

CONSOLIDATED FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION

Baptist Health Care Corporation and Subsidiaries  
Years Ended September 30, 2018 and 2017  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Baptist Health Care Corporation and Subsidiaries

Consolidated Financial Statements  
and Supplementary Information

Years Ended September 30, 2018 and 2017

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## Report of Independent Auditors

The Board of Directors  
Baptist Health Care Corporation

We have audited the accompanying consolidated financial statements of Baptist Health Care Corporation and Subsidiaries (the Company), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Baptist Health Care Corporation and Subsidiaries at September 30, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

## **Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating and combining details on pages 56 through 58 are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

*Ernst + Young LLP*

December 21, 2018

# Baptist Health Care Corporation and Subsidiaries

## Consolidated Balance Sheets

(In Thousands)

	September 30	
	2018	2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 137,939	\$ 162,961
Short-term investments	166,948	139,933
Accounts receivable, less allowance for uncollectible accounts of \$75,256 in 2018 and \$48,251 in 2017	82,569	64,199
Contracts receivable	24,116	20,384
Current portion of investments limited as to use	1,337	1,869
Inventories	14,294	13,305
Prepaid expenses and other current assets	17,722	14,543
Total current assets	444,925	417,194
Investments limited as to use, less current portion	98,739	93,656
Net property, plant, and equipment	242,706	244,702
Other assets	19,555	19,013
Total assets	<u>\$ 805,925</u>	<u>\$ 774,565</u>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 51,847	\$ 55,559
Accrued compensation and benefits	28,612	26,991
Accrued interest	1,487	1,434
Estimated third-party settlements	10,026	14,231
Current portion of long-term debt	10,871	11,919
Other current liabilities	72,034	43,619
Total current liabilities	174,877	153,753
Long-term debt, less current portion	213,700	216,012
Asset retirement obligations	2,579	2,546
Other long-term liabilities	61,528	67,503
Total liabilities	452,684	439,814
Net assets:		
Unrestricted:		
Controlling interest	339,395	321,799
Noncontrolling interests in subsidiaries	6,767	5,502
	<u>346,162</u>	<u>327,301</u>
Temporarily restricted – controlling interest	7,079	7,450
Total net assets	<u>353,241</u>	<u>334,751</u>
Total liabilities and net assets	<u>\$ 805,925</u>	<u>\$ 774,565</u>

See accompanying notes.

## Baptist Health Care Corporation and Subsidiaries

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

	Year Ended September 30	
	2018	2017
Unrestricted revenues and other support:		
Patient service revenue	\$ 638,948	\$ 615,632
Provision for bad debts	(92,212)	(69,196)
Net patient service revenue	546,736	546,436
Federal, state, and other awards	70,186	68,733
Vocational service contracts	181,989	163,932
Contract revenue	30,316	31,873
EHR incentive payments	–	138
Other revenue	31,568	25,181
Net assets released from restrictions used for operations	1,275	1,302
Total unrestricted revenues and other support	862,070	837,595
Expenses:		
Salaries and benefits	435,153	410,427
Supplies	144,602	136,465
General, administrative, and other	108,801	97,512
Professional fees and purchased services	118,876	103,402
Contract medical costs	16,132	19,799
Depreciation and amortization	26,707	26,168
Interest	11,423	10,527
Total expenses	861,694	804,300
Income from operations before gain from weather related events	376	33,295
Gain from weather related events	2,644	1,155
Income from operations	3,020	34,450
Nonoperating gains (losses):		
Change in fair value of interest rate swap agreements	764	845
Net unrealized gains on trading securities	3,376	5,435
Investment income	7,215	8,395
Other, net	(3,535)	(3,386)
	7,820	11,289
Excess of revenues, other support, and gains over expenses and losses	10,840	45,739
Less excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,618	4,388
Excess of revenues, other support, and gains over expenses and losses attributable to controlling interest	9,222	41,351

Baptist Health Care Corporation and Subsidiaries

Consolidated Statements of Operations  
and Changes in Net Assets (continued)  
(In Thousands)

	Year Ended September 30	
	2018	2017
Unrestricted net assets:		
Excess of revenues, other support, and gains over expenses and losses attributable to controlling interest	\$ 9,222	\$ 41,351
Excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,618	4,388
Net unrealized gains on other-than-trading securities	164	212
Net assets released from restrictions for purchase of property, plant, and equipment	1,087	—
Pension adjustment	7,089	6,166
Other	(319)	(3,699)
Increase in unrestricted net assets	<u>18,861</u>	<u>48,418</u>
Temporarily restricted net assets:		
Contributions	2,069	1,555
Net unrealized gains on other-than-trading securities	(128)	449
Net assets released from restrictions	(2,362)	(1,302)
Other	50	83
(Decrease) increase in temporarily restricted net assets	<u>(371)</u>	<u>785</u>
Increase in net assets	18,490	49,203
Net assets at beginning of year	334,751	285,548
Net assets at end of year	<u>\$ 353,241</u>	<u>\$ 334,751</u>

See accompanying notes.

# Baptist Health Care Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended September 30	
	2018	2017
<b>Operating activities</b>		
Increase in net assets	\$ 18,490	\$ 49,203
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Restricted contributions received	(2,069)	(1,555)
Depreciation and amortization	26,707	26,168
Change in fair value of interest rate swap agreements	(764)	(845)
Net unrealized gains on other-than-trading securities	(36)	(661)
Net unrealized gains on trading securities	(3,376)	(5,435)
Pension adjustment	(7,089)	(6,166)
Provision for bad debts	92,212	69,196
Distribution to noncontrolling interests	2,908	4,607
Increase in other long-term liabilities	1,878	618
Net increase in components of working capital	(121,477)	(84,159)
Net cash provided by operating activities	7,384	50,971
<b>Investing activities</b>		
Purchase of investments	(65,809)	(64,687)
Proceeds from sale of investments	37,655	29,809
Increase in other assets	(542)	(153)
Capital expenditures	(24,678)	(43,377)
Net cash used in investing activities	(53,374)	(78,408)
<b>Financing activities</b>		
Proceeds from lines of credit	62,000	69,162
Payments on lines of credit	(36,833)	(61,674)
Repayments of long-term debt	(11,102)	(7,829)
Issuance of long-term debt	7,742	17,258
Distribution to noncontrolling interests	(2,908)	(4,607)
Restricted contributions received	2,069	1,555
Net cash provided by financing activities	20,968	13,865
Net decrease in cash and cash equivalents	(25,022)	(13,572)
Cash and cash equivalents, beginning of year	162,961	176,533
Cash and cash equivalents, end of year	\$ 137,939	\$ 162,961

See accompanying notes.

# Baptist Health Care Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Dollars in Thousands)

September 30, 2018

### 1. Organization and Mission

#### Organization

Baptist Health Care Corporation (the Parent) is a tax-exempt parent holding company located in Pensacola, Florida, whose primary purpose is to direct the affairs of a multi-entity health care system (BHCC) that includes the following subsidiaries:

- Baptist Hospital, Inc. (Baptist) – a tax-exempt organization that operates two acute care hospitals on campuses in downtown Pensacola and Gulf Breeze, Florida. Baptist provides inpatient, outpatient, and emergency care services for residents of northwest Florida and southeast Alabama. Wholly owned subsidiaries include Baptist Physician Associates, LLC; Baptist Medical Group, LLC; and Langhorne Cardiology Consultants, M.D.'s, P.A. (Cardiology Consultants), which provide hospitalist services on the Pensacola and Gulf Breeze campuses, and neonatal services on the Pensacola campus, primary care and subspecialty physician services, and cardiology services, respectively. Baptist owns 52.1% of the Andrews Institute Ambulatory Surgery Center (AIASC) and 60% of Lighthouse Health Plan, LLC (LHP) and consolidates AIASC and LHP in the accompanying consolidated financial statements.
- Baptist Health Ventures, Inc. (Ventures) – a taxable corporation that oversees the operations of various for-profit subsidiaries.
- Lakeview Center, Inc. (LCI) – a tax-exempt organization whose mission is to help people overcome life's challenges by providing behavioral health services, vocational services, and child protection services.
- Jay Hospital, Inc. (Jay) – a tax-exempt organization that operates an acute care hospital.
- Baptist Health Care Foundation (HCF) – a foundation with the primary purpose of raising funds to support the activities of the tax-exempt subsidiaries of BHCC.

The Parent is the sole member or owner of each of the above affiliates and controls the multi-entity structure through board appointments and approval of all major transactions.

# Baptist Health Care Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

### 1. Organization and Mission (continued)

#### Operating and Nonoperating Activities

BHCC's primary mission is to meet the health care needs in the region through an integrated network of affiliated organizations. BHCC's affiliated organizations are committed to providing a broad range of general and specialized health care services, including inpatient primary care, long-term care, outpatient services, and other health care-related ventures. Activities directly associated with the furtherance of this purpose are considered to be operating activities.

Other activities that result in gains or losses unrelated to BHCC's primary mission are considered to be nonoperating. Nonoperating gains and losses include rents from medical office buildings, changes in the value of interest rate swap agreements, unrealized gains and losses on trading securities, income, and losses from investments in joint ventures, and earnings on investments.

#### Charity Care

Quality medical care is provided to all persons requiring immediate treatment regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of BHCC. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, BHCC utilizes the most recently published federal poverty income guidelines, but also includes certain cases in which incurred charges are significant when compared to income. These charges are not included in net patient service revenue.

BHCC estimates the direct and indirect costs of providing charity care by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. The cost of providing charity care was \$19,883 and \$20,316 for the years ended September 30, 2018 and 2017, respectively.

# Baptist Health Care Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

### 2. Summary of Significant Accounting Policies

#### Principles of Consolidation

The accompanying consolidated financial statements of BHCC include the accounts of the Parent, Baptist, Jay, HCF, Ventures, and LCI. Significant transactions between entities have been eliminated.

#### Use of Estimates

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) 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.

#### Cash and Cash Equivalents

All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents. Cash deposits are federally insured in limited amounts.

