                                | <u>\$ 85,225,763</u> | <u>\$ 81,406,040</u> |

**North Country Health Systems, Inc.**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2017 and 2016**

|   | <b>2017</b>   | <b>2016</b>   |
|---|---------------|---------------|
| <b>Unrestricted Revenues, Gains and Other Support</b>   |               |               |
| Net patient service revenue (net of contractual discounts and allowances)   | \$ 78,908,517 | \$ 80,956,069 |
| Provision for uncollectible accounts  | (1,751,358)   | (2,823,491)   |
| Net patient service revenue less provision for uncollectible accounts   | 77,157,159    | 78,132,578    |
| Other   | 7,672,065     | 8,214,263     |
| Net assets released from restriction used for operations  | 124,779       | 40,751        |
| Total unrestricted revenues, gains and other support  | 84,954,003    | 86,387,592    |
| <b>Expenses and Losses</b>  |               |               |
| Salaries  | 39,687,953    | 38,478,040    |
| Employee benefits   | 11,613,412    | 10,906,070    |
| Supplies and other  | 30,191,302    | 31,176,613    |
| Depreciation and amortization   | 4,675,089     | 5,039,136     |
| Interest  | 733,717       | 657,091       |
| Total expenses and losses   | 86,901,473    | 86,256,950    |
| <b>Operating Income (Loss)</b>  | (1,947,470)   | 130,642       |
| <b>Other Income (Expense)</b>   |               |               |
| Contributions received  | 240,052       | 124,921       |
| Contributions paid  | -             | (50,452)      |
| Investment return and other-than-temporary losses   | 1,225,970     | 1,103,449     |
| Investment return – change in fair value of investments accounted for under the fair value option of FASB ASC Topic 825 | (149,243)     | (112,619)     |
| Loss on extinguishment of debt  | -             | (202,888)     |
| Loss on impairment of goodwill  | -             | (368,000)     |
| Other   | 72,571        | 50,070        |
| Total other income (expense)  | 1,389,350     | 544,481       |
| <b>Excess (Deficiency) of Revenues Over Expenses</b>  | (558,120)     | 675,123       |
| Investment return – change in unrealized gains and losses on other than trading securities                              | 2,490,245     | 1,503,524     |
| Change in fair value of interest rate swap agreements   | 1,034,307     | (331,635)     |
| Net assets released from restriction used for property and equipment  | 81,440        | -             |
| Distributions to noncontrolling interest  | (40,000)      | (80,000)      |
| <b>Increase in Unrestricted Net Assets</b>  | \$ 3,007,872  | \$ 1,767,012  |

**North Country Health Systems, Inc.**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended September 30, 2017 and 2016**

|  | <b>2017</b>   | <b>2016</b>   |
|--|---------------|---------------|
| <b>Unrestricted Net Assets Attributable to the Health System</b>                           |               |               |
| Excess (deficiency) of revenues over expenses  | \$ (638,260)  | \$ 578,005    |
| Investment return – change in unrealized gains and losses on other than trading securities | 2,490,245     | 1,503,524     |
| Net assets released from restriction used for property, plant and equipment, net           | 81,440        | -             |
| Change in fair value of interest rate swap agreements                                      | 1,034,307     | (331,635)     |
| Increase in unrestricted net assets attributable to the Health System                      | 2,967,732     | 1,749,894     |
| <b>Unrestricted Net Assets Attributable to Noncontrolling Interest</b>                     |               |               |
| Excess of revenues over expenses   | 80,140        | 97,118        |
| Distributions to noncontrolling interest   | (40,000)      | (80,000)      |
| Increase in unrestricted net assets attributable to noncontrolling interest                | 40,140        | 17,118        |
| Increase in unrestricted net assets  | 3,007,872     | 1,767,012     |
| <b>Temporarily Restricted Net Assets</b>   |               |               |
| Contributions received   | 102,096       | 70,225        |
| Investment return – change in unrealized gains and losses on other than trading securities | 466,076       | 257,022       |
| Net assets released from restriction   | (206,219)     | (40,751)      |
| Increase in temporarily restricted net assets  | 361,953       | 286,496       |
| <b>Permanently Restricted Net Assets</b>   |               |               |
| Contributions received   | 150           | -             |
| Increase in permanently restricted net assets  | 150           | -             |
| <b>Change in Net Assets</b>  | 3,369,975     | 2,053,508     |
| <b>Net Assets, Beginning of Year</b>   | 49,507,914    | 47,454,406    |
| <b>Net Assets, End of Year</b>   | \$ 52,877,889 | \$ 49,507,914 |

**North Country Health Systems, Inc.**  
**Consolidated Statements of Cash Flows**  
**Years Ended September 30, 2017 and 2016**

|   | <b>2017</b>  | <b>2016</b>  |
|---|--------------|--------------|
| <b>Operating Activities</b>                                   |              |              |
| Change in net assets  | \$ 3,369,975 | \$ 2,053,508 |
| Items not requiring (providing) cash                          |              |              |
| (Gain) loss on disposal of property and equipment             | 22,136       | (58,420)     |
| Depreciation and amortization                                 | 4,675,089    | 5,039,136    |
| Net (gain) loss on investments                                | (3,412,651)  | (2,329,093)  |
| Change in fair value of interest rate swap agreements         | (1,034,307)  | 331,635      |
| Restricted contributions received                             | (102,246)    | (70,225)     |
| Distributions to noncontrolling interest                      | 40,000       | 80,000       |
| Loss on extinguishment of debt                                | -            | 202,888      |
| Loss on impairment of goodwill                                | -            | 368,000      |
| Changes in  |              |              |
| Patient accounts receivable, net                              | (61,422)     | 559,217      |
| Estimated amounts due to third-party payers                   | 1,567,190    | (1,735,315)  |
| Accounts payable and accrued expenses                         | 790,990      | (1,695,120)  |
| Other current assets and liabilities                          | 1,369,123    | (69,421)     |
| Net cash provided by operating activities                     | 7,223,877    | 2,676,790    |
| <b>Investing Activities</b>                                   |              |              |
| Proceeds from disposition of assets limited as to use         | 7,703,978    | 9,212,738    |
| Purchases of assets limited as to use                         | (12,632,572) | (9,391,553)  |
| Purchase of property and equipment                            | (2,297,772)  | (3,860,973)  |
| Proceeds from sale of property and equipment                  | 45,059       | 75,595       |
| Net cash used in investing activities                         | (7,181,307)  | (3,964,193)  |
| <b>Financing Activities</b>                                   |              |              |
| Distributions to noncontrolling interest                      | (40,000)     | (80,000)     |
| Proceeds from restricted contributions                        | 102,246      | 70,225       |
| Payment of deferred financing costs                           | -            | (222,402)    |
| Proceeds from issuance of long-term debt                      | -            | 18,743,131   |
| Principal payments on long-term debt                          | (1,204,864)  | (20,152,117) |
| Net cash used in financing activities                         | (1,142,618)  | (1,641,163)  |
| <b>Decrease in Cash and Cash Equivalents</b>                  | (1,100,048)  | (2,928,566)  |
| <b>Cash and Cash Equivalents, Beginning of Year</b>           | 3,239,093    | 6,167,659    |
| <b>Cash and Cash Equivalents, End of Year</b>                 | \$ 2,139,045 | \$ 3,239,093 |
| <b>Supplemental Cash Flows Information</b>                    |              |              |
| Interest paid   | \$ 733,717   | \$ 642,576   |
| Property and equipment in accounts payable                    | \$ 113,670   | \$ 219,328   |
| Capital lease obligations incurred for property and equipment | \$ 163,819   | \$ 40,749    |

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

North Country Health Systems, Inc. and its subsidiaries collectively do business as North Country Health System.

North Country Health Systems, Inc. (Health System) is the parent holding company for its wholly owned subsidiaries, which include North Country Hospital and Health Center, Inc. (Hospital), North Country Health Services, Inc., d/b/a Derby Green (Derby Green).

North Country Hospital and Health Center, Inc. operates a 25-bed acute care hospital facility in Newport, Vermont. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Newport, Vermont, and the surrounding area. The Hospital also operates a number of physician clinics in the same geographic area.

Derby Green operates a 23-bed nursing home located in Derby, Vermont.

North Country Hospital and Health Center, Inc. is the majority general shareholder of Northeast Kingdom Healthcare Collaborative, LLC (NEK), which is a limited liability corporation. The Hospital controls Northeast Kingdom Healthcare Collaborative, LLC through its 60% majority interest of the general partnership membership units. The noncontrolling interest represents the proportionate share of Northeast Kingdom Healthcare Collaborative, LLC equity owned by a third party.

***Principles of Consolidation***

The consolidated financial statements include the financial statements of North Country Health Systems, Inc., its wholly owned subsidiaries, North Country Hospital and Health Center, Inc., North Country Health Services, d/b/a Derby Green and the majority owned Northeast Kingdom Healthcare Collaborative, LLC (collectively, "NCHS"). All significant intercompany accounts and transactions have been eliminated in consolidation.

***Noncontrolling Interest***

Noncontrolling interest represents the third-party member's equity contribution and the proportionate share of income or loss in NEK. Income passes through to its members and any associated income taxes are paid by the members under their respective income tax status.

***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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Cash and Cash Equivalents***

NCHS considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2017 and 2016, cash equivalents consisted primarily of repurchase agreements in sweep accounts with financial institutions.

At September 30, 2017, NCHS had approximately \$165,000 of cash accounts in excess of FDIC limits that were not fully collateralized.

