



CHESAPEAKE HOSPITAL AUTHORITY

Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

CHESAPEAKE HOSPITAL AUTHORITY

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KPMG LLP
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Independent Auditors' Report

The Members
Chesapeake Hospital Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the enterprise fund, as of and for the years ended June 30, 2017 and 2016, and the pension trust fund, as of and for the years ended December 31, 2016 and 2015, of Chesapeake Hospital Authority (the Authority), and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these 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 financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the enterprise fund, as of and for the years ended June 30, 2017 and 2016, and pension trust fund, as of and for the years ended December 31, 2016 and 2015, of Chesapeake Hospital Authority, and the respective changes in financial position and where applicable, cash flows thereof for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 3 through 11, the Schedule of Changes in Net Pension Liability and Related Ratios (Schedule 1), the Schedule of Contributions (Schedule 2) and the Schedule of Investment Returns (Schedule 3) on pages 44 through 46, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Chesapeake Hospital Authority's basic financial statements. The supplementary information included in Schedules 4 and 5 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, supplementary the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

November 21, 2017

CHESAPEAKE HOSPITAL AUTHORITY

Management's Discussion and Analysis – Unaudited

June 30, 2017 and 2016

This discussion and analysis of Chesapeake Hospital Authority's (the Authority) financial performance provides an overview of the Authority's financial statements for the fiscal years ended June 30, 2017 and 2016. Please read it in conjunction with the Authority's financial statements, which begin on page 12.

Financial Statement Overview

The financial statements of the Authority comprise the balance sheets, the statements of revenues, expenses, and changes in net position, and the statements of cash flows. These financial statements and accompanying notes provide information about the activities of the Authority, including resources held by the Authority but restricted for specified purposes by contributors, grantors, or enabling legislation.

The Authority is the trustee, or fiduciary, for its employees' pension plan. The Authority's pension plan activities are reported in separate balance sheets and statements of changes in net position on pages 16 and 17. The Authority excludes these activities from the Authority's other financial statements because the Authority cannot use these assets to finance its operations. The Authority is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The Authority's financial statements include Chesapeake General Hospital (the Hospital), Chesapeake Hospital Authority Foundation, a blended component unit, and other wholly owned or controlled subsidiaries.

June 30, 2017 compared to June 30, 2016

Financial Highlights

- The Authority's net position at June 30, 2017 increased by \$15.5 million, or 5.3%, from June 30, 2016 due to \$20.1 million of investment income offset by negative operating results of \$(3.7) million and other changes in net position of \$(0.9) million.
- Patient service revenues comprise the majority of the Authority's revenues. Net patient service revenue increased by \$14.9 million, or 5.1%, from the prior year. Despite a 4.7% decline in adjusted patient days, gross patient charges increased \$37.5 million, or 4.3%, due primarily to a 13.0% increase in case mix index over the prior year. The provision for bad debt and charity care as a percentage of gross patient charges decreased from 6.6% in FY16 to 5.7% in FY17 primarily due to improved point-of-service collections which also contributed to the growth in net patient service revenue.
- Other operating revenues decreased \$1.9 million, or 13.1%, due primarily to the receipt of a \$1.9 million settlement related to Medicare's Rural Floor Budget Neutrality in FY16 that did not recur in FY17.
- Operating expenses increased \$16.6 million, or 5.4%, over the prior year. Salaries and benefits, comprising 47.7% of total operating expenses, increased \$6.0 million, or 4.1%, due to increases in annual wages and retirement plan expenses. Other operating expenses increased \$10.2 million, or 7.6%, primarily due to an increase in purchased services by \$2.3 million, maintenance and service contracts by \$4.0 million and drug expense by \$1.2 million.

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

As indicated in Table 1 below, the Authority's total assets and deferred outflows of resources exceeded total liabilities and deferred inflows of resources by \$308.4 million as of June 30, 2017. Approximately 10.4% of net position is related to capital assets. The majority of the remaining position (\$274.4 million) was unrestricted and can be used for ongoing operations of the Authority.

Table 1
CHESAPEAKE HOSPITAL AUTHORITY
Condensed Balance Sheet

	<u>2017</u>	<u>2016</u>
Current assets	\$ 90,847,188	86,541,499
Capital assets	123,865,837	124,977,325
Other noncurrent assets	<u>228,457,851</u>	<u>209,218,494</u>
Total assets	443,170,876	420,737,318
Deferred outflow of resources – pension	<u>16,024,789</u>	<u>10,355,388</u>
Total assets and deferred outflow of resources	<u>\$ 459,195,665</u>	<u>431,092,706</u>
Current liabilities	\$ 33,431,308	30,099,641
Pension liability	24,090,881	15,689,436
Other long-term liabilities outstanding	<u>89,667,534</u>	<u>88,340,809</u>
Total liabilities	147,189,723	134,129,886
Deferred inflow of resources	3,565,660	3,991,532
Net position:		
Net investment in capital assets	32,265,408	38,972,767
Unrestricted	274,354,313	250,968,946
Restricted – minority interest	105,539	745,030
Restricted	<u>1,715,022</u>	<u>2,284,545</u>
Total net position	<u>308,440,282</u>	<u>292,971,288</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 459,195,665</u>	<u>431,092,706</u>

