

**Cabell Huntington Hospital, Inc.
and Subsidiaries**

Consolidated Financial Statements
and Supplementary Information

September 30, 2017 and 2016



BAKER TILLY

Candor. Insight. Results.

Cabell Huntington Hospital, Inc. and Subsidiaries

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September 30, 2017 and 2016

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Independent Auditors' Report

Board of Directors
Cabell Huntington Hospital, Inc.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Cabell Huntington Hospital, Inc. and subsidiaries, which comprise the consolidated balance sheet as of September 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary consolidating information on pages 38-40 is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Pittsburgh, Pennsylvania
December 12, 2017

Cabell Huntington Hospital, Inc. and Subsidiaries

 Consolidated Balance Sheet
 September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>		<u>2017</u>	<u>2016</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 70,543,249	\$ 98,241,853	Lines of credit	\$ 365,955	\$ 370,735
Patient accounts receivable (net of estimated allowance for doubtful accounts of \$30,212,000 in 2017 and \$25,266,000 in 2016)	70,424,748	67,972,456	Current maturities of long-term debt	5,561,026	5,446,312
Inventories, prepaid expenses, and other receivables	12,269,311	11,259,997	Accounts payable	8,001,259	12,538,559
Estimated third-party payor settlements	8,742,931	6,905,680	Accrued expenses	59,612,465	57,901,901
Other current assets	9,299,432	7,945,174	Estimated third-party payor settlements	2,826,899	3,792,552
			Current portion of estimated professional liabilities	2,856,000	2,424,000
Total current assets	<u>171,279,671</u>	<u>192,325,160</u>	Total current liabilities	79,223,604	82,474,059
Investments			Long-Term Debt, Net	95,479,892	100,336,031
Board designated	201,082,206	151,339,345	Derivative Financial Instruments	11,916,091	17,621,281
Funds held by Foundation	167,219	107,284	Deferred Gains	1,204,111	1,972,554
Total investments	<u>201,249,425</u>	<u>151,446,629</u>	Accrued Professional Liability and Other	11,674,678	11,726,128
Property and Equipment, Net	230,787,015	213,876,900	Accrued Pension and Postretirement Liabilities	134,335,198	150,910,492
Partnership Investments	9,809,084	10,640,061	Total liabilities	<u>333,833,574</u>	<u>365,040,545</u>
Other Assets, Net	12,666,146	12,519,783	Net Assets		
			Controlling interest	288,473,721	212,552,521
			Noncontrolling interest	206,734	290,094
			Total unrestricted	288,680,455	212,842,615
			Temporarily restricted	3,277,312	2,925,373
			Total net assets	<u>291,957,767</u>	<u>215,767,988</u>
Total assets	<u>\$ 625,791,341</u>	<u>\$ 580,808,533</u>	Total liabilities and net assets	<u>\$ 625,791,341</u>	<u>\$ 580,808,533</u>

See notes to consolidated financial statements

Cabell Huntington Hospital, Inc. and SubsidiariesConsolidated Statement of Operations
Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Unrestricted Revenues		
Patient service revenues (net of contractual allowances and discounts)	\$ 568,141,861	\$ 546,597,987
Provision for bad debts	(26,666,099)	(29,222,289)
Net patient service revenues	541,475,762	517,375,698
Other revenues, including net assets released from restrictions for operations	46,043,445	42,538,290
Total unrestricted revenues	<u>587,519,207</u>	<u>559,913,988</u>
Expenses		
Salaries and wages	168,070,390	168,778,964
Employee benefits	65,420,830	64,964,549
Supplies	104,047,900	102,585,693
Professional services	60,896,256	47,972,118
Maintenance and repairs	15,187,767	12,586,009
Interest	5,132,163	5,171,222
Depreciation and amortization	19,676,346	18,522,608
Provider tax	13,659,900	13,450,397
Insurance	4,976,224	3,516,572
Other	89,948,358	83,594,663
Total expenses	<u>547,016,134</u>	<u>521,142,795</u>
Operating income	<u>40,503,073</u>	<u>38,771,193</u>
Other Income (Loss)		
Investment income	12,030,684	11,744,117
Change in fair value of derivative financial instruments	5,705,190	(2,370,451)
Equity income from partnership investments	209,355	2,023,274
Acquisition costs	(328,964)	(23,275,180)
Revenues in excess of expenses	58,119,338	26,892,953
Pension and Postretirement Liabilities Adjustment	16,992,119	(11,208,473)
Net Assets Released from Restrictions for Property and Equipment	964,664	376,134
Equity Distributions	<u>(238,281)</u>	<u>(231,019)</u>
Increase in unrestricted net assets	<u>\$ 75,837,840</u>	<u>\$ 15,829,595</u>

See notes to consolidated financial statements

Cabell Huntington Hospital, Inc. and SubsidiariesConsolidated Statement of Changes in Net Assets
Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Unrestricted Net Assets		
Revenues in excess of expenses	\$ 58,119,338	\$ 26,892,953
Pension and postretirement liabilities adjustment	16,992,119	(11,208,473)
Net assets released from restrictions for property and equipment	964,664	376,134
Equity distributions	<u>(238,281)</u>	<u>(231,019)</u>
Increase in unrestricted net assets	<u>75,837,840</u>	<u>15,829,595</u>
Temporarily Restricted Net Assets		
Contributions and investment income, net	1,889,221	3,511,848
Net assets released from restrictions	<u>(1,537,282)</u>	<u>(1,238,363)</u>
Increase in temporarily restricted net assets	<u>351,939</u>	<u>2,273,485</u>
Change in net assets	76,189,779	18,103,080
Net Assets, Beginning of Year	<u>215,767,988</u>	<u>197,664,908</u>
Net Assets, End of Year	<u>\$ 291,957,767</u>	<u>\$ 215,767,988</u>

See notes to consolidated financial statements

Cabell Huntington Hospital, Inc. and Subsidiaries

Consolidated Statement of Cash Flows

Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities		
Change in net assets	\$ 76,189,779	\$ 18,103,080
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Provision for bad debts	26,666,099	29,222,289
Depreciation and amortization	19,676,346	18,522,608
Amortization of debt issuance costs and accretion of bond discount	82,320	82,321
Pension and postretirement liabilities adjustment	(16,992,119)	11,208,473
Net realized and unrealized gains on investments	(9,154,585)	(9,325,417)
Change in fair value of derivative financial instruments	(5,705,190)	2,370,451
Equity income from partnership investments	(209,355)	(2,023,274)
Distributions received from partnership investments	935,550	-
Restricted contributions and investment income	(1,889,221)	(3,511,848)
Other operating activities	104,782	475,823
Changes in assets and liabilities:		
Patient accounts receivable	(29,118,391)	(23,174,781)
Inventories, prepaid expenses, and other receivables	(1,009,314)	(2,878,684)
Estimated third-party payor settlements	(2,802,904)	837,293
Other assets	(1,500,621)	(1,763,563)
Accounts payable and accrued expenses	(2,826,736)	7,755,996
Deferred gains	(768,443)	(663,933)
Other liabilities	797,375	6,375,700
Net cash provided by operating activities	<u>52,475,372</u>	<u>51,612,534</u>
Cash Flows from Investing Activities		
Purchases of property and equipment	(36,586,461)	(27,874,110)
Net purchases of investments	(40,648,211)	(5,707,426)
Capital contributions to investees	-	(250,005)
Net cash used in investing activities	<u>(77,234,672)</u>	<u>(33,831,541)</u>
Cash Flows from Financing Activities		
Repayment of long-term debt	(4,823,745)	(4,235,509)
Net repayment of line of credit	(4,780)	(4,478)
Restricted contributions and investment income	1,889,221	3,511,848
Net cash used in financing activities	<u>(2,939,304)</u>	<u>(728,139)</u>
Net (decrease) increase in cash and cash equivalents	(27,698,604)	17,052,854
Cash and Cash Equivalents, Beginning of Year	<u>98,241,853</u>	<u>81,188,999</u>
Cash and Cash Equivalents, End of Year	<u>\$ 70,543,249</u>	<u>\$ 98,241,853</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	<u>\$ 5,074,926</u>	<u>\$ 5,121,106</u>

See notes to consolidated financial statements

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

1. Organizational Structure and Nature of Operations

Cabell Huntington Hospital, Inc. (the "Hospital") is an acute care facility in Huntington, West Virginia, that provides integrated health care solutions to residents of Cabell County and surrounding communities.

The consolidated financial statements include the accounts of the Hospital; Cabell Huntington Hospital Foundation, Inc. (the "Foundation"); Mountain Regional Services, Inc. ("MRS"), which owns certain real estate near the Hospital; CHH-Cabell Development Corporation, which owns certain long-lived assets used for outpatient surgery; Occumed, LLC ("Occumed"), which provides urgent care and occupational medicine and related services; and Cabell Huntington Hospital Auxiliary, Inc. ("Auxiliary").

2. Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Hospital and its majority-owned subsidiaries, (collectively, the "Corporation"). The minority ownership interest of the subsidiaries is treated as a noncontrolling interest in the consolidated financial statements. All significant intercompany transactions and amounts have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 consolidated 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

Cash and cash equivalents consist of cash on deposit and temporary investments with financial institutions, which have original maturities of three months or less at the date of purchase. The carrying amount of cash equivalents approximates fair value.

The Corporation maintains cash and cash equivalent accounts which may at times exceed federally insured limits. The Corporation has not experienced any losses from maintaining these accounts in excess of federally insured limits. Management believes it is not subject to significant risks associated with these accounts.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Patient Accounts Receivable

Patient accounts receivable are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. The provision for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, 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 doubtful accounts.

The Corporation has demonstrated successful results in collecting receivables from patients who have agreed to a payment plan, and these amounts will remain in patient accounts receivable at their estimated net realizable amounts and will be evaluated as part of management's assessment of the adequacy of the allowance for doubtful accounts.

The Corporation's allowance for doubtful accounts for self-pay patients was 72% of self-pay accounts receivable at September 30, 2017 and 2016. The Corporation's self-pay account write-offs (net of recoveries) were approximately \$21,720,000 in 2017 and \$27,159,000 in 2016. The decrease was the result of the adoption of Section 501(r) of the Internal Revenue Code which increased the period of time the Corporation attempts collection on self-pay accounts, therefore decreasing write-offs in 2017.

The Corporation has not changed its financial assistance policy in 2017 and 2016. The Corporation does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined on a weighted average basis.

Pledges Receivable

Unconditional pledges to contribute cash and other assets are reported at their estimated fair value at the date the promise is received. Pledges receivable that are expected to be collected within one year are recorded at their net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of estimated net realizable future cash flows. The current portion of pledges receivable was approximately \$402,000 in 2017 and \$403,000 in 2016, and is included in inventories, prepaid expenses, and other receivables in the accompanying consolidated balance sheet. The long-term portion of pledges receivable was approximately \$952,000 in 2017 and \$1,249,000 in 2016, and is included in other assets, net in the accompanying consolidated balance sheet.

The Corporation annually evaluates the collectability of its pledges receivable and either reserves for or writes off uncollectible pledges when it is determined the pledge is uncollectible. Recoveries of accounts previously written off are recorded as a reduction to bad debt expense when received.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Investments and Investment Risk

Investments include assets set aside by the Board of Directors (the "Board"), primarily for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes. Funds held by the Foundation are primarily restricted by donors to support the Hospital.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in revenues in excess of expenses unless the income or loss is restricted by donor or law.

The Corporation's investments are comprised of a variety of financial instruments and are managed by investment advisors. The fair values reported in the consolidated balance sheet are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying consolidated financial statements could change materially in the near term.

Property and Equipment

Property and equipment acquisitions are recorded at cost. The Corporation provides for depreciation on a straight-line basis over the estimated useful lives of the assets, generally ranging from 3 to 40 years. Such lives, in the opinion of management, are adequate to allocate asset costs over their productive lives. Maintenance, repairs, and minor improvements are expensed as incurred. Equipment under capital leases is amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Depreciation and amortization expense was approximately \$19,676,000 in 2017 and \$18,523,000 in 2016.

Net interest costs on borrowed funds in the period of construction of capital assets are capitalized as a component of the cost of those constructed assets. No interest costs were capitalized in 2017 or 2016.

Gifts of long-lived assets such as land, buildings, or equipment are recorded at fair value and reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of Property and Equipment

Property and equipment are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If expected cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. No impairment losses were recognized in 2017 or 2016.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

Partnership Investments

The Corporation uses the equity method of accounting for its partnership investments that it does not control but over which it does exercise significant influence. The Corporation considers whether the fair values of any of its partnership investments have declined below their carrying value whenever adverse events or changes in circumstances indicate that recorded values may not be recoverable. If the Corporation considers any such declines to be other than temporary (based on various factors including, but not limited to, current and historical financial results), an impairment charge would be recognized to reduce the carrying amount of the investment to its estimated fair value. No such indicators were present with respect to the Corporation's partnership investments as of September 30, 2017 and 2016.

Debt Issuance Costs

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the term of the related debt using the straight-line method, which approximates the effective interest method. Such costs are reflected as a reduction of long-term debt in the accompanying consolidated balance sheet. Amortization of debt issuance costs was approximately \$74,000 in 2017 and 2016, and is included in interest expense in the accompanying consolidated statement of operations.

Derivative Financial Instruments

The Corporation entered into interest rate swap agreements, which are considered derivative financial instruments, to manage its interest rate risk on certain long-term debt obligations. The interest rate swap agreements are reported at fair value in the consolidated balance sheet and related changes in fair value are reported in the consolidated statement of operations as a change in fair value of derivative financial instruments.

Estimated Professional Liability

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported including costs associated with litigation or settling claims. Anticipated insurance recoveries associated with reported claims are reported separately in the Corporation's consolidated balance sheet at net realizable value.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those assets whose use has been specifically limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity. There are no permanently restricted net assets at September 30, 2017 or 2016. The Corporation records restricted contributions whose restrictions are met in the same reporting period as unrestricted.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

Revenues in Excess of Expenses

The consolidated statement of operations includes the determination of revenues in excess of expenses. Changes in unrestricted net assets that are excluded from the determination of revenues in excess of expenses, consistent with industry practice, include changes in pension and postretirement benefit obligations, contributions of long-lived assets (including assets acquired using contributions that by donor restrictions are to be used for the purpose of acquiring such assets), and permanent transfers of assets to and from affiliates for other than goods and services.

Net Patient Service Revenues

The Corporation has agreements with third-party payors that provide for payments to the Corporation 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 revenues are 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, as necessary, in future periods as tentative and final settlements are received. It is reasonably possible that the estimates used could change in the near term.

For uninsured patients, the Corporation recognizes revenues on the basis of its standard rates, discounted in accordance with its policy. On the basis of historical experience, a significant portion of the Corporation's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenues, net of contractual allowances and discounts (but before the provision for bad debts), recognized in 2017 and 2016 from these major payor sources, are as follows:

	2017		
	Third-Party Payors	Self-Pay	Total
Patient service revenues (net of contractual allowances and discounts)	\$ 547,823,755	\$ 20,318,106	\$ 568,141,861
	2016		
Patient service revenues (net of contractual allowances and discounts)	\$ 527,258,017	\$ 19,339,970	\$ 546,597,987

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as patient service revenues (Note 4).

Medicaid Provider Tax

The West Virginia Broad Based Health Care Related Tax of 1993 assesses a tax on net patient service revenues at rates ranging from 0.35% to 5.00%, depending on the type of services provided. Additionally, the West Virginia Department of Tax and Revenue assesses a tax on net patient service revenues related to the Upper Payment Limit ("UPL") program (Note 5). The Corporation incurred related taxes of approximately \$13,660,000 in 2017 and \$13,450,000 in 2016.

Federal and State Income Taxes

The Hospital, Foundation and Auxiliary are tax-exempt organizations and are not subject to federal or state income taxes in accordance with Section 501(c)(3) of the Internal Revenue Code. On such basis, they will not incur any liability for income taxes, except for possible unrelated business income.

MRS, CHH-Cabell Development Corporation and Occumed are organizations subject to federal and/or state income taxes.

The Corporation accounts for uncertainty in income taxes using a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold is met. Management determined there were no tax uncertainties that met the recognition threshold in 2017 and 2016. The Corporation's policy is to recognize interest related to unrecognized tax benefits in interest expense and penalties in operating expenses.

Subsequent Events

The Corporation evaluated subsequent events for recognition or disclosure through December 12, 2017, the date the consolidated financial statements were issued.

Reclassifications

Certain reclassifications were made to the 2016 consolidated financial statements to conform with the 2017 presentation.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

New Accounting Pronouncements

During 2017, the Corporation adopted Accounting Standards Update (“ASU”) No. 2015-03, *Interest–Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*, which required the Corporation to change its method of presenting long-term debt issuance costs. Prior to the issuance of ASU No. 2015-03, the Corporation presented long-term debt issuance costs as an other asset in the consolidated balance sheet. As required by ASU No. 2015-03, the Corporation now presents long-term debt issuance costs as a direct reduction of its long-term debt liability. The effects of the required retrospective application of this change in presentation was to decrease other assets and long-term debt liability by approximately \$1,158,000 and to decrease depreciation and amortization expense and increase interest expense by approximately \$74,000 as of September 30, 2016.