***Investments and Investment Return***

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Investments in hedge funds are carried at fair value pursuant to the provisions of ASC Topic 825. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments. NCHS recognizes an impairment loss when an impairment is deemed other than temporary. For the years ended September 30, 2017 and 2016, respectively, NCHS did not record any other-than-temporary impairment.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the consolidated statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

***Assets Limited as to Use***

Assets limited as to use include (1) assets held by trustees under bond indentures and deferred compensation agreements, (2) assets restricted by donors and (3) assets set aside by the Board of Trustees for future capital improvements and debt service over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of NCHS are included in current assets.

***Patient Accounts Receivable***

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, NCHS analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

For receivables associated with services provided to patients who have third-party coverage, NCHS analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), NCHS records a significant provision for uncollectible accounts 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 uncollectible accounts.

NCHS's allowance for uncollectible accounts for self-pay patients decreased from 72% of self-pay accounts receivable at September 30, 2016, to 67% of self-pay accounts receivable at September 30, 2017. NCHS's write-offs decreased approximately \$384,000 from approximately \$3,000,000 for the year ended September 30, 2016, to approximately \$2,616,000 for the year ended September 30, 2017.

***Supplies***

NCHS states supply inventories at the lower of cost, determined using the first-in, first-out method, or market.

***Property and Equipment***

Property and equipment acquisitions are recorded at cost and are depreciated using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations are depreciated over the shorter of the lease term or their respective estimated useful lives.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

|                               |               |
|-------------------------------|---------------|
| Land improvements             | 5 - 25 years  |
| Buildings                     | 10 - 40 years |
| Fixed equipment               | 5 - 20 years  |
| Moveable equipment            | 3 - 20 years  |
| Vehicles                      | 4 years       |
| Equipment under capital lease | 4 - 5 years   |

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Long-Lived Asset Impairment***

NCHS evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended September 30, 2017 and 2016.

***Goodwill***

Goodwill is evaluated annually for impairment or more frequently if impairment indicators are present. A qualitative assessment is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value is less than the carrying amount, including goodwill. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then goodwill is tested further for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the consolidated financial statements.

The changes in the carrying amount of goodwill for the years ended September 30, 2017 and 2016, were:

|  | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|
| Balance of Goodwill as of October 1    | \$ -        | \$ 368,000  |
| Goodwill acquired during the year      | -           | -           |
| Impairment losses                      | -           | 368,000     |
| Balance of Goodwill as of September 30 | \$ -        | \$ -        |

All goodwill was allocated to the pediatrics clinic segment of the business that was acquired during the year ended September 30, 2015. Because of decreased volume and revenues, primarily due to the loss of a key physician in NCHS's primary market, operating profits and cash flows were lower than expected in 2016. Based on that trend, the pediatrics clinic forecast for the next several years was revised resulting in a goodwill impairment loss of \$0 and \$368,000 for the years ended September 30, 2017 and 2016, respectively. The fair value of the pediatrics clinic segment of the business was estimated using the expected present value of future cash flows.

***Deferred Financing Costs***

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method and are included as a component of long-term debt on the consolidated balance sheets.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by NCHS has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by NCHS in perpetuity.

***Net Patient Service Revenue***

The Hospital and Derby Green have agreements with third-party payers that provide for payments at amounts different from their established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

***Charity Care***

NCHS provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

***Contributions***

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

***Professional Liability Claims***

The Hospital recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in *Note 6*.

***Estimated Self-Insurance Costs***

NCHS accrues estimated liabilities for self-insurance losses associated with employee health insurance, employee unemployment claims and workers' compensation claims by estimating the ultimate costs for both reported claims and claims incurred but not reported. NCHS has purchased insurance that limits its exposure for individual claims.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Income Taxes***

NCHS and its subsidiaries have been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, NCHS and its subsidiaries are subject to federal income tax on any unrelated business taxable income.

NCHS files tax returns in the U.S. federal jurisdiction. With a few exceptions, NCHS is no longer subject to U.S. federal examinations by tax authorities for years before 2014.

***Excess (Deficiency) of Revenues Over Expenses***

The consolidated statements of operations include excess (deficiency) of revenues over expenses. Changes in unrestricted net assets which are excluded from excess (deficiency) of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, the change in fair value of interest rate swap agreements and distributions to noncontrolling interest.

***Electronic Health Records Incentive Program***

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Critical access hospitals (CAHs) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare share fraction, which includes a 20% incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Hospital is subject to penalties that would reduce future payments for services. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

NCHS has recognized the incentive payment revenue received for qualified EHR technology expenditures during 2017 and 2016, respectively, which was the period during which management was reasonably assured meaningful use was achieved and the earnings process was complete. Management believes the incentive payments reflect a change in how "allowable costs" are determined in paying CAHs for providing services to Medicare beneficiaries. In 2017 and 2016, NCHS recorded approximately \$255,000 and \$225,000, respectively, of revenue related to the meaningful use programs which is recorded in other operating revenue.

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***Transfers Between Fair Value Hierarchy Levels***

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period ending date.

***Subsequent Events***

Subsequent events have been evaluated through December 15, 2017, which is the date the consolidated financial statements were issued.

***Reclassifications***

Certain reclassifications have been made to the 2016 consolidated financial statements to conform to the 2017 financial statement presentation. These reclassifications had no effect on the change in net assets.

**Note 2: Net Patient Service Revenue**

NCHS recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, NCHS recognizes revenue on the basis of its standard rates for services. On the basis of historical experience, a significant portion of NCHS' uninsured patients will be unable or unwilling to pay for the services provided. Thus, NCHS records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the consolidated statements of operations as a component of net patient service revenue.

The Hospital and Derby Green have agreements with third-party payers that provide for payments at amounts different from its established rates. These payment arrangements include:

*Medicare.* The Hospital is designated as a critical access hospital and is paid based on cost formulas for most inpatient and outpatient services from the Medicare program.

Skilled nursing services rendered to Medicare program beneficiaries at Derby Green are paid at prospectively determined per diem rates.

The Hospital and Derby Green are reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and Derby Green and audits thereof by the Medicare Administrative Contractor. The most recent Hospital cost report audited by the Medicare Administrative Contractor is for the period ended September 30, 2014.

The 2017 and 2016 net patient service revenue increased approximately \$300,000 and \$125,000, due to tentative settlements in excess of amounts previously estimated.

*Medicaid.* Inpatient, outpatient and skilled nursing services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates.

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*Blue Cross.* Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed at submitted charges less a contractually determined discount.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

NCHS has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended September 30, 2017 and 2016, respectively, was approximately:

|                          | <b>2017</b>   | <b>2016</b>   |
|--------------------------|---------------|---------------|
| Medicare                 | \$ 26,712,779 | \$ 25,751,831 |
| Medicaid                 | 10,680,561    | 12,035,010    |
| Other third-party payers | 22,809,014    | 26,125,723    |
| Blue Cross               | 17,845,532    | 16,305,258    |
| Self-pay                 | 860,631       | 738,247       |
| Total                    | \$ 78,908,517 | \$ 80,956,069 |

**Note 3: Concentration of Credit Risk**

NCHS grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at September 30, 2017 and 2016, is:

|                          | <b>2017</b> | <b>2016</b> |
|--------------------------|-------------|-------------|
| Medicare                 | 36.1%       | 29.6%       |
| Medicaid                 | 9.7%        | 8.9%        |
| Other third-party payers | 20.4%       | 26.8%       |
| Blue Cross               | 19.4%       | 17.9%       |
| Self-pay                 | 14.4%       | 16.8%       |
|                          | 100.0%      | 100.0%      |

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**Note 4: Investments and Investment Return**

***Assets Limited as to Use***

Assets limited as to use, at September 30, 2017 and 2016, include:

|  | <b>2017</b>          | <b>2016</b>          |
|--|----------------------|----------------------|
| Cash and cash equivalents                                      | \$ 1,955,503         | \$ 2,326,286         |
| U.S. Treasury securities                                       | 1,898,337            | 1,405,152            |
| Government agency securities                                   | 249,749              | 585,640              |
| Corporate fixed income securities                              | 5,614,272            | 4,506,551            |
| Equities   |                      |                      |
| Consumer discretionary industry                                | 2,997,505            | 2,565,350            |
| Consumer staples industry                                      | 2,570,990            | 2,387,730            |
| Energy industry  | 2,034,648            | 1,115,735            |
| Financial industry   | 4,169,830            | 2,787,437            |
| Health care industry   | 3,325,779            | 2,401,087            |
| Industrial industry  | 3,396,739            | 2,220,807            |
| Information technology industry                                | 5,633,296            | 4,228,408            |
| Materials and manufacturing industry                           | 531,915              | 250,554              |
| Telecommunications industry                                    | 1,996,649            | 931,895              |
| Utilities industry   | 1,171,770            | 1,679,713            |
| Real estate industry   | 3,434,448            | 2,840,909            |
| Other industries   | -                    | 628,759              |
| Mutual funds - equities  | 891,590              | 912,813              |
| Exchange-traded funds  | 140,805              | 130,358              |
| Alternative investments  | 1,951,746            | 2,100,989            |
| Life insurance policies and deferred compensation arrangements | 2,405,412            | 2,023,565            |
|  | <u>\$ 46,370,983</u> | <u>\$ 38,029,738</u> |

The alternative investments were acquired to balance the investment portfolio risks associated with the volatility of fluctuations in the financial market through diversification and, as such, are subject to varying degrees of market and credit risks.