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

Table 2
CHESAPEAKE HOSPITAL AUTHORITY

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	Years ended June 30	
	2017	2016
Revenues:		
Net patient service revenue	\$ 305,241,597	290,320,620
Other operating revenue	12,906,327	14,851,359
Total revenues	<u>318,147,924</u>	<u>305,171,979</u>
Operating expenses:		
Depreciation and amortization expense	24,754,478	24,204,045
Other operating expenses	297,096,250	280,948,935
Total operating expenses	<u>321,850,728</u>	<u>305,152,980</u>
Operating (loss) income	(3,702,804)	18,999
Nonoperating income (loss), net	<u>20,082,112</u>	<u>(1,990,932)</u>
Income (loss) before other changes in net position	16,379,308	(1,971,933)
Other changes in net position	<u>(910,314)</u>	<u>(393,109)</u>
Increase (decrease) in net position	15,468,994	(2,365,042)
Beginning net position	<u>292,971,288</u>	<u>295,336,330</u>
Ending net position	<u>\$ 308,440,282</u>	<u>292,971,288</u>

The Authority's total revenues increased by 4.3%, or approximately \$13.0 million. Total operating expenses increased \$15.5 million over the prior year.

- Patient service revenues comprise the majority of the Authority's revenues. Net patient service revenue increased by \$14.9 million, or 5.1%, from prior year. Despite a 4.7% decline in adjusted patient days, gross patient charges increased \$37.5 million, or 4.3%, due primarily to a 13.0% increase in case mix index over prior year. The provision for bad debt and charity care as a percentage of gross patient charges decreased from 6.6% in FY16 to 5.7% in FY17 primarily due to improved point of service collections which also contributed to the growth in net patient service revenue.
- Other operating revenues decreased \$1.9 million, or 13.1%, due primarily to the receipt of a \$1.9 million settlement related to Medicare's Rural Floor Budget Neutrality in FY16 that did not recur in FY17.
- Operating expenses increased \$16.6 million, or 5.4%, over the prior year. Salaries and benefits, comprising 47.7% of total operating expenses, increased \$6.0 million, or 4.1%, due to increases in annual wages and retirement plan expenses. Other expenses increased \$10.2 million, or 7.6%, primarily due to an increase in

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

purchased services by \$2.3 million, maintenance and service contracts by \$4.0 million, and drug expense by \$1.2 million.

Capital Asset and Obligation Administration

Capital Assets

The Authority's capital assets decreased by \$1.1 million, or 0.9%, from prior year amounts.

Table 3
CHESAPEAKE HOSPITAL AUTHORITY

Capital Assets

	2017	2016
Land and improvements	\$ 9,803,643	8,685,992
Buildings	170,849,526	163,741,138
Equipment	304,248,221	294,595,877
	484,901,390	467,023,007
Less accumulated depreciation and amortization	(368,318,873)	(343,407,021)
	116,582,517	123,615,986
Construction in progress	7,283,320	1,361,339
Total	\$ 123,865,837	124,977,325

Major capital assets purchased and capitalized during fiscal year 2017 included the Mazor Robotic System, a 64 Slice CT Scanner, an ultrasound system for cardiac diagnostics, and the purchase of a building at 1034 Battlefield Boulevard.

The Hospital has an annual capital budget plan for fiscal year 2018 that includes the following major initiatives: an Open Heart program, land purchases, facility renovations, and various equipment purchases and upgrades. Additional information regarding the Authority's capital assets is included in note 5 to the financial statements.

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

Obligations

At June 30, 2017, the Authority had approximately \$92.9 million in obligations outstanding as shown in Table 4. Additional information about the Authority's long-term obligations is included in note 6 to the financial statements.

Table 4
CHESAPEAKE HOSPITAL AUTHORITY

	Debt	
	2017	2016
Hospital Facility Revenue Bonds:		
Series 2015A	\$ 42,535,000	43,185,000
Series 2015B	45,561,822	39,348,986
Other obligations	4,755,927	5,073,224
Total	\$ 92,852,749	87,607,210

During fiscal year 2017, the Authority drew \$6.2 million against the Series 2015B Bond to finance the second phase of the new Electronic Medical Records (EMR) system implementation.

June 30, 2016 compared to June 30, 2015

Financial Highlights

- The Authority's net position decreased by \$2.4 million, or 0.8%, from June 30, 2015 due to a net investment loss of \$2.0 million and other changes in net position of \$0.4 million.
- Patient service revenues comprise the majority of the Authority's revenues. Net patient service revenue increased by \$8.0 million, or 2.8%, from prior year. Despite a 6% decline in adjusted patient days, gross patient service revenue increased \$23.1 million, or 2.8%, due primarily to a 21% increase in case mix index over prior year. The provision for bad debt and charity care as a percentage of gross patient charges decreased from 8.3% in FY15 to 6.6% in FY16 primarily due to improved point-of-service collections which also contributed to the growth in net patient service revenue.
- Other operating revenues increased \$4.3 million, or 41%, due in part to the nonrecurring receipt of two settlements: \$1.9 million related to Medicare's Rural Floor Budget Neutrality Settlement and \$0.4 million related to a dispute with a vendor. The remaining increase was primarily due to improved operating performance by some of the Authority's joint ventures, which contributed \$0.9 million, and an increase in the net proceeds from the Center for Medicare and Medicaid Services' (CMS) meaningful use program.
- Operating expenses increased \$16.0 million, or 5.5%, over the prior year. Salaries increased \$7.3 million, or 6.6%, due to increased staffing and the use of agency nurses associated with the implementation of a new electronic medical records (EMR) system that went live at the end of February 2016. Other expense increases associated with the new EMR implementation included accelerated depreciation on the old system of \$3.2 million and additional purchased services of \$2.8 million. Interest expense was \$1.2 million higher than the prior year due to increased borrowings of \$22.9 million on the Series 2015B Bonds related to the financing of the new EMR system.