#### Investments

Investments in equity securities with readily determinable fair values and all debt securities are stated at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenues, other support, and gains over expenses and losses unless the income or loss is restricted by donor or law. BHCC accounts for its investments as trading and accounts for investment transactions on a settlement-date basis.

BHCC invests in alternative investments (primarily hedge funds and a real estate investment fund) through partnership investment trusts. These alternative investments provide BHCC with a proportionate share of investment gains and losses. The partnership investment trusts generally contract with a manager who has full discretionary authority over investment decisions. BHCC accounts for its ownership interests in these alternative investments under the equity method.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

Accordingly, BHCC's share of the alternative investments' income or loss, both realized and unrealized, is recognized as investment income or loss, which is a component of excess of revenues, other support, and gains over expenses and losses.

#### **Inventories**

Inventories (primarily pharmaceutical and medical supplies) are stated at the lower of cost (average cost method) or net realizable value using the first-in, first-out method.

#### **Investments Limited as to Use**

Investments limited as to use include certain investments limited as to use under the terms of bond indenture agreements and designated assets set aside by the Board of Directors (the Board) or management for future capital improvements and to pay malpractice claims over which the Board or management retains control, and may at its discretion subsequently use for other purposes.

#### **Property, Plant, and Equipment**

Property, plant, and equipment are recorded at historical cost or at fair market value at the date of donation. Major asset classifications and useful lives generally are in accordance with those recommended by the American Hospital Association. The straight-line method of computing depreciation is used for all depreciable assets. The straight-line method is also used for computing amortization expense for capital leased assets. Amortization expense of capital leased assets is included in depreciation and amortization expense and in accumulated depreciation and amortization.

#### **Temporarily Restricted Net Assets**

Temporarily restricted net assets are those whose use by BHCC has been limited by donors to a specific time period or purpose. At September 30, 2018 and 2017, temporarily restricted net assets are available for indigent care and capital purchases. During 2018 and 2017, \$2,362 and \$1,302, respectively, in net assets were released from donor restriction by incurring expenditures or acquiring property, plant, and equipment satisfying the restricted purposes.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Excess of Revenues, Other Support, and Gains Over Expenses and Losses**

The accompanying consolidated statements of operations and changes in net assets include excess of revenues, other support, and gains over expenses and losses. Changes in unrestricted net assets that are excluded from excess of revenues, other support, and gains over expenses and losses, consistent with industry practice, include unrealized gains and losses on other-than-trading securities, pension adjustments, and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets).

##### **Net Patient Service Revenue and Accounts Receivable**

BHCC has agreements with third-party payors that provide for payments to BHCC 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 the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

##### **Provision for Bad Debts and Allowance for Uncollectible Accounts**

The provision for bad debts is based upon management's assessment of historical and expected net collections, considering business and economic conditions, trends in health care coverage, and other collection indicators. Accounts receivable are written off after collection effort has been followed in accordance with BHCC's policies. Accounts written off as uncollectible are deducted from the allowance for uncollectible accounts and subsequent recoveries are added. Periodically, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible receivables.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Medicaid Managed Medical Assistance Contract Revenue**

LCI is licensed as a prepaid limited health services organization pursuant to Chapter 636, *Florida Statutes*. Effective August 1, 2014, LCI was awarded contracts with the Medicaid Managed Medical Assistance Plan (the MMA Plan). LCI receives a per-member per-month rate to provide mental health and substance abuse services to approximately 105,700 Medicaid beneficiaries. Amounts received are recognized as contract revenue during the period in which LCI is obligated to provide services to beneficiaries. Approximately \$30,316 and \$31,873 was recognized as revenue under the MMA Plan during the years ended September 30, 2018 and 2017, respectively.

##### **Medicaid Prepaid Mental Health Plan Costs**

LCI is directly responsible for providing mental health and substances abuse services to beneficiaries residing in Escambia and Santa Rosa counties, representing approximately 70% of the covered lives under the MMA Plan. LCI has entered into subcontracts with two comprehensive community mental health centers to provide mental health services to the MMA Plan beneficiaries residing in Okaloosa and Walton counties. These subcontracts are on a full risk capitated basis. The mental health services covered under the MMA Plan are generally the same as those covered under the Medicaid fee-for-service program. Covered services include inpatient psychiatric care, outpatient care, substance abuse, and physician services. The majority of services for which LCI is directly responsible are provided within its own service delivery system; however, some services are contracted for on a fee-for-service basis with local area hospitals and providers. A provision has been made for services rendered but not reported to LCI as of September 30, 2018 and 2017.

##### **Functional Expenses**

BHCC does not present expense information by functional classification because its resources and activities are primarily related to providing health care services. Further, since BHCC receives substantially all of its resources from providing health care 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.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### Donor-Restricted Gifts

Unconditional promises to give cash and other assets to BHCC are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. 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 unrestricted net assets and reported in the accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions. BHCC had no permanently restricted net assets at September 30, 2018 and 2017.

##### Income Taxes

The Parent, Baptist, Jay, HCF, and LCI are exempt from federal income taxes under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and are also exempt from state income taxes. For the years ended September 30, 2018 and 2017, unrelated business income activities conducted by BHCC and its tax-exempt affiliates did not generate a material amount of combined federal and state income tax.

Ventures and Cardiology Consultants are taxable corporations and file federal and state income tax returns. Ventures and Cardiology Consultants did not generate taxable income for the years ended September 30, 2018 and 2017. Accordingly, there is no provision for current federal or state income taxes for the years ended September 30, 2018 and 2017, in the accompanying consolidated statements of operations and changes in net assets.

At September 30, 2018 and 2017, Ventures and Cardiology Consultants had combined net deferred tax assets of approximately \$41,600 and \$55,800, respectively, tax effected at a rate of 25.3% for 2018 and 37.6% for 2017. Deferred tax assets are primarily composed of federal and state net operating loss carryforwards. At September 30, 2018 and 2017, Ventures and Cardiology Consultants had combined approximately \$159,200 and \$141,700, respectively, of federal net operating loss carryforwards and \$158,200 and \$140,200, respectively, of state net operating loss carryforwards. These net operating losses will expire between 2018 and 2038. A valuation allowance has been provided to offset the full amount of the deferred tax asset as of

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

September 30, 2018 and 2017, since management determined that it is more likely than not that the benefit of the deferred tax assets will not be realized in future years.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, prescribes the accounting for uncertainty in income tax positions recognized in the financial statements. ASC Topic 740 provides guidance for recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. There were no material uncertain tax positions as of September 30, 2018 and 2017.

As a result of the recent federal income tax reform enacted into law under the Tax Cuts and Jobs Act of 2017, certain provisions will impact tax-exempt organizations, including revisions to taxes on unrelated business activities, excise taxes on compensation of certain employees, and various other provisions. The regulations necessary to implement the law have not yet been promulgated, and the ultimate outcome of these regulations and the impact to BHCC cannot be determined presently. BHCC will continue to review and assess the impact of the legislation to the financial statements, but do not expect that the impact will be material.

#### **Debt Issue Costs**

The costs incurred in connection with the issuance of long-term debt (Note 7) are being amortized over the term of the related indebtedness and are included in long-term debt.

#### **Recent Accounting Pronouncements**

In August 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans* (ASU 2018-14). The amendments in ASU 2018-14 modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020. Management is currently evaluating the impact of ASU 2018-14 on BHCC's consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities* (ASU 2018-08). The amendments in ASU 2018-08 clarify accounting guidance for contributions received and contributions made. The amendments will assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions), or as exchange (reciprocal)

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

transactions, and (2) determining whether a contribution is conditional. For contributions received, ASU 2018-08 is effective for annual periods beginning after June 15, 2018, and interim periods within those annual periods. For contributions made, ASU 2018-08 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. Management is currently evaluating the impact of ASU 2018-08 on the Hospital's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation-Retirement Benefits* (ASU 2017-07). The amendments in ASU 2017-07 require that an employer report the service cost component of the net periodic benefit cost in the same line item as other employee compensation costs. The other components of net benefit cost will be required to be presented in the income statement separately from the service cost component and outside of any subtotal of operating income (i.e., in non-operating income). ASU 2017-07 is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Management is currently evaluating the impact of ASU 2017-05 on BHCC's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016-14). The amendments in ASU 2016-14 change the presentation of not-for-profit financial statements by requiring two classes of net assets on the statement of financial position rather than for the currently required three classes, and presenting the amount of the change in each of these two classes on the statement of activities. A not-for-profit that uses the direct method of cash flow reporting will no longer be required to present or disclose the indirect method reconciliation, and not-for-profits will continue to have the option to utilize either the direct or indirect method for the statement of cash flows. Not-for-profits will no longer be required to disclose netted expenses when reporting investment returns, and will be required to provide certain enhanced disclosures. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Management is currently evaluating the impact of ASU 2016-14 on BHCC's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (ASU 2016-02). The amendments in ASU 2016-02 require lessees to recognize the assets and liabilities arising from leases on their balance sheets, but recognize expenses on their income statements similar to current accounting requirements. The amendments also eliminate real estate-specific provisions for all entities. For

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

lessors, the amendments modify classification criteria and the accounting for sales-type and direct financing leases. In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, which affects narrow aspects of the guidance issued in ASU 2016-02. The FASB also issued ASU 2018-11, *Targeted Improvements*, which provides entities with an additional transition method to adopt the leases standard, and provides lessors with a practical expedient to not separate nonlease components from the associated lease. ASU 2016-02, 2018-10 and 2018-11 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Management is currently evaluating the impact of ASU 2016-02, 2018-10, and 2018-11 on BHCC's consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The FASB codified ASU 2014-09 in the FASB Accounting Standards Codification (ASC) as topic 606 (ASC 606). The standard outlines a single comprehensive revenue recognition principles-based model that replaces most of the existing revenue recognition guidance, including industry-specific guidance. The standard will be effective for BHCC effective in fiscal year 2019. Management is continuing to evaluate the effects the adoption of this standard will have on the financial statements and disclosures. The standard will change the presentation of revenue related to uninsured or underinsured patients, which is a significant portion of the allowance for doubtful accounts. After adopting this standard, these amounts will be recognized as a direct reduction to revenue in the form of a price concession compared to the current presentation as a separate line item reducing patient service revenue.