During 2017, the Corporation also adopted ASU No. 2015-07, *Fair Value Measurement: Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU No. 2015-07 was issued to address diversity in practice related to how certain investments measured at net asset value with redemption dates in the future are categorized within the fair value hierarchy. Under ASU No. 2015-07, investments for which fair value is measured using the net asset value per share as a practical expedient are no longer required to be categorized within the fair value hierarchy. It also removes certain disclosure requirements for investments eligible to be measured using the net asset value per share practical expedient; however, it does not remove such disclosures for investments for which the entity has elected to measure fair value using that practical expedient. The guidance is retrospective and the adoption of this ASU did not have a significant impact on the Corporation.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The Corporation will be required to retrospectively adopt the guidance in ASU No. 2014-09 for its year ending September 30, 2019; early application is permitted. The Corporation is currently assessing the effect that ASU No. 2014-09 will have on their consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit’s liquidity, financial performance and cash flows. The Corporation will be required to retrospectively adopt the guidance in ASU No. 2016-14 for its year ending September 30, 2019; early application is permitted. The Corporation is currently assessing the effect that the adoption of ASU No. 2016-14 will have on their consolidated financial statements.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU No. 2017-07 was issued to provide guidance on the presentation of net periodic pension/postretirement benefit cost in the income statement and the components that are eligible for capitalization in assets. ASU No. 2017-07 requires that an employer report the service cost component of net periodic pension/postretirement benefit cost in the same line item used to record compensation expense for the related employees during the period. The other components are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item is used to present the other components, it must be appropriately described. If a separate line item is not used, then the line item(s) used in the income statement must be disclosed in the footnotes. The Corporation will be required to retrospectively adopt the guidance in ASU No. 2017-07 for its year ending September 30, 2019; early application is permitted. The Corporation is currently assessing the effect that the adoption of ASU No. 2017-07 will have on their consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Corporation's leasing activities. The Corporation will be required to retrospectively adopt the guidance in ASU No. 2016-02 for its year ending September 30, 2020; early application is permitted. The Corporation is currently assessing the effect that the adoption of ASU No. 2016-02 will have on their consolidated financial statements.

3. Edwards Comprehensive Cancer Center

The Edwards Foundation was established in 2002 as a supporting nonprofit organization to the Hospital and the Marshall University School of Medicine through a \$16,000,000 endowment funded by James F. Edwards and Joan C. Edwards. The members of the Edwards Foundation include representatives of the Hospital, the Marshall University School of Medicine, and designees selected by the Edwards family.

In September 2003, the Hospital and the Edwards Foundation executed a 99-year ground lease whereby the Edwards Foundation leases land from the Hospital for \$1 per year. During the year ended September 30, 2005, the Edwards Foundation commenced construction of the Edwards Comprehensive Cancer Center ("ECCC") on the campus of the Hospital pursuant to the ground lease.

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In January 2006, the Hospital and the Edwards Foundation executed a 97-year lease whereby the Hospital leases the building and associated equipment for the purpose of operating the ECCC. During the term of the building and equipment lease, the Hospital is required to make annual lease payments to the Edwards Foundation in an amount equal to the sum of \$12 per year plus 50% of annual net profit, as defined in the lease agreement, generated by the operations of the ECCC. Additionally, the Edwards Foundation obtained a bank loan to finance a portion of the construction costs and equipment. As long as any portion of the loan, or any extensions or renewals thereof, remains outstanding, the Hospital shall make annual lease payments up to 100% of the amount necessary to amortize the loan over a period of 15 years, as defined in the lease agreement. The loan had a balance of \$3,903,000 at September 30, 2017 and matures in August 2021. The loan is secured by the property and equipment of the ECCC.

Under the ground lease, the title to the building and equipment associated with the ECCC will transfer to the Hospital and perfect upon the expiration or early termination of the lease. Construction and equipping of the ECCC was completed by the Edwards Foundation in 2006 at a total cost of approximately \$31,605,000. This amount, net of accumulated amortization, is classified in property and equipment in the accompanying consolidated balance sheet (Note 8).

The building and equipment related to the ECCC are being amortized over their estimated useful lives, which is included in depreciation and amortization in the accompanying consolidated statement of operations (Note 8). Additionally, any rent payment due under the terms of the building and equipment lease is recorded as rental expense, which approximated \$3,667,000 in 2017 and \$3,783,000 in 2016, and is included in other expense in the accompanying consolidated statement of operations.

4. Charity Care

The Corporation estimates the cost of providing charity care using the ratio of average patient care cost to gross charges and then applies that ratio to the gross uncompensated charges associated with providing charity care. The amount of charges forgone for services and supplies furnished under the Corporation's charity care policies follows for the years ended September 30:

	<u>2017</u>	<u>2016</u>
Charges forgone, based on established rates	<u>\$ 14,891,000</u>	<u>\$ 12,577,000</u>
Management's estimate of expenses incurred to provide charity care	<u>\$ 4,807,000</u>	<u>\$ 4,057,000</u>
Equivalent percentage of charity care services to gross patient service revenues, based on established rates	<u>0.9%</u>	<u>0.8%</u>

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5. Net Patient Service Revenues

The Corporation has agreements with third-party payors that provide for payments to the Corporation at amounts different from its established rates. A significant portion of the Corporation's net patient service revenues are derived from these third-party payor programs. Revenues received under third-party arrangements are subject to audit and retroactive adjustment. The following summarizes the significant payment arrangements with major third-party payors:

Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are paid primarily at prospectively determined rates. The Corporation receives additional reimbursement for disproportionate share based on the level of Medicaid and Supplementary Security Income patients it serves. The Corporation also receives payments for direct and indirect medical education from the Medicare program.

The Corporation's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a Medicare quality improvement organization. The Corporation's cost reports have been audited by the Medicare fiscal intermediary through September 30, 2013. Revenue from Medicare was 24% in 2017 and 25% in 2016 of total net patient service revenues.

Medicaid

Payments for inpatient acute care services rendered to Medicaid program beneficiaries are based primarily upon a prospectively determined rate per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are paid on a published fee schedule. Revenue from Medicaid was 22% in 2017 and 2016 of total net patient service revenues.

The State of West Virginia increases Medicaid reimbursement to qualified public safety net hospitals for services to Medicaid-eligible patients. Supplemental payments may be received in an amount up to the difference between current reimbursement and the maximum permissible payments under Upper Payment Limit ("UPL") regulations. The first payment was made in August 2012 and periodic payments have been made subsequent to that date. Additionally, in 2016 a supplemental UPL program was introduced to include the Medicaid expansion beneficiaries known as the "Bridge" population.

UPL payments are recorded in the period they are received. The Corporation received combined UPL payments of approximately \$23,514,000 in 2017 and \$16,993,000 in 2016 that are included in net patient service revenues.

The laws and regulations governing the UPL program are complex and subject to interpretation. The UPL program is funded by a portion of the Medicaid Provider Tax (Note 2). There is risk that Congress may change federal policy in the future in a way that might limit or eliminate the UPL payments but maintain the Medicaid Provider Tax.

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Blue Cross

Inpatient and outpatient services rendered to Blue Cross subscribers are paid at either prospectively determined rates per case or discounts from established charges. Revenue from Blue Cross was 33% in 2017 and 34% in 2016 of total net patient service revenues.

Other Payors

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

Health Care Authority

Effective June 5, 2016, legislation was enacted that eliminated the rate setting powers of the Health Care Authority ("HCA"). However, the HCA was given the power to review, approve and regulate "cooperative agreements" between qualified hospitals which are members of academic medical centers and one or more other hospitals or other health care providers. The Hospital has received approval from the HCA for its cooperative agreement to acquire St. Mary's Medical Center (Note 20), and it will be subject to the regulatory powers of the HCA upon completion of the acquisition. Those regulatory powers include annual reporting requirements, rate setting controls, and the authority to order rebates for failure to meet quality metrics or consumer price increase targets.

6. Investments

The composition of investments at September 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 36,146,181	\$ 26,933,860
Marketable equity securities	96,935,596	81,107,973
U.S. government and agency obligations	34,861,036	11,908,136
Corporate bonds	23,393,196	23,481,793
Mutual funds, fixed income	9,913,416	8,014,867
Total	<u>\$ 201,249,425</u>	<u>\$ 151,446,629</u>

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Unrestricted investment income, gains, and losses are comprised of the following in 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Interest and dividend income	\$ 3,463,395	\$ 3,046,217
Net unrealized gains on trading securities	7,716,974	8,124,680
Net realized gains on sales of securities	1,437,611	1,200,737
Investment manager and trustee fees	<u>(587,296)</u>	<u>(627,517)</u>
Net unrestricted investment income	<u>\$ 12,030,684</u>	<u>\$ 11,744,117</u>

7. Fair Value Measurements and Financial Instruments

The Corporation measures its investments and derivative financial instruments on a recurring basis in accordance with accounting principles generally accepted in the United States. Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the same term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value is based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

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The fair value of financial instruments listed below was determined using the following valuation hierarchy at September 30, 2017 and 2016:

	Carrying Value	Fair Value	2017		
			Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets - recurring fair value measurements:					
Investments:					
Cash and cash equivalents	\$ 36,146,181	\$ 36,146,181	\$ 36,146,181	\$ -	-
Marketable equity securities:					
Consumer discretionary	8,726,268	8,726,268	8,726,268	-	-
Consumer staples	6,544,062	6,544,062	6,544,062	-	-
Energy	8,243,463	8,243,463	8,243,463	-	-
Financials	14,385,727	14,385,727	14,385,727	-	-
Healthcare	17,143,050	17,143,050	17,143,050	-	-
Industrials	10,580,147	10,580,147	10,580,147	-	-
Information technology	17,846,338	17,846,338	17,846,338	-	-
Materials	3,459,050	3,459,050	3,459,050	-	-
Other	4,424,417	4,424,417	4,424,417	-	-
Real estate	1,384,312	1,384,312	1,384,312	-	-
Telecommunications	2,857,135	2,857,135	2,857,135	-	-
Utilities	1,341,627	1,341,627	1,341,627	-	-
U.S. government and agency obligations	34,861,036	34,861,036	-	34,861,036	-
Corporate bonds	23,393,196	23,393,196	-	23,393,196	-
Mutual funds, fixed income	9,913,416	9,913,416	9,913,416	-	-
Total investments	\$ 201,249,425	\$ 201,249,425	\$ 142,995,193	\$ 58,254,232	\$ -
Liabilities - recurring fair value measurements:					
Derivative financial instruments	\$ 11,916,091	\$ 11,916,091	\$ -	\$ 11,916,091	\$ -
Assets disclosed at fair value:					
Cash and cash equivalents	\$ 70,543,249	\$ 70,543,249	\$ 70,543,249	\$ -	\$ -
Pledges receivable	1,353,648	1,353,648	-	-	1,353,648
Total	\$ 71,896,897	\$ 71,896,897	\$ 70,543,249	\$ -	\$ 1,353,648
Liabilities disclosed at fair value:					
Bonds payable	\$ 101,298,070	\$ 101,298,070	\$ -	\$ 78,963,991	\$ 22,334,079
Other notes payable	743,267	743,267	-	-	743,267
Total	\$ 102,041,337	\$ 102,041,337	\$ -	\$ 78,963,991	\$ 23,077,346

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	2016				
	Carrying Value	Fair Value	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets - recurring fair value measurements:					
Investments:					
Cash and cash equivalents	\$ 26,933,860	\$ 26,933,860	\$ 26,933,860	\$ -	\$ -
Marketable equity securities:					
Consumer discretionary	9,224,779	9,224,779	9,224,779	-	-
Consumer staples	8,963,576	8,963,576	8,963,576	-	-
Energy	8,515,481	8,515,481	8,515,481	-	-
Financials	10,602,809	10,602,809	10,602,809	-	-
Healthcare	15,086,255	15,086,255	15,086,255	-	-
Industrials	7,912,722	7,912,722	7,912,722	-	-
Information technology	14,196,758	14,196,758	14,196,758	-	-
Materials	2,394,894	2,394,894	2,394,894	-	-
Other	362,909	362,909	362,909	-	-
Telecommunications	2,598,667	2,598,667	2,598,667	-	-
Utilities	1,249,123	1,249,123	1,249,123	-	-
U.S. government and agency obligations	11,908,136	11,908,136	-	11,908,136	-
Corporate bonds	23,481,793	23,481,793	-	23,481,793	-
Mutual funds, fixed income	8,014,867	8,014,867	8,014,867	-	-
Total investments	\$ 151,446,629	\$ 151,446,629	\$ 116,056,700	\$ 35,389,929	\$ -
Liabilities - recurring fair value measurements:					
Derivative financial instruments	\$ 17,621,281	\$ 17,621,281	\$ -	\$ 17,621,281	\$ -
Assets disclosed at fair value:					
Cash and cash equivalents	\$ 98,241,853	\$ 98,241,853	\$ 98,241,853	\$ -	\$ -
Pledges receivable	1,651,233	1,651,233	-	-	1,651,233
Total	\$ 99,893,086	\$ 99,893,086	\$ 98,241,853	\$ -	\$ 1,651,233
Liabilities disclosed at fair value:					
Bonds payable	\$ 105,903,062	\$ 105,903,062	\$ -	\$ 82,206,156	\$ 23,696,906
Other notes payable	904,387	904,387	-	-	904,387
Total	\$ 106,807,449	\$ 106,807,449	\$ -	\$ 82,206,156	\$ 24,601,293

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The following is a description of the valuation methodologies used for assets and liabilities measured at fair value and for financial instruments disclosed at fair value. There have been no changes in methodologies used at September 30, 2017 and 2016.

Cash and cash equivalents: The carrying amounts approximate fair value because of the short maturity of these financial instruments.

Marketable equity securities: Valued at the closing price reported on the active market on which the individual securities are traded.

Corporate bonds and U.S. government and agency obligations: Valued based on spreads of published interest rate curves.

Mutual funds: Valued at the quoted net asset value of shares (basis for trade) held by the Corporation at year end.

Pledges receivable: Valued based on the original pledge amount, adjusted by a discount rate that a market participant would demand and an evaluation for uncollectible pledges.

Long-term debt: Valued based on current rates offered for similar issues with similar securities terms and maturities, or estimated using a discount rate that a market participant would demand.

Derivative financial instruments: Valued based on proprietary models of an independent third party valuation specialist. The fair value takes into consideration the prevailing interest rate environment and the specific terms and conditions of the derivative financial instruments and was estimated using the zero-coupon discounting method. This method calculates the future payments required by the derivative financial instruments, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement payment on the derivative financial instruments. The value represents the estimated exit price the Corporation would pay to terminate the agreements. The change in fair value of derivative financial instruments is included in revenues in excess of expenses.

It is not practicable to estimate the fair value of amounts due to or from related parties since terms could not be duplicated in the market and related parties can revise terms, making assumptions supporting fair values potentially unreliable.

The preceding methods described may produce a fair value calculation that may not be indicative of the net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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8. Property and Equipment

Property and equipment and related accumulated depreciation consist of the following at September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Land and land improvements	\$ 18,689,431	\$ 18,508,972
Buildings	236,198,639	206,745,496
Fixed equipment	53,911,631	52,975,849
Major movable equipment	175,099,485	162,168,760
Buildings and equipment under long-term lease with related party (Note 3)	<u>31,604,714</u>	<u>31,604,714</u>
Total	515,503,900	472,003,791
Less accumulated depreciation and amortization	<u>288,308,930</u>	<u>270,000,381</u>
	227,194,970	202,003,410
Construction in progress	<u>3,592,045</u>	<u>11,873,490</u>
Property and equipment, net	<u>\$ 230,787,015</u>	<u>\$ 213,876,900</u>

Accumulated amortization on buildings and equipment under long-term lease with related party approximates \$16,292,000 at September 30, 2017 and \$15,687,000 at September 30, 2016.

Construction in progress consists primarily of renovation and expansion projects. Purchase commitments related to these and other miscellaneous projects were approximately \$6,342,000 at September 30, 2017.

9. Lines of Credit

The Hospital maintains a \$5,000,000 unsecured revolving loan agreement with Branch Banking and Trust Company ("BB&T"). There were no borrowings outstanding at September 30, 2017 and 2016. Borrowings under the agreement bear interest at one-month LIBOR plus 1.75% per annum.

Occumed has a \$401,524 revolving loan agreement with First Sentry Bank. Borrowings under the agreement were \$365,955 at September 30, 2017 and \$370,735 at September 30, 2016. Borrowings under the agreement bear interest at 4.5% per annum. Under the terms of the agreement, the amounts borrowed are due and payable on February 28, 2018, and interest is payable monthly. The revolving loan agreement is guaranteed by the members of Occumed.

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10. Long-Term Debt

Long-term debt consists of the following at September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Revenue refunding bonds - 2008 Series A and B	\$ 79,090,000	\$ 82,340,000
Revenue bonds - City of Huntington	6,956,071	7,400,544
Revenue bonds - WVHFA	10,628,736	11,258,561
Revenue bonds - Cabell County	4,749,272	5,037,801
Capital leases and other notes payable	826,629	1,037,547
Total	102,250,708	107,074,453
Debt issuance costs	(1,083,781)	(1,158,266)
Net unaccreted bond discount	(126,009)	(133,844)
Current maturities of long-term debt	(5,561,026)	(5,446,312)
Long-term debt	<u>\$ 95,479,892</u>	<u>\$ 100,336,031</u>

In October 2008, the Hospital issued \$48,480,000 of West Virginia Hospital Finance Authority ("WVHFA") Hospital Revenue Refunding Bonds 2008 Series A and \$48,475,000 of WVHFA Hospital Revenue Refunding Bonds 2008 Series B (the "2008 Bonds"). The 2008 Bonds are repayable through January 1, 2034, and bear interest based on a weekly rate model (0.96% at September 30, 2017). The 2008 Bonds are secured by a bank letter-of-credit agreement with BB&T that will provide the Hospital financing in an amount necessary to purchase a portion of the 2008 Bonds if not remarketed. The bank letter-of-credit agreement will expire on October 17, 2019.

In March 2007, the Hospital executed a \$15,000,000 revolving loan agreement with JP Morgan Chase Bank, N.A. In March 2008, the Hospital executed an amendment with JP Morgan Chase Bank, N.A. that provided an additional \$10,000,000 in borrowings under the revolving loan agreement. During the year ended September 30, 2009, the Hospital refunded \$25,000,000 of the revolving loan with JP Morgan Chase Bank, N.A. through a private placement of bank-qualified, tax-exempt revenue bonds through the City of Huntington and Cabell County and a private placement of non-bank-qualified, tax-exempt revenue bonds through WVHFA. The tax-exempt revenue bonds bear interest at a fixed rate ranging from 5.03% to 6.00% and require monthly principal and interest payments of approximately \$200,000 through February 2029. The bonds are secured by substantially all assets of the Hospital.

