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# LAKELAND REGIONAL HEALTH SYSTEMS, INC.
# AND SUBSIDIARIES

Consolidated Financial Statements

September 30, 2017

(With Independent Auditors' Report Thereon)

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

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KPMG LLP
Suite 1700
100 North Tampa Street
Tampa, FL 33602-5145

# Independent Auditors' Report

The Board of Directors
Lakeland Regional Health Systems, Inc.:

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Lakeland Regional Health Systems, Inc. and Subsidiaries (The Health System), which comprise the consolidated balance sheet as of September 30, 2017, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; 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.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 auditors' 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 Lakeland Regional Health Systems, Inc. and Subsidiaries as of September 30, 2017, and the results of its operations and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

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*Other Matter*

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying other financial information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Certified Public Accountants
December 21, 2017

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidated Balance Sheet

September 30, 2017

(In thousands)

**Assets**

| | | |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ | 24,370 |
| Current portion of assets limited as to use | | 58,337 |
| Patient accounts receivable, less allowance for uncollectible accounts of $98,489 | | 118,380 |
| Estimated third-party settlements, net | | 6,265 |
| Inventories | | 13,279 |
| Prepaid expenses and other current assets | | 15,685 |
| Total current assets | | 236,316 |
| Assets limited as to use, less current portion | | 78,313 |
| Long-term marketable securities | | 14,433 |
| Investments | | 380,632 |
| Property and equipment, net | | 535,117 |
| Pledges receivable, net | | 22,828 |
| Other assets | | 20,653 |
| Total assets | $ | 1,288,292 |

**Liabilities and Net Assets**

| | | |
|---|---|---|
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ | 39,731 |
| Employee compensation and benefits | | 46,395 |
| State of Florida medical assistance assessment | | 8,507 |
| Current portion of long-term debt | | 7,670 |
| Total current liabilities | | 102,303 |
| Long-term debt, less current portion | | 340,684 |
| Long-term liabilities | | 32,794 |
| Total liabilities | | 475,781 |
| Net assets: | | |
| Unrestricted | | 780,628 |
| Temporarily restricted | | 30,345 |
| Permanently restricted | | 1,538 |
| Total net assets | | 812,511 |
| Total liabilities and net assets | $ | 1,288,292 |

See accompanying notes to consolidated financial statements.

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidated Statement of Operations

Year ended September 30, 2017

(In thousands)

| | | |
|---|---|---|
| Unrestricted revenues and other support: | | |
| Patient service revenue (net of contractual allowances and discounts) | $ | 839,395 |
| Provision for bad debt | | (93,253) |
| Net patient service revenue | | 746,142 |
| Other revenues | | 11,699 |
| Net assets released from restrictions used in operations | | 140 |
| Total unrestricted revenues and other support | | 757,981 |
| Expenses: | | |
| Employee compensation and benefits | | 395,183 |
| Supplies | | 155,143 |
| General and administrative | | 78,510 |
| Professional fees | | 18,511 |
| State of Florida medical assistance assessment | | 8,067 |
| Depreciation | | 53,135 |
| Interest | | 20,449 |
| Total expenses | | 728,998 |
| Operating income | | 28,983 |
| Nonoperating gains (losses): | | |
| Investment income | | 36,600 |
| Equity in earnings from interests in joint venture partnerships, net of applicable taxes | | 715 |
| Gain on disposal of property and equipment | | 13 |
| Total nonoperating gains, net | | 37,328 |
| Excess of revenues, gains, and other support over expenses and losses | $ | 66,311 |

See accompanying notes to consolidated financial statements.

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidated Statement of Changes in Net Assets

Year ended September 30, 2017

(In thousands)

| | | |
|---|---|---|
| Unrestricted net assets: | | |
| Excess of revenues, gains, and other support over expenses and losses | $ | 66,311 |
| Net assets released from restrictions used for capital | | 4,376 |
| Pension related changes other than net periodic pension costs | | 266 |
| Other changes | | (281) |
| Increase in unrestricted net assets | | 70,672 |
| Temporarily restricted net assets: | | |
| Contributions | | 1,965 |
| Investment income | | 50 |
| Net assets released from restrictions | | (4,516) |
| Decrease in temporarily restricted net assets | | (2,501) |
| Increase in net assets | | 68,171 |
| Net assets, beginning of year | | 744,340 |
| Net assets, end of year | $ | 812,511 |

See accompanying notes to consolidated financial statements.

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidated Statement of Cash Flows

Year ended September 30, 2017

(In thousands)

| | | |
|---|---|---|
| Cash flows from operating activities: | | |
| Increase in net assets | $ | 68,171 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Equity in earnings from joint venture partnerships, net of applicable taxes | | (715) |
| Realized gains on investments | | (60,546) |
| Change in unrealized gains and losses on investments | | 21,984 |
| Gain on disposal of property and equipment | | (13) |
| Restricted contributions and investment income | | (2,015) |
| Depreciation | | 53,135 |
| Amortization of bond premium | | (2,692) |
| Amortization of debt issue costs | | 286 |
| Provision for bad debts | | 93,253 |
| Changes in operating assets and liabilities: | | |
| Patient accounts receivable | | (105,160) |
| Estimated third-party settlements | | (5,981) |
| Inventories | | (1,543) |
| Prepaid expenses and other current assets | | (1,270) |
| Pledges receivable, net | | 2,448 |
| Accounts payable and accrued expenses | | (3,977) |
| Employee compensation and benefits | | 2,045 |
| State of Florida medical assistance assessment | | (134) |
| Long-term liabilities | | 3,084 |
| Net cash provided by operating activities | | 60,360 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | | (129,620) |
| Proceeds from sale of property and equipment | | 35 |
| Dividends received from joint venture partnerships | | 1,391 |
| Purchases of investments and assets limited as to use | | (270,969) |
| Proceeds from sale of investments | | 270,269 |
| Purchases of held-to-maturity securities | | (81,012) |
| Proceeds from maturities of held-to-maturity securities | | 153,095 |
| Proceeds from sale of long-term marketable securities | | 401 |
| Net change in other long-term assets | | 271 |
| Net cash used in investing activities | | (56,139) |
| Cash flows from financing activities: | | |
| Restricted contributions and investment income | | 2,015 |
| Payments on capital lease obligations | | (3,546) |
| Payments on long-term debt | | (6,020) |
| Net cash used in financing activities | | (7,551) |
| Decrease in cash and cash equivalents | | (3,330) |
| Cash and cash equivalents, beginning of year | | 27,700 |
| Cash and cash equivalents, end of year | $ | 24,370 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the year for interest | $ | 25,417 |
| Cash paid during the year for federal and state income taxes | | 910 |
| Purchases of property and equipment included in accounts payable and accrued expenses | | 5,142 |

See accompanying notes to consolidated financial statements.