#### **Reclassifications**

Certain reclassifications were made in 2017 reported amounts. These reclassifications had no impact on the change in net assets previously reported.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### **3. Net Patient Service Revenue, Patient Accounts Receivable, and Allowance for Uncollectible Accounts**

BHCC's hospital subsidiaries have agreements with third-party payors that provide for payments to them at amounts different from their established rates. A summary of the payment arrangements with major third-party payors follows.

##### **Medicare**

The Medicare program pays hospitals for inpatient acute care services and outpatient services on a prospective basis, which is determined based on each patient's clinical diagnosis and medical procedures. Annual provisions for contractual adjustments are based on management's computation of prospective payments and allowable costs. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits thereof by a Medicare Administrative Contractor. These settlements are estimated and recorded in the accompanying consolidated financial statements. Medicare cost reports through 2015, except for 2013, for Baptist Hospital and through 2015 for Gulf Breeze Hospital and Jay Hospital, have been audited and settled as of September 30, 2018.

##### **Medicaid**

The hospitals are paid for Medicaid inpatient and outpatient acute care services on a prospective basis, which is determined based on each patient's clinical diagnosis and medical procedures. Medicaid outpatient services are paid on an amount per line item based on filed cost reports. Retroactive adjustments are made to the prospective payments for inpatient services and per line item payments for outpatient services after the related cost report is audited by the intermediary. These settlements are estimated and recorded in the accompanying consolidated financial statements.

Revenues from the Medicare and Medicaid programs accounted for approximately 45% of BHCC's net patient service revenue for the years ended September 30, 2018 and 2017. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in the Medicare and Medicaid programs and the reduction of funding levels could have an adverse impact on BHCC. During the years

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### **3. Net Patient Service Revenue, Patient Accounts Receivable, and Allowance for Uncollectible Accounts (continued)**

ended September 30, 2018 and 2017, net patient service revenue increased by approximately \$7,542 and \$1,468, respectively, due to changes in estimated prior-year settlements. Amounts due from third-party payors for retroactive adjustments of items such as final settlements or appeals totaled \$3,138 and \$1,225 at September 30, 2018 and 2017, respectively, and are included in accounts receivable in the accompanying consolidated balance sheets.

#### **Other**

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

BHCC accepts patients in immediate need of care, regardless of their ability to pay, and serves certain patients whose care costs are not paid at established rates, including those sponsored under government programs such as Medicare and Medicaid, those sponsored under private contractual agreements, charity patients, and other uninsured patients who have limited ability to pay. BHCC recognizes patient service revenue associated with patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, revenue is recognized on the basis of discounted rates in accordance with BHCC policy.

Patient service revenue is reduced by the provision for bad debts and accounts receivable are reduced by an allowance for uncollectible accounts based on management's assessment of historical and expected net collections for each major payor source, considering business and economic conditions, trends in healthcare coverage and other collection indicators. Management regularly reviews collections data by major payor sources in evaluating the sufficiency of the allowance for uncollectible accounts. On the basis of historical experience, a significant portion of self-pay patients will be unable or unwilling to pay for the services provided. Thus, BHCC records a significant provision for bad debts in the period services are provided to self-pay patients. BHCC's allowance for uncollectible accounts for self-pay patients was 97% of self-pay accounts receivable as of September 30, 2018 and 2017, respectively. For receivables associated with patients who have third-party coverage, BHCC analyzes contractually due amounts and provides a provision for bad debts, if necessary.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

**3. Net Patient Service Revenue, Patient Accounts Receivable, and Allowance for Uncollectible Accounts (continued)**

Accounts receivable are written off after collection efforts have been followed in accordance with BHCC policies.

Patient service revenue is not recognized for those patients that qualify for charity under BHCC's policies. For all others, patient service revenue, net of contractual allowances and self-pay discounts and before the provision for bad debts, recognized from major payor sources is as follows:

	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
Third-party payors, net of contractual allowances	\$ 561,981	\$ 563,521
Self-pay patients, net of discounts	76,967	52,111
	<u>\$ 638,948</u>	<u>\$ 615,632</u>

BHCC has not experienced significant changes in write-off trends and has not changed its self-pay discount or charity care policy for the years ended September 30, 2018 or 2017.

BHCC has determined, based on an assessment at the reporting-entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for bad debts is recorded as a deduction from patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) *(Dollars in Thousands)*

#### **4. Other Factors Affecting Income From Operations**

##### **Weather Events**

In August 2016, Baptist sustained property and equipment damage from heavy flooding affecting northwest Florida. BHCC carries both property damage (with a \$100 deductible per event) and business interruption insurance. Estimated losses related to this event recorded during the year ended September 30, 2016 totaled \$3,484, and through September 30, 2018, Baptist has received \$3,799 from insurers used for recovery of costs and business interruption. The business interruption claim was settled for \$1,933. Included in the accompanying consolidated statements of operations and changes in net assets is an estimated gain related to this event totaling \$2,644 and \$1,155 for the years ended September 30, 2018 and 2017, respectively.

##### **Lighthouse Health Plan**

In 2018, Lighthouse Health Plan, LLC (LHP) contracted with the Florida Agency for Health Care Administration to provide Medicaid Managed Care Program services for northwest Florida. Baptist is a 60% member of LHP, and consolidates LHP in the accompanying consolidated financial statements.

Included in operating expenses are start-up costs of LHP totaling \$3,551 for the year ended September 30, 2018. LHP is scheduled to begin servicing members in February 2019.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**5. Cash and Investments**

The composition of cash, cash equivalents, and investments is presented below:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Cash and cash equivalents and short-term investments	<b>\$ 141,275</b>	\$ 171,220
U.S. corporate obligations	<b>63,009</b>	55,510
U.S. Treasury obligations	<b>20,360</b>	12,410
U.S. government agencies and sponsored entities	<b>20,968</b>	16,904
Collateralized debt obligations	<b>5,447</b>	5,363
Equity securities	<b>107,044</b>	94,197
Alternative investments	<b>36,691</b>	32,663
Other	<b>10,169</b>	10,152
	<b>\$ 404,963</b>	<b>\$ 398,419</b>

A summary of the limitations as to the use of investments limited as to use is as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Internally designated:		
For expansion	<b>\$ 46,859</b>	\$ 43,894
Malpractice trust funds	<b>7,115</b>	7,049
Other	<b>32,671</b>	31,150
Held by trustee under bond indenture agreements:		
Debt service reserve fund	<b>13,431</b>	13,432
	<b>100,076</b>	95,525
Less amount to pay current liabilities	<b>1,337</b>	1,869
	<b>\$ 98,739</b>	<b>\$ 93,656</b>

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**5. Cash and Investments (continued)**

Investment income (including unrealized gains and losses) from investments limited as to use, short-term investments, cash, and cash equivalents comprised the following:

	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
Excess of revenues, other support, and gains over expenses and losses:		
Nonoperating gains (losses):		
Interest and dividend income	\$ 5,920	\$ 5,681
Realized gains (losses) on sales of securities	1,295	2,714
Net unrealized gains on trading securities	3,376	5,435
	<u>\$ 10,591</u>	<u>\$ 13,830</u>
Other changes in unrestricted net assets:		
Net unrealized gains on other-than-trading securities	<u>\$ 164</u>	<u>\$ 212</u>
Other changes in temporarily restricted net assets:		
Net unrealized (losses) gains on other-than-trading securities	<u>\$ (128)</u>	<u>\$ 449</u>

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**6. Property, Plant, and Equipment**

BHCC had property, plant, and equipment, less allowances for depreciation and amortization, as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Land	\$ 22,765	\$ 23,965
Land improvements	14,950	14,878
Buildings	298,354	292,755
Equipment	307,498	276,028
	<u>643,567</u>	<u>607,626</u>
Accumulated for depreciation and amortization	<u>(404,669)</u>	<u>(393,332)</u>
	238,898	214,294
Construction-in-progress	3,808	30,408
	<u>\$ 242,706</u>	<u>\$ 244,702</u>

At September 30, 2018 and 2017, property, plant, and equipment included \$12,093 and \$11,871 in equipment under capital leases, net of \$4,738 and \$3,919 in accumulated amortization, respectively.

Depreciation expense for the years ended September 30, 2018 and 2017 was \$26,674 and \$26,199, respectively.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**7. Long-Term Debt**

BHCC was obligated under long-term debt as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Health Facilities Revenue Bonds, Series 2009A, net of issue costs of \$40 and \$48 at September 30, 2018 and 2017, respectively, principal and interest payable in monthly amounts of \$115 through January 1, 2024, at a fixed interest rate of 3.25%	<b>\$ 6,727</b>	\$ 7,863
Health Facilities Revenue Bonds (Baptist Hospital, Inc.), Series 2010A, net of unamortized discount of \$538 and \$568, and unamortized issue costs of \$3,143 and \$3,315, at September 30, 2018 and 2017, respectively, with \$3,585 due August 15, 2019, at an interest rate of 5.0%; \$3,760 in serial bonds due August 15, 2020, at an interest rate of 5.13%; \$18,195 of term bonds at an interest rate of 5.5% due on August 15, 2024; \$36,440 of term bonds at an interest rate of 5.75% due on August 15, 2029; and \$73,075 of term bonds at an interest rate of 6.0% due on August 15, 2036, with interest payable semiannually	<b>131,374</b>	134,582
Promissory Note Payable, net of issue costs of \$30 and \$31 at September 30, 2018 and 2017, respectively, payable in varying amounts until February 1, 2040, at a fixed rate of 3.72%	<b>18,255</b>	18,994
Pensacola POB, Inc. Note Payable, payable monthly in varying amounts through March 1, 2020, at a variable rate of interest (3.65% at September 30, 2018)	<b>9,394</b>	9,854