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Total investment return is comprised of the following:

|   | <b>2017</b>         | <b>2016</b>         |
|---|---------------------|---------------------|
| Interest and dividend income  | \$ 620,397          | \$ 422,283          |
| Realized and unrealized gains and losses on other than trading securities | <u>3,412,651</u>    | <u>2,329,093</u>    |
|   | <u>\$ 4,033,048</u> | <u>\$ 2,751,376</u> |

Total investment return is reflected in the consolidated statements of operations and changes in net assets as follows:

|   | <b>2017</b>         | <b>2016</b>         |
|---|---------------------|---------------------|
| Unrestricted net assets   |                     |                     |
| Other nonoperating income   | \$ 1,225,970        | \$ 1,103,449        |
| Change in fair value of investments accounted for under the fair value option of FASB ASC Topic 825 | (149,243)           | (112,619)           |
| Change in unrealized gains and losses on other than trading securities                              | 2,490,245           | 1,503,524           |
| Temporarily restricted net assets   |                     |                     |
| Change in unrealized gains and losses on other than trading securities                              | <u>466,076</u>      | <u>257,022</u>      |
|   | <u>\$ 4,033,048</u> | <u>\$ 2,751,376</u> |

***Unrealized Losses on Investments***

Certain investments in debt and marketable equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at September 30, 2017 and 2016, was \$9,085,353 and \$7,441,128, which is approximately 20% of NCHS' assets limited as to use. These declines primarily resulted from recent increases in market interest rates, failure of certain investments to maintain consistent credit quality ratings, changes in the market's perception of the current risks or failure to meet projected earnings targets.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

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NCHS' investments in marketable equity securities consist primarily of investments in companies in various industries in domestic and international markets. NCHS routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment has occurred. For each security in the investment portfolio (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine if an other-than-temporary impairment has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other than temporary such as severity of loss, length of time in a loss position and other significant factors.

No other-than-temporary impairment losses were recorded during the years ended September 30, 2017 and 2016.

The following table shows NCHS' investments' gross unrealized losses and fair value for investments in a loss position for which other-than-temporary impairment has not been taken as of year end, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2017 and 2016:

| Description of Securities             | Less than 12 Months |                   | September 30, 2017<br>12 Months or More |                   | Total               |                   |
|---------------------------------------|---------------------|-------------------|---|-------------------|---------------------|-------------------|
|                                       | Fair Value          | Unrealized Losses | Fair Value                              | Unrealized Losses | Fair Value          | Unrealized Losses |
| Debt securities                       | \$ 2,774,594        | \$ 32,198         | \$ 681,717                              | \$ 31,632         | \$ 3,456,311        | \$ 63,830         |
| Equity securities                     | 3,634,550           | 298,442           | 1,994,492                               | 300,801           | 5,629,042           | 599,243           |
| Total temporarily impaired securities | <u>\$ 6,409,144</u> | <u>\$ 330,640</u> | <u>\$ 2,676,209</u>                     | <u>\$ 332,433</u> | <u>\$ 9,085,353</u> | <u>\$ 663,073</u> |

  

| Description of Securities             | Less than 12 Months |                   | September 30, 2016<br>12 Months or More |                   | Total               |                   |
|---------------------------------------|---------------------|-------------------|---|-------------------|---------------------|-------------------|
|                                       | Fair Value          | Unrealized Losses | Fair Value                              | Unrealized Losses | Fair Value          | Unrealized Losses |
| Debt securities                       | \$ 1,180,024        | \$ 18,170         | \$ 285,269                              | \$ 22,828         | \$ 1,465,293        | \$ 40,998         |
| Equity securities                     | 3,732,959           | 308,919           | 2,242,876                               | 369,087           | 5,975,835           | 678,006           |
| Total temporarily impaired securities | <u>\$ 4,912,983</u> | <u>\$ 327,089</u> | <u>\$ 2,528,145</u>                     | <u>\$ 391,915</u> | <u>\$ 7,441,128</u> | <u>\$ 719,004</u> |

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***Alternative Investments***

The fair value of alternative investments that have been estimated using the net asset value per share as a practical expedient consist of the following at September 30:

|                               | <b>September 30,<br/>2017<br/>Fair Value</b> | <b>September 30,<br/>2016<br/>Fair Value</b> | <b>Unfunded<br/>Commitments</b> | <b>Redemption<br/>Frequency</b> | <b>Redemption<br/>Notice Period</b> |
|-------------------------------|--|--|---------------------------------|---------------------------------|-------------------------------------|
| Multistrategy hedge funds (A) | \$ 1,951,746                                 | \$ 2,100,989                                 | \$ -                            | Quarterly                       | 65 days' written notice             |

(A) This category includes investments in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. For the investment, the Funds' primary investment objective is to provide capital appreciation consistent with the return characteristics of alternative investment portfolios of larger endowments through investments in the six asset classes of Opportunistic Equity, Enhanced Fixed Income, Absolute Return, Real Estate, Private Equity and Energy and Natural Resources.

**Note 5: Property and Equipment**

Property and equipment are stated at cost. A summary of cost by category follows:

|                               | <b>2017</b>          | <b>2016</b>          |
|-------------------------------|----------------------|----------------------|
| Land                          | \$ 435,921           | \$ 435,921           |
| Land improvements             | 1,781,495            | 1,721,255            |
| Buildings                     | 44,247,974           | 43,674,909           |
| Fixed equipment               | 1,781,029            | 1,781,029            |
| Moveable equipment            | 25,493,651           | 24,638,957           |
| Vehicles                      | 54,850               | 54,850               |
| Equipment under capital lease | 1,792,941            | 1,859,359            |
| Construction in progress      | 1,282,562            | 1,285,575            |
|                               | <u>\$ 76,870,423</u> | <u>\$ 75,451,855</u> |

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Construction in progress at September 30, 2017, primarily consists of several smaller projects which the anticipated costs of completion combined are approximately \$1,100,000 and are anticipated to be completed during fiscal year 2018.

**Note 6: Contingent Liabilities**

***Professional Liability Claims***

NCHS purchases medical malpractice insurance under a claims made policy. Under such a policy, only claims made and reported to the insurer during the policy term, regardless of when the incidents giving rise to the claims occurred, are covered. NCHS also purchases excess umbrella liability coverage, which provides additional coverage above the basic policy limits up to the amount specified in the umbrella policy.

Based upon the claims experience, no such accrual had been made for NCHS' estimated medical malpractice costs, including costs associated with litigating or settling claims, under its malpractice insurance policy, as of September 30, 2017 and 2016. It is reasonably possible that this estimate could change materially in the near term.

***Self-Insurance***

NCHS is self-insured for employee health and workers' compensation claims and has accrued an estimate of the ultimate costs for reported claims and claims incurred but not reported. Actual results could differ from these estimates. Effective October 1, 2013, NCHS purchased a commercial workers' compensation policy and is no longer self-insured for claims after September 30, 2013.

NCHS is self-insured for employee unemployment insurance benefits. The accrual for self-insurance is evaluated periodically throughout the fiscal year for adequacy based on staffing changes. Actual results could differ from these estimates.

**Note 7: Line of Credit**

The Hospital has a \$2,000,000 revolving bank line of credit which expires in March 2020. At September 30, 2017 and 2016, there was \$0 borrowed against this line. The line is collateralized by substantially all of the Hospital's assets. Interest varies with the bank's prime rate, with a 1% margin added to the prime rate, with a minimum rate of 4.25%. At September 30, 2017, the interest rate was 5.25%.

The Hospital has a \$150,000 revolving bank line of credit which expires in June 2018. At September 30, 2017 and 2016, there was \$0 borrowed against this line. The line is collateralized by substantially all of the Hospital's assets and has an interest rate of 7.75% at September 30, 2017.

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**Note 8: Long-Term Debt**

|   | <b>2017</b>          | <b>2016</b>          |
|---|----------------------|----------------------|
| Hospital Revenue Bonds, Series 2016 (A) | \$ 17,806,674        | \$ 18,559,818        |
| Note payable (B)                        | 238,446              | 262,696              |
| Note payable (C)                        | 342,090              | 357,174              |
| Capital lease obligations (D)           | 870,754              | 1,119,321            |
|   | 19,257,964           | 20,299,009           |
| Less unamortized debt issuance costs    | 190,205              | 214,989              |
| Less current maturities                 | 1,099,637            | 1,154,258            |
|   | <b>\$ 17,968,122</b> | <b>\$ 18,929,762</b> |

(A) Vermont Educational and Health Buildings Financing Agency Revenue Refunding Bond (North Country Hospital Project), Series 2016 A in the original amount of \$18,743,131 dated June 1, 2016, which bear interest at a variable rate equal to the sum of 68% of one-month LIBOR plus 78.2 basis points per annum (1.62% and 1.28% at September 30, 2017 and 2016, respectively), and are due in graduated installments through October 2034 with a due on demand clause June 1, 2026, and thereafter. Proceeds from the bonds were used to repay the outstanding debt from the Series 2007 bonds. The bonds are collateralized by equipment, personal property, hardware, supplies and inventory of the Hospital. The Hospital is subject to certain financial covenants related to this bond issue. Unamortized debt issuance costs associated with the borrowing are \$190,205 and \$214,989 at September 30, 2017 and 2016, respectively.

(B) Note payable to Vermont Economic Development Authority for assistance with development of renal dialysis services. Principal on the note is due annually and the rate of interest on this loan is 0%. The note is collateralized by an interest in the gross receipts of the Hospital.

(C) Note payable originally issued in the amount of \$400,000 for capital improvements. Principal on the note is due monthly and the rate of interest on this loan is 4.00% until September 2023, with the interest rate varying thereafter. The note is collateralized by real estate at Derby Green.