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

- The Authority broke even for the year ended June 30, 2016 as compared to operating income of \$3.6 million, or 1.2% of net operating revenue, in the prior year.

As indicated in Table 5 below, the Authority's total assets and deferred outflows of resources exceeded total liabilities and deferred inflows of resources by \$293.0 million as of June 30, 2016. Approximately 13.3% of net position is related to capital assets. The majority of the remaining position (\$251.0 million) was unrestricted and can be used for ongoing operations of the Authority.

Table 5
CHESAPEAKE HOSPITAL AUTHORITY
Condensed Statements of Net Position

	<u>2016</u>	<u>2015</u>
Current assets	\$ 86,541,499	82,469,163
Capital assets	124,977,325	110,370,218
Other noncurrent assets	<u>209,218,494</u>	<u>205,026,911</u>
Total assets	420,737,318	397,866,292
Deferred outflow of resources – pension	<u>10,355,388</u>	<u>5,061,456</u>
Total assets and deferred outflow of resources	<u>\$ 431,092,706</u>	<u>402,927,748</u>
Current liabilities	\$ 30,099,641	26,532,788
Pension liability	15,689,436	12,691,457
Other long-term liabilities outstanding	<u>88,340,809</u>	<u>64,628,293</u>
Total liabilities	134,129,886	103,852,538
Deferred inflow of resources	3,991,532	3,738,880
Net position:		
Net investment in capital assets	38,972,767	47,213,827
Unrestricted	250,968,946	245,727,544
Restricted - minority interest	745,030	743,925
Restricted	<u>2,284,545</u>	<u>1,651,034</u>
Total net position	<u>292,971,288</u>	<u>295,336,330</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 431,092,706</u>	<u>402,927,748</u>

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

Table 6
CHESAPEAKE HOSPITAL AUTHORITY

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	Years ended June 30	
	2016	2015
	<u> </u>	<u> </u>
Revenues:		
Net patient service revenue	\$ 290,320,620	282,293,361
Other operating revenue	<u>14,851,359</u>	<u>10,544,939</u>
Total revenues	<u>305,171,979</u>	<u>292,838,300</u>
Operating expenses:		
Depreciation and amortization expense	24,204,045	21,991,120
Other operating expenses	<u>280,948,935</u>	<u>267,209,186</u>
Total operating expenses	<u>305,152,980</u>	<u>289,200,306</u>
Operating income	18,999	3,637,994
Nonoperating (loss) income, net	<u>(1,990,932)</u>	<u>1,696,275</u>
(Loss) income before other changes in net position	(1,971,933)	5,334,269
Other changes in net position	<u>(393,109)</u>	<u>(13,568,112)</u>
Decrease in net position	(2,365,042)	(8,233,843)
Beginning net position	<u>295,336,330</u>	<u>303,570,173</u>
Ending net position	<u>\$ 292,971,288</u>	<u>295,336,330</u>

The Authority's total revenues increased by 4.2%, or approximately \$12.3 million. Total operating expenses increased approximately \$16.0 million over the prior year.

- Patient service revenue comprise the majority of the Authority's revenues. Net patient service revenue increased by \$8.0 million, or 2.8%, from prior year. Despite a 6% decline in adjusted patient days, gross patient service revenue increased \$23.1 million, or 2.8%, due primarily to a 21% increase in case mix index over prior year. The provision for bad debt and charity care as a percentage of gross patient charges decreased from 8.3% in FY15 to 6.6% in FY16 primarily due to improved point-of-service collections which also contributed to the growth in net patient service revenue.
- Other operating revenues increased \$4.3 million, or 40.8%, due in part to the nonrecurring receipt of two settlements: \$1.9 million related to Medicare's Rural Floor Budget Neutrality Settlement and \$0.4 million related to a dispute with a vendor. The remaining increase was primarily due to improved operating performance by some of the Authority's joint ventures, which contributed \$0.9 million, and an increase in the net proceeds from the CMS meaningful use program.

CHESAPEAKE HOSPITAL AUTHORITY

Management's Discussion and Analysis – Unaudited

June 30, 2017 and 2016

- Operating expenses increased \$16.0 million, or 5.5%, over the prior year. Salaries increased \$7.3 million, or 6.6%, due to increased staffing and the use of agency nurses associated with the implementation of a new EMR system that went live at the end of February 2016. Other expense increases associated with the new EMR implementation included accelerated depreciation on the old system of \$3.2 million and additional purchased services of \$2.8 million. Interest expense was \$1.2 million higher than the prior year due to increased borrowings of \$22.9 million on the Series 2015B Bonds related to the financing of the new EMR system.
- The Authority broke even for the year ended June 30, 2016 as compared to operating income of \$3.6 million, or 1.2% of net operating revenue, in the prior year.

Capital Asset and Obligation Administration

Capital Assets

The Authority's capital assets increased by \$14.6 million, or 13.2%, from prior year amounts.