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**7. Long-Term Debt (continued)**

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Andrews Institute Medical Park Note Payable, payable monthly in varying amounts until March 1, 2020, at a variable rate of interest (3.65% at September 30, 2018)	<b>\$ 11,701</b>	\$ 12,274
Andrews Institute Medical Park Note Payable, payable monthly in varying amounts until March 1, 2020, at a variable rate of interest (3.65% at September 30, 2018)	<b>5,579</b>	5,852
Tax-Exempt Lease Obligation, net of issue costs of \$3 at September 30, 2017, principal and interest payable in monthly amounts of \$150 through April 30, 2018, at fixed interest rate 2.2%	—	1,038
Infrastructure improvement construction loan, net of issue costs of \$12 and \$13 at September 30, 2018 and 2017, respectively, drawn over 24 months; interest payable monthly during draw period based on 30-day LIBOR plus 160 basis points (3.84% at September 30, 2018)	<b>12,988</b>	13,987
Electronic Health Record financing loan, payable over ten years, at a fixed rate of 2.56%	<b>22,778</b>	17,258
Capital lease obligations	<b>1,768</b>	2,440
Other long-term debt	<b>4,007</b>	3,789
	<b>224,571</b>	227,931
Less current portion	<b>10,871</b>	11,919
	<b>\$ 213,700</b>	\$ 216,012

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### **7. Long-Term Debt (continued)**

##### **2009A Health Facilities Revenue Bonds**

In December 2009, \$15,000 of Health Facilities Revenue Bonds, Series 2009A (the 2009A Bonds) were issued by the Escambia County Health Facilities Authority (the Authority) on behalf of Baptist at a fixed rate of 5.49%. The proceeds of the 2009A Bonds were used to extinguish previously issued bonds.

##### **2010A Health Facilities Revenue Bonds**

In February 2010, \$155,000 of Health Facilities Revenue Bonds, Series 2010A (the 2010A Bonds) were issued by the Authority on behalf of Baptist at fixed rates ranging from 3% to 6%. The proceeds of the 2010A Bonds were used to extinguish previously issued bonds, to pay or reimburse the cost of acquiring, constructing, and equipping certain capital projects, to pay related cost of issuance, and fund a debt service reserve and capitalized interest fund.

##### **2010B Health Facilities Revenue Bonds**

In February 2010, \$24,000 of Taxable Variable Rate Demand Bonds, Series 2010B (the 2010B Bonds) were issued by the Authority on behalf of Baptist. The proceeds of the 2010B Bonds were used to reimburse Baptist for previous expenditures and to pay related cost of issuance.

##### **Promissory Note Payable**

In December 2011, Baptist and Bank of America, N.A. (Bank of America) modified and replaced the 2010B Bonds with a promissory note payable in order to eliminate the Baptist's renewal risk related to a letter of credit and reimbursement agreement entered into between a remarketing agent and Baptist. In December 2016, Baptist modified the 2010B Bonds, converting from a variable interest rate to a fixed interest rate of 3.72%.

The 2009A Bonds and the 2010A Bonds (the Bonds) are limited obligations of the Authority, payable principally from the receipts of loan agreements between the Authority and Baptist. The Bonds are secured by a gross revenue pledge of Baptist and The Manor (the Obligated Group) and a mortgage on the Gulf Breeze Hospital campus. Baptist and LCI comprise the Combined Group under a Master Trust Indenture. LCI, as a restricted affiliate under the Master Trust

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **7. Long-Term Debt (continued)**

Indenture, agrees to be bound by its terms but is not directly liable for obligations issued under the Master Trust Indenture. The Master Trust Indenture requires certain covenants and reporting requirements to be met by the Combined Group. All covenants were complied with for the years ended September 30, 2018 and 2017, respectively.

#### **Pensacola POB, Inc. Note Payable**

In March 2010, Pensacola POB, Inc., a subsidiary of Ventures, entered into a note for \$13,423. The proceeds of the note were used to extinguish previously issued bonds. The note, modified in 2013 to extend the maturity date and decrease monthly debt service, is payable in varying amounts until March 2020 at a variable rate of interest, which is based on the bond rating of the Combined Group. The Obligated Group has provided a guaranty as security for the note that requires the Combined Group to meet certain financial covenants.

#### **Andrews Institute Medical Park Notes Payable**

In March 2010, Andrews Institute Medical Park (Andrews), a subsidiary of Ventures, entered into two notes for \$17,358 and \$7,971. The proceeds of the notes were used to extinguish previously issued debt. The notes, modified in 2013 to extend the maturity dates and decrease monthly debt service, are payable in varying amounts until March 2020 at a variable rate of interest, which is based on the bond rating of the Combined Group. The Obligated Group has provided a guaranty as security for the note that requires the Combined Group to meet certain financial covenants.

#### **Tax-Exempt Lease Obligation**

In December 2010, a \$15,000 tax-exempt lease obligation was issued by the Authority on behalf of Baptist. The lease can be drawn in multiple schedules over three years. The first draw of \$6,500 was made in December 2010, and the second draw of \$8,500 was made in May 2013. The proceeds were used by Baptist to pay for acquiring and equipping certain capital projects and paying the related costs of issuance. The lease is secured by the equipment it is financing.

# Baptist Health Care Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

### 7. Long-Term Debt (continued)

#### Construction Loan

During February 2014, Baptist entered into a \$15,000 loan with Bank of America. The proceeds, to be used for infrastructure improvements, were drawn over 24 months, with interest payable only during the draw period. The loan matures 15 years from closing, with interest payable based on the 30-day LIBOR plus 160 basis points.

#### Electronic Health Record Loan

In October 2016, Baptist entered into an agreement to borrow up to \$25,000 to finance the purchase and implementation of a new Electronic Health Record (Note 12). The debt was interest only until September 2017 at LIBOR plus 125 basis points and then converted to a fully amortizing note, payable over ten years, at a fixed interest rate of 2.56%.

#### Debt Maturities

Maturities of long-term debt (excluding capital leases) for the succeeding five years are as follows:

	<u>Amount</u>
Year ending September 30:	
2019	\$ 10,386
2020	24,483
2021	20,538
2022	11,536
2023	10,215
Thereafter	149,412

#### Capital Lease Obligations

BHCC has entered into capital leases for various pieces of equipment, payable in monthly installments ranging from 44 to 72 months, at varying interest rates from 1.6% to 6.0%.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### 7. Long-Term Debt (continued)

Future minimum payments under the capital leases are as follows:

	<u>Amount</u>
Year ending September 30:	
2019	\$ 547
2020	565
2021	333
2022	316
2023	148
Thereafter	—
Total minimum capital lease payments	<u>1,909</u>
Less amount representing interest	141
Present value of minimum lease payments	<u>1,768</u>
Less current portion	485
	<u><u>\$ 1,283</u></u>

#### 8. Line of Credit Arrangements

At September 30, 2018 and 2017, BHCC has available line of credit arrangements totaling \$47,500 and \$24,000, respectively. These lines of credit bear interest at rates ranging from LIBOR plus 1.30% to LIBOR plus 3.15% (3.40% to 3.81% at September 30, 2018, and 2.64% to 2.74% at September 30, 2017). At September 30, 2018 and 2017, amounts outstanding under these line of credit arrangements were \$47,500 and \$22,333, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets.

#### 9. Derivative Financial Instruments

BHCC has entered into interest rate swap agreements. BHCC accounts for its derivative financial instruments under ASC Topic 815, *Derivatives and Hedging*, and ASC Topic 954, *Health Care Entities*. ASC Topic 954 requires that not-for-profit health care organizations apply the provisions of ASC Topic 815 (including the provisions pertaining to cash flow hedge accounting) in the same manner as for-profit enterprises.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### 9. Derivative Financial Instruments (continued)

ASC Topic 815 requires companies to recognize all derivative instruments as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative financial instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. For those derivative financial instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of the foreign currency exposure of a net investment in a foreign operation. BHCC has not designated any of its derivative financial instruments as hedges under ASC Topic 815.

The primary risk managed by using derivative financial instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with BHCC's variable-rate borrowings. Interest rate swap agreements between BHCC and third parties (counterparties) provide for the periodic exchange of payments between the parties based on changes in a defined index and a fixed rate and expose BHCC to market risk and credit risk. Credit risk is the risk that contractual obligations of the counterparties will not be fulfilled. Concentrations of credit risk relate to groups of counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Counterparty credit risk is managed by requiring high credit standards for BHCC's counterparties. The counterparties to these contracts are financial institutions that carry investment-grade credit ratings. The interest rate swap agreements contain collateral provisions applicable to both parties to mitigate credit risk. BHCC does not anticipate nonperformance by its counterparties. BHCC has not been requested to post collateral for any interest rate swap agreements in a negative position. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of BHCC derivative positions in the context of its blended cost of capital. At September 30, 2018 and 2017, the notional amount of BHCC's interest rate swap agreements was \$55,155.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**9. Derivative Financial Instruments (continued)**

Substantially all of BHCC's derivative instruments contain provisions that require the Combined Group to maintain an investment-grade credit rating. If the Combined Group's credit rating was to fall below investment grade, it would be in violation of such provisions, and the counterparties to the derivative instruments could request immediate payment on derivative instruments in net liability positions. The aggregate fair value of all derivative financial instruments with credit-related contingent features that are in a liability position at September 30, 2018 and 2017, is \$300 and \$1,064, respectively. If the credit-risk-related contingent features underlying these agreements had been triggered on September 30, 2018, BHCC could have been required to settle the agreements with the counterparties, requiring cash or other liquid assets of \$303.