(D) Capital lease obligations at varying rates of imputed interest from 1.3% to 12.4%, collateralized by leased equipment expiring at various dates through 2022. Property and equipment include the following equipment under capital leases:

|                               | <b>2017</b>       | <b>2016</b>         |
|-------------------------------|-------------------|---------------------|
| Moveable equipment            | \$ 1,792,941      | \$ 1,859,359        |
| Less accumulated depreciation | 1,023,185         | 823,422             |
|                               | <b>\$ 769,756</b> | <b>\$ 1,035,937</b> |

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Aggregate annual maturities and sinking fund requirements of long-term debt and payments on capital lease obligations at September 30, 2017, are:

|                                   | <b>Long-Term<br/>Debt<br/>Excluding<br/>Capital<br/>Lease<br/>Obligations</b> | <b>Capital<br/>Lease<br/>Obligations</b> |
|-----------------------------------|---|--|
| 2018                              | \$ 818,892  | \$ 318,211                               |
| 2019                              | 846,618   | 288,879                                  |
| 2020                              | 874,882   | 236,932                                  |
| 2021                              | 906,074   | 93,689                                   |
| 2022                              | 936,468   | 14,850                                   |
| Thereafter                        | <u>14,004,276</u>   | <u>-</u>                                 |
|                                   | <u><u>\$ 18,387,210</u></u>   | 952,561                                  |
| Less amount representing interest |   | <u>81,807</u>                            |
| Present value of future minimum   |   |  |
| lease payments                    |   | 870,754                                  |
| Less current maturities           |   | <u>280,745</u>                           |
| Noncurrent portion                |   | <u><u>\$ 590,009</u></u>                 |

**Note 9: Derivative Financial Instrument**

***2007 Interest Rate Swap***

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, NCHS entered into an interest rate swap agreement for \$15,466,750 of the outstanding Hospital Revenue Bonds, Series 2007, in December 2007. During the year ended September 30, 2016, the Hospital paid in full the Hospital Revenue Bonds, Series 2007 and entered into a new financing arrangement with the issuance of the Hospital Revenue Bonds, Series 2016 A. Upon execution of the Hospital Revenue Bonds, Series 2016 A the Hospital elected to continue its strategy to limit its exposure to interest rate risk by applying this swap agreement to the 2016 debt.

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The agreement provides for NCHS to receive interest from the counterparty of 68% of LIBOR and to pay interest to the counterparty at a fixed rate of 3.285% on notional amounts of \$11,878,750 and \$12,346,750 at September 30, 2017 and 2016, respectively. Under the agreement, NCHS pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The interest rate swap agreement terminates on November 1, 2027. This swap is valued at \$(1,548,240) and \$(2,341,314) at September 30, 2017 and 2016, respectively.

**2016 Interest Rate Swap**

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, NCHS entered into an interest rate swap agreement for \$6,396,381 of the outstanding Hospital Revenue Bonds, Series 2016, in June 2016.

The agreement provides for NCHS to receive interest from the counterparty of 68% of LIBOR and to pay interest to the counterparty at a fixed rate of 1.12% on a notional amount of \$5,927,924 and \$6,213,156 at September 30, 2017 and 2016, respectively. Under the agreement, NCHS pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The interest rate swap agreement terminates on June 1, 2026. The swap is valued at \$102,715 and \$(138,518) at September 30, 2017 and 2016, respectively.

Management has designated the interest rate swap agreements as cash flow hedging instruments. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of unrestricted net assets and reclassified into excess revenues over expenses in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current excess revenues over expenses.

The table below presents certain information regarding NCHS' interest rate swap agreements designated as cash flow hedges. NCHS did not have any derivative instruments at September 30, 2017 and 2016, that were not designated as hedging instruments.

|   | <b>2017</b>    | <b>2016</b>    |
|---|----------------|----------------|
| <b>Other Liabilities</b>  |                |                |
| Fair value of interest rate swap agreements                                       | \$ (1,445,525) | \$ (2,479,832) |
| <b>Changes in Unrestricted Net Assets</b>   |                |                |
| Change in interest rate swap agreements   | 1,034,307      | (331,635)      |
| <b>Interest Expense</b>   |                |                |
| Loss reclassified from unrestricted net assets into excess revenues over expenses | 200,900        | 354,888        |

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**Note 10: Deferred Compensation**

During the year ended September 30, 2002, the Hospital established the North Country Hospital Executive and Physician Stock Option Plan. This plan provides options as a form of compensation for a select group of management, physicians or highly compensated employees of the Hospital and its affiliates. The balance in this plan was \$644,377 and \$668,583 at September 30, 2017 and 2016, respectively. At September 30, 2003, this plan was frozen and no more employee contributions will be put into the plan.

During the year ended September 30, 2003, the Hospital established the Split Dollar Insurance and Death Benefit Only Programs to certain key employees of the Hospital and its affiliates. Eligible employees may elect to have a minimum of \$10,000 withheld from their compensation, up to a maximum of 75% of annual gross compensation. At September 30, 2017 and 2016, three employees were participating in this plan, with a balance of \$265,843 and \$301,378 at September 30, 2017 and 2016, respectively.

The Hospital has established a 457(b) deferred compensation plan eligible to certain key employees of the Hospital and its affiliates. At September 30, 2017 and 2016, four employees were participating in this plan with a balance of \$2,139,569 and \$1,722,187, respectively.

**Note 11: Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purpose or periods:

|                       | <b>2017</b>         | <b>2016</b>         |
|-----------------------|---------------------|---------------------|
| Healthcare services   | \$ 1,780,475        | \$ 1,632,561        |
| Purchase of equipment | 1,358,927           | 1,152,669           |
| Nursing scholarships  | 195,906             | 188,125             |
|                       | <b>\$ 3,335,308</b> | <b>\$ 2,973,355</b> |

During 2017 and 2016, net assets were released from donor restriction by incurring expenses satisfying the restricted purposes in the amount of \$124,779 and \$40,751, respectively. During 2017 and 2016, net assets of \$81,440 and \$0, respectively, were released to purchase equipment.

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Permanently restricted net assets are restricted to:

|   | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|
| Investments to be held in perpetuity, the income is expendable to support |             |             |
| Purchases of equipment  | \$ 402,631  | \$ 401,481  |
| Health care services  | 392,228     | 393,228     |
|   | \$ 794,859  | \$ 794,709  |

**Note 12: Endowments**

NCHS' endowment consists of various individual funds established for a variety of purposes. As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

NCHS' governing body has interpreted the State of Vermont Prudent Management of Institutional Funds Act (SPMIFA) as requiring preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, NCHS classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment. The remaining portion of donor-restricted endowment funds is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Hospital in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. Duration and preservation of the fund
2. Purposes of NCHS and the fund
3. General economic conditions
4. Possible effect of inflation and deflation
5. Expected total return from investment income and appreciation or depreciation of investments
6. Other resources of the NCHS
7. Investment policies of the NCHS

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The composition of net assets by type of endowment fund and changes in net assets for the years ended September 30, 2017 and 2016, were:

|   | 2017         |                        |                        | Total               |
|---|--------------|------------------------|------------------------|---------------------|
|   | Unrestricted | Temporarily Restricted | Permanently Restricted |                     |
| <b>Donor-Restricted Endowment Funds</b>     |              |                        |                        |                     |
| Endowment net assets, beginning of the year | \$ -         | \$ 2,060,979           | \$ 794,709             | \$ 2,855,688        |
| Investment return                           | -            | 392,141                | -                      | 392,141             |
| Endowment net assets, end of year           | <u>\$ -</u>  | <u>\$ 2,453,120</u>    | <u>\$ 794,709</u>      | <u>\$ 3,247,829</u> |
|   |              |                        |                        |                     |
|   | 2016         |                        |                        | Total               |
|   | Unrestricted | Temporarily Restricted | Permanently Restricted |                     |
| <b>Donor-Restricted Endowment Funds</b>     |              |                        |                        |                     |
| Endowment net assets, beginning of the year | \$ -         | \$ 1,852,675           | \$ 794,709             | \$ 2,647,384        |
| Investment return                           | -            | 208,304                | -                      | 208,304             |
| Endowment net assets, end of year           | <u>\$ -</u>  | <u>\$ 2,060,979</u>    | <u>\$ 794,709</u>      | <u>\$ 2,855,688</u> |

NCHS has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and other items supported by its endowment while seeking to maintain the purchasing power of the endowment. Under NCHS' policies, the primary investment goal is growth in the endowment accounts. NCHS expects its endowment funds to provide an average rate of return that exceeds benchmark returns indicated for various asset classes. Actual returns in any given year may vary.

To satisfy its long-term rate of return objectives, the NCHS relies on a strategy in which investment returns are achieved through both current yield and capital appreciation (both realized and unrealized). NCHS invests in a variety of securities to achieve its long-term return objectives within prudent risk constraints.

NCHS has a spending policy of appropriating amounts for expenditure that do not exceed the temporarily restricted net assets for an individual purpose. The original amount of the permanently restricted net assets is not to be spent by NCHS.

**Note 13: Charity Care**

The costs of charity care provided under NCHS' charity care policy were approximately \$615,000 and \$440,000 for 2017 and 2016, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

**Note 14: Functional Expenses**

NCHS provides health care services primarily to residents within its geographic area. Expenses related to providing these services are as follows:

|                            | <b>2017</b>   | <b>2016</b>   |
|----------------------------|---------------|---------------|
| Health care services       | \$ 71,491,069 | \$ 70,469,801 |
| General and administrative | 15,410,404    | 15,787,149    |
|                            | \$ 86,901,473 | \$ 86,256,950 |

**Note 15: Pension Plan**

The Hospital has a 403(b) defined contribution pension plan covering substantially all employees. Employee contributions, which are at the discretion of the employee, are matched by NCHS at a maximum of 50% of the employee's contributions not exceeding 5% of an employee's gross salary. Additional contributions are made to the plan based on amounts determined annually by the Board of Trustees. Pension expense was \$1,155,000 and \$1,590,000 for 2017 and 2016, respectively.