## (1) Organization and Summary of Significant Accounting Policies

### *(a) Organization*

Lakeland Regional Health Systems, Inc. (the Parent) is a tax-exempt parent holding company organized to promote the continued development of high-quality, cost-effective healthcare services in Lakeland, Florida (the City). The consolidated financial statements include the accounts of the Parent and its subsidiaries: Lakeland Regional Medical Center, Inc. (the Medical Center), Lakeland Regional Health Ventures, Inc. (Ventures), and Lakeland Regional Medical Center Foundation, Inc. (the Foundation). The consolidated entities are hereinafter referred to as the Health System. All significant intercompany transactions among these entities have been eliminated from the consolidated financial statements. Articles of Dissolution were filed in September 2017 dissolving Ventures effective September 30, 2017.

The Medical Center has a lease and transfer agreement (the Agreement) with the City, whereby the Medical Center was formed primarily to manage, control, govern, and lease the existing medical center facility. In consideration of the Agreement, the Medical Center must pay rent of $1.00 per operating year plus additional payments to the City, as defined by the Agreement.

On July 31, 2017, the Health System entered into a Membership and Affiliation Agreement (the Affiliation Agreement) with Orlando Health, Inc. (OHI), a Florida nonprofit corporation, to combine their respective health care systems into an integrated health care system with common objectives, fully aligned interests, and unity of purpose, utilizing a hub-and-hub organizational model for the system. The Affiliation Agreement closed on October 1, 2017. Upon closing, OHI became the sole corporate member of the Health System with certain powers reserved to the Health System. The Health System will not become a member of the OHI Obligated Group and no material change occurred to the Health System's existing indebtedness and will remain subject to existing financial terms disclosed in note 5. The Affiliation Agreement does not conflict with the Agreement with the City and the Medical Center will continue to be subject to the terms of the Agreement.

### *(b) Mission Statement*

The Health System's strategic imperative is to develop as a nationally recognized, fiscally strong and growing collaborative regional health system that improves lives by offering safe, high quality, equitable and affordable healthcare, while demonstrating an equal commitment to the promotion of individual and community health, wellness and disease prevention.

### *(c) Use of Estimates*

The preparation of these consolidated financial statements, in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### *(d) Cash and Cash Equivalents*

Cash and cash equivalents include highly liquid investments with a remaining maturity of three months or less at date of acquisition, excluding amounts included in assets limited as to use.

### *(e) Investments*

Investments include trading securities and held-to-maturity securities. The trading securities portfolio includes investments in private placement funds, debt and equity securities with readily determinable fair values and are measured at fair value in the consolidated balance sheet. Investment income (including realized gains and losses on investments, unrealized gains and losses on trading securities, interest, and dividends) is included in excess of revenues, gains, and other support over expenses and losses unless such earnings are subject to donor restrictions. Investment income that is restricted by donor stipulations is reported as an increase in temporarily restricted net assets.

The Health System invests a significant portion of its portfolio in private placement funds that are managed by Russell Investments. The funds employ an approach whereby portions of the funds are allocated to different money managers who employ distinct investment styles. The earnings and losses of the fund result from the dividends, interest, and realized and unrealized gains or losses of the financial instruments held.

Marketable securities are recorded at fair value in the consolidated balance sheet and consist of equity and debt securities. The fair value of marketable securities is based on quoted market prices.

The Health System's investment securities are managed by external investment managers that are authorized to buy and sell investment securities in accordance with the Health System's approved investment policy. Since the Health System's investment securities, excluding those designated as held-to-maturity securities, are actively managed by outside investment managers, the Health System has classified its marketable securities, assets limited as to use and investments as trading securities.

Investments which the Health System has the positive intent and ability to hold to maturity are classified as held-to-maturity and are stated at amortized cost. Such investments are limited as to use under a bond indenture agreement for capital acquisitions.

Management annually evaluates investments designated as held-to-maturity and recognizes any "other-than-temporary" losses as deductions from the performance indicator (as defined below). Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired as of September 30, 2017.

### *(f) Assets Limited as to Use*

Assets limited as to use include assets held by trustees under a malpractice funding arrangement and a bond indenture agreement. Additionally, assets limited as to use include assets internally designated by the board of directors for future capital improvements and self-insurance liability obligations. The board of directors retains control and may, at its discretion, subsequently use such assets for other purposes. Amounts expected to meet current obligations have been presented as current assets in the consolidated balance sheet at September 30, 2017. Assets limited as to use designated as trading securities are included in the consolidated balance sheet at their fair values, which are based on quoted market prices, if available or estimated using quoted market prices for similar securities. Assets limited as to use that are designated as held-to-maturity securities are stated at amortized cost.

***(g) Inventories***

Inventories consist principally of medical and surgical supplies and pharmaceuticals which are valued at the lower of cost (first-in, first-out method) or market.

***(h) Property and Equipment***

Property and equipment have been recorded at historical cost at the date of acquisition or fair value at the date of donation. The cost of repairs and maintenance is charged to expense as incurred and remodeling and refurbishing costs are capitalized. Major asset classifications and useful lives are generally in accordance with those recommended by the American Hospital Association. The straight-line method of depreciation is used for all depreciable assets. Equipment under capital leases is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation expense. Estimated useful lives by asset category are as follows:

| | |
|---|---|
| Buildings and land improvements | 5 to 50 years |
| Equipment | 3 to 10 years |

Interest costs incurred as part of related construction projects are capitalized during the period of construction. Net interest capitalized for the year ended September 30, 2017 was approximately $6,105,000.

The Health System had outstanding contracts and other commitments of approximately $126,000,000 relating to the purchase or construction of various fixed assets as of September 30, 2017.

***(i) Temporarily and Permanently Restricted Net Assets***

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

***(j) Net Patient Service Revenue and Allowances for Uncollectible Accounts and Contractuals***

The Health System has agreements with third-party payers that provide for payments to the Health System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at estimated net realizable amounts due from patients, third-party payers, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Net patient service revenue was increased by approximately $7,175,000 for the year ended September 30, 2017 for adjustments to prior year estimated third-party settlements, primarily due to final settlements received from the Medicaid fiscal intermediary for the fiscal years September 30, 2002 through September 30, 2015.