BHCC's derivative financial instruments are reported in the accompanying consolidated balance sheets as follows:

<b>Derivatives Not Designated as Hedging Instruments</b>	<b>Balance Sheet Location</b>	<b>Liability Derivatives</b>	
		<b>Fair Value</b>	
		<b>September 30 2018</b>	<b>2017</b>
Interest rate swap agreements	Other long-term liabilities	<b>\$ 300</b>	<b>\$ 1,064</b>

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Dollars in Thousands)

**9. Derivative Financial Instruments (continued)**

The effects of BHCC's derivative financial instruments on the accompanying consolidated statements of operations and changes in net assets are as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) on Derivatives Recognized in Excess of Revenues, Other Support, and Gains over Expenses and Losses	Amount of Gain (Loss) on Derivatives Recognized in Excess of Revenues, Other Support, and Gains Over Expenses and Losses	
		Year Ended September 30 2018	2017
Interest rate swap agreements	Change in fair value of interest rate swap agreements	\$ 764	\$ 845
	Other nonoperating losses	(262)	(393)
		<u>\$ 502</u>	<u>\$ 452</u>

**10. Retirement Plans**

The Parent sponsors a noncontributory, defined benefit pension plan that covers substantially all of BHCC's employees, other than the employees of LCI who participate in a separate plan. BHCC froze the plan effective February 28, 2007. The effect of the curtailment is that no new benefits will be accrued after February 28, 2007. All benefits earned by the defined benefit plan's participants through that date will be available upon retirement under the plan provisions. Future growth in benefits will no longer occur beyond February 28, 2007. BHCC's policy is to contribute annually the minimum amount necessary to comply with the requirements of the Employee Retirement Income Security Act of 1974. BHCC funds the required contributions to the plan.

The Parent also sponsors a supplemental employee retirement benefit plan (SERP) for certain executives. This plan is not funded.

ASC Topic 715, *Compensation – Retirement Benefits*, requires employers that sponsor defined benefit plans to recognize the funded status of their postretirement benefit plans in the balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end balance sheet, and provide additional disclosures.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**10. Retirement Plans (continued)**

The following tables set forth the benefit obligations and the assets of the defined benefit plan and SERP changes in the plan assets and benefit obligations recognized in unrestricted net assets, and the components of net periodic benefit costs:

	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
Accumulated benefit obligation	<b>\$ 127,264</b>	<b>\$ 135,255</b>
Change in projected benefit obligation:		
Projected benefit obligation, as of prior measurement date	<b>\$ 135,255</b>	<b>\$ 136,545</b>
Interest cost	<b>5,115</b>	<b>5,008</b>
Benefit payments	<b>(5,866)</b>	<b>(5,531)</b>
Actuarial (gain) loss	<b>(7,240)</b>	<b>(767)</b>
Projected benefit obligation (carryforward)	<b>127,264</b>	<b>135,255</b>
Changes in plan assets at fair value (bring forward):		
Fair value of plan assets, as of prior measurement date	<b>94,193</b>	<b>86,693</b>
Actual return on plan assets	<b>2,266</b>	<b>7,914</b>
Employer contributions	<b>4,661</b>	<b>5,117</b>
Benefit payments	<b>(5,866)</b>	<b>(5,531)</b>
Fair value of plan assets	<b>95,254</b>	<b>94,193</b>
Deficiency of fair value of plan assets over projected benefit obligation included in other long-term liabilities	<b>\$ (32,010)</b>	<b>\$ (41,062)</b>

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**10. Retirement Plans (continued)**

No plan assets are expected to be returned to BHCC during the fiscal year ending September 30, 2019.

Included in unrestricted net assets at September 30, 2018 and 2017, were unrecognized actuarial losses of \$61,963 and \$69,052, respectively.

Changes in plans' assets and benefit obligations recognized in unrestricted net assets were as follows:

	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
Net actuarial gain	\$ 4,990	\$ 4,042
Amortization of:		
Net actuarial loss	2,099	2,097
Prior service cost	-	27
Total recognized in unrestricted net assets	<u>\$ 7,089</u>	<u>\$ 6,166</u>

The components of net periodic pension expense were as follows:

	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
Interest cost	\$ 5,115	\$ 5,008
Expected return on plan assets	(4,515)	(4,640)
Amortization of:		
Net actuarial loss	2,099	2,097
Prior service cost	-	27
Net periodic pension expense	<u>\$ 2,699</u>	<u>\$ 2,492</u>

The unrecognized actuarial loss and prior service cost included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ending September 30, 2018, is \$1,838.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**10. Retirement Plans (continued)**

The assumptions used to determine accrued pension costs and net periodic pension cost are set forth below:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
<b>Used to determine projected benefit obligation</b>		
Defined benefit pension plan:		
Weighted-average discount rate	<b>4.32%</b>	3.89%
Weighted-average rate of compensation increase	<b>N/A</b>	N/A
Weighted-average expected long-term rate of return on plan assets	<b>5.05%</b>	4.90%
Supplemental employee retirement benefit plan:		
Weighted-average discount rate	<b>4.22%</b>	3.65%
Weighted-average rate of compensation increase	<b>N/A</b>	N/A
Weighted-average expected long-term rate of return on plan assets	<b>N/A</b>	N/A
	<b>Year Ended September 30</b>	
	<b>2018</b>	<b>2017</b>
<b>Used to determine benefit cost</b>		
Defined benefit pension plan:		
Weighted-average discount rate	<b>3.89%</b>	3.77%
Weighted-average rate of compensation increase	<b>N/A</b>	N/A
Weighted-average expected long-term rate of return on plan assets	<b>4.90%</b>	5.25%
Supplemental employee retirement benefit plan:		
Weighted-average discount rate	<b>3.65%</b>	3.46%
Weighted-average rate of compensation increase	<b>N/A</b>	N/A
Weighted-average expected long-term rate of return on plan assets	<b>N/A</b>	N/A

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Dollars in Thousands)

**10. Retirement Plans (continued)**

**Asset Allocation**

The weighted-average asset allocation for the defined benefit pension plan as of September 30, 2018 and 2017, and the target allocation for fiscal 2018, by asset category, is as follows:

Asset Category	Target Allocation Fiscal 2018	Percentage of Plan Assets	
		September 30 2018	2017
U.S. equities	19.0%	<b>15.2%</b>	17.1%
International equities	18.9	<b>23.2</b>	29.7
Fixed income	56.0	<b>53.4</b>	43.8
Real estate	6.1	<b>6.2</b>	7.0
Cash and cash equivalents	0.0	<b>2.0</b>	2.4
Total	100.0%	<b>100.0%</b>	100.0%

The Retirement Plan Committee has approved the investment of the defined benefit pension plan's asset in mutual funds that invest in the asset categories noted above.

**Fair Value of Plan Assets**

The defined benefit pension plan's assets, measured at fair value on a recurring basis by the valuation hierarchy defined in Note 15, at September 30, 2018 and 2017, were as follows:

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,882	\$ —	\$ —	\$ 1,882

  

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 2,243	\$ —	\$ —	\$ 2,243

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### 10. Retirement Plans (continued)

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of the securities included in Level 2 are based on pricing inputs that are either directly observable or that can be derived or supported from observable data as of the reporting date.

The following table represents a reconciliation of the plan's assets presented in the valuation hierarchy to the total plan assets:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Cash and cash equivalents	\$ 1,882	\$ 2,243
Other investments at net asset value (NAV)	93,372	91,950
Total plan assets	<u>\$ 95,254</u>	<u>\$ 94,193</u>

The plan holds units of various Aon Hewitt Group Trust Funds (Trust Funds) offered through a private placement. The units are valued daily using the net asset value (NAV). The NAVs are based on the fair value of each fund's underlying investments. Level 1 assets are priced using quotes for trades occurring in active markets for the identical asset. Level 2 assets are priced using observable inputs for the asset (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates) or inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

#### Investment Strategy

The defined benefit pension plan's asset allocation and investment strategy are designed to earn returns on plan assets, consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors, and manager style to minimize the risk of large losses. BHCC uses investment managers specializing in each asset category and provides the investment managers with specific guidelines that include allowable and/or prohibited investment types. BHCC regularly monitors manager performance and compliance with investment guidelines.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### 10. Retirement Plans (continued)

##### Expected Rate of Return

The expected long-term rate of return on the defined benefit pension plan's assets is based on historical and projected rates of return for current and planned asset categories in the plan's investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets.

The expected employer contributions for the year ending September 30, 2019, are \$2,790.

The following represents the expected benefit plan payments for the next five years and the five years thereafter:

	<u>Amount</u>
Year ending September 30:	
2019	\$ 6,819
2020	7,114
2021	7,368
2022	7,577
2023	7,747
2024–2028	40,123

BHCC sponsors a defined contribution plan, covering all eligible associates, excluding LCI's employees. Benefits are determined as a percentage of a participant's salary and increase over specified periods of employee service. Participants become fully vested in the employer contributions after six years. Defined contribution expense matched by BHCC was \$3,442 and \$3,320 for the years ended September 30, 2018 and 2017, respectively. The service-graded employer contribution expense was \$815 and \$789 for the years ended September 30, 2018 and 2017, respectively.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**10. Retirement Plans (continued)**

LCI provides a tax deferred annuity 403(b) retirement plan to all eligible employees. Employees of LCI who work a minimum of 20 hours per week are eligible to participate in the plan after completing one year of employment. Voluntary employee contributions are allowed to the extent permitted by law. LCI contributes a total of 3%, with a match of up to 2% of each eligible participant's compensation. In compliance with Internal Revenue Service regulations, employer contributions for eligible participants vest under a six-year graduated vesting schedule. Retirement expense for the years ended September 30, 2018 and 2017, was \$2,284 and \$2,142, respectively.

**11. Concentrations of Credit Risk**

BHCC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Medicare	<b>38%</b>	39%
Medicaid	<b>8</b>	9
Other third-party payors	<b>41</b>	38
Patient responsibility	<b>13</b>	14
	<b>100%</b>	100%

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

**12. Commitments and Contingencies**

**Operating Leases**

BHCC leases certain equipment and building space under operating leases. Future minimum lease payments, by year and in the aggregate, under noncancelable operating leases with terms of one year or more are as follows:

	<u>Amount</u>
Year ending September 30:	
2019	\$ 2,583
2020	2,524
2021	2,106
2022	1,419
2023	1,279
Thereafter	5,042
	<u>\$ 14,953</u>

Total expense under operating leases was \$14,819 and \$13,111 for the years ended September 30, 2018 and 2017, respectively.