Capital leases and other notes payable consist of capital leases and bank loan agreements that are secured by equipment and property with various expiration dates and require monthly principal and interest payments.

The Corporation's indebtedness agreements contain restrictive covenants, the most significant of which are the maintenance of minimum debt service, capitalization, and liquidity levels, and restrictions as to the incurrence of additional indebtedness and transfers of assets.

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The scheduled principal repayments as of September 30, 2017 are as follows:

Years ending September 30:		
2018	\$	5,561,026
2019		5,059,074
2020		5,309,046
2021		5,419,329
2022		5,741,185
Thereafter		<u>75,161,048</u>
Total	\$	<u>102,250,708</u>

11. Derivative Financial Instruments

The Hospital has two interest rate swap agreements to manage its exposure on its debt instruments. During the term of these agreements, the fixed rate swaps convert variable rate debt to a fixed rate. The notional amount under each interest rate swap is reduced over the term of the respective agreement to correspond with reductions in the outstanding bond series.

The following table summarizes the Hospital's interest rate swap agreements:

Swap Type	Expiration Date	Cabell Receives	Cabell Pays	Notional Amounts at September 30, 2017
Floating to fixed	2034	62.2% one-month LIBOR	3.68%	\$ 41,425,000
Floating to fixed	2034	64.8% one-month LIBOR	3.48%	<u>41,300,000</u>
				<u>\$ 82,725,000</u>

By using derivative financial instruments to manage these risks, the Hospital exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the Hospital, which creates credit exposure for the Hospital. When the fair value of a derivative contract is negative, the Hospital owes the counterparty. If the Hospital has a derivative in a liability position, the credit-adjusted market values could be adjusted downward. Market risk is the 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 its derivative positions in the context of its total blended cost of capital.

The fair value of the interest rate swap agreements was \$11,916,091 at September 30, 2017 and \$17,621,281 at September 30, 2016. The net cash paid or received under the swap agreements is recognized as an adjustment to interest expense. As a result of the swap agreements, interest expense increased by approximately \$2,261,000 in 2017 and \$2,698,000 in 2016.

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12. Benefit Plans

The Corporation sponsors noncontributory defined benefit plans covering substantially all eligible employees. Pension benefits to participating employees are based on years of credited service and salaries. The Corporation provides funding sufficient to meet minimum funding requirements under applicable federal laws. Plan assets, primarily consisting of U.S. government and equity securities, are held in trust. Beginning January 1, 2011, all new employees participate in a 401(k) plan in lieu of the defined benefit plans. Eligibility requires one year of service with 1,080 hours worked. The Corporation contributes 3% of eligible salary annually, and employees vest in employer contributions after five years of service.

Benefit accruals under the non-union retirement plan were frozen effective September 30, 2015 and benefit accruals under the union retirement plan were frozen effective November 2, 2016. This resulted in curtailment gains being recognized in the plans at September 30, 2016.

In addition, the Corporation sponsors a postretirement health benefit plan for its employees who have at least 17 years of service and who retire at age 62 or older. Entrance into the postretirement plan became frozen to new employees and restricted to existing employees effective November 2, 2016. This resulted in a curtailment gain being recognized in the plan at September 30, 2016.

The following table presents a reconciliation of the beginning and ending balances of the various plans' projected benefit obligations and the fair value of plan assets and funded status of the plans measured at September 30:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Changes in projected benefit obligation:				
Projected benefit obligation, beginning of year	\$ 327,491,701	\$ 297,700,378	\$ 41,922,429	\$ 39,369,036
Service cost	200,087	2,889,050	1,211,161	1,775,532
Interest cost	12,112,752	12,926,557	1,688,258	1,789,826
Actuarial (gain) loss	(9,565,345)	34,254,093	3,693,006	6,542,163
Benefits paid	(8,230,481)	(7,131,594)	(1,235,758)	(1,455,080)
Curtailment gain	-	(13,146,783)	-	(6,099,048)
Projected benefit obligation, end of year	<u>\$ 322,008,714</u>	<u>\$ 327,491,701</u>	<u>\$ 47,279,096</u>	<u>\$ 41,922,429</u>
Changes in plan assets:				
Fair value of plan assets, beginning of year	\$ 217,201,126	\$ 201,393,645	\$ -	\$ -
Actual return on plan assets	22,239,656	20,700,595	-	-
Employer contributions	2,249,974	2,238,480	1,235,758	1,455,080
Benefits paid	(8,230,481)	(7,131,594)	(1,235,758)	(1,455,080)
Fair value of plan assets, end of year	<u>\$ 233,460,275</u>	<u>\$ 217,201,126</u>	<u>\$ -</u>	<u>\$ -</u>
Funded status at end of year	<u>\$ (88,548,439)</u>	<u>\$ (110,290,575)</u>	<u>\$ (47,279,096)</u>	<u>\$ (41,922,429)</u>

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The following table is a reconciliation of the funded status at end of year to the amounts recognized in the consolidated balance sheet at September 30:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Accrued expenses	\$ -	\$ -	\$ 1,492,337	\$ 1,302,512
Accrued pension and postretirement liabilities	88,548,439	110,290,575	45,786,759	40,619,917
Total	<u>\$ 88,548,439</u>	<u>\$ 110,290,575</u>	<u>\$ 47,279,096</u>	<u>\$ 41,922,429</u>

The accumulated benefit obligation of the pension plans was \$322,008,714 at September 30, 2017 and \$327,491,701 at September 30, 2016.

The following table sets forth the components of net periodic benefit costs in 2017 and 2016:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Service cost	\$ 200,087	\$ 2,889,050	\$ 1,211,161	\$ 1,775,532
Interest cost	12,112,752	12,926,557	1,688,258	1,789,826
Expected return on plan assets	(14,945,820)	(13,869,597)	-	-
Recognized net actuarial loss	3,310,323	2,474,851	-	-
Amortization of prior service cost	-	55,761	(772,031)	-
Amortization of losses	-	-	1,287,652	618,250
Curtailment	-	103,980	-	-
Net periodic benefit expense	<u>\$ 677,342</u>	<u>\$ 4,580,602</u>	<u>\$ 3,415,040</u>	<u>\$ 4,183,608</u>

Included in unrestricted net assets at September 30 are the following amounts that have not yet been recognized in net periodic pension cost:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Unrecognized actuarial loss	\$ (49,875,265)	\$ (70,044,769)	\$ (20,117,946)	\$ (17,712,592)
Prior service credit	-	-	5,327,017	6,099,048
Total	<u>\$ (49,875,265)</u>	<u>\$ (70,044,769)</u>	<u>\$ (14,790,929)</u>	<u>\$ (11,613,544)</u>

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Changes in plan assets and benefit obligations recognized in unrestricted net assets include:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Actuarial (gain) loss	\$ (16,859,181)	\$ 27,164,983	\$ 3,693,006	\$ 6,542,163
Amortization of actuarial gain (loss)	(3,310,323)	(2,474,851)	(1,287,652)	(618,250)
Amortization of prior service (cost) credit	-	(55,761)	772,031	-
Curtailment gain	-	(13,250,763)	-	(6,099,048)
Total	<u>\$ (20,169,504)</u>	<u>\$ 11,383,608</u>	<u>\$ 3,177,385</u>	<u>\$ (175,135)</u>

The weighted-average assumptions used in the measurement of the Corporation's projected benefit obligation at September 30, 2017 and 2016 are as follows:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Discount rate	3.90%	3.75%	4.16%	4.09%
Range of expected rate of compensation increase	N/A	N/A to 2.50%	-	-

The weighted-average assumptions used in the measurement of the Corporation's net periodic pension cost for the years ended September 30, 2017 and 2016 are as follows:

	Pension Plans		Postretirement Plan	
	2017	2016	2017	2016
Discount rate	3.75%	4.40%	4.09%	4.60%
Expected long-term rate of return on plan assets	7.00%	7.00%	-	-
Range of expected rate of compensation increase	N/A to 2.50%	N/A to 2.50%	-	-

In selecting the expected long-term return on plan assets for the pension plans, the Corporation considered the average rate of earnings on the funds invested or to be invested to provide for the benefits of these plans. This included considering the asset allocation and the expected returns likely to be earned over the life of the plans. Plan assets are invested in an actively managed portfolio that integrates asset allocation strategies across equity and debt markets within the United States. The portfolio objectives include long-term growth, balanced with moderate variability, with an expected shift to assets having a greater fixed income allocation as the plan population ages and nears retirement. The use of an appropriate asset management policy combines the various asset pools to ensure flexibility and to adapt to the changing retirement needs of the plan participants.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
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The pension plans' objectives are to have approximately 57% of plan assets invested in equities, approximately 40% invested in fixed income securities, and approximately 3% invested in cash and cash equivalents. For the long term, the primary investment objective for the portfolio is to earn the highest possible total return consistent with prudent levels of risk. The primary objective overall is to enable the pension plans to meet their future obligations for employee retirement.