Table 7
CHESAPEAKE HOSPITAL AUTHORITY

Capital Assets

	<u>2016</u>	<u>2015</u>
Land and improvements	\$ 8,685,992	8,685,992
Buildings	163,741,138	162,320,704
Equipment	<u>294,595,877</u>	<u>249,843,067</u>
	467,023,007	420,849,763
Less accumulated depreciation and amortization	<u>(343,407,021)</u>	<u>(319,202,976)</u>
	123,615,986	101,646,787
Construction in progress	<u>1,361,339</u>	<u>8,723,431</u>
Total	\$ <u><u>124,977,325</u></u>	<u><u>110,370,218</u></u>

Major projects completed and capitalized during the fiscal year 2016 included the first phase of the new EMR system and the build out and purchase of equipment for the Virginia Beach Ambulatory Surgery Center.

The Hospital has an annual capital budget plan for fiscal year 2017 that includes the following major initiatives: a 3D mobile mammography unit, the replacement of operating room tower equipment and the renovation of the post-anesthesia care unit, the intensive care unit, and the emergency department observation area.

CHESAPEAKE HOSPITAL AUTHORITY
Management's Discussion and Analysis – Unaudited
June 30, 2017 and 2016

Obligations

At June 30, 2016, the Authority had approximately \$87.6 million in obligations outstanding as shown in Table 8. Additional information about the Authority's long-term obligations is included in note 6 to the financial statements.

Table 8
CHESAPEAKE HOSPITAL AUTHORITY

	Debt	
	2016	2015
Hospital Facility Revenue Bonds:		
Series 2015A	\$ 43,185,000	43,185,000
Series 2015B	39,348,986	16,408,588
Other obligations	5,073,224	5,982,398
Total	\$ 87,607,210	65,575,986

In March 2015, the Authority issued Hospital Facility Revenue Bond (Chesapeake General Hospital) Series 2015B (the Series 2015B Bond), with a maximum borrowing of up to \$80.0 million, to (1) finance certain capital projects at the Authority's facilities and (2) pay costs of issuance. As of June 30, 2016 and 2015, the Authority has drawn \$39.3 and \$16.4 million, respectively, against the Series 2015B Bond.

Finance Contact

The Authority's financial statements are designed to present users with a general overview of the Authority's finances and to demonstrate the Authority's accountability. If you have any questions about the report or need additional financial information, please contact the Chief Financial officer, Chesapeake Hospital Authority, 736 Battlefield Boulevard, North, Chesapeake, VA 23320.

CHESAPEAKE HOSPITAL AUTHORITY

Balance Sheets – Enterprise Fund

June 30, 2017 and 2016

Assets and Deferred Outflows of Resources	2017	2016
	<u> </u>	<u> </u>
Current assets:		
Cash and cash equivalents	\$ 48,177,615	36,038,411
Patient accounts receivable, less allowances for uncollectible accounts of approximately \$25,960,000 in 2017 and \$25,988,000 in 2016	31,403,294	38,878,733
Supplies inventories	5,725,766	6,226,448
Settlements due from third-party payors	1,147,378	825,197
Current portion of assets whose use is limited	68,609	95,471
Other	4,324,526	4,477,239
	<u> </u>	<u> </u>
Total current assets	90,847,188	86,541,499
Assets whose use is limited, less current portion:		
Internally designated by the board for capital acquisition	175,335,375	158,501,730
Externally restricted by donors	1,124,956	1,694,181
	<u> </u>	<u> </u>
	176,460,331	160,195,911
Capital assets:		
Land	2,745,915	1,752,471
Buildings, equipment, and land improvements, less accumulated depreciation and amortization of \$368,318,873 in 2017 and \$343,407,021 in 2016	113,836,602	121,863,515
Construction in progress	7,283,320	1,361,339
	<u> </u>	<u> </u>
	123,865,837	124,977,325
Other assets:		
Property held for future use	16,208,405	16,208,405
Investment in The Outer Banks Hospital, Inc.	24,149,772	22,239,116
Other investments	11,639,343	10,575,062
	<u> </u>	<u> </u>
	51,997,520	49,022,583
Total assets	443,170,876	420,737,318
Deferred outflows of resources – pension	16,024,789	10,355,388
	<u> </u>	<u> </u>
Total assets and deferred outflows of resources	\$ <u>459,195,665</u>	<u>431,092,706</u>

CHESAPEAKE HOSPITAL AUTHORITY

Balance Sheets – Enterprise Fund

June 30, 2017 and 2016

Liabilities, Deferred Inflows of Resources, and Net Position	2017	2016
	<u> </u>	<u> </u>
Current liabilities:		
Accounts payable	\$ 9,941,171	8,630,999
Employee compensation	10,259,881	11,855,625
Settlements due to third-party payors	3,800,000	3,087,152
Accrued interest	635,154	681,087
Other accrued expenses	4,383,111	4,456,588
Current portion of long-term obligations	<u>4,411,991</u>	<u>1,388,190</u>
Total current liabilities	33,431,308	30,099,641
Pension liability	24,090,881	15,689,436
Interest rate swap liability	731,800	2,121,789
Long-term obligations, less current portion	88,440,758	86,219,020
Other long-term liabilities	<u>494,976</u>	<u>—</u>
Total liabilities	<u>147,189,723</u>	<u>134,129,886</u>
Deferred inflows of resources – pension	3,565,660	3,991,532
Net position:		
Net investment in capital assets	32,265,408	38,972,767
Unrestricted	274,354,313	250,968,946
Restricted - minority interest	105,539	745,030
Restricted	<u>1,715,022</u>	<u>2,284,545</u>
Total net position	<u>308,440,282</u>	<u>292,971,288</u>
Total liabilities, deferred outflow of resources, and net position	<u>\$ 459,195,665</u>	<u>431,092,706</u>

See accompanying notes to financial statements.