**Malpractice**

With the exception of LCI, BHCC's subsidiaries maintain a self-insured retention (SIR) for general and professional liability insurance on a claims-made basis. The SIR is \$3,000 per occurrence with a \$9,000 aggregate plus a \$2,000 aggregate buffer. In addition, these subsidiaries have various excess claims-made policies extending coverages up to \$30,000. BHCC's employed physicians are self-insured with coverage limits of \$1,000 per occurrence and \$3,000 in the aggregate.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**12. Commitments and Contingencies (continued)**

Losses are accrued based on estimates provided by BHCC's consulting actuary and are based on actuarial assumptions that incorporate past experience and other considerations, including the nature of each claim or incident and relevant trends. The accrued liability for self-insured claims, discounted at 2.5% and 1.4%, amounted to \$13,650 and \$9,518 at September 30, 2018 and 2017, respectively, and is included in the accompanying consolidated balance sheets as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Other current liabilities	\$ 1,337	\$ 871
Other long-term liabilities	<b>12,313</b>	8,647
	<b>\$ 13,650</b>	<b>\$ 9,518</b>

BHCC has on deposit, in a revocable trust, cash and investments totaling \$7,115 and \$7,049 at September 30, 2018 and 2017, respectively, to be used for payment of self-insured claims in the future, which are included in investments limited as to use.

LCI carries general and professional liability insurance on a claims-made basis, with coverage up to \$1,000 per occurrence and \$3,000 in the aggregate, and employee benefits liability insurance with coverage up to \$1,000 per occurrence and \$1,000 in the aggregate. In addition, LCI has excess coverage policies for losses up to \$5,000 per occurrence and in the aggregate.

Should any of the claims-made policies not be renewed or replaced with equivalent insurance, claims based on occurrences during the terms but reported subsequently will be uninsured.

Malpractice insurance expense for the years ended September 30, 2018 and 2017, was approximately \$9,010 and \$1,216, respectively.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### 12. Commitments and Contingencies (continued)

##### Asset Retirement Obligations

ASC Topic 410-20, *Asset Retirement and Environmental Obligations*, provides guidance with respect to the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation are conditional on a future event. ASC Topic 410-20 requires that the fair value of a liability for a conditional asset retirement obligation be recognized in the period in which it occurred if a reasonable estimate of fair value can be made. BHCC has determined that conditional legal obligations exist for certain of its facilities related primarily to underground storage tanks and asbestos materials. Conditional asset retirement obligations recorded as of September 30, 2018 and 2017, were \$2,579 and \$2,546, respectively. There are no assets legally restricted for purposes of settling asset retirement obligations.

During 2018 and 2017, \$2 and \$62, respectively, of retirement obligations were settled. Accretion expense of \$35 and \$31 was recorded during the years ended September 30, 2018 and 2017, respectively.

##### Air Rights

BHCC owns medical office buildings and has executed agreements with several parties in which these parties purchase office space. Simultaneously with the execution of the purchase agreements, Baptist entered into an air rights lease with the purchasers, providing for access to building easements. Included in the air rights lease are put options that grant the purchaser the right to sell the office space back to Baptist at the 7th, 10th, 20th, and 30th anniversaries of the execution of the lease. Because of the put options, the purchases of the office space do not qualify as a sale under generally accepted accounting principles and instead are accounted for as financing transactions. A purchaser has provided notice to exercise a put option with an anticipated transaction date in 2019. Included in other current liabilities at September 30, 2018 is \$1,000, and in other long-term liabilities in the accompanying consolidated balance sheets at September 30, 2018 and 2017, is \$6,390 and \$7,103, respectively, in financing obligations related to these transactions.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

#### 12. Commitments and Contingencies (continued)

##### Electronic Health Record

In October 2015, BHCC finalized its vendor selections for the purchase and implementation of a new EHR impacting BHCC's acute care and ambulatory practices, as well as certain ancillary and revenue cycle systems. BHCC executed a ten-year agreement for implementation costs and services, as well as ongoing maintenance and support for a total of \$34.7 million over the life of the contract. The costs include acquisition, implementation, and ongoing support and maintenance. Through September 30, 2018, Baptist has capitalized \$31,327 related to the EHR project. The EHR went live in December 2017, and is being amortized over eight years. Amortization expense was \$3,680 for the year ended September 30, 2018.

#### 13. Supplemental Cash Flows Information

BHCC experienced changes in the components of working capital as follows:

	Year Ended September 30	
	2018	2017
Increase in accounts and contracts receivable	\$ (114,314)	\$ (79,406)
(Increase) decrease in inventories	(989)	924
Increase in prepaid expenses and other current assets	(3,179)	(1,265)
Decrease in accounts payable and accrued expenses	(2,038)	(1,674)
Decrease in amounts due to third-party payors	(4,205)	(520)
Increase (decrease) in other current liabilities	3,248	(2,218)
	<u>\$ (121,477)</u>	<u>\$ (84,159)</u>

Interest paid was \$11,370 and \$10,416 for the years ended September 30, 2018 and 2017, respectively.

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Dollars in Thousands)

**13. Supplemental Cash Flows Information (continued)**

During 2018 BHCC corrected the presentation of activities associated with the lines of credit activities by revising the 2017 statement of cash flows. Previously, activities associated with the lines of credit were incorrectly presented as operating cash flows instead of as financing activities. During 2018, the 2017 statement of cash flows was revised as outlined in the table below. Management believes the impact of such revision is immaterial.

<u>Consolidated Statement of Cash Flows</u>	<u>Year Ended September 30, 2017</u>		
	<u>As Previously Reported</u>	<u>Adjustment</u>	<u>As adjusted</u>
Operating activities:			
Net increase in components of working capital (change in other current liabilities)	\$ (76,671)	\$ (7,488)	\$ (84,159)
Net cash provided by operating activities	58,459	(7,488)	50,971
Financing activities:			
Proceeds from lines of credit	–	69,162	69,162
Payments on lines of credit	–	(61,674)	(61,674)
Net cash provided by financing activities	6,377	7,488	13,865

**14. Other Assets**

The composition of other assets is as follows:

	<u>September 30</u>	
	<u>2018</u>	<u>2017</u>
Cash surrender value of insurance	\$ 5,929	\$ 5,647
Goodwill	9,456	9,456
Physician guarantees	4	94
Investment in joint ventures	769	792
Investment in rental property	460	469
Other	2,937	2,555
	<u>\$ 19,555</u>	<u>\$ 19,013</u>

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

#### 14. Other Assets (continued)

Goodwill is evaluated for impairment annually or when there is an indicator of impairment. If it is determined that goodwill is impaired, the carrying value is reduced.

#### 15. Fair Value Measurements

As defined in ASC Topic 820, *Fair Value Measurement*, 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. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

Certain of BHCC's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market, fixed income and equity instruments, and interest rate swap agreements. The three levels of the fair value hierarchy defined by ASC Topic 820 and a description of the valuation methodologies used for instruments measured at fair value are as follows:

*Level 1* – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that BHCC has the ability to access.

*Level 2* – Financial assets and liabilities whose values are based on pricing inputs that are either directly observable or that can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets or liabilities in nonactive markets or pricing models whose inputs are observable for substantially the full term of the asset or liability.

*Level 3* – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both significant to the fair value of the financial asset or financial liability and are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. BHCC has no financial assets or financial liabilities with significant Level 3 inputs.

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

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Dollars in Thousands)

**15. Fair Value Measurements (continued)**

The fair value of financial assets and financial liabilities at September 30, 2018 and 2017, measured at fair value on a recurring basis was as follows:

	<b>September 30, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Cash and cash equivalents	\$ 137,939	\$ —	\$ —	\$ 137,939
Short-term investments:				
U.S. corporate obligations	—	40,399	—	40,399
U.S. Treasury obligations	7,427	—	—	7,427
U.S. government agencies and sponsored entities	—	14,608	—	14,608
Collateralized debt obligations	—	3,911	—	3,911
Domestic equities	40,162	—	—	40,162
Foreign equities	32,911	—	—	32,911
Other	—	1,164	—	1,164
Total short-term investments	<b>80,500</b>	<b>60,082</b>	—	<b>140,582</b>
Investments limited as to use:				
Cash and cash equivalents	3,336	—	—	3,336
U.S. corporate obligations	—	22,610	—	22,610
U.S. Treasury obligations	12,933	—	—	12,933
U.S. government agencies and sponsored entities	—	6,360	—	6,360
Collateralized debt obligations	—	1,536	—	1,536
Domestic equities	20,757	—	—	20,757
Foreign equities	13,214	—	—	13,214
Other	6,705	457	—	7,162
Total investments limited as to use	<b>56,945</b>	<b>30,963</b>	—	<b>87,908</b>
	<b>\$ 275,384</b>	<b>\$ 91,045</b>	<b>\$ —</b>	<b>\$ 366,429</b>
<b>Liabilities</b>				
Interest rate swap agreements	\$ —	\$ 300	\$ —	\$ 300

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

15. Fair Value Measurements (continued)

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash and cash equivalents	\$ 162,961	\$ —	\$ —	\$ 162,961
Short-term investments:				
U.S. corporate obligations	—	35,238	—	35,238
U.S. Treasury obligations	2,830	—	—	2,830
U.S. government agencies and sponsored entities	—	11,632	—	11,632
Collateralized debt obligations	—	3,829	—	3,829
Domestic equities	30,671	—	—	30,671
Foreign equities	32,277	—	—	32,277
Other	—	451	—	451
Total short-term investments	65,778	51,150	—	116,928
Investments limited as to use:				
Cash and cash equivalents	8,259	—	—	8,259
U.S. corporate obligations	—	20,272	—	20,272
U.S. Treasury obligations	9,580	—	—	9,580
U.S. government agencies and sponsored entities	—	5,272	—	5,272
Collateralized debt obligations	—	1,534	—	1,534
Domestic equities	16,934	—	—	16,934
Foreign equities	14,315	—	—	14,315
Other	6,639	1,578	—	8,217
Total investments limited as to use	55,727	28,656	—	84,383
	\$ 284,466	\$ 79,806	\$ —	\$ 364,272
<b>Liabilities</b>				
Interest rate swap agreements	\$ —	\$ 1,064	\$ —	\$ 1,064