**Note 16: Disclosures About Fair Value of Financial Instruments**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Recurring Measurements***

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2017 and 2016:

|   | Fair Value          | Fair Value Measurements Using   |   |  |
|---|---------------------|---|---|--|
|   |                     | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>September 30, 2017</b>                                 |                     |   |   |  |
| Investments   |                     |   |   |  |
| Money market funds  | \$ 1,471,613        | \$ 1,471,613  | \$ -  | \$ -   |
| Mutual funds - equity                                     | 891,590             | 891,590   | -   | -  |
| Equity securities   | 31,263,569          | 31,263,569  | -   | -  |
| Exchange traded funds                                     | 140,805             | 140,805   | -   | -  |
| U.S. Treasury securities                                  | 1,898,337           | -   | 1,898,337   | -  |
| Government agencies securities                            | 249,749             | -   | 249,749   | -  |
| Corporate fixed income securities                         | 5,614,272           | -   | 5,614,272   | -  |
| Alternative investment measured<br>at net asset value (A) | <u>1,951,746</u>    |   |   |  |
| Total investments   | <u>43,481,681</u>   |   |   |  |
| Interest rate swap agreement                              | <u>(1,445,525)</u>  | -   | (1,445,525)   | -  |
| Total fair value of recurring<br>measurements             | <u>\$42,036,156</u> |   |   |  |

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

|   | Fair Value              | Fair Value Measurements Using   |   |  |
|---|-------------------------|---|---|--|
|   |                         | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>September 30, 2016</b>                                 |                         |   |   |  |
| Investments   |                         |   |   |  |
| Money market funds  | \$ 1,784,510            | \$ 1,784,510  | \$ -  | \$ -   |
| Mutual funds - equity                                     | 912,813                 | 912,813   | -   | -  |
| Equity securities   | 24,038,384              | 24,038,384  | -   | -  |
| Exchange traded funds                                     | 130,358                 | 130,358   | -   | -  |
| U.S. Treasury securities                                  | 1,405,152               | -   | 1,405,152   | -  |
| Government agencies securities                            | 585,640                 | -   | 585,640   | -  |
| Corporate fixed income securities                         | 4,506,551               | -   | 4,506,551   | -  |
| Alternative investment measured<br>at net asset value (A) | 2,100,989               | -   | -   | -  |
| Total investments   | <u>35,464,397</u>       |   |   |  |
| Interest rate swap agreement                              | <u>(2,479,832)</u>      | -   | (2,479,832)   | -  |
| <br>Total fair value of recurring<br>measurements         | <br><u>\$32,984,565</u> |   |   |  |

(A) Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts included above are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the balance sheets.

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended September 30, 2017.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

**Investments**

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. At September 30, 2017 and 2016, there were no securities classified as Level 3 within the hierarchy.

**Interest Rate Swap Agreement**

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy.

**Nonrecurring Measurements**

The following table presents the fair value measurement of assets and liabilities measured at fair values on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2016. For the year ended September 30, 2017, there were no nonrecurring measurements identified.

|                    | <b>Fair Value Measurements Using</b>  |  |  |                                       |           |
|--------------------|---|--|--|---------------------------------------|-----------|
| <b>Fair Value</b>  | <b>Quoted<br/>Prices in<br/>Active<br/>Markets for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Other<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Year to<br/>Date<br/>Gain/Loss</b> |           |
| September 30, 2016 |   |  |  |                                       |           |
| Goodwill           | \$ -  | \$ -   | \$ -   | \$ -                                  | (368,000) |

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

**Note 17: The Fair Value Option**

As permitted by Topic 825, NCHS has elected to measure its hedge fund investment at fair value. Management has elected the fair value option for these items because it more accurately reflects the portfolio returns and financial position of NCHS. The fair value of the hedge investments at September 30, 2017 and 2016, is \$1,951,746 and \$2,100,989, respectively.

See *Note 4* for additional disclosures regarding fair value of the hedge fund listed in the preceding paragraph.

***Changes in Fair Value***

Changes in fair value for items for which the fair value option has been elected are reported as investment return in other income (expense) in the financial statements. The change for 2017 and 2016 was a decrease of \$149,243 and \$112,619, respectively, which reflects all investment return from the hedge fund investment.

**Note 18: Significant Estimates and Concentrations**

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

***Allowance for Net Patient Service Revenue Adjustments***

Estimates of allowances for adjustments included in net patient service revenue are described in *Notes 1* and *2*.

***Contingencies***

Estimates related to the accrual for medical malpractice claims, employee health insurance, workers' compensation and employee unemployment insurance are described in *Notes 1* and *6*.

***Litigation***

In the normal course of business, NCHS is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the NCHS' self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. NCHS evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

**North Country Health Systems, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2017 and 2016**

***Interest Rate Swap Agreements***

As discussed in *Note 9*, NCHS has recorded a liability representing estimated fair value of the interest rate swap agreement.

***Asset Retirement Obligation***

As discussed in *Note 19*, NCHS has recorded a liability for its conditional asset retirement obligations related to asbestos abatement.

***Investments***

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated balance sheets.

**Note 19: Asset Retirement Obligation**

Accounting principles generally accepted in the United States of America require that an asset retirement obligation (ARO) associated with the retirement of a tangible long-lived asset be recognized as a liability in the period in which it is incurred or becomes determinable (as defined by the standard). NCHS' conditional asset retirement obligations primarily relate to asbestos contained in buildings that the NCHS owns. Environmental regulations exist that require NCHS to handle and dispose of asbestos in a special manner if a building undergoes major renovations or is demolished. A liability of \$87,050 and \$77,473 has been recognized in the accompanying 2017 and 2016 financial statements, respectively, for the portion of the liability that can be reasonably estimated.

**Note 20: Contract Pharmacy Program**

NCHS participates in the 340B outpatient drug discount program administered by the Office of Pharmacy Affairs of the Health Resources and Services Administration (HRSA). NCHS contracts with local retail pharmacies under the program, which resulted in significant additional revenues and discounts of outpatient pharmaceuticals. In 2017 and 2016, net revenue from this program was approximately \$2,740,000 and \$2,640,000, respectively, greater than the cost of operating the program. The benefits from this program allow NCHS to continue to provide, improve and expand access to health care services in the surrounding communities. Laws and regulations surrounding the 340B drug program are complex and are subject to interpretation and change.

## **Supplementary Information**

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Balance Sheet Information**  
**September 30, 2017**

|   | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations        | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green      | Eliminations          | Consolidated<br>Total |
|---|--|---|---------------------|--|---------------------------------|---------------------|-----------------------|-----------------------|
| <b>Current Assets</b>   |  |   |                     |  |                                 |                     |                       |                       |
| Cash and cash equivalents                                       | \$ 1,567,456                                   | \$ 304,034  | \$ -                | \$ 1,871,490   | \$ 237,880                      | \$ 29,675           | \$ -                  | \$ 2,139,045          |
| Patient accounts receivable,<br>net of allowance                | 7,016,024                                      | 94,226  | -                   | 7,110,250  | -                               | 143,058             | -                     | 7,253,308             |
| Other receivables   | 510,081  | -   | (46,767)            | 463,314  | -                               | -                   | -                     | 463,314               |
| Due from affiliate  | 182,907  | 77,145  | (77,145)            | 182,907  | -                               | -                   | (182,907)             | -                     |
| Supplies  | 2,433,140                                      | -   | -                   | 2,433,140  | -                               | 100                 | -                     | 2,433,240             |
| Estimated amounts due from<br>third-party payers                | 100,955  | -   | -                   | 100,955  | -                               | -                   | -                     | 100,955               |
| Prepaid expenses and other                                      | 1,176,800                                      | -   | -                   | 1,176,800  | 710                             | 23,535              | -                     | 1,201,045             |
| Total current assets  | <u>12,987,363</u>                              | <u>475,405</u>  | <u>(123,912)</u>    | <u>13,338,856</u>  | <u>238,590</u>                  | <u>196,368</u>      | <u>(182,907)</u>      | <u>13,590,907</u>     |
| <b>Assets Limited As To Use</b>                                 |  |   |                     |  |                                 |                     |                       |                       |
| Internally designated   | 38,599,398                                     | -   | -                   | 38,599,398   | -                               | 476,348             | -                     | 39,075,746            |
| Externally restricted by donors<br>Held by trustee              | 3,247,828                                      | -   | -                   | 3,247,828  | 997,620                         | -                   | -                     | 4,245,448             |
| Under deferred compensation<br>arrangements                     | 3,049,789                                      | -   | -                   | 3,049,789  | -                               | -                   | -                     | 3,049,789             |
|   | <u>44,897,015</u>                              | <u>-</u>  | <u>-</u>            | <u>44,897,015</u>  | <u>997,620</u>                  | <u>476,348</u>      | <u>-</u>              | <u>46,370,983</u>     |
| <b>Property and Equipment, At Cost</b>                          | 75,320,123                                     | 44,094  | -                   | 75,364,217   | -                               | 1,506,206           | -                     | 76,870,423            |
| Less accumulated depreciation                                   | 50,622,197                                     | 23,581  | -                   | 50,645,778   | -                               | 991,039             | -                     | 51,636,817            |
|   | <u>24,697,926</u>                              | <u>20,513</u>   | <u>-</u>            | <u>24,718,439</u>  | <u>-</u>                        | <u>515,167</u>      | <u>-</u>              | <u>25,233,606</u>     |
| <b>Other Assets</b>   |  |   |                     |  |                                 |                     |                       |                       |
| Interest in net assets of North<br>Country Health Systems, Inc. | 882,188  | -   | -                   | 882,188  | -                               | -                   | (882,188)             | -                     |
| Other   | 286,518  | -   | (261,251)           | 25,267   | 5,000                           | -                   | -                     | 30,267                |
|   | <u>1,168,706</u>                               | <u>-</u>  | <u>(261,251)</u>    | <u>907,455</u>   | <u>5,000</u>                    | <u>-</u>            | <u>(882,188)</u>      | <u>30,267</u>         |
| Total assets  | <u>\$ 83,751,010</u>                           | <u>\$ 495,918</u>   | <u>\$ (385,163)</u> | <u>\$ 83,861,765</u>   | <u>\$ 1,241,210</u>             | <u>\$ 1,187,883</u> | <u>\$ (1,065,095)</u> | <u>\$ 85,225,763</u>  |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Balance Sheet Information**  
**September 30, 2017**