For uninsured patients who do not qualify for charity care, the Health System recognizes revenue on the basis of its standard rates for services provided or on the basis of discounted rates. The Health System's policy is to provide an uninsured patient that did not qualify for financial assistance and whose income is greater than 400% of the Federal Poverty Guidelines a discount that is calculated using a 'look-back' method. By November 15 of each year, claims for services provided during the prior 12-month period ended September 30, which were paid in full by Medicare fee-for-service and private insurers are analyzed to compute the discount percentage. The amount of discount provided to the uninsured in 2017 was 75% of standard rates. On the basis of historical experiences, a significant portion of the Health System's uninsured patients will be unable or unwilling to pay for services provided. Thus, the Health System records a significant provision for bad debts in the period the services are provided.

Patient service revenue, net of contractual allowances and discounts, before provision for bad debt recognized in the period from major payer sources is as follows at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Third-party payers | $ | 782,307 |
| Self-pay | | 57,088 |
| Net patient service revenue before provision for bad debt | $ | 839,395 |

Accounts receivable are recorded at the estimated net realizable amounts due from patients, third-party payers, and others for services rendered. The allowance for uncollectible accounts is maintained at the amount estimated to be sufficient to absorb future write-offs of bad debts, net of estimated recoveries. Patient service revenue is reduced by the provision for bad debts and accounts receivable are reduced by an allowance for uncollectable accounts. These amounts are based on management's assessment of historical and expected net collections for each major payer source, considering business and economic conditions, trends in healthcare coverage, and other collection indicators. The Health System records the provision for doubtful accounts at the time the services are provided for uninsured patients 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 Health System records the provision for doubtful accounts related to the self-pay portion of insured accounts after the insurance payment has been received. The Health System classifies pending Medicaid approval as self-pay accounts in its account receivable aging report.

The Health System's allowance for doubtful accounts for self-pay patients was 95.0% of self-pay accounts receivable at September 30, 2017. In addition, the Health System's self-pay write-offs decreased approximately $23,200,000 in 2017. The decrease is primarily due to a change in the percentage of discount provided to uninsured patients from 70% to 75% effective October 1, 2016. The Health System does not maintain a material allowance for doubtful accounts from third-party payers, nor did it have significant write-offs from third-party payers.



(Continued)

### *(k) Charity Care*

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. A patient is classified as a charity patient by reference to certain established policies of the Health System. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Partial payments to which the Health System is entitled from public assistance and other programs on behalf of patients that meet the Health System's charity care criteria are reported as net patient service revenue in the consolidated statement of operations and changes in net assets.

The Health System maintains records to identify and monitor the level of charity care and public assistance and other program services provided. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies.

Accounting Standards Update (ASU) No. 2010-23, *Measuring Charity Care for Disclosure*, requires healthcare entities to identify costs for providing care as direct or indirect, and disclose the method used to make this distinction. The Health System estimates its cost by calculating a ratio of cost to charges, and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. Charges foregone, based on established rates for charity totaled approximately $160,367,000 for the year ending September 30, 2017. The estimated cost of providing these services totaled approximately $29,668,000 during the year ending September 30, 2017.

### *(l) Excess of Revenues, Gains, and Other Support over Expenses and Losses*

The accompanying consolidated statement of operations and changes in net assets includes excess of revenues, gains, and other support over expenses and losses (the performance indicator). Changes in unrestricted net assets, which are excluded from excess of revenues, gains, and other support over expenses and losses, consistent with industry practice, include changes in defined benefit plan obligations and contributions of long-lived assets, including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets.

### *(m) Income Taxes*

The Parent, Medical Center, and Foundation have been recognized by the Internal Revenue Service as tax-exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code of 1986. Income earned in furtherance of the organizations' tax-exempt purposes is exempt from federal and state income taxes. Income taxes related to Ventures, a taxable entity, and the Health System's ownership interests in joint venture partnerships are not material to the Health System.

U.S. GAAP requires the Health System's management to evaluate tax positions taken by the Health System and recognize a tax liability (or asset) if the Health System has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service. The Health System has analyzed its tax positions and has concluded that as of September 30, 2017, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) in the consolidated financial statements or disclosure in the notes to the consolidated financial statements. The Health System is subject to routine audits by taxing jurisdictions; however, there are



(Continued)

currently no audits for any tax periods in progress. The Health System believes it is no longer subject to income tax examinations for tax years prior to 2013.

### *(n) Debt Issue Costs*

Costs incurred in connection with the issuance of long-term debt are capitalized and amortized over the life of the debt. Amortization of debt issue costs of approximately $286,000 is included in interest expense in the accompanying consolidated statement of operations for the year ended September 30, 2017. Accumulated amortization of debt issue costs is approximately $753,000 at September 30, 2017 and is recorded as a direct reduction of long-term debt.

### *(o) Bond Premiums*

Bond premiums are being amortized using the effective interest method over the life of the related debt. Long-term debt on the consolidated balance sheet includes the related unamortized bond premiums.

### *(p) Nonoperating Gains (Losses)*

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenues and expenses. Activities that result in gains or losses unrelated to the Health System's operations are considered to be nonoperating. Nonoperating gains (losses) include investment income and dividends on unrestricted investments, equity in the earnings (losses) of investment funds, equity in earnings from interests in joint venture partnerships, and gains (losses) on disposals of property and equipment.

### *(q) Donor-Restricted Gifts*

Unconditional promises to give cash and other assets to the Health System are reported at fair value at the date the promise is received. Unconditional promises to give that are expected to be collected in future years are recorded at fair value, which is measured as the present value of their future cash flows. The discounts on those amounts are computed using risk-adjusted interest rates applicable to the years in which the promises are received. Conditional promises to give are reported at fair value at the time the conditions are substantially met. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as revenue if used in operations and as a change in unrestricted net assets if used for the purchase of property and equipment. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

### *(r) Impairment of Long-Lived Assets*

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate an impairment of the value of long-lived assets. If there is an indication that the carrying amount of an asset is not recoverable, the Health System estimates the projected undiscounted cash flows from the use and eventual disposition of the asset, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss, if any, is determined by comparing the historical carrying value of the asset to its estimated fair value. There were no such impairment losses recorded during the year ended September 30, 2017.



(Continued)

In addition to consideration of impairment upon the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over the remaining lives.

### *(s) Collective Bargaining Agreements*

The Medical Center's registered nurses and technical employees are represented by the United Food and Commercial Workers Union. The registered nurse and technical employee contracts expire on April 30, 2020. Approximately 36% of the Medical Center's total employees are represented by the union contracts. The registered nurses represent 78% of the employees under union contract.