Baptist Health Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Dollars in Thousands)*

**15. Fair Value Measurements (continued)**

Financial assets and financial liabilities are reflected in the accompanying consolidated balance sheets as follows:

	<b>September 30</b>	
	<b>2018</b>	<b>2017</b>
Short-term investments, at fair value	<b>\$ 140,582</b>	\$ 116,928
Alternative investments accounted for under the equity method	<b>26,366</b>	23,005
Total short-term investments	<b><u>\$ 166,948</u></b>	<u>\$ 139,933</u>
Investments limited as to use, at fair value	<b>\$ 87,908</b>	\$ 84,383
Alternative investments accounted for under the equity method	<b>10,325</b>	9,658
Other	<b>1,843</b>	1,484
Total investments limited as to use	<b><u>\$ 100,076</u></b>	<u>\$ 95,525</u>

Included in alternative investments, within investments limited as to use, is \$9,251 and \$8,200 at September 30, 2018 and 2017, respectively, of investments required to be held a minimum of twenty-four months prior to redemption. This restriction will expire March 31, 2019.

See Note 9 for location of interest rate swap liabilities in the accompanying consolidated balance sheets.

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 financial assets and financial liabilities were determined as follows:

*U.S. government agencies and sponsored entities, residential mortgage-backed, collateralized debt obligations, and other securities* – The fair values of these securities were determined through evaluated bid prices provided by third-party pricing services where quoted market values are not available.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### **15. Fair Value Measurements (continued)**

*Interest rate swaps* – The fair value of interest rate swaps was determined based on the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. The analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest rate curves. In addition, credit valuation adjustments are included to reflect both BHCC's nonperformance risk and the respective counterparty's nonperformance risk. BHCC pays fixed rates, ranging from 3.3% to 3.5%, and receives cash flows based primarily on percentages of LIBOR, ranging from 67% to 74% of LIBOR.

The carrying value of accounts receivable, accounts payable, and accrued liabilities are reasonable estimates of their fair value due to the short-term nature of these financial instruments. The fair values of BHCC's fixed-rate bonds are estimated using Level 2 inputs based on quoted market prices for the same or similar issues and approximate \$149,679 and \$159,816 as of September 30, 2018 and 2017, respectively. The carrying values of these fixed-rate bonds were \$141,822 and \$146,377 as of September 30, 2018 and 2017, respectively. The carrying amount approximates fair value for all other long-term debt.

## Baptist Health Care Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Dollars in Thousands)*

#### 16. Changes in Consolidated Unrestricted Net Assets

Changes in consolidated unrestricted net assets that are attributable to BHCC and the noncontrolling interests in subsidiaries are as follows:

	<b>Total</b>	<b>Controlling Interest</b>	<b>Noncontrolling Interests</b>
Balance October 1, 2017	\$ 327,301	\$ 321,799	\$ 5,502
Excess of revenues, other support, and gains over expenses and losses	10,840	9,222	1,618
Other activity	8,021	8,374	(353)
Change in unrestricted net assets	18,861	17,596	1,265
Balance September 30, 2018	\$ 346,162	\$ 339,395	\$ 6,767

	<b>Total</b>	<b>Controlling Interest</b>	<b>Noncontrolling Interests</b>
Balance October 1, 2016	\$ 278,883	\$ 273,162	\$ 5,721
Excess of revenues, other support, and gains over expenses and losses	45,739	41,351	4,388
Other activity	2,679	7,286	(4,607)
Change in unrestricted net assets	48,418	48,637	(219)
Balance September 30, 2017	\$ 327,301	\$ 321,799	\$ 5,502

#### 17. Subsequent Events

BHCC evaluated events and transactions occurring subsequent to September 30, 2018, and through December 21, 2018, the date the accompanying consolidated financial statements were available to be issued. During this period, there were no subsequent events that required recognition or disclosure in the accompanying consolidated financial statements.

# Supplementary Information

# Baptist Health Care Corporation and Subsidiaries

## Consolidating Balance Sheet Information (In Thousands)

September 30, 2018

	Consolidated Total	Consolidating/ Eliminating Entries	Baptist Health Care Corporation	Combined Group	Jay Hospital, Inc.	Baptist Health Care Foundation, Inc.	Baptist Health Ventures, Inc. and Subsidiaries
<b>Assets</b>							
Current assets:							
Cash and cash equivalents	\$ 137,939	\$ –	\$ 1,865	\$ 135,187	\$ 66	\$ 844	\$ (23)
Short-term investments	166,948	(123,755)	123,755	157,857	–	9,091	–
Accounts receivable, net	82,569	–	1,652	76,822	879	–	3,216
Contracts receivable	24,116	–	–	24,116	–	–	–
Current portion of investments limited as to use	1,337	–	–	1,337	–	–	–
Inventories	14,294	–	–	13,041	131	–	1,122
Prepaid expenses and other current assets	17,722	–	4,019	12,187	66	–	1,450
Total current assets	444,925	(123,755)	131,291	420,547	1,142	9,935	5,765
Investments limited as to use, less current portion	98,739	(81,163)	87,210	89,793	–	2,899	–
Net property, plant, and equipment	242,706	–	176	187,110	2,568	–	52,852
Other assets	19,555	(51,570)	(66,792)	137,054	–	52	811
Total assets	\$ 805,925	\$ (256,488)	\$ 151,885	\$ 834,504	\$ 3,710	\$ 12,886	\$ 59,428

## Baptist Health Care Corporation and Subsidiaries

### Consolidating Balance Sheet Information (continued) (In Thousands)

	Consolidated Total	Consolidating/ Eliminating Entries	Baptist Health Care Corporation	Combined Group	Jay Hospital, Inc.	Baptist Health Care Foundation, Inc.	Baptist Health Ventures, Inc. and Subsidiaries
<b>Liabilities and net assets</b>							
Current liabilities:							
Accounts payable	\$ 51,847	\$ —	\$ 4,156	\$ 45,653	\$ 483	\$ —	\$ 1,555
Accrued compensation and benefits	28,612	—	4,595	21,917	366	—	1,734
Accrued interest	1,487	—	—	1,414	—	—	73
Estimated third-party settlements	10,026	—	—	9,121	905	—	—
Current portion of long-term debt	10,871	—	—	9,342	28	—	1,501
Other current liabilities	72,034	—	3,492	68,231	7	—	304
<b>Total current liabilities</b>	<b>174,877</b>	<b>—</b>	<b>12,243</b>	<b>155,678</b>	<b>1,789</b>	<b>—</b>	<b>5,167</b>
Long-term debt, less current portion	213,700	—	—	185,691	52	—	27,957
Asset retirement obligations	2,579	—	—	2,444	135	—	—
Other long-term liabilities	61,528	(2,625)	18,679	42,494	257	98	2,625
Due to affiliated organizations	—	(185,474)	96,826	—	10,127	141	78,380
<b>Total liabilities</b>	<b>452,684</b>	<b>(188,099)</b>	<b>127,748</b>	<b>386,307</b>	<b>12,360</b>	<b>239</b>	<b>114,129</b>
Net assets (deficit):							
Unrestricted:							
Controlling interest	339,395	(66,562)	24,137	439,008	(8,650)	7,022	(55,560)
Noncontrolling interests in subsidiaries	6,767	—	—	5,908	—	—	859
	346,162	(66,562)	24,137	444,916	(8,650)	7,022	(54,701)
Temporarily restricted – controlling interest	7,079	(1,827)	—	3,281	—	5,625	—
<b>Total net assets (deficit)</b>	<b>353,241</b>	<b>(68,389)</b>	<b>24,137</b>	<b>448,197</b>	<b>(8,650)</b>	<b>12,647</b>	<b>(54,701)</b>
<b>Total liabilities and net assets (deficit)</b>	<b>\$ 805,925</b>	<b>\$ (256,488)</b>	<b>\$ 151,885</b>	<b>\$ 834,504</b>	<b>\$ 3,710</b>	<b>\$ 12,886</b>	<b>\$ 59,428</b>

## Baptist Health Care Corporation and Subsidiaries

### Consolidating Statement of Operations and Changes in Net Assets Information (In Thousands)

Year Ended September 30, 2018

	Consolidated Total	Consolidating/ Eliminating Entries	Baptist Health Care Corporation	Combined Group	Jay Hospital, Inc.	Baptist Health Care Foundation, Inc.	Baptist Health Ventures, Inc. and Subsidiaries
Unrestricted revenues and other support:							
Patient service revenue	\$ 638,948	\$ 499	\$ 4,972	\$ 604,780	\$ 11,676	\$ –	\$ 17,021
Provision for bad debts	(92,212)	–	(47)	(88,732)	(3,243)	–	(190)
Net patient service revenue	546,736	499	4,925	516,048	8,433	–	16,831
Federal, state, and other awards	70,186	–	–	70,186	–	–	–
Vocational service contracts	181,989	–	–	181,989	–	–	–
Contract revenue	30,316	–	–	30,316	–	–	–
Other revenue	31,568	(64,504)	60,257	17,648	522	1,440	16,205
Net assets released from restrictions used for operations	1,275	–	–	211	–	1,064	–
Total unrestricted revenues and other support	862,070	(64,005)	65,182	816,398	8,955	2,504	33,036
Expenses:							
Salaries and benefits	435,153	(202)	41,487	369,130	6,832	–	17,906
Supplies	144,602	–	1,800	137,105	1,247	–	4,450
General, administrative, and other	108,801	(65,544)	14,131	139,461	3,217	1,067	16,469
Professional fees and purchased services	118,876	(941)	8,037	108,605	1,146	–	2,029
Contract medical costs	16,132	–	–	16,132	–	–	–
Depreciation and amortization	26,707	(99)	340	23,472	454	–	2,540
Interest	11,423	(465)	99	10,407	7	–	1,375
Total expenses	861,694	(67,251)	65,894	804,312	12,903	1,067	44,769
Income (loss) from operations before gain							
from weather related events	376	3,246	(712)	12,086	(3,948)	1,437	(11,733)
Gain from weather related events	2,644	–	–	2,644	–	–	–
Income (loss) from operations	3,020	3,246	(712)	14,730	(3,948)	1,437	(11,733)