The pension plans' weighted-average asset allocations at September 30, by asset category, are as follows:

	<u>2017</u>	<u>2016</u>
Asset category:		
Equity securities	70 %	65 %
Debt/fixed income securities	30 %	35
	<u>100 %</u>	<u>100 %</u>

The following tables summarize instruments measured at fair value on a recurring basis:

	<u>September 30, 2017</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>NAV (1)</u>
Cash and cash equivalents	\$ 2,503,561	\$ -	\$ -
Marketable equity securities:			
Consumer discretionary	8,496,595	-	-
Consumer staples	9,664,631	-	-
Energy	4,718,674	-	-
Financials	13,251,065	-	-
Healthcare	12,293,468	-	-
Industrials	10,781,634	-	-
Information technology	18,221,317	-	-
Materials	3,417,460	-	-
Other	2,180,117	-	-
Real estate	426,443	-	-
Telecommunications	2,180,662	-	-
Utilities	2,087,701	-	-
Marketable debt securities	-	10,775,132	-
U.S. government and agency obligations	-	6,886,147	-
Pooled separate accounts:			
Money market accounts	-	-	1,069,288
Domestic equity accounts	-	-	69,250,692
Bond and mortgage accounts	-	-	55,255,688
Total	<u>90,223,328</u>	<u>17,661,279</u>	<u>125,575,668</u>

- (1) Certain investments that are measured at fair value using the net asset value ("NAV") per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the accompanying consolidated balance sheet

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

	September 30, 2016		
	Level 1	Level 2	NAV (1)
Cash and cash equivalents	\$ 3,636,327	\$ -	\$ -
Marketable equity securities:			
Consumer discretionary	6,861,103	-	-
Consumer staples	11,157,047	-	-
Energy	5,448,248	-	-
Information technology	15,706,818	-	-
Financials	8,984,777	-	-
Healthcare	13,770,801	-	-
Industrials	8,355,637	-	-
Materials	2,638,051	-	-
Other	5,400,665	-	-
Real estate	898,478	-	-
Telecommunications	1,878,635	-	-
Utilities	1,690,978	-	-
Pooled separate accounts:			
Money market accounts	-	-	1,027,511
Domestic equity accounts	-	-	54,205,934
Bond and mortgage accounts	-	-	75,540,116
Total	\$ 86,427,565	\$ -	\$ 130,773,561

- (1) Certain investments that are measured at fair value using the net asset value ("NAV") per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the accompanying consolidated balance sheet.

There were no Level 3 investments at September 30, 2017 and 2016.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2017 and 2016.

Cash and cash equivalents: The carrying amounts approximate fair value because of the short maturity of these financial instruments.

Marketable equity securities: Valued at the closing price reported on the active market on which the individual securities are traded.

Marketable debt securities: Valued based on spreads of published interest rate curves.

U.S. government and agency obligations: Valued based on spreads of published interest rate curves.

Pooled separate accounts: Valued using the net asset value ("NAV") provided by the administrator of the related fund. The NAV is based on the value of the underlying assets owned by the fund minus applicable costs and liabilities and then divided by the number of shares outstanding.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The following represents the investment strategies of the pooled separate accounts:

Name of Fund	Fair Value at September 30, 2017	Fair Value at September 30, 2016	Investment Strategy	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Principal Core Plus Bond Separate Account	\$ 69,280,691	\$ 75,540,116	Invests primarily in intermediate-term, fixed-income investments such as public and private corporate bonds, commercial and residential mortgages, asset-backed securities, and US government and agency-backed securities. Value is added primarily through sector allocation and security selection. May enter into reverse repurchase agreements to attempt to enhance portfolio return and income.	N/A	Daily	1 day
Principal LargeCap S&P 500 Index Separate Account	45,913,763	38,638,689	Invests primarily in common stocks of companies that compose the S&P 500 Index. Attempts to mirror the investment performance of the Index by allocating assets in approximately the same weightings as the S&P 500 Index. Over the long-term, seeks a very close correlation to the performance of the S&P 500 Index.	N/A	Daily	1 day
Principal SmallCap Separate Account	9,311,926	15,567,245	Seeks long-term growth of capital and primarily invests in common stocks of small capitalization companies. Invests in companies with market capitalizations similar to those of companies in the Russell 2000 Index. Management of the fund looks at stocks with value and/or growth characteristics and constructs an investment portfolio that has a blend of stocks with these characteristics. May invest up to 25% of assets in foreign securities.	N/A	Daily	1 day
Principal Liquid Assets Separate Account	1,069,288	1,027,511	Seeks as high a level of current income as is considered consistent with preservation of principal and maintenance of liquidity. Invests in a portfolio of high quality, short-term money market instruments. Investments are U.S. dollar denominated securities which present minimal credit risks. Maintains a dollar weighted average portfolio maturity of 60 days or less.	N/A	Daily	1 day
Total	<u>\$ 125,575,668</u>	<u>\$ 130,773,561</u>				

The preceding methods described may produce a fair value calculation that may not be indicative of the net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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The Corporation expects to contribute approximately \$1,771,000 to the defined benefit plans and \$1,492,000 to the postretirement plan in 2018.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	<u>Pension Plans</u>	<u>Postretirement Plan</u>
Years ending September 30:		
2018	\$ 11,422,000	\$ 1,492,000
2019	11,768,000	1,478,000
2020	12,330,000	1,380,000
2021	13,201,000	1,461,000
2022	14,122,000	1,572,000
2023 - 2027	85,162,000	10,352,000

The weighted-average annual assumed rate of increase in the health care cost trend rate is 7.00% for non-Medicare and 6.00% for Medicare for the year beginning October 1, 2017, and is assumed to decrease to 4.50% for non-Medicare for the year beginning October 1, 2022, and Medicare for the year beginning October 1, 2020 and remain at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported for the postretirement benefit plan. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	<u>1% Increase</u>	<u>1% Decrease</u>
Postretirement plan:		
Change in total of service and interest cost	\$ 639,521	\$ (498,880)
Change in postretirement benefit obligation	8,798,318	(7,006,265)

13. Professional and General Liability

The Corporation uses a combination of self-insurance and purchased commercial excess liability insurance to manage exposure to general and professional liability claims. The reserve recorded at September 30, 2017 and 2016, includes an amount for asserted, unasserted, and incurred but not reported professional and general liability claims.

As the Corporation believes that the amount and timing of its future claims payments are reliably determinable, it discounts the amount accrued for losses resulting from professional liability claims using a weighted average of the trailing return on the lower risk investments in its investment portfolio and the risk-free interest rate corresponding to the timing of expected payments. The net present value of the projected payments was discounted using a weighted-average, risk-free rate of 2.2% in 2017 and 1.6% in 2016. This liability is adjusted for new claims information in the period such information becomes known. The estimated liability for the self-insured portion of professional and general liability claims was \$13,894,000 at September 30, 2017 and \$12,856,000 at September 30, 2016. The current portion of the liability for the self-insured portion of professional and general liability claims was \$2,856,000 at September 30, 2017 and \$2,424,000 at September 30, 2016. Insurance expense includes the losses resulting from professional liability claims and loss adjustment expense, as well as paid excess insurance premiums.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
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The Corporation believes it has adequate self-insurance and insurance coverages and accruals for all asserted claims and it has no knowledge of unasserted claims which would exceed its self-insurance and insurance coverages and accruals.

14. Partnership Investments

Tri-State MRI

The Hospital has a 50% interest in Tri-State MRI through a general partnership agreement with St. Mary's Hospital ("St. Mary's"). Tri-State MRI was formed for the purpose of acquiring and operating a magnetic resonance imaging unit. The Hospital is accounting for its investment in Tri-State MRI under the equity method of accounting.

The Hospital's interest in Tri-State MRI was approximately \$38,000 at September 30, 2017 and \$100,000 at September 30, 2016. Equity losses in Tri-State MRI approximated \$62,000 in 2017 and \$59,000 in 2016, and are included in equity income from partnership investments in the accompanying consolidated statement of operations. No cash distributions were received from Tri-State MRI by the Hospital in 2017 or 2016.

HealthNet, Inc.

HealthNet, Inc. is a West Virginia nonprofit organization that provides aeromedical transportation services to patients. The Hospital has a 33 1/3% ownership percentage in HealthNet, Inc. The Hospital's ownership is accounted for under the equity method of accounting. Prior year losses have reduced the Corporation's investment in HealthNet, Inc. to zero. The Hospital has an affiliate payable of \$1,282,000 at September 30, 2017 and \$149,000 at September 30, 2016 included in accrued expenses in the accompanying consolidated balance sheet.

FMS Dialysis Cabell Huntington Dialysis Centers, LLC

During 2009, the Hospital contributed cash of approximately \$8,709,000 to FMS Dialysis Cabell Huntington Dialysis Centers, LLC ("Dialysis Centers") in exchange for a 45% membership interest. Dialysis Centers then purchased Cabell's hemodialysis operations and related equipment in a purchase transaction totaling \$16,923,000. In 2009, the Hospital recorded a gain on the sale of its hemodialysis operations and related equipment totaling approximately \$9,200,000. The Hospital also recorded a deferred gain of approximately \$7,500,000 in connection with the purchase transaction, which is being amortized to income ratably over ten years. The deferred gain approximated \$1,204,000 at September 30, 2017 and \$1,973,000 at September 30, 2016.