CHESAPEAKE HOSPITAL AUTHORITY

Statements of Revenues, Expenses, and Changes in
Net Position – Enterprise Fund

Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating revenues:		
Net patient service revenue	\$ 305,241,597	290,320,620
Other operating revenue	<u>12,906,327</u>	<u>14,851,359</u>
	<u>318,147,924</u>	<u>305,171,979</u>
Operating expenses:		
Salaries	122,452,499	118,319,118
Fringe benefits	30,537,635	28,707,854
Medical supplies	65,107,629	62,891,809
Professional fees	15,671,175	15,324,048
Purchased services	22,022,599	19,725,346
Other expenses	39,152,938	34,081,767
Interest	2,151,775	1,898,993
Depreciation and amortization	<u>24,754,478</u>	<u>24,204,045</u>
	<u>321,850,728</u>	<u>305,152,980</u>
Operating (loss) income	(3,702,804)	18,999
Nonoperating income (loss):		
Investment income (loss), net	<u>20,082,112</u>	<u>(1,990,932)</u>
Excess (deficit) of revenues over (under) expenses before other changes in net position	16,379,308	(1,971,933)
Other changes in net position	<u>(910,314)</u>	<u>(393,109)</u>
Increase (decrease) in net position	15,468,994	(2,365,042)
Net position at beginning of year	<u>292,971,288</u>	<u>295,336,330</u>
Net position at end of year	<u>\$ 308,440,282</u>	<u>292,971,288</u>

See accompanying notes to financial statements.

CHESAPEAKE HOSPITAL AUTHORITY
Statements of Cash Flows – Enterprise Fund
Years ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from patients and third-party payors	\$ 313,107,703	279,391,859
Cash paid to employees	(148,572,920)	(142,557,747)
Cash paid to suppliers	(141,159,293)	(130,068,022)
Cash paid for pension	(3,706,786)	(5,800,000)
Other operating cash receipts and payments, net	10,084,103	11,059,715
Net cash provided by operating activities	29,752,807	12,025,805
Cash flows from capital and related financing activities:		
Repayment of long-term obligations	(1,437,903)	(4,447,865)
Purchases of capital assets	(22,004,940)	(36,777,327)
Proceeds from issuance of long-term obligations	6,412,836	26,479,089
Interest payments on long-term borrowings	(2,127,847)	(1,200,000)
Net cash used in capital and related financing activities	(19,157,854)	(15,946,103)
Cash flows from investing activities:		
Changes in assets whose use is limited:		
Purchases of investments	(179,618,475)	(24,376,886)
Sales of investments	181,260,386	17,358,174
Investment income	4,128,669	6,579,478
Other	(910,314)	(393,111)
Net cash provided by (used in) investing activities	4,860,266	(832,345)
Increase (decrease) in cash and cash equivalents	15,455,219	(4,752,643)
Cash and cash equivalents at beginning of year	36,607,337	41,359,980
Cash and cash equivalents at end of year	\$ 52,062,556	36,607,337
Cash and cash equivalents at end of year by balance sheet amount:		
Cash and cash equivalents in current assets	\$ 48,177,615	36,038,411
Cash and cash equivalents in assets whose use is limited:		
Internally designated by the board for capital acquisition	3,859,241	315,505
Externally restricted by donors	25,700	253,421
	\$ 52,062,556	36,607,337
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	\$ (3,702,804)	18,999
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Depreciation and amortization	24,754,478	24,204,045
Provision for bad debts	39,667,907	44,946,197
Interest expense considered capital financing activity	2,127,847	1,200,000
Changes in operating assets and liabilities:		
Patient accounts receivable	(32,192,468)	(55,217,997)
Supplies inventories	500,682	1,203,011
Other current assets	152,713	(120,052)
Other miscellaneous assets	(2,974,937)	(3,671,592)
Accounts payable	(57,272)	839,430
Employee compensation	(1,595,744)	712,526
Settlements with third-party payors	390,667	(656,961)
Accrued interest	(45,933)	662,222
Pension funded status	2,306,172	(2,043,301)
Other accrued expenses	421,499	(50,722)
Net cash provided by operating activities	\$ 29,752,807	12,025,805
Noncash supplemental information:		
Capital lease obligation	\$ 270,606	—
Purchases of capital assets included in accounts payable	1,367,444	2,033,825

See accompanying notes to financial statements.

CHESAPEAKE HOSPITAL AUTHORITY

Balance Sheets – Pension Trust Fund

Pension Plan Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Assets:		
Cash and cash equivalents	\$ 52,058,753	874,232
Investments (measured at fair value)	<u>41,682,995</u>	<u>84,924,049</u>
Total assets	<u>\$ 93,741,748</u>	<u>85,798,281</u>
Net position:		
Restricted for employees' pension benefits	<u>\$ 93,741,748</u>	<u>85,798,281</u>

See accompanying notes to financial statements.