### *(t) Electronic Health Records Incentive Amounts*

Under certain provisions of the American Recovery and Reinvestment Act of 2009, federal incentive payments are available to hospitals, physicians, and certain other professionals when they adopt certified electronic health record (EHR) technology or become meaningful users of EHR technology in ways that demonstrate improved quality, safety, and effectiveness of care. Providers can become eligible for annual Medicare incentive payments by demonstrating meaningful use of EHR technology in each period over four periods. Medicaid providers can receive their initial incentive payment by adopting, implementing, or upgrading certified EHR technology in subsequent years in order to qualify for additional payments.

Hospitals may be eligible for both Medicare and Medicaid EHR incentive payments, however, physicians and other professionals may be eligible for either Medicare or Medicaid incentive payments but not both. Medicaid EHR incentive payments to providers are 100% federally funded and administered by the states; however, the states are not required to offer EHR incentive payments to providers. Revenue is recognized for Medicare and Medicaid incentive payments when the Health System complies with applicable EHR meaningful use grant requirements and payment is reasonably assured. During the year ended September 30, 2012, the Health System was entitled to receive the first year incentive payment from Medicaid by demonstrating to the state that a certified EHR system was being implemented and that the Health System had the intent to complete the implementation. During 2017, the Health System received and recognized revenue from EHR incentive payments of approximately $98,000 from Medicare and included such revenues as part of other revenues in the consolidated statement of operations.

### *(u) Recently Issued Accounting Pronouncements*

In May 2014, the Financial Accounting Standards (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* and updated through ASU 2015-14, which supersedes the revenue recognition requirements in ASC 606, *Revenue Recognition.* This ASU addresses when an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients (Topic 606)*. This ASU adds further clarification to the revenue recognition standards issued in ASU 2014-09. The Health System has not evaluated all of the provisions of these updates, which are both effective for annual reporting periods beginning after December 15, 2017 for public business entities and nonprofit entities that have publicly traded debt.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Topic 205)*, which requires management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date of the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). The Health System adopted this ASU in 2017 and the adoption did not have a material impact on the consolidated financial statements and the accompanying footnote disclosures.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value Per Share (or its Equivalent)(a Consensus of the Emerging Issues Task Force),* which eliminates the requirement to classify investments in the fair value hierarchy if their fair value is measured at net asset value (NAV) using the practical expedient. The Health System adopted this ASU in 2017.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*. This ASU removes the requirement to disclose the fair value of financial instruments at amortized cost. The Health System adopted ASU-2016-70 and removed the fair value disclosure for its fixed rate debt in 2017.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to record a lease liability that represents the lessee's future lease payments obligation and right-of-use asset that represents the lessee's right to use or control of a specified asset for the lease term. The Health System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2018 for public business entities and not-for-profit entities that have issued publicly traded debt.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958).* This ASU requires not-for-profit entities to report two classes of net assets, as well enhances disclosures on board designated funds, liquidity and functional expenses. The Health System has not evaluated all of the provisions, which are effective for fiscal years beginning after December 15, 2017.

## (2) Marketable Securities, Assets Limited as to Use and Investments

Certain investments are included in an investment pool maintained by the Health System for which the Health System and certain of its affiliated organizations are the only participants. The combined funds are included in various investment pools, which are managed by external investment managers.

Marketable securities, assets limited as to use and investments, stated at fair value, include the following at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Cash equivalents | $ | 2,999 |
| Mutual funds | | 14,433 |
| Common stock | | 570 |
| Private placement funds: | | |
| Fixed income | | 175,866 |
| Multi-asset | | 253,055 |
| Hedge fund | | 36,523 |
| | | 483,446 |
| Held-to-maturity securities recorded at amortized cost | | 48,269 |
| Less amount included in current assets | | (58,337) |
| | $ | 473,378 |

The composition of assets limited as to use is as follows at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Under malpractice funding arrangement | $ | 2,999 |
| Under bond indenture agreement for capital acquisitions | | 48,269 |
| Internally designated by the board of directors: | | |
| Capital improvement fund | | 51,312 |
| Self-insurance funds | | 34,070 |
| Total assets limited as to use | | 136,650 |
| Less amount included in current assets | | (58,337) |
| Assets limited as to use, less current portion | $ | 78,313 |

Held-to-maturity securities included in assets limited as to use are carried at amortized cost and consist of the following at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Cash and cash equivalents | $ | 28,177 |
| U.S. government agency securities | | 19,940 |
| Accrued interest | | 152 |
| | $ | 48,269 |



(Continued)

Held-to-maturity securities had gross unrealized losses of approximately $5,000 as of September 30, 2017. At September 30, 2017, the Health System did not hold securities within the held-to-maturity portfolio which had been in an unrealized loss position for over one year. At September 30, 2017, the contractual maturities of held-to-maturity securities were approximately $19,940,000 due in one year or less through January 2018.

Investment income and gains and losses on cash equivalents, marketable securities, assets limited as to use, and investments are composed of the following during the year ended September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Nonoperating gains (losses): | | |
| Interest and dividend income | $ | 18 |
| Realized gains, net of investment fees | | 58,566 |
| Unrealized gains (losses), net | | (21,984) |
| Total | $ | 36,600 |
| Changes in temporarily restricted net assets: | | |
| Interest income | $ | 12 |
| Unrealized gains (losses), net | | 38 |
| Total | $ | 50 |

## (3) Property and Equipment

The components of property and equipment are as follows at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| Land | $ | 28,623 |
| Land improvements | | 19,381 |
| Building and improvements | | 304,521 |
| Equipment | | 714,444 |
| | | 1,066,969 |
| Less accumulated depreciation | | (670,778) |
| | | 396,191 |
| Construction in progress | | 138,926 |
| Total | $ | 535,117 |

Included in equipment are assets leased under capital leases with a net book value of approximately $3,572,000 at September 30, 2017.



(Continued)

## (4) Estimated Third-Party Settlements

Estimated third-party settlements include amounts payable or receivable from the Medicare and Medicaid programs. A summary of the significant payment arrangements with these programs is as follows:

### *(a) Medicare*

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on diagnosis and other factors. Also, capital costs and outpatient services are reimbursed at prospectively determined rates. The Health System is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after audit by the fiscal intermediary. The Health System's Medicare cost reports have been audited and a Notice of Program Reimbursement was issued by the Fiscal Intermediary through September 30, 2014.