During 2010, the Hospital contributed cash of approximately \$456,000 to the Dialysis Centers to fund the acquisition of a dialysis facility in Chesapeake, Ohio. In November 2010, the partners of the Dialysis Centers contributed additional capital of approximately \$2,100,000 to fund expansion activities; the Hospital's contribution approximated \$996,000.

During 2017, Dialysis Centers entered into a new joint venture for the operation of a dialysis center located in West Hamlin, West Virginia. The capital contributions due from Dialysis Centers are to be paid out of cash retained in the joint venture, with the first capital contribution due on October 1, 2017.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
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Dialysis Centers provides hemodialysis services to dialysis patients residing primarily within the Hospital's service area. Equity earnings in Dialysis Centers approximated \$166,000 in 2017 and \$1,657,000 in 2016, and is included in equity income from partnership investments in the accompanying consolidated statement of operations. Cash distributions received from the Dialysis Centers approximated \$936,000 in 2017. There were no cash distributions received from the Dialysis Centers in 2016. The Hospital's interest in the Dialysis Centers approximated \$9,370,000 at September 30, 2017 and \$10,140,000 at September 30, 2016.

Summary financial information for the Dialysis Centers is as follows for the years ended September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Assets:		
Current assets	\$ 6,455,061	\$ 4,065,303
Property and equipment, net	1,583,747	1,764,527
Other assets	15,675,619	17,654,704
Total assets	<u>\$ 23,714,427</u>	<u>\$ 23,484,534</u>
Liabilities and Stockholders' Equity:		
Current liabilities	\$ 2,295,745	\$ 1,583,917
Stockholders' equity	21,418,680	21,900,615
Total liabilities and stockholders' equity	<u>\$ 23,714,425</u>	<u>\$ 23,484,532</u>
Net Patient Revenue	<u>\$ 15,007,753</u>	<u>\$ 13,182,494</u>
Net Income	<u>\$ 3,617,852</u>	<u>\$ 4,036,893</u>

15. Operating Leases

The Corporation leases certain equipment, buildings and land under the terms of noncancellable leases expiring on various dates through 2022. These leases generally contain renewal options for periods ranging from one to five years and require the Corporation to pay all executory costs (property taxes, maintenance and insurance).

The schedule of future minimum lease payments under these operating leases as of September 30, 2017 is approximately as follows:

Years ending September 30:	
2018	\$ 3,850,000
2019	2,057,000
2020	979,000
2021	356,000
Total future minimum lease payments	<u>\$ 7,242,000</u>

Rent expense under these leases was approximately \$4,042,000 in 2017 and \$3,826,000 in 2016.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

16. Related-Party Transactions

The Hospital participates in various medical education programs and research activities in cooperation with the Marshall University Joan C. Edwards School of Medicine (the "School of Medicine"). The Hospital recorded expenses of approximately \$21,330,000 in 2017 and \$19,617,000 in 2016, related to these activities, which is included in professional services and other expenses in the accompanying consolidated statement of operations.

On July 1, 2012, the Hospital entered into an Academic Medical Center Agreement (the "Agreement") with the School of Medicine and University Physicians & Surgeons, Inc. ("UP&S"). The Agreement memorialized the past supplemental support provided to the School of Medicine, defines the Academic Medical Center as being comprised of the Hospital, the School of Medicine and UP&S and defines a process for determining support in the future.

In 1998, the Marshall University Medical Center opened on the Hospital's campus. During 2013, the Hospital opened provider based clinics on its campus for which UP&S provides physician services.

The Hospital had amounts due to the School of Medicine, related to the provider based clinics, of approximately \$379,000 at September 30, 2017 and \$770,000 at September 30, 2016, and is included in accrued expenses in the accompanying consolidated balance sheet.

17. Functional Expenses

The Corporation provides general acute care and related services to individuals within its geographic region. Expenses related to providing these services in 2017 and 2016 are approximately as follows:

	<u>2017</u>	<u>2016</u>
Healthcare and other related services	\$ 471,363,000	\$ 456,080,000
General and administrative	74,450,000	63,669,000
Fundraising	<u>1,203,000</u>	<u>1,394,000</u>
Total	<u>\$ 547,016,000</u>	<u>\$ 521,143,000</u>

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2017 and 2016

18. Concentration of Credit Risk

The Corporation grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements, primarily with Medicare, Medicaid, and various commercial insurance companies. The Corporation maintains allowances for potential credit losses and such losses have historically been within management's expectations.

The mix of receivables at September 30, 2017 and 2016 from patients and third-party payors is as follows:

	<u>2017</u>	<u>2016</u>
Medicare	15 %	15 %
Medicaid	13	18
Blue Cross	27	27
Commercial/HMO/Other	32	31
Patients	<u>13</u>	<u>9</u>
Total	<u>100 %</u>	<u>100 %</u>

Approximately 33% of the Corporation's employees are covered by a collective bargaining agreement with District 1199, The Health Care and Social Service Union, SEIU, CTW. This agreement expires on November 2, 2021.

19. Commitments and Contingencies

Litigation

The Corporation is party to several routine lawsuits incidental to its operations, some involving substantial amounts. It is not possible at the present time to estimate the ultimate legal and financial liability, if any, of the Corporation with respect to such lawsuits. In the opinion of management, based on the advice of legal counsel, adequate insurance or funds held for self-insured matters exist to cover financial exposure, in the event there is any, to the Corporation.

Physician Guarantees

To entice physicians to relocate to the Huntington, West Virginia area, the Corporation enters into agreements with non-employed physicians to provide income guarantees and signing bonuses. The carrying amount of the liability for the Corporation's obligation under these guarantees approximates \$637,000 at September 30, 2017 and \$1,294,000 at September 30, 2016, and is included in accrued professional liability and other in the accompanying consolidated balance sheet. When the liability is recorded by the Corporation, a corresponding intangible asset is also recorded and subsequently amortized to salary expense over the life of the agreement. This intangible asset is approximately \$1,437,000 at September 30, 2017 and \$2,406,000 at September 30, 2016, and is included in other assets, net in the accompanying consolidated balance sheet.

Cabell Huntington Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Healthcare Industry

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance that have not been provided for in the accompanying consolidated financial statements; however, the possible future financial effects of such matters on the Corporation, if any, are not presently determinable.

Disproportionate Share Hospital State Plan

The State of West Virginia's Disproportionate Share Hospital ("DSH") State Plan, which reimburses hospitals in the state that provide Medicaid services and meet other eligibility criteria, was amended to provide for a settlement process among participating hospitals. The state has not completed a settlement process for the years subsequent to 1996. The Bureau for Medical Services of the State of West Virginia Department of Health and Human Resources has contracted with a third-party vendor to assist with the audit settlement process for the DSH State Plan. The laws and regulations governing the DSH settlement process are complex, involving statistical data from all participating hospitals, and subject to interpretation. Accordingly, the Corporation is not able to estimate the possible loss or gain that could arise upon completion of the DSH settlement process. The results of the resolution of the settlement process could materially impact the Corporation's future results of operations or cash flows in a particular period.

20. Subsequent Events

St. Mary's Medical Center Acquisition

During May 2014, the Hospital responded to a request for proposal issued by Pallottine Health Services, Inc. ("PHS") with a proposal to acquire St. Mary's Medical Center, a 393 bed hospital located in Huntington, West Virginia, and its affiliated entities (collectively, "SMMC"). Subsequent negotiations with PHS culminated in the execution of a Definitive Agreement on November 7, 2014. Subsequently, the Hospital filed its application for a Certificate of Need ("CON") with the HCA and filed a Hart-Scott-Rodino notice with the Federal Trade Commission ("FTC").

The FTC notified the Hospital in January 2015 that it would review the transaction in detail and issued a Request for Additional Information and Documentary Material (also known as a Second Request). After providing the requested information and documentary material, the Hospital was advised in November 2015 that the FTC commissioners had voted 4-0 to challenge the transaction and authorized the initiation of an administrative complaint.

Cabell Huntington Hospital, Inc. and Subsidiaries

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During July 2015, the Hospital entered into an Assurance of Voluntary Compliance ("AVC") with SMMC and the West Virginia Attorney General, which sets forth certain pro-competitive steps that the Hospital will take should the transaction be finalized. During November 2015 the AVC was amended and restated to strengthen consumer protections.

On March 12, 2016, West Virginia Senate Bill 597 went into effect and provides antitrust protection for certain transactions involving academic medical centers in West Virginia. Cabell had entered into an academic medical center agreement with the Marshall University Joan C. Edwards School of Medicine and Marshall Health, its faculty practice plan in July 2012. Subsequent to the enactment of West Virginia Senate Bill 597, the FTC agreed to stay its administrative proceeding pending its review of West Virginia Senate Bill 597 and the actions contemplated by that bill.