CHESAPEAKE HOSPITAL AUTHORITY

Statements of Changes in Net Position – Pension Trust Fund

Pension Plan Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Beginning net position – restricted for employee's pension benefits	\$ 85,798,281	87,005,537
Additions:		
Pension contributions	5,900,000	4,502,974
Investment gain (loss)	<u>6,313,457</u>	<u>(932,921)</u>
Total additions	12,213,457	3,570,053
Deductions:		
Pension benefit payments	<u>(4,269,990)</u>	<u>(4,777,309)</u>
Ending net position – restricted for employee's pension benefits	<u>\$ 93,741,748</u>	<u>85,798,281</u>

See accompanying notes to financial statements.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(1) Reporting Entity

Chesapeake Hospital Authority (the Authority), a public instrumentality created to provide for public health and welfare by an Act of the General Assembly of the Commonwealth of Virginia, is a tax-exempt, government organization under the provisions of Internal Revenue Code Section 115. The Authority's principal activities are the ownership and operation of Chesapeake General Hospital (the Hospital) and Chesapeake Hospital Authority Foundation (the Foundation). The Hospital is a division of the Authority, and the Foundation is a blended component unit of the Authority due to the significance of the operational and financial relationship between the two entities. The Foundation is a not-for-profit, nonstock organization that operates exclusively to carry out the charitable, educational, and scientific purposes of the Authority and its subsidiaries. The Authority also engages in other healthcare-related activities through several subsidiaries, some of which are taxable corporations. The Hospital, the Foundation, and other wholly owned or controlled subsidiaries are included in the enterprise fund of the Authority.

The Authority has a 40% interest in The Outer Banks Hospital, Inc. (TOBH), a joint venture between the Authority and Vidant Community Hospitals which opened in 2002. TOBH, located in Nags Head, North Carolina, is a nonprofit, tax-exempt critical access hospital offering a wide range of inpatient and outpatient services. The Authority's investment in TOBH totaled \$24,149,772 and \$22,239,116 at June 30, 2017 and 2016, respectively. Distributions received by the Authority in 2017 and 2016 totaled \$1,520,000 and \$3,040,000, respectively. During 2017 and 2016, the Authority recognized equity in TOBH's earnings in the amount of \$3,430,656 and \$4,286,948, respectively, as other operating revenue.

On August 28, 2000, The Surgery Center of Chesapeake, LLC (SCC) was formed to provide outpatient ambulatory surgical services. At June 30, 2017, the Authority owned approximately 65% of the SCC, with the remaining portion owned by certain physicians. The SCC is a limited liability corporation. SCC does not issue publicly available separate financial statements. The physicians' interest in the net assets of SCC was \$105,539 and \$745,030 at June 30, 2017 and 2016, respectively.

The following is a summary of the Authority's blended components' condensed financial information as of and for the years ended June 30:

	Foundation		SCC	
	2017	2016	2017	2016
Assets:				
Current assets	\$ —	—	2,705,622	2,667,772
Noncurrent assets	167,580,523	150,181,383	3,863,639	3,910,473
Total assets	\$ 167,580,523	150,181,383	6,569,261	6,578,245

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

	Foundation		SCC	
	2017	2016	2017	2016
Liabilities and net position:				
Current liabilities	\$ —	—	967,534	825,116
Noncurrent liabilities	24,852,295	24,783,589	3,330,476	3,479,830
Net position – restricted	594,640	594,640	105,539	745,030
Net position – unrestricted	142,133,588	124,803,154	2,165,712	1,528,269
Total liabilities and net position	\$ <u>167,580,523</u>	<u>150,181,383</u>	<u>6,569,261</u>	<u>6,578,245</u>

	Foundation		SCC	
	2017	2016	2017	2016
Total operating revenue	\$ —	5	9,344,995	10,132,006
Total operating expenses	(136,567)	(135)	(8,300,743)	(9,206,832)
Total nonoperating income, net	17,467,001	432,185	—	3,487
Distributions to owners	—	—	(1,046,300)	(976,158)
Increase (decrease) in net position	\$ <u>17,330,434</u>	<u>432,055</u>	<u>(2,048)</u>	<u>(47,497)</u>

(2) Summary of Significant Accounting Policies

(a) Principles of Presentation

The accounts of the Authority are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, deferred outflows, liabilities, deferred inflows, net position, revenues, and expenses, as appropriate.

The enterprise fund, which includes the accounts of the Authority and its wholly owned or controlled subsidiaries (collectively referred to herein as the Authority), is used to account for the Authority's ongoing activities. Significant intercompany accounts and transactions have been eliminated in combination of these entities.

The pension trust fund is used to account for assets held in trust by PNC Institutional Investments and Trust Company for the benefit of the employees of the Authority. The pension plan is sponsored by the Authority and governed by the Board of Directors of the Authority (the Board); therefore, the pension plan is included as a component unit of the Authority.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

The Governmental Accounting Standards Board (GASB) establishes standards for external financial reporting for all state and local governmental entities. These standards require the classification of net position into three components – net investment in capital assets; amounts that are restricted; and amounts that are unrestricted. These classifications are defined as follows:

- *Net investment in capital assets* – This component consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are included in this component. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent proceeds are not included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources is included in the same component as the unspent proceeds.
- *Unrestricted* – This component is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position.
- *Restricted – minority interest* – This component represents the minority members' proportionate share of the SCC.
- *Restricted* – This component consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Assets may be restricted through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

The accounting policies and practices of the Authority conform to U.S. generally accepted accounting principles (GAAP) applicable to a proprietary fund of a government unit. The financial statement presentation and significant accounting policies adopted by the Authority materially conform to the general practice within the healthcare industry, as published by the American Institute of Certified Public Accountants in its *Audit and Accounting Guide, Health Care Organizations*.

(b) Basis of Accounting

The Authority utilizes the proprietary fund method of accounting for its enterprise fund activity, whereby revenues and expenses are recognized on the accrual basis.