### *(b) Medicaid*

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology, subject to certain limitations. The Health System's payment rates are calculated based on allowable costs included in the most recently filed cost report available at the time of the payment calculation. The Health System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Medicaid regulations provide for retroactive settlements between the Health System and the Medicaid program if differences exist in allowable costs between the filed cost report and the audited cost reports. The Health System's Medicaid settlements have been audited by the Medicaid fiscal intermediary through September 30, 2015.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Health System is aware of these laws and regulations and, to the best of its knowledge and belief, is in compliance. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

## (5) Long-Term Debt and Capital Lease Obligations

The Obligated Group, which includes the Medical Center and the Parent, is obligated under long-term debt as follows at September 30, 2017 (in thousands):

| | | |
|---|---|---|
| City of Lakeland, Florida, Hospital Revenue Refunding Bonds, Series 2016, including $83,245 of serial bonds due in varying amounts through November 2032, with interest rates from 3.00% to 5.00% | $ | 83,245 |
| City of Lakeland, Florida, Hospital Revenue Bonds, Series 2015, including $31,815 of 5.00% serial bonds due in varying amounts through November 2033, $64,875 of 5.00% term bonds due November 2040, and $83,310 of 5.00% term bonds due November 2045 | | 180,000 |
| City of Lakeland, Florida, Hospital Revenue Refunding Bonds, Series 2011, refunding of the Refunded 1996, 1997 and 1999 bonds including $77,580 of serial bonds due in varying amounts through November 2025, with interest rates from 2.00% to 5.00% | | 50,150 |
| | | 313,395 |
| Unamortized premiums and debt issue costs, net | | 34,959 |
| | | 348,354 |
| Less current portion | | (7,670) |
| | $ | 340,684 |

Maturities of long-term debt as of September 30, 2017 are as follows (in thousands):

| | | |
|---|---|---|
| 2018 | $ | 7,670 |
| 2019 | | 8,040 |
| 2020 | | 8,425 |
| 2021 | | 8,850 |
| 2022 | | 9,295 |
| Thereafter | | 271,115 |
| | | 313,395 |
| Unamortized premiums and debt issue costs, net | | 34,959 |
| | $ | 348,354 |

In 2016, the Health System issued $83,245,000 in Hospital Revenue Refunding Bonds through the City of Lakeland, Florida (Series 2016 Bonds) for the purpose of refunding the outstanding indebtedness of the Series 2006 Bonds. The Series 2016 Bonds include serial bonds with maturities ranging from November 15, 2017 to November 15, 2032, with fixed rate coupons ranging from 3.00% to 5.00%. The Health System incurred approximately $938,000 in debt issuance costs as part of the issuance of the Series 2016 Bonds. The proceeds from the Series 2016 Bonds were placed in an irrevocable trust in order to satisfy remaining scheduled principal and interest payments of the Series 2006 Bonds. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust account have contractually relieved the Health System of any future obligations with respect to the Series 2006 Bonds, and the debt is not considered a liability of the Health System as of September 30, 2017. Therefore, such debt has been derecognized.

In 2015, the Health System issued $180,000,000 in Hospital Revenue Bonds through the City of Lakeland, Florida (Series 2015 Bonds) for the purpose of financing capital projects. The Series 2015 Bonds include serial and term bonds with maturities ranging from November 15, 2033 to November 15, 2045, with a fixed rate coupon of 5.00%. The Series 2015 Bonds are subject to a mandatory redemption at a redemption price equal to the outstanding principal plus accrued interest at the redemption date if, at least 180 days prior to the scheduled expiration date of the term of the Agreement with the City (note 9), the bond trustee has not received written notice from the Health System that the Agreement has been extended. The Health System incurred approximately $1,924,000 in debt issuance costs as part of the issuance of the Series 2015 Bonds.

As part of the issuance of the Series 2015 Bonds, the Health System received approximately $205,545,000 in proceeds from the sale of the bonds. The proceeds were placed into an escrow account with a custodian to be used by the Health System for eligible capital projects. Such amounts are invested in cash and U.S. government agency securities and are included as part of assets limited as to use in the consolidated balance sheet. The Health System made eligible draws on the escrow account of approximately $72,082,000 during the year ending September 30, 2017.

Prior to 2015, the Series 2006 and 2011 Bonds were secured under the Series 1999 Master Trust Indenture. In conjunction with the issuance of the Series 2015 Bonds, the 1999 Master Trust was amended and restated in its entirety effective February 1, 2015 for the purpose of, among others, substituting new covenants, modifying existing covenants and redefining terms to more accurately reflect the purpose of the Series 1999 Master Trust Indenture. The Series 2015 Master Trust Indenture secures all outstanding obligations under the Series 2016, 2015, and Series 2011. The Series 2015 Master Trust Indenture contains covenants that require, among other things, the maintenance of certain ratios. These ratios are calculated based on the Obligated Group’s financial position and results of operations. Principal and interest payments are secured by the gross revenues and accounts (after payment of operating expenses) of the Obligated Group as defined in the Series 2015 Master Trust Indenture.

The Health System has capital lease arrangements primarily comprised of medical equipment. These capital lease arrangements incur interest at rates ranging between 2.02% and 6.83% with maturities through November 2018. Future minimum capital lease payments under these arrangements as of September 30, 2017 are as follows (in thousands):

| | | |
|---|---|---|
| Year ending September 30: | | |
| 2018 | $ | 1,394 |
| 2019 | | 65 |
| | | 1,459 |
| Less amounts representing interest | | (216) |
| Present value of minimum lease payments | | 1,243 |
| Current installments of obligations under capital leases (included as a component of accounts payable and accrued expenses) | | (1,243) |
| Obligations under capital leases, excluding current installments | $ | — |

## (6) Long-Term Liabilities

Long-term liabilities are comprised of the following (in thousands):

| | | |
|---|---|---|
| State of Florida medical assistance assessment | $ | 4,277 |
| Section 457(f) defined benefit plan liability | | 6,448 |
| Section 457(f) defined contribution plan liability | | 633 |
| Workers' compensation claims | | 683 |
| Accrued malpractice liability | | 20,338 |
| Pledge commitments | | 100 |
| Rent abatement liability | | 315 |
| | $ | 32,794 |

## (7) Employee Benefits

The Health System provides retirement and other benefits to substantially all employees through several benefit plans. Under the defined-contribution plans (the Plans), for all employee groups who meet minimum service requirements, the Health System provides a contribution of 3% of eligible employee wages up to the taxable wage base for Social Security tax purposes for each plan year and 6% of eligible employee wages in excess of the taxable wage base for each plan year up to IRS limits. Additionally, the Health System provides a matching contribution of 50% of employee deferred contributions not to exceed 2% of the taxable wage base for Social Security. In addition to the calculated annual contributions, the board of directors may establish an additional discretionary contribution to be made to the Plans for each year.