## Baptist Health Care Corporation and Subsidiaries

### Consolidating Statement of Operations and Changes in Net Assets Information (continued) (In Thousands)

	Consolidated Total	Consolidating/ Eliminating Entries	Baptist Health Care Corporation	Combined Group	Jay Hospital, Inc.	Baptist Health Care Foundation, Inc.	Baptist Health Ventures, Inc. and Subsidiaries
Nonoperating gains (losses):							
Change in fair value of interest rate swap agreements	\$ 764	\$ —	\$ —	\$ 764	\$ —	\$ —	\$ —
Net unrealized gains on trading securities	3,376	(3,424)	3,425	3,261	—	114	—
Investment income (loss)	7,215	(7,077)	6,001	9,650	(257)	614	(1,716)
Other, net	(3,535)	10,683	(13,440)	(332)	(5)	(661)	220
	<u>7,820</u>	<u>182</u>	<u>(4,014)</u>	<u>13,343</u>	<u>(262)</u>	<u>67</u>	<u>(1,496)</u>
Excess (deficiency) of revenues, other support, and gains over expenses and losses	10,840	3,428	(4,726)	28,073	(4,210)	1,504	(13,229)
Less excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,618	—	—	1,382	—	—	236
Excess (deficiency) of revenues, other support, and gains over expenses and losses attributable to controlling interest	9,222	3,428	(4,726)	26,691	(4,210)	1,504	(13,465)
Unrestricted net assets:							
Excess (deficiency) of revenues, other support, and gains over expenses and losses attributable to controlling interests	9,222	3,428	(4,726)	26,691	(4,210)	1,504	(13,465)
Excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,618	—	—	1,382	—	—	236
Net unrealized gains on other-than-trading securities	164	—	164	—	—	—	—
Net assets released from restrictions for purchase of property, plant, and equipment	1,087	—	—	1,087	—	—	—
Pension adjustment	7,089	—	382	6,707	—	—	—
Other	(319)	(105)	—	(102)	—	—	(112)
Increase (decrease) in unrestricted net assets	<u>18,861</u>	<u>3,323</u>	<u>(4,180)</u>	<u>35,765</u>	<u>(4,210)</u>	<u>1,504</u>	<u>(13,341)</u>

## Baptist Health Care Corporation and Subsidiaries

### Consolidating Statement of Operations and Changes in Net Assets Information (continued) (In Thousands)

	Consolidated Total	Consolidating/ Eliminating Entries	Baptist Health Care Corporation	Combined Group	Jay Hospital, Inc.	Baptist Health Care Foundation, Inc.	Baptist Health Ventures, Inc. and Subsidiaries
Temporarily restricted net assets:							
Contributions	\$ 2,069	\$ –	\$ –	\$ 872	\$ –	\$ 1,197	\$ –
Net unrealized losses on other-than-trading securities	(128)	–	–	–	–	(128)	–
Net assets released from restrictions	(2,362)	–	–	(1,298)	–	(1,064)	–
Other	50	(68)	–	130	–	(12)	–
Decrease in temporarily restricted net assets	(371)	(68)	–	(296)	–	(7)	–
Increase (decrease) in net assets	18,490	3,255	(4,180)	35,469	(4,210)	1,497	(13,341)
Net assets (deficit) at beginning of year	334,751	(71,644)	28,317	412,728	(4,440)	11,150	(41,360)
Net assets (deficit) at end of year	\$ 353,241	\$ (68,389)	\$ 24,137	\$ 448,197	\$ (8,650)	\$ 12,647	\$ (54,701)

Combined Group Under Master Trust Indenture  
(Baptist Hospital, Inc. and Lakeview Center, Inc.)

Combining Balance Sheet Information  
(In Thousands)

September 30, 2018

	Combined Total	Combining/ Eliminating Entries	Baptist Hospital, Inc.	Lakeview Center, Inc. and Subsidiaries
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 135,187	\$ –	\$ 75,548	\$ 59,639
Short-term investments	157,857	–	84,182	73,675
Accounts receivable, net	76,822	–	72,429	4,393
Contracts receivable	24,116	–	–	24,116
Current portion of investments limited as to use	1,337	–	1,337	–
Inventories	13,041	–	12,488	553
Prepaid expenses and other current assets	12,187	–	8,893	3,294
Total current assets	420,547	–	254,877	165,670
Investments limited as to use, less current portion	89,793	–	37,623	52,170
Net property, plant, and equipment	187,110	–	166,880	20,230
Other assets	137,054	–	117,657	19,397
Total assets	<u>\$ 834,504</u>	<u>\$ –</u>	<u>\$ 577,037</u>	<u>\$ 257,467</u>
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 45,653	\$ –	\$ 35,479	\$ 10,174
Accrued compensation and benefits	21,917	–	18,244	3,673
Accrued interest	1,414	–	1,414	–
Estimated third-party settlements	9,121	–	9,121	–
Current portion of long-term debt	9,342	–	9,304	38
Other current liabilities	68,231	–	53,119	15,112
Total current liabilities	155,678	–	126,681	28,997
Long-term debt, less current portion	185,691	–	185,019	672
Asset retirement obligations	2,444	–	2,444	–
Other long-term liabilities	42,494	–	42,494	–
Total liabilities	386,307	–	356,638	29,669
Net assets:				
Unrestricted:				
Controlling interest	439,008	–	213,037	225,971
Noncontrolling interests in subsidiaries	5,908	–	5,908	–
	444,916	–	218,945	225,971
Temporarily restricted – controlling interest	3,281	–	1,454	1,827
Total net assets	448,197	–	220,399	227,798
Total liabilities and net assets	<u>\$ 834,504</u>	<u>\$ –</u>	<u>\$ 577,037</u>	<u>\$ 257,467</u>

Combined Group Under Master Trust Indenture  
(Baptist Hospital, Inc. and Lakeview Center, Inc.)

Combining Statement of Operations  
and Changes in Net Assets Information  
(In Thousands)

Year Ended September 30, 2018

	Combined Total	Combining/ Eliminating Entries	Baptist Hospital, Inc.	Lakeview Center, Inc. and Subsidiaries
Unrestricted revenues and other support:				
Patient service revenue	\$ 604,780	\$ –	\$ 590,184	\$ 14,596
Provision for bad debts	(88,732)	–	(88,442)	(290)
Net patient service revenue	516,048	–	501,742	14,306
Federal, state, and other awards	70,186	–	–	70,186
Vocational service contracts	181,989	–	–	181,989
Contract revenue	30,316	–	–	30,316
Other revenue	17,648	(7,232)	21,663	3,217
Net assets released from restrictions used for operations	211	–	211	–
Total unrestricted revenues and other support	816,398	(7,232)	523,616	300,014
Expenses:				
Salaries and benefits	369,130	–	233,553	135,577
Supplies	137,105	–	126,161	10,944
General, administrative, and other	139,461	–	102,529	36,932
Professional fees and purchased services	108,605	(6,139)	44,526	70,218
Contract medical costs	16,132	–	–	16,132
Depreciation and amortization	23,472	–	21,041	2,431
Interest	10,407	–	10,336	71
Total expenses	804,312	(6,139)	538,146	272,305
Income (loss) from operations before gain from weather related events	12,086	(1,093)	(14,530)	27,709
Gain from weather related events	2,644	–	2,644	–
Income (loss) from operations	14,730	(1,093)	(11,886)	27,709
Nonoperating gains (losses):				
Change in fair value of interest rate swap agreements	764	–	764	–
Unrealized gains on trading securities	3,261	–	1,740	1,521
Investment income	9,650	–	5,967	3,683
Other, net	(332)	1,093	(1,425)	–
	13,343	1,093	7,046	5,204
Excess (deficiency) of revenues, other support, and gains over expenses and losses	28,073	–	(4,840)	32,913
Less excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,382	–	1,382	–
Excess (deficiency) of revenues, other support, and gains over expenses and losses attributable to controlling interest	26,691	–	(6,222)	32,913

Combined Group Under Master Trust Indenture  
(Baptist Hospital, Inc. and Lakeview Center, Inc.)

Combining Statement of Operations  
and Changes in Net Assets Information (continued)  
(In Thousands)

	Combined Total	Combining/ Eliminating Entries	Baptist Hospital, Inc.	Lakeview Center, Inc. and Subsidiaries
Unrestricted net assets:				
Excess (deficiency) of revenues, other support, and gains over expenses and losses attributable to controlling interest	\$ 26,691	\$ —	\$ (6,222)	\$ 32,913
Excess of revenues, other support, and gains over expenses and losses attributable to noncontrolling interests	1,382	—	1,382	—
Net assets released from restriction for purchase of property, plant, and equipment	1,087	—	1,087	—
Pension adjustment	6,707	—	6,707	—
Other	(102)	—	(207)	105
Increase in unrestricted net assets	35,765	—	2,747	33,018
Temporarily restricted net assets:				
Contributions	872	—	872	—
Net assets released from restrictions	(1,298)	—	(1,298)	—
Other	130	—	62	68
(Decrease) increase in temporarily restricted net assets	(296)	—	(364)	68
Increase in net assets	35,469	—	2,383	33,086
Net assets at beginning of year	412,728	—	218,016	194,712
Net assets at end of year	\$ 448,197	\$ —	\$ 220,399	\$ 227,798

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