The financial statements of the pension trust fund are prepared using the accrual basis of accounting. Actuarially determined employer contributions to the plan are made by the Authority in order to maintain sufficient assets to pay benefits and are recognized when due. Benefits are recognized when due and payable in accordance with the terms of the plan.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows, liabilities, deferred inflows, revenues, and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include valuation of patient accounts receivable, third-party settlements, pension liability, self-insurance liabilities, and the carrying amount of investments.

(d) Cash Equivalents

The Authority considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

(e) Allowance for Uncollectible Accounts

The Authority records an allowance for uncollectible accounts during the period in which collection is considered doubtful. Provision for bad debts is included within net patient service revenue.

(f) Investments and Investment Income

Investments in money market funds, mutual funds, and marketable debt securities are carried at fair value based on quoted market prices. Investment income, including net realized and unrealized gains or losses, and interest and dividends earned are recorded as nonoperating (loss) income. Gains and losses from the sale of securities are recorded using the specific-identification method.

(g) Assets Whose Use is Limited

Unrestricted resources appropriated or designated by the Board for investments and other nonoperating purposes and resources restricted under the pension plan trust agreement are reported as assets whose use is limited and carried at fair value. All assets whose use is limited, except for the portion required for the payment of current liabilities, are classified as noncurrent assets.

Resources restricted by donors to a specific period or purpose are also reported as assets whose use is limited. Gifts of cash and other assets are reported at fair value at the date of the gift.

(h) Supplies Inventories

Supplies inventories are stated at the lower of cost (first-in, first-out) or market.

(i) Capital Assets

Capital assets (property, plant, and equipment) are stated at cost, or, if donated, at fair value at the date of donation. The Authority capitalizes expenditures for capital assets when the acquisition cost is \$1,000 or greater. Depreciation on capital assets and amortization of capital leases is computed on a straight-line basis over the estimated useful lives of the related assets. The general range of estimated useful lives for buildings and land improvements is 20 to 40 years and the general range for equipment is 5 to 10 years.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

The Authority evaluates long-lived assets regularly for impairment. If circumstances suggest that assets may be impaired, an assessment of recoverability is performed prior to any write-down of assets. An impairment charge is recorded on those assets for which the estimated fair value is below its carrying amount. In April 2015, the Authority accelerated the depreciation of its legacy electronic medical record system in anticipation of the implementation of a new system that went live on February 28, 2016. The effect of the accelerated depreciation was an increase in depreciation expense of \$2,126,982 and \$4,253,964 for the fiscal years ended June 30, 2017 and 2016, respectively.

(j) *Deferred Outflow of Resources*

Deferred outflow of resources consist of pension-related differences between expected and actual experience, pension-related differences between expected and actual investment earnings and contributions made to the Authority's pension plan subsequent to the measurement date but as of the date of the enterprise fund financial statements.

(k) *Pension Liability*

Pension liability represents the portion of the present value of projected benefit payments attributed to past periods of service to be provided through the Authority's pension plan to current active and inactive employees less the fiduciary net position of the pension plan. It represents the Authority's total pension liability minus the fiduciary net position available to pay that liability. Investments that comprise the fiduciary net position are reported at fair value.

(l) *Deferred Inflow of Resources*

Deferred inflow of resources include pension-related deferred inflows, which represent differences between expected and actual experience, differences between expected and actual investment earnings and pension plan assumption changes.

(m) *Performance Indicator*

The Authority's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses and other changes in net position. Operating revenues result primarily from exchange transactions associated with the provision of healthcare services, the Authority's principal activity and the earnings from TOBH. Nonoperating (loss) income includes investment and dividend income, realized and unrealized gains and losses on investments, change in market value of interest rate swap, and gains and losses on the sale of assets. Other changes in the net position are excluded from operating (loss) income and nonoperating income, consistent with industry practice, and include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets) and extraordinary items. Operating expenses are all expenses incurred to provide healthcare services.

(n) *Net Patient Service Revenue*

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as adjustments and settlements become known or as years are no longer subject to such audits, reviews,

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

appeals, and investigations. The effect of these settlement adjustments to net patient service revenue was an increase of \$475,796 and decrease of \$664,008 in 2017 and 2016, respectively.

Revenues from the Medicare and Medicaid programs accounted for approximately 44% of the Authority's net patient service revenue for the year ended June 30, 2017 and 48% for the year ended June 30, 2016. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Authority has agreements with third-party payors that provide for payments at amounts different from established rates. A summary of the payment arrangements with major third-party payors follows:

- *Medicare*. Inpatient acute care services rendered to Medicare program beneficiaries and defined capital costs 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. Inpatient nonacute services and certain outpatient services and education related to Medicare beneficiaries are paid based on prospectively determined rates and a discounted cost reimbursement methodology. The Authority is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Authority and audits thereof by the Medicare fiscal intermediary. The Authority's Medicare cost reports have been substantially resolved with the respective fiscal intermediary through June 30, 2015.
- *Medicaid*. Inpatient acute care services rendered to Medicaid program beneficiaries are paid at a per diem rate and APDRG (rate per discharge). Outpatient services rendered to Medicaid beneficiaries are reimbursed on prospectively determined rates and a cost reimbursement methodology. The Authority is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Authority and audits thereof by the Medicaid program. The Authority's Medicaid cost reports have been substantially resolved with the fiscal intermediary through June 30, 2016.
- *Anthem*. Inpatient and outpatient services rendered to Anthem subscribers are reimbursed at prospectively determined discounted rates. The prospectively determined rates are not subject to retroactive adjustment.
- *Managed Care*. Inpatient services rendered to Tricare and health management organization beneficiaries are paid at prospectively determined rates per discharge. Outpatient services are reimbursed at prospectively determined discounted rates. The Authority is reimbursed by Tricare for allowed capital expenditures after submission of annual requests for reimbursement.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