Employees are fully vested after completing three years of service with at least 1,000 hours of service in each year.

The Health System provides a Supplemental Executive Retirement Plan (SERP) under Section 457(f) of the Internal Revenue Code. The SERP is a nonqualified defined-benefit plan limited to generally certain management or highly compensated employees as determined by the Health System. Upon vesting, the SERP provides participants with deferred compensation annually for 20 years, equal to 2% of the participant's final average compensation multiplied by his/her years of service (up to a maximum of 25 years of service). Compensation is based on participants' average compensation during the last three complete calendar years. Only calendar years beginning on or after January 1, 2004 are considered. Full vesting is generally effective after a participant completes 10 years of service with the Health System; however, the initial participants had individual vesting schedules. The SERP also provides for certain death or disability benefits. The actuarially computed net periodic benefit cost for the Health System's SERP for the year ended September 30, 2017 totaled approximately $1,285,000. The net periodic benefit cost was determined based on a discount rate of 3.50% for the year ended September 30, 2017, with an assumed rate of compensation increase of 5.00% for the year ending September 30, 2017.

The SERP's accrued benefit cost at September 30, 2017 was approximately $6,657,000. Of these amounts, approximately $6,448,000 is included in long-term liabilities in the accompanying consolidated balance sheet at September 30, 2017. At September 30, 2017, the SERP's accrued benefit cost expected to be paid in 2018 is $209,000 and is included in employee compensation and benefits in the accompanying consolidated balance sheet. These amounts were actuarially determined using a discount rate of 3.75% for the year ended September 30, 2017, with an assumed rate of compensation increase of 5.00% at September 30, 2017. The accumulated benefit obligation for the SERP was $4,216,000 at September 30, 2017.

The benefits expected to be paid in each year from 2019 through 2022 are approximately $2,865,000, $174,000, $3,852,000 and $2,714,000 respectively. No benefits are expected to be paid beyond 2022. The expected benefits are based on the same assumptions used to measure the Health System's benefit obligations at September 30, 2017 and include estimated future employee service.

In 2015, the Health System implemented a new Supplemental Executive Defined Contribution Plan (DC SERP) under Section 457(f) of the Internal Revenue Code. The DC SERP is limited to certain members of management as determined by the Health System. The DC SERP provides annual contributions equal to 15% of eligible compensation, as defined by the plan, over a ten year period. The contributions will also be credited with a discretionary fixed interest rate (5.00% in 2017) as determined by the board of directors. Participants are vested 20% after two years of plan participation, and increases 10% per year of participation thereafter. The DC SERP's accrued benefit cost during the year ended September 30, 2017 was approximately $252,000.

Expenses incurred for all employee retirement plans were approximately $12,866,000 for the year ended September 30, 2017, which is included in employee compensation and benefits expense in the accompanying consolidated statement of operations and changes in net assets.



(Continued)

## (8) Functional Expenses

The Health System does not present expense information by functional classification because its resources and activities are primarily related to providing healthcare services. Further, since the Health System receives substantially all of its resources from providing healthcare services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged its stewardship responsibilities.

## (9) Commitments and Contingencies

### *(a) City Lease Obligation*

Under the terms of the Agreement prior to fiscal year 2016, annual rent of $1.00 per operating year plus additional payments were made to the City of Lakeland (the City) based on a formula, which took into consideration the net revenues of the Medical Center, and net income of certain affiliated organizations, as defined in the Agreement.

An amendment to the Agreement was reached and became effective October 1, 2015. The amendment provided a lump sum payment of $15,000,000 to the City on October 1, 2015, with fixed annual additional payments due beginning in fiscal year ending September 30, 2016 through fiscal year ending September 30, 2040. The additional payment for the fiscal year ending September 30, 2017 was approximately $13,619,000 and will increase by 2.75% per operating year through the duration of the Agreement. The Health System recognized the lump sum payment of $15,000,000 to the City as a deferred charge included as part of other assets in the accompanying consolidated balance sheet as of September 30, 2017 and is amortizing the payment on a straight-line basis over the 25 year term. Expenses under the terms of the amended Agreement, included in interest expense in the accompanying consolidated statement of operations was approximately $14,219,000 during the year ended September 30, 2017.

### *(b) Operating Leases*

The Health System leases equipment and facilities under operating leases expiring at various dates through 2023. Minimum future rental payments under noncancelable operating leases having terms in excess of one year are as follows (in thousands):

| | | |
|---|---|---|
| 2018 | $ | 3,195 |
| 2019 | | 2,950 |
| 2020 | | 2,229 |
| 2021 | | 2,056 |
| 2022 | | 2,109 |
| Thereafter | | 1,446 |
| | $ | 13,985 |

Rental expense under operating leases amounted to approximately $4,958,000 for the year ended September 30, 2017, respectively, and is included in general and administrative expenses in the consolidated statement of operations.



(Continued)

***(c) Litigation***

During the normal course of business, the Health System is involved in litigation with respect to professional liability claims and other matters. In addition, the Health System is subject to periodic regulatory investigations. The Health System has purchased insurance coverage to minimize its exposure to such risk. This coverage includes property, directors and officers, vehicles, medical malpractice, and general liability. Each policy has its own deductible and/or self-insurance retention.

***(d) Professional Malpractice Insurance***

As a provider of healthcare services, the Health System is subject to malpractice claims. The Health System is substantially self-insured for malpractice and general liability claims and related expenses. The Health System's current malpractice insurance policy provides for claims-made coverage. Under its current insurance coverage, the Health System's limit is $50 million (inclusive of defense costs) with a self-insured retention of $3 million per claim and an inner-aggregate deductible of $2 million. The Health System's self-insured retention exposure is capped by a single annual aggregate of $18 million (inclusive of defense costs).

Losses from both asserted and unasserted claims are accrued based on estimates that incorporate the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of incurred but not reported amounts. The Health System has engaged an independent actuary to estimate ultimate losses to be accrued. The Health System has internally designated certain funds for the payment of professional liability claim settlements. The balances of the internally designated funds were approximately $31,710,000 as of September 30, 2017, and are included in assets limited as to use in the accompanying consolidated balance sheet. Additionally, the Health System maintains funds in the amount of approximately $2,999,000 held in a separate trust account to fund professional liability claim settlements as required by the State of Florida.