|  | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green | Eliminations   | Consolidated<br>Total |
|--|--|---|--------------|--|---------------------------------|----------------|----------------|-----------------------|
| <b>Current Liabilities</b>   |  |   |              |  |                                 |                |                |                       |
| Current maturities of long-term debt                               | \$ 1,083,889                                   | \$ -  | \$ -         | \$ 1,083,889   | \$ -                            | \$ 15,748      | \$ -           | \$ 1,099,637          |
| Accounts payable   | 2,564,388                                      | 47,452  | (46,767)     | 2,565,073  | 3,376                           | 62,284         | -              | 2,630,733             |
| Accrued expenses   | 4,247,659                                      | -   | -            | 4,247,659  | -                               | 13,768         | -              | 4,261,427             |
| Resident personal funds payable                                    | -  | -   | -            | -  | -                               | 599            | -              | 599                   |
| Due to affiliate   | 77,145   | 13,047  | (77,145)     | 13,047   | 2,522                           | 180,385        | (182,907)      | 13,047                |
| Estimated amounts due to<br>third-party payers                     | 1,791,945                                      | -   | -            | 1,791,945  | -                               | -              | -              | 1,791,945             |
| Total current liabilities  | 9,765,026                                      | 60,499  | (123,912)    | 9,701,613  | 5,898                           | 272,784        | (182,907)      | 9,797,388             |
| <b>Deferred Compensation and Other</b>                             | 3,136,839                                      | -   | -            | 3,136,839  | -                               | -              | -              | 3,136,839             |
| <b>Long-Term Debt</b>  | 17,641,780                                     | -   | -            | 17,641,780   | -                               | 326,342        | -              | 17,968,122            |
| <b>Interest Rate Swap Agreement</b>                                | 1,445,525                                      | -   | -            | 1,445,525  | -                               | -              | -              | 1,445,525             |
| Total liabilities  | 31,989,170                                     | 60,499  | (123,912)    | 31,925,757   | 5,898                           | 599,126        | (182,907)      | 32,347,874            |
| <b>Net Assets</b>  |  |   |              |  |                                 |                |                |                       |
| Unrestricted net assets attributable to<br>the Health System       | 47,631,673                                     | 261,251   | (261,251)    | 47,631,673   | 353,124                         | 588,757        | -              | 48,573,554            |
| Unrestricted net assets attributable to<br>noncontrolling interest | -  | 174,168   | -            | 174,168  | -                               | -              | -              | 174,168               |
| Total unrestricted net assets                                      | 47,631,673                                     | 435,419   | (261,251)    | 47,805,841   | 353,124                         | 588,757        | -              | 48,747,722            |
| Temporarily restricted   | 3,335,308                                      | -   | -            | 3,335,308  | 882,188                         | -              | (882,188)      | 3,335,308             |
| Permanently restricted   | 794,859  | -   | -            | 794,859  | -                               | -              | -              | 794,859               |
| Total net assets   | 51,761,840                                     | 435,419   | (261,251)    | 51,936,008   | 1,235,312                       | 588,757        | (882,188)      | 52,877,889            |
| Total liabilities and net assets                                   | \$ 83,751,010                                  | \$ 495,918  | (385,163)    | \$ 83,861,765  | \$ 1,241,210                    | \$ 1,187,883   | \$ (1,065,095) | \$ 85,225,763         |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Statement of Operations Information**  
**Year Ended September 30, 2017**

|   | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green | Eliminations | Consolidated<br>Total |
|---|--|---|--------------|--|---------------------------------|----------------|--------------|-----------------------|
| <b>Unrestricted Revenues, Gains and Other Support</b>   |  |   |              |  |                                 |                |              |                       |
| Net patient service revenue (net of contractual discounts and allowances)   | \$ 76,479,305                                  | \$ 726,334  | -            | \$ 77,205,639  | \$ -                            | \$ 1,702,878   | \$ -         | \$ 78,908,517         |
| Provision for uncollectible accounts  | (1,738,501)                                    | (12,857)  | -            | (1,751,358)  | -                               | -              | -            | (1,751,358)           |
| Net patient service revenue less provision for uncollectible accounts   | 74,740,804                                     | 713,477   | -            | 75,454,281   | -                               | 1,702,878      | -            | 77,157,159            |
| Other   | 7,600,493                                      | 50,545  | -            | 7,651,038  | -                               | 21,027         | -            | 7,672,065             |
| Net assets released from restriction used for operations  | -  | -   | -            | -  | 124,779                         | -              | -            | 124,779               |
| Total unrestricted revenues, gains and other support  | 82,341,297                                     | 764,022   | -            | 83,105,319   | 124,779                         | 1,723,905      | -            | 84,954,003            |
| <b>Expenses and Losses</b>  |  |   |              |  |                                 |                |              |                       |
| Salaries  | 38,756,651                                     | -   | -            | 38,756,651   | -                               | 931,302        | -            | 39,687,953            |
| Employee benefits   | 11,165,780                                     | -   | -            | 11,165,780   | -                               | 447,632        | -            | 11,613,412            |
| Supplies and other  | 28,913,611                                     | 557,884   | -            | 29,471,495   | 304,508                         | 415,299        | -            | 30,191,302            |
| Depreciation and amortization   | 4,623,123                                      | 5,789   | -            | 4,628,912  | -                               | 46,177         | -            | 4,675,089             |
| Interest  | 719,706  | -   | -            | 719,706  | -                               | 14,011         | -            | 733,717               |
| Total expenses and losses   | 84,178,871                                     | 563,673   | -            | 84,742,544   | 304,508                         | 1,854,421      | -            | 86,901,473            |
| <b>Operating Income (Loss)</b>  | (1,837,574)                                    | 200,349   | -            | (1,637,225)  | (179,729)                       | (130,516)      | -            | (1,947,470)           |
| <b>Other Income (Expense)</b>   |  |   |              |  |                                 |                |              |                       |
| Contributions received  | 108,524  | -   | -            | 108,524  | 131,528                         | -              | -            | 240,052               |
| Investment return and other-than-temporary losses   | 1,213,650                                      | -   | -            | 1,213,650  | -                               | 12,320         | -            | 1,225,970             |
| Investment return - change in fair value of investments accounted for under the fair value option of FASB ASC Topic 825 | (149,243)                                      | -   | -            | (149,243)  | -                               | -              | -            | (149,243)             |
| Gain on investments in equity investee  | 120,209  | -   | (120,209)    | -  | -                               | -              | -            | -                     |
| Other   | 73,140   | -   | -            | 73,140   | -                               | (569)          | -            | 72,571                |
| Total other income (expense)  | 1,366,280                                      | -   | (120,209)    | 1,246,071  | 131,528                         | 11,751         | -            | 1,389,350             |
| <b>Excess (Deficiency) of Revenues Over Expenses</b>  | \$ (471,294)                                   | \$ 200,349  | \$ (120,209) | \$ (391,154)   | \$ (48,201)                     | \$ (118,765)   | \$ -         | \$ (558,120)          |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Statement of Changes in Net Assets Information**  
**Year Ended September 30, 2017**