On March 16, 2016, the Hospital received a CON for the transaction from the HCA and on June 22, 2016, the Hospital received an order from the HCA approving the Cooperative Agreement for the transaction between the Hospital and SMMC.

On July 6, 2016, in response to the HCA order, the FTC dismissed its administrative complaint without prejudice.

Steel of West Virginia, Inc. ("SWVA") appealed the decisions in both the CON and Cooperative Agreement proceedings before the HCA. The appeal of the Cooperative Agreement decision was voluntarily dismissed and the CON decision was affirmed by the West Virginia Office of Judges and the Circuit Court of Kanawha County, West Virginia, but has been further appealed by SWVA to the Supreme Court of Appeals of West Virginia. Upon the final resolution of this appeal and approval of the transaction on behalf of SMMC from the Vatican, closing can occur.

The expenses incurred related to the acquisition were approximately \$329,000 in 2017 and \$23,275,000 in 2016 and have been presented as non-operating expenses in the accompanying consolidated statement of operations.

Information Technology Upgrade

In November 2017, the Hospital entered into an agreement with a vendor for a system-wide information technology upgrade. The contract outlines initial system build costs of approximately \$14,100,000, as well as ongoing support and maintenance fees of approximately \$10,000,000 through November 2024.

Cabell Huntington Hospital, Inc. and Subsidiaries

 Consolidating Schedule of Balance Sheet Information
 September 30, 2017

	Cabell Huntington Hospital, Inc.	Mountain Regional Services, Inc.	Cabell Huntington Hospital Foundation, Inc.	CHH-Cabell Development Corporation	Occumed, LLC	Cabell Huntington Hospital Auxiliary, Inc.	Consolidation Eliminations	Consolidated
Assets								
Current Assets								
Cash and cash equivalents	\$ 66,102,361	\$ 19,749	\$ 3,762,727	\$ 111,419	\$ 120,874	\$ 426,119	\$ -	\$ 70,543,249
Patient accounts receivable, net	70,424,748	-	-	-	-	-	-	70,424,748
Inventories, prepaid expenses, and other receivables	11,575,493	490	402,110	-	3,306	311,062	(23,150)	12,269,311
Estimated third-party payor settlements	8,742,931	-	-	-	-	-	-	8,742,931
Other current assets	11,785,279	-	-	-	-	-	(2,485,847)	9,299,432
Total current assets	168,630,812	20,239	4,164,837	111,419	124,180	737,181	(2,508,997)	171,279,671
Investments								
Board designated	201,082,206	-	-	-	-	-	-	201,082,206
Funds held by Foundation	-	-	167,219	-	-	-	-	167,219
Total investments	201,082,206	-	167,219	-	-	-	-	201,249,425
Property and Equipment, Net	228,248,422	434,856	-	754,755	1,346,132	2,850	-	230,787,015
Partnership Investments	10,023,453	-	-	-	-	-	(214,369)	9,809,084
Other Assets, Net	11,714,608	-	951,538	-	-	-	-	12,666,146
Total assets	<u>\$ 619,699,501</u>	<u>\$ 455,095</u>	<u>\$ 5,283,594</u>	<u>\$ 866,174</u>	<u>\$ 1,470,312</u>	<u>\$ 740,031</u>	<u>\$ (2,723,366)</u>	<u>\$ 625,791,341</u>

Cabell Huntington Hospital, Inc. and Subsidiaries

 Consolidating Schedule of Balance Sheet Information
 September 30, 2017

	Cabell Huntington Hospital, Inc.	Mountain Regional Services, Inc.	Cabell Huntington Hospital Foundation, Inc.	CHH-Cabell Development Corporation	Occumed, LLC	Cabell Huntington Hospital Auxiliary, Inc.	Consolidation	
							Eliminations	Consolidated
Liabilities and Net Assets								
Current Liabilities								
Lines of credit	\$ -	\$ -	\$ -	\$ -	\$ 365,955	\$ -	\$ -	\$ 365,955
Current maturities of long-term debt	4,817,759	-	-	-	743,267	-	-	5,561,026
Accounts payable	7,982,920	-	-	2,579	-	15,760	-	8,001,259
Accrued expenses	59,560,003	211,403	1,424,012	48,444	1,084,985	6,984	(2,723,366)	59,612,465
Estimated third-party payor settlements	2,826,899	-	-	-	-	-	-	2,826,899
Current portion of estimated professional liabilities	2,856,000	-	-	-	-	-	-	2,856,000
Total current liabilities	78,043,581	211,403	1,424,012	51,023	2,194,207	22,744	(2,723,366)	79,223,604
Long-Term Debt, Net	95,479,892	-	-	-	-	-	-	95,479,892
Derivative Financial Instruments	11,916,091	-	-	-	-	-	-	11,916,091
Deferred Gains	1,204,111	-	-	-	-	-	-	1,204,111
Accrued Professional Liability and Other	11,674,678	-	-	-	-	-	-	11,674,678
Accrued Pension and Postretirement Liabilities	134,335,198	-	-	-	-	-	-	134,335,198
Total liabilities	332,653,551	211,403	1,424,012	51,023	2,194,207	22,744	(2,723,366)	333,833,574
Net Assets								
Controlling interest	287,045,950	243,692	582,270	387,839	(503,317)	717,287	-	288,473,721
Noncontrolling interest	-	-	-	427,312	(220,578)	-	-	206,734
Total unrestricted	287,045,950	243,692	582,270	815,151	(723,895)	717,287	-	288,680,455
Temporarily restricted	-	-	3,277,312	-	-	-	-	3,277,312
Total net assets	287,045,950	243,692	3,859,582	815,151	(723,895)	717,287	-	291,957,767
Total liabilities and net assets	\$ 619,699,501	\$ 455,095	\$ 5,283,594	\$ 866,174	\$ 1,470,312	\$ 740,031	\$ (2,723,366)	\$ 625,791,341

Cabell Huntington Hospital, Inc. and Subsidiaries

Consolidating Schedule of Operations

Year Ended September 30, 2017

	Cabell Huntington Hospital, Inc.	Mountain Regional Services, Inc.	Cabell Huntington Hospital Foundation, Inc.	CHH-Cabell Development Corporation	Occumed, LLC	Cabell Huntington Hospital Auxiliary, Inc.	Consolidation	
							Eliminations	Consolidated
Unrestricted Revenues								
Patient service revenues (net of contractual allowances and discounts)	\$ 566,375,409	\$ -	\$ -	\$ -	\$ 1,766,452	\$ -	\$ -	\$ 568,141,861
Provision for bad debts	(26,666,099)	-	-	-	-	-	-	(26,666,099)
Net patient service revenues	539,709,310	-	-	-	1,766,452	-	-	541,475,762
Other revenues, including net assets released from restrictions for operations	42,810,291	-	1,499,508	244,874	-	1,488,772	-	46,043,445
Total unrestricted revenues	582,519,601	-	1,499,508	244,874	1,766,452	1,488,772	-	587,519,207
Expenses								
Salaries and wages	166,370,730	-	463,828	-	1,235,832	-	-	168,070,390
Employee benefits	65,219,648	-	-	-	201,182	-	-	65,420,830
Supplies	103,954,911	-	-	-	79,504	13,485	-	104,047,900
Professional services	60,777,982	-	-	2,201	116,073	-	-	60,896,256
Maintenance and repairs	15,161,199	-	-	-	26,568	-	-	15,187,767
Interest	5,064,062	-	-	-	68,101	-	-	5,132,163
Depreciation and amortization	19,530,827	-	-	53,034	90,956	1,529	-	19,676,346
Provider tax	13,659,900	-	-	-	-	-	-	13,659,900
Insurance	4,971,414	-	-	-	4,810	-	-	4,976,224
Other	87,830,303	7,457	738,835	2,468	111,780	1,257,515	-	89,948,358
Total expenses	542,540,976	7,457	1,202,663	57,703	1,934,806	1,272,529	-	547,016,134
Operating income (loss)	39,978,625	(7,457)	296,845	187,171	(168,354)	216,243	-	40,503,073
Other Income (Loss)								
Investment income	12,029,396	3	1,285	-	-	-	-	12,030,684
Change in fair value of derivative financial instruments	5,705,190	-	-	-	-	-	-	5,705,190
Equity income from partnership investments	209,355	-	-	-	-	-	-	209,355
Acquisition costs	(328,964)	-	-	-	-	-	-	(328,964)
Revenues in excess of (less than) expenses	57,593,602	(7,454)	298,130	187,171	(168,354)	216,243	-	58,119,338
Pension and Postretirement Liabilities Adjustment	16,992,119	-	-	-	-	-	-	16,992,119
Net Assets Released from Restrictions for Property and Equipment	964,664	-	-	-	-	-	-	964,664
Equity Distributions	-	-	-	(238,281)	-	-	-	(238,281)
Transfers from (to) Affiliates	330,000	-	(330,000)	-	-	-	-	-
Increase (decrease) in unrestricted net assets	\$ 75,880,385	\$ (7,454)	\$ (31,870)	\$ (51,110)	\$ (168,354)	\$ 216,243	\$ -	\$ 75,837,840