Estimated losses of approximately $28,484,000 for medical malpractice claims are included in accounts payable and accrued expenses and other long-term liabilities in the accompanying consolidated balance sheet as of September 30, 2017. The Health System may be liable for losses in excess of amounts accrued, but within the deductible provisions.

***(e) Workers' Compensation Liability and Employee Medical Insurance***

The Health System is self-insured for workers' compensation claims and employee medical claims. Workers' compensation losses for asserted and unasserted claims are accrued based on estimates provided by an independent actuary. Estimated costs accrued for incurred but not reported workers' compensation claims and employee medical claims of approximately $5,896,000 are included in employee compensation and benefits and other long-term liabilities in the accompanying consolidated balance sheet as of September 30, 2017. The estimates are based on the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of amounts incurred but not reported. The Health System has established internally designated self-insurance funds for the payment of workers' compensation liability claim settlements. The balances of these funds totaled approximately $2,360,000 as of September 30, 2017 and are included in assets limited as to use in the accompanying consolidated balance sheet.



(Continued)

### *(f) Healthcare Industry*

Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

## (10) Concentration of Credit Risk

The Health System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The Health System does not charge interest on accounts receivable. The credit risk for other concentrations of receivables is limited due to the large number of insurance companies and other payers that provide payments for services. Accounts receivable are reported net of an estimated allowance for uncollectible accounts in the accompanying consolidated balance sheet.

The table below summarizes the percentage of net patient accounts receivable due from major payers as of September 30, 2017:

| | |
|---|---|
| Medicare | 29% |
| Medicaid | 7 |
| Commercial | 41 |
| Self-pay/other | 23 |

## (11) Investments in Joint Venture Partnerships

As of September 30, 2017, the Health System had a 44.75% ownership interest in the Lakeland Surgical and Diagnostic Center, LLP (the Surgical Center). The ownership interest is accounted for using the equity method. The equity in earnings of the Surgical Center was approximately $1,085,000 for the year ended September 30, 2017. This amounts is net of federal and state income taxes of approximately $652,000 for the year ended September 30, 2017. The carrying value of the Health System's investment in the Surgical Center was approximately $4,929,000 as of September 30, 2017, and is included in other assets in the accompanying consolidated balance sheet.

The Health System also has partnership interests in other joint ventures accounted for using the equity method. The equity in losses from these joint ventures were approximately $370,000 for the year ended September 30, 2017. The carrying value of these joint ventures were approximately $1,912,000 at September 30, 2017, and is included in other assets in the accompanying consolidated balance sheet.

## (12) Fair Value Measurements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 requires investments to be grouped into three categories based on certain criteria as noted below:

Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Observable inputs other than quoted prices included within Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets and liabilities.

The table below summarizes the fair values of the Health System's cash, marketable securities, assets limited as to use and investments, excluding held-to-maturity securities, as of September 30, 2017 (in thousands):

| | | Fair value measurements at reporting date using | | | |
|---|---|---|---|---|---|
| | September 30, 2017 | (Level 1) | (Level 2) | (Level 3) | Net Asset Value[2] |
| Assets: | | | | | |
| Cash and cash equivalents | $ 24,370 | 24,370 | — | — | — |
| Marketable securities, assets limited as to use and investments: | | | | | |
| Cash equivalents | 2,999 | 2,999 | — | — | — |
| Common stock | 570 | 570 | — | — | — |
| Mutual funds | 14,433 | 14,433 | — | — | — |
| Fixed income | 175,866 | — | 175,866 | — | — |
| Multi-asset [1] | 253,055 | — | 253,055 | — | — |
| Hedge funds | 36,523 | — | — | — | 36,523 |
| Total | $ 507,816 | 42,372 | 428,921 | — | 36,523 |

(1) Consists of investments in a Multi-Asset Core Plus Fund which is a dynamic, diversified portfolio, designed to capture market opportunities. The underlying allocations to various asset classes will shift over time, but the overall strategic allocation is 75% global equity; 12% marketable real estate; 13% global fixed income.

(2) Under ASU 2015-07, investments that are measured at fair value using net asset value (NAV) as a practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation to the fair value hierarchy to the amounts presented in the consolidated balance sheet.

The Health System's Level 1 assets include trading investments in equity securities and mutual funds and are valued at the quoted market prices. Trading investments in private placement funds that invest in U.S. treasuries and agency obligations, government securities, corporate debt securities, and asset-backed securities with fair values modeled by external pricing vendors are included as Level 2. There are no withdrawal restrictions on such funds.

Investments in the Hedge funds consist of a Total Return Fund with an objective to offer low correlation to traditional assets and aims to provide diversification, lower volatility, and higher risk-adjusted returns at the portfolio level. The Total Return Fund is valued at fair value using NAV as provided by the fund custodian on a monthly basis.

The Health System's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers of financial assets between Level 1, Level 2, or Level 3 during the year ended September 30, 2017.

The fair value of financial instruments has been estimated by the Health System using available market information as of September 30, 2017, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Health System could realize in a current market exchange. Estimates of fair values are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could affect the estimates.

The estimated fair value of the Health System's held-to-maturity securities at September 30, 2017 is approximately $48,109,000. Fair values of the Health System's held-to-maturity securities are based upon quoted market prices for the same or similar securities as determined by the custodian bank.

## (13) Pledges Receivable, net

Pledges receivable, net of discounts, ranging from 0.74% and 2.55%, include the following unconditional promises to give as of September 30, 2017:

| | | |
|---|---|---|
| Capital campaign | $ | 28,271 |
| Less unamortized discount | | (2,289) |
| | $ | 25,982 |
| Amounts due in: | | |
| Less than one year | $ | 3,155 |
| One to five years | | 18,099 |
| More than five years | | 7,017 |
| | $ | 28,271 |

## (14) Subsequent Events

The Health System has evaluated events and transactions occurring subsequent to September 30, 2017 through December 21, 2017 which is the date the consolidated financial statements were issued. The Health System believes that no material events, other than the Affiliation Agreement disclosed in note 1, have occurred since September 30, 2017 that require recognition or disclosure in the accompanying consolidated financial statements and notes to consolidated financial statements.