|  | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations     | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green    | Eliminations        | Consolidated<br>Total |
|--|--|---|------------------|--|---------------------------------|-------------------|---------------------|-----------------------|
| <b>Unrestricted Net Assets Attributable to the Health System</b>                           |  |   |                  |  |                                 |                   |                     |                       |
| Excess (deficiency) of revenues over expenses  | \$ (471,294)                                   | \$ 120,209  | (120,209)        | \$ (471,294)   | \$ (48,201)                     | \$ (118,765)      | \$ -                | \$ (638,260)          |
| Investment return - change in unrealized gains and losses on other than trading securities | 2,471,189                                      | -   | -                | 2,471,189  | -                               | 19,056            | -                   | 2,490,245             |
| Change in fair value of interest rate swap agreements                                      | 1,034,307                                      | -   | -                | 1,034,307  | -                               | -                 | -                   | 1,034,307             |
| Net assets released from restriction for property, plant and equipment, net                | -  | -   | -                | -  | 81,440                          | -                 | -                   | 81,440                |
| Distributions  | -  | (60,000)  | 60,000           | -  | -                               | -                 | -                   | -                     |
| Increase (decrease) in unrestricted net assets attributable to the Health System           | <u>3,034,202</u>                               | <u>60,209</u>   | <u>(60,209)</u>  | <u>3,034,202</u>   | <u>33,239</u>                   | <u>(99,709)</u>   | <u>-</u>            | <u>2,967,732</u>      |
| <b>Unrestricted Net Assets Attributable to Noncontrolling Interest</b>                     |  |   |                  |  |                                 |                   |                     |                       |
| Excess of revenues over expenses   | -  | 80,140  | -                | 80,140   | -                               | -                 | -                   | 80,140                |
| Distributions to noncontrolling interest   | -  | (40,000)  | -                | (40,000)   | -                               | -                 | -                   | (40,000)              |
| Increase in unrestricted net assets attributable to noncontrolling interest                | <u>-</u>                                       | <u>40,140</u>   | <u>-</u>         | <u>40,140</u>  | <u>-</u>                        | <u>-</u>          | <u>-</u>            | <u>40,140</u>         |
| Increase (decrease) in unrestricted net assets   | <u>3,034,202</u>                               | <u>100,349</u>  | <u>(60,209)</u>  | <u>3,074,342</u>   | <u>33,239</u>                   | <u>(99,709)</u>   | <u>-</u>            | <u>3,007,872</u>      |
| <b>Temporarily Restricted Net Assets</b>   |  |   |                  |  |                                 |                   |                     |                       |
| Contributions received   | -  | -   | -                | -  | 102,096                         | -                 | -                   | 102,096               |
| Change in interest in net assets of North Country Health Systems, Inc.                     | (30,188)                                       | -   | -                | (30,188)   | -                               | -                 | 30,188              | -                     |
| Investment return - change in unrealized gains and losses on other than trading securities | 392,141  | -   | -                | 392,141  | 73,935                          | -                 | -                   | 466,076               |
| Net assets released from restriction   | -  | -   | -                | -  | (206,219)                       | -                 | -                   | (206,219)             |
| Increase in temporarily restricted net assets  | <u>361,953</u>                                 | <u>-</u>  | <u>-</u>         | <u>361,953</u>   | <u>(30,188)</u>                 | <u>-</u>          | <u>30,188</u>       | <u>361,953</u>        |
| <b>Permanently Restricted Net Assets</b>   |  |   |                  |  |                                 |                   |                     |                       |
| Contributions received   | 150  | -   | -                | 150  | -                               | -                 | -                   | 150                   |
| Increase in permanently restricted net assets  | <u>150</u>                                     | <u>-</u>  | <u>-</u>         | <u>150</u>   | <u>-</u>                        | <u>-</u>          | <u>-</u>            | <u>150</u>            |
| <b>Change in Net Assets</b>  | <u>3,396,305</u>                               | <u>100,349</u>  | <u>(60,209)</u>  | <u>3,436,445</u>   | <u>3,051</u>                    | <u>(99,709)</u>   | <u>30,188</u>       | <u>3,369,975</u>      |
| <b>Net Assets, Beginning of Year</b>   | <u>48,365,535</u>                              | <u>335,070</u>  | <u>(201,042)</u> | <u>48,499,563</u>  | <u>1,232,261</u>                | <u>688,466</u>    | <u>(912,376)</u>    | <u>49,507,914</u>     |
| <b>Net Assets, End of Year</b>   | <u>\$ 51,761,840</u>                           | <u>\$ 435,419</u>   | <u>(261,251)</u> | <u>\$ 51,936,008</u>   | <u>\$ 1,235,312</u>             | <u>\$ 588,757</u> | <u>\$ (882,188)</u> | <u>\$ 52,877,889</u>  |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Balance Sheet Information**  
**September 30, 2016**

|   | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations        | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green      | Eliminations          | Consolidated<br>Total |
|---|--|---|---------------------|--|---------------------------------|---------------------|-----------------------|-----------------------|
| <b>Current Assets</b>   |  |   |                     |  |                                 |                     |                       |                       |
| Cash and cash equivalents                                       | \$ 2,562,859                                   | \$ 409,907  | \$ -                | \$ 2,972,766   | \$ 231,065                      | \$ 35,262           | \$ -                  | \$ 3,239,093          |
| Patient accounts receivable,<br>net of allowance                | 6,942,034                                      | 73,023  | -                   | 7,015,057  | -                               | 176,829             | -                     | 7,191,886             |
| Other receivables   | 1,050,690                                      | -   | (82,864)            | 967,826  | -                               | -                   | -                     | 967,826               |
| Due from affiliate  | 100,992  | -   | -                   | 100,992  | -                               | -                   | (100,992)             | -                     |
| Supplies  | 2,530,946                                      | -   | -                   | 2,530,946  | -                               | 100                 | -                     | 2,531,046             |
| Estimated amounts due from<br>third-party payers                | 363,316  | -   | -                   | 363,316  | -                               | -                   | -                     | 363,316               |
| Prepaid expenses and other                                      | 979,462  | -   | -                   | 979,462  | 500                             | 24,273              | -                     | 1,004,235             |
| Total current assets  | <u>14,530,299</u>                              | <u>482,930</u>  | <u>(82,864)</u>     | <u>14,930,365</u>  | <u>231,565</u>                  | <u>236,464</u>      | <u>(100,992)</u>      | <u>15,297,402</u>     |
| <b>Assets Limited As To Use</b>                                 |  |   |                     |  |                                 |                     |                       |                       |
| Internally designated   | 31,055,457                                     | -   | -                   | 31,055,457   | -                               | 444,972             | -                     | 31,500,429            |
| Externally restricted by donors<br>Held by trustee              | 2,855,687                                      | -   | -                   | 2,855,687  | 981,474                         | -                   | -                     | 3,837,161             |
| Under deferred compensation<br>arrangements                     | 2,692,148                                      | -   | -                   | 2,692,148  | -                               | -                   | -                     | 2,692,148             |
|   | <u>36,603,292</u>                              | <u>-</u>  | <u>-</u>            | <u>36,603,292</u>  | <u>981,474</u>                  | <u>444,972</u>      | <u>-</u>              | <u>38,029,738</u>     |
| Less amount required to meet<br>current obligations             | -  | -   | -                   | -  | -                               | -                   | -                     | -                     |
|   | <u>36,603,292</u>                              | <u>-</u>  | <u>-</u>            | <u>36,603,292</u>  | <u>981,474</u>                  | <u>444,972</u>      | <u>-</u>              | <u>38,029,738</u>     |
| <b>Property and Equipment, At Cost</b>                          | 73,927,209                                     | 44,094  | -                   | 73,971,303   | -                               | 1,480,552           | -                     | 75,451,855            |
| Less accumulated depreciation                                   | 47,111,821                                     | 17,792  | -                   | 47,129,613   | -                               | 947,962             | -                     | 48,077,575            |
|   | <u>26,815,388</u>                              | <u>26,302</u>   | <u>-</u>            | <u>26,841,690</u>  | <u>-</u>                        | <u>532,590</u>      | <u>-</u>              | <u>27,374,280</u>     |
| <b>Other Assets</b>   |  |   |                     |  |                                 |                     |                       |                       |
| Interest in net assets of North Country<br>Health Systems, Inc. | 912,376  | -   | -                   | 912,376  | -                               | -                   | (912,376)             | -                     |
| Other   | 878,662  | -   | (201,042)           | 677,620  | 27,000                          | -                   | -                     | 704,620               |
|   | <u>1,791,038</u>                               | <u>-</u>  | <u>(201,042)</u>    | <u>1,589,996</u>   | <u>27,000</u>                   | <u>-</u>            | <u>(912,376)</u>      | <u>704,620</u>        |
| Total assets  | <u>\$ 79,740,017</u>                           | <u>\$ 509,232</u>   | <u>\$ (283,906)</u> | <u>\$ 79,965,343</u>   | <u>\$ 1,240,039</u>             | <u>\$ 1,214,026</u> | <u>\$ (1,013,368)</u> | <u>\$ 81,406,040</u>  |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Balance Sheet Information**  
**September 30, 2016**

|  | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green | Eliminations   | Consolidated<br>Total |
|--|--|---|--------------|--|---------------------------------|----------------|----------------|-----------------------|
| <b>Current Liabilities</b>   |  |   |              |  |                                 |                |                |                       |
| Current maturities of long-term debt                               | \$ 1,139,123                                   | \$ -  | \$ -         | \$ 1,139,123   | \$ -                            | \$ 15,135      | \$ -           | \$ 1,154,258          |
| Accounts payable   | 1,820,154                                      | 83,452  | (82,864)     | 1,820,742  | 7,778                           | 51,625         | (35,141)       | 1,845,004             |
| Accrued expenses   | 4,090,913                                      | -   | -            | 4,090,913  | -                               | 50,018         | -              | 4,140,931             |
| Resident personal funds payable                                    | -  | -   | -            | -  | -                               | 892            | -              | 892                   |
| Due to affiliate   | -  | 90,710  | -            | 90,710   | -                               | 65,851         | (65,851)       | 90,710                |
| Estimated amounts due to<br>third-party payers                     | 487,116  | -   | -            | 487,116  | -                               | -              | -              | 487,116               |
| Total current liabilities  | 7,537,306                                      | 174,162   | (82,864)     | 7,628,604  | 7,778                           | 183,521        | (100,992)      | 7,718,911             |
| <b>Deferred Compensation and Other</b>                             | 2,769,621                                      | -   | -            | 2,769,621  | -                               | -              | -              | 2,769,621             |
| <b>Long-Term Debt</b>  | 18,587,723                                     | -   | -            | 18,587,723   | -                               | 342,039        | -              | 18,929,762            |
| <b>Interest Rate Swap Agreement</b>                                | 2,479,832                                      | -   | -            | 2,479,832  | -                               | -              | -              | 2,479,832             |
| Total liabilities  | 31,374,482                                     | 174,162   | (82,864)     | 31,465,780   | 7,778                           | 525,560        | (100,992)      | 31,898,126            |
| <b>Net Assets</b>  |  |   |              |  |                                 |                |                |                       |
| Unrestricted net assets attributable to<br>the Health System       | 44,597,471                                     | 201,042   | (201,042)    | 44,597,471   | 319,885                         | 688,466        | -              | 45,605,822            |
| Unrestricted net assets attributable to<br>noncontrolling interest | -  | 134,028   | -            | 134,028  | -                               | -              | -              | 134,028               |
| Total unrestricted net assets                                      | 44,597,471                                     | 335,070   | (201,042)    | 44,731,499   | 319,885                         | 688,466        | -              | 45,739,850            |
| Temporarily restricted   | 2,973,355                                      | -   | -            | 2,973,355  | 912,376                         | -              | (912,376)      | 2,973,355             |
| Permanently restricted   | 794,709  | -   | -            | 794,709  | -                               | -              | -              | 794,709               |
| Total net assets   | 48,365,535                                     | 335,070   | (201,042)    | 48,499,563   | 1,232,261                       | 688,466        | (912,376)      | 49,507,914            |
| Total liabilities and net assets                                   | \$ 79,740,017                                  | \$ 509,232  | \$ (283,906) | \$ 79,965,343  | \$ 1,240,039                    | \$ 1,214,026   | \$ (1,013,368) | \$ 81,406,040         |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Statement of Operations Information**  
**Year Ended September 30, 2016**