# OTHER FINANCIAL INFORMATION

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidating Schedule – Balance Sheet Information

September 30, 2017

(In thousands)

| Assets | Lakeland Regional Health Systems, Inc. | Lakeland Regional Medical Center, Inc. | Eliminations | Obligated group | Lakeland Regional Health Ventures, Inc. | Lakeland Regional Medical Center, Foundation Inc. | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|
| Current assets: | | | | | | | | |
| Cash and cash equivalents | $ 24,140 | 14 | — | 24,154 | — | 216 | — | 24,370 |
| Current portion of assets limited as to use | — | 58,337 | — | 58,337 | — | — | — | 58,337 |
| Patient accounts receivable, net | 12,269 | 106,111 | — | 118,380 | — | — | — | 118,380 |
| Estimated third-party settlements, net | — | 6,265 | — | 6,265 | — | — | — | 6,265 |
| Inventories | — | 13,279 | — | 13,279 | — | — | — | 13,279 |
| Prepaid expenses and other current assets | 1,642 | 10,888 | — | 12,530 | — | 3,155 | — | 15,685 |
| Due from affiliates | — | — | — | — | — | — | — | — |
| Total current assets | 38,051 | 194,894 | — | 232,945 | — | 3,371 | — | 236,316 |
| Assets limited as to use, less current portion | 88,381 | (10,068) | — | 78,313 | — | — | — | 78,313 |
| Due to affiliates, less current portion | — | 85,381 | (85,381) | — | — | — | — | — |
| Long-term marketable securities | — | 14,317 | — | 14,317 | — | 116 | — | 14,433 |
| Investments | 365,710 | — | — | 365,710 | — | 14,922 | — | 380,632 |
| Property and equipment, net | 55,252 | 479,865 | — | 535,117 | — | — | — | 535,117 |
| Interest in net assets of the Foundation | 707 | 40,510 | — | 41,217 | — | — | (41,217) | — |
| Pledges receivable, net | — | — | — | — | — | 22,828 | — | 22,828 |
| Other assets | 6,842 | 13,811 | — | 20,653 | — | — | — | 20,653 |
| Total assets | $ 554,943 | 818,710 | (85,381) | 1,288,272 | — | 41,237 | (41,217) | 1,288,292 |
| **Liabilities and Net Assets** | | | | | | | | |
| Current liabilities: | | | | | | | | |
| Accounts payable and accrued expenses | $ 1,893 | 37,830 | — | 39,723 | — | 8 | — | 39,731 |
| Employee compensation and benefits | 7,179 | 39,205 | — | 46,384 | — | 11 | — | 46,395 |
| State of Florida medical assistance assessment | — | 8,507 | — | 8,507 | — | — | — | 8,507 |
| Current portion of long-term debt | — | 7,670 | — | 7,670 | — | — | — | 7,670 |
| Total current liabilities | 9,072 | 93,212 | — | 102,284 | — | 19 | — | 102,303 |
| Long-term debt, less current portion | — | 340,684 | — | 340,684 | — | — | — | 340,684 |
| Due to affiliates, less current portion | 85,380 | — | (85,381) | (1) | — | 1 | — | — |
| Long-term liabilities | — | 32,794 | — | 32,794 | — | — | — | 32,794 |
| Total liabilities | 94,452 | 466,690 | (85,381) | 475,761 | — | 20 | — | 475,781 |
| Net assets: | | | | | | | | |
| Unrestricted | 459,914 | 320,714 | — | 780,628 | — | 10,774 | (10,774) | 780,628 |
| Temporarily restricted | 577 | 29,768 | — | 30,345 | — | 28,905 | (28,905) | 30,345 |
| Permanently restricted | — | 1,538 | — | 1,538 | — | 1,538 | (1,538) | 1,538 |
| Total net assets | 460,491 | 352,020 | — | 812,511 | — | 41,217 | (41,217) | 812,511 |
| Total liabilities and net assets | $ 554,943 | 818,710 | (85,381) | 1,288,272 | — | 41,237 | (41,217) | 1,288,292 |

See accompanying independent auditors’ report.

**LAKELAND REGIONAL HEALTH SYSTEMS, INC.**
**AND SUBSIDIARIES**

Consolidating Schedule – Statement of Operations Information

For the Twelve Months ended September 30, 2017

(In thousands)

| | Lakeland Regional Health Systems, Inc. | Lakeland Regional Medical Center, Inc. | Obligated group | Lakeland Regional Health Ventures, Inc. | Lakeland Regional Medical Center, Foundation Inc. | Eliminations | Total |
|---|---|---|---|---|---|---|---|
| Unrestricted revenues and other support: | | | | | | | |
| Net patient service revenue (net of contractual allowances and discounts) | $ 56,347 | 783,048 | 839,395 | — | — | — | 839,395 |
| Provision for bad debt | — | (93,253) | (93,253) | — | — | — | (93,253) |
| Net patient service revenue | 56,347 | 689,795 | 746,142 | — | — | — | 746,142 |
| Other revenues | 3,603 | 9,697 | 13,300 | — | 553 | (2,154) | 11,699 |
| Net assets released from restrictions used for operations | — | — | — | — | 140 | — | 140 |
| Contributions from affiliate | — | — | — | — | 1,573 | (1,573) | — |
| Total unrestricted revenues and other support | 59,950 | 699,492 | 759,442 | — | 2,266 | (3,727) | 757,981 |
| Expenses: | | | | | | | |
| Employee compensation and benefits | 84,061 | 310,708 | 394,769 | — | 414 | — | 395,183 |
| Supplies | 5,706 | 149,430 | 155,136 | — | 7 | — | 155,143 |
| General and administrative | 11,384 | 66,827 | 78,211 | — | 2,444 | (2,145) | 78,510 |
| Professional fees | 4,161 | 15,932 | 20,093 | — | — | (1,582) | 18,511 |
| State of Florida medical assistance assessment | — | 8,067 | 8,067 | — | — | — | 8,067 |
| Depreciation | 3,578 | 49,557 | 53,135 | — | — | — | 53,135 |
| Interest | — | 20,449 | 20,449 | — | — | — | 20,449 |
| Total expenses | 108,890 | 620,970 | 729,860 | — | 2,865 | (3,727) | 728,998 |
| Operating income (loss) | (48,940) | 78,522 | 29,582 | — | (599) | — | 28,983 |
| Nonoperating gains (losses): | | | | | | | |
| Investment income | 34,029 | 1,166 | 35,195 | — | 1,405 | — | 36,600 |
| Equity in earnings from interests in joint venture partnerships, net of applicable taxes | 715 | — | 715 | — | — | — | 715 |
| Gain (loss) on disposal of property and equipment | (1) | 14 | 13 | — | — | — | 13 |
| Total nonoperating gains (losses), net | 34,743 | 1,180 | 35,923 | — | 1,405 | — | 37,328 |
| Excess (deficit) of revenues, gains, and other support over expenses and losses | $ (14,197) | 79,702 | 65,505 | — | 806 | — | 66,311 |

See accompanying independent auditors' report.