|   | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green | Eliminations | Consolidated<br>Total |
|---|--|---|--------------|--|---------------------------------|----------------|--------------|-----------------------|
| <b>Unrestricted Revenues, Gains and Other Support</b>   |  |   |              |  |                                 |                |              |                       |
| Net patient service revenue (net of contractual discounts and allowances)   | \$ 78,538,688                                  | \$ 720,194  | \$ -         | \$ 79,258,882  | \$ -                            | \$ 1,697,187   | \$ -         | \$ 80,956,069         |
| Provision for uncollectible accounts  | (2,804,196)                                    | (19,295)  | -            | (2,823,491)  | -                               | -              | -            | (2,823,491)           |
| Net patient service revenue less provision for uncollectible accounts   | 75,734,492                                     | 700,899   | -            | 76,435,391   | -                               | 1,697,187      | -            | 78,132,578            |
| Other   | 8,214,009                                      | -   | -            | 8,214,009  | -                               | 254            | -            | 8,214,263             |
| Net assets released from restriction used for operations  | -  | -   | -            | -  | 40,751                          | -              | -            | 40,751                |
| Total unrestricted revenues, gains and other support  | 83,948,501                                     | 700,899   | -            | 84,649,400   | 40,751                          | 1,697,441      | -            | 86,387,592            |
| <b>Expenses and Losses</b>  |  |   |              |  |                                 |                |              |                       |
| Salaries  | 37,646,175                                     | -   | -            | 37,646,175   | -                               | 831,865        | -            | 38,478,040            |
| Employee benefits   | 10,509,739                                     | -   | -            | 10,509,739   | -                               | 396,331        | -            | 10,906,070            |
| Supplies and other  | 30,026,513                                     | 451,077   | -            | 30,477,590   | 129,350                         | 569,673        | -            | 31,176,613            |
| Depreciation and amortization   | 4,985,672                                      | 7,026   | -            | 4,992,698  | -                               | 46,438         | -            | 5,039,136             |
| Interest  | 642,450  | -   | -            | 642,450  | -                               | 14,641         | -            | 657,091               |
| Total expenses and losses   | 83,810,549                                     | 458,103   | -            | 84,268,652   | 129,350                         | 1,858,948      | -            | 86,256,950            |
| <b>Operating Income (Loss)</b>  | 137,952  | 242,796   | -            | 380,748  | (88,599)                        | (161,507)      | -            | 130,642               |
| <b>Other Income (Expense)</b>   |  |   |              |  |                                 |                |              |                       |
| Contributions received  | (50,452)                                       | -   | -            | -  | 124,921                         | -              | -            | 124,921               |
| Contributions paid  | -  | -   | -            | (50,452)   | -                               | -              | -            | (50,452)              |
| Investment return and other-than-temporary losses   | 1,105,964                                      | -   | -            | 1,105,964  | -                               | (2,515)        | -            | 1,103,449             |
| Investment return - change in fair value of investments accounted for under the fair value option of FASB ASC Topic 825 | (112,619)                                      | -   | -            | (112,619)  | -                               | -              | -            | (112,619)             |
| Gain on investments in equity investee  | 145,678  | -   | (145,678)    | -  | -                               | -              | -            | -                     |
| Loss on extinguishment of debt  | (202,888)                                      | -   | -            | (202,888)  | -                               | -              | -            | (202,888)             |
| Loss resulting from impairment of goodwill  | (368,000)                                      | -   | -            | (368,000)  | -                               | -              | -            | (368,000)             |
| Other   | 50,320   | -   | -            | 50,320   | -                               | (250)          | -            | 50,070                |
| Total other income (expense)  | 568,003  | -   | (145,678)    | 422,325  | 124,921                         | (2,765)        | -            | 544,481               |
| <b>Excess (Deficiency) of Revenues Over Expenses</b>  | \$ 705,955                                     | \$ 242,796  | \$ (145,678) | \$ 803,073   | \$ 36,322                       | \$ (164,272)   | \$ -         | \$ 675,123            |

**North Country Health Systems, Inc.**  
**Consolidating Schedule – Statement of Changes in Net Assets Information**  
**Year Ended September 30, 2016**

|  | North Country<br>Hospital and<br>Health Center | Northeast<br>Kingdom<br>Healthcare<br>Collaborative,<br>LLC | Eliminations        | Consolidated<br>North Country<br>Hospital and<br>Health Center | North Country<br>Health Systems | Derby<br>Green    | Eliminations        | Consolidated<br>Total |
|--|--|---|---------------------|--|---------------------------------|-------------------|---------------------|-----------------------|
| <b>Unrestricted Net Assets Attributable to the Health System</b>                           |  |   |                     |  |                                 |                   |                     |                       |
| Excess (deficiency) of revenues over expenses  | \$ 705,955                                     | \$ 145,678  | \$ (145,678)        | \$ 705,955   | \$ 36,322                       | \$ (164,272)      | \$ -                | \$ 578,005            |
| Investment return - change in unrealized gains and losses on other than trading securities | 1,478,466                                      | -   | -                   | 1,478,466  | -                               | 25,058            | -                   | 1,503,524             |
| Change in fair value of interest rate swap agreement                                       | (331,635)                                      | -   | -                   | (331,635)  | -                               | -                 | -                   | (331,635)             |
| Distributions  | -  | (120,000)   | 120,000             | -  | -                               | -                 | -                   | -                     |
| Increase (decrease) in unrestricted net assets attributable to the Health System           | <u>1,852,786</u>                               | <u>25,678</u>   | <u>(25,678)</u>     | <u>1,852,786</u>   | <u>36,322</u>                   | <u>(139,214)</u>  | <u>-</u>            | <u>1,749,894</u>      |
| <b>Unrestricted Net Assets Attributable to Noncontrolling Interest</b>                     |  |   |                     |  |                                 |                   |                     |                       |
| Excess of revenues over expenses   | -  | 97,118  | -                   | 97,118   | -                               | -                 | -                   | 97,118                |
| Distributions to noncontrolling interest   | -  | (80,000)  | -                   | (80,000)   | -                               | -                 | -                   | (80,000)              |
| Increase in unrestricted net assets attributable to noncontrolling interest                | <u>-</u>                                       | <u>17,118</u>   | <u>-</u>            | <u>17,118</u>  | <u>-</u>                        | <u>-</u>          | <u>-</u>            | <u>17,118</u>         |
| Increase in unrestricted net assets  | <u>1,852,786</u>                               | <u>42,796</u>   | <u>(25,678)</u>     | <u>1,869,904</u>   | <u>36,322</u>                   | <u>(139,214)</u>  | <u>-</u>            | <u>1,767,012</u>      |
| <b>Temporarily Restricted Net Assets</b>   |  |   |                     |  |                                 |                   |                     |                       |
| Contributions received   | -  | -   | -                   | -  | 70,225                          | -                 | -                   | 70,225                |
| Change in interest in net assets of North Country Health Systems, Inc.                     | 78,192   | -   | -                   | 78,192   | -                               | -                 | (78,192)            | -                     |
| Investment return - change in unrealized gains and losses on other than trading securities | 208,304  | -   | -                   | 208,304  | 48,718                          | -                 | -                   | 257,022               |
| Net assets released from restriction   | -  | -   | -                   | -  | (40,751)                        | -                 | -                   | (40,751)              |
| Increase in temporarily restricted net assets  | <u>286,496</u>                                 | <u>-</u>  | <u>-</u>            | <u>286,496</u>   | <u>78,192</u>                   | <u>-</u>          | <u>(78,192)</u>     | <u>286,496</u>        |
| <b>Change in Net Assets</b>  | <u>2,139,282</u>                               | <u>42,796</u>   | <u>(25,678)</u>     | <u>2,156,400</u>   | <u>114,514</u>                  | <u>(139,214)</u>  | <u>(78,192)</u>     | <u>2,053,508</u>      |
| <b>Net Assets, Beginning of Year</b>   | <u>46,226,253</u>                              | <u>292,274</u>  | <u>(175,364)</u>    | <u>46,343,163</u>  | <u>1,117,747</u>                | <u>827,680</u>    | <u>(834,184)</u>    | <u>47,454,406</u>     |
| <b>Net Assets, End of Year</b>   | <u>\$ 48,365,535</u>                           | <u>\$ 335,070</u>   | <u>\$ (201,042)</u> | <u>\$ 48,499,563</u>   | <u>\$ 1,232,261</u>             | <u>\$ 688,466</u> | <u>\$ (912,376)</u> | <u>\$ 49,507,914</u>  |