The following table sets forth the detail of net patient service revenue for the years ending June 30:

	2017	2016
Gross patient charges	\$ 902,089,584	864,586,654
Charity care adjustment	(11,909,474)	(12,538,001)
Gross patient service revenue	890,180,110	852,048,653
Revenue deductions:		
Medicare contractual adjustments	262,584,714	232,196,916
Medicaid contractual adjustments	55,687,771	46,722,166
Anthem contractual adjustments	91,356,174	91,924,236
Provision for bad debts	39,667,907	44,946,197
Managed care and other contractual adjustments	135,641,947	145,938,518
Total deductions	584,938,513	561,728,033
Net patient service revenue	\$ 305,241,597	290,320,620

(o) Charity Care

The Authority accepts all patients, regardless of ability to pay. A patient is classified as a charity patient in accordance with certain established policies of the Authority. Because the Authority does not pursue collection of charges determined to qualify as uncompensated care from the patients, they are not reported as revenue. The costs and expenses incurred in providing these services are included in the Authority's operating expenses.

(p) Income Taxes

The Authority and the Foundation are exempt from federal income taxes under Sections 115 and 501(c)(3) of the Internal Revenue Code, respectively. Accordingly, with the exception of the Authority's taxable subsidiaries, no provision for income taxes has been made in the accompanying financial statements.

The provision for income taxes of the Authority's wholly-owned, taxable subsidiaries is determined using the asset and liability method based on tax laws, as currently enacted. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

The Authority recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. At June 30, 2017 and 2016, the Authority has no income tax positions that are not considered more likely than not of being sustained.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(q) Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

GASB Statement No. 72, *Fair Value Measurement and Application*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted market prices in active markets for identical assets (Level 1) and the lowest priority to unobservable inputs (Level 3).

(3) Cash and Cash Equivalents

At June 30, 2017 and 2016, the carrying values of the Authority's deposits were \$48,177,615 and \$36,038,411, respectively. The bank balances of these deposits at June 30, 2017 and 2016 were \$50,987,792 and \$37,702,922, respectively.

Deposits are placed with banks and are insured by federal depository insurance or collateralized deposits in accordance with the Virginia Security for Public Deposits Act (the Act). In accordance with the Act, the depository institution pledged collateral in the form of federal agency obligations with a market value equal to 105% of the Authority's deposits with a third-party trustee in the name of the Treasurer of the Commonwealth of Virginia. In the event that the banking institution fails, the Treasurer will take possession of the collateral, liquidate it, and reimburse the Authority up to the value of its deposits.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(4) Assets Whose Use is Limited and Investments

Assets whose use is limited held in the enterprise fund and investments held in the pension trust fund at June 30, 2017 and December 31, 2016, respectively, are summarized as follows:

	2017	2016
Internally designated by the Board:		
Cash and cash equivalents	\$ 166,506	307,982
Mutual funds – equities	2,163,034	3,411,028
Mutual funds – mixed	252,170	533,617
Foundation:		
Cash and cash equivalents	3,692,735	7,523
Money market funds	—	17,972
Mutual funds – equities	94,553,896	45,985,085
Mutual funds – fixed income	28,155,194	58,752,312
Mutual funds – mixed	16,045,820	49,259,913
Mutual funds – alternatives	28,020,082	—
Structured note	2,015,200	—
Pledges receivable	68,609	95,471
Corporate obligations and other	270,738	226,298
	<u>175,403,984</u>	<u>158,597,201</u>
Externally restricted by donors:		
Cash and cash equivalents	25,700	253,421
Mutual funds – equities	1,005,533	1,425,382
Pledges receivable	93,723	15,378
	<u>1,124,956</u>	<u>1,694,181</u>
	<u>\$ 176,528,940</u>	<u>160,291,382</u>
Pension trust fund:		
Externally restricted under pension plan agreement:		
Cash and money market	\$ 52,058,753	874,232
Mutual funds – equities	14,602,935	60,087,267
Mutual funds – mixed	1,248,798	—
Mutual funds – fixed income	25,831,262	24,836,782
	<u>\$ 93,741,748</u>	<u>85,798,281</u>

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

The Authority's assets whose use is limited held in the enterprise fund and investments held in the pension trust fund at June 30, 2017 and December 31, 2016, respectively, mature as follows:

	Fair value	Investment maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Enterprise funds:					
Cash and cash equivalents	\$ 3,884,941	3,884,941	—	—	—
Mutual funds – equities	97,722,463	—	—	—	—
Mutual funds – mixed	16,297,990	—	—	—	—
Mutual funds – fixed income	28,155,194	12,135,392	3,738,598	12,281,204	—
Mutual funds – alternatives	28,020,082	28,020,082	—	—	—
Structured note	2,015,200	2,015,200	—	—	—
Corporate obligations and other	270,738	270,738	—	—	—
Pledges receivable	162,332	158,332	4,000	—	—
	<u>\$ 176,528,940</u>	<u>46,484,685</u>	<u>3,742,598</u>	<u>12,281,204</u>	<u>—</u>
Pension trust fund:					
Cash and cash equivalents	\$ 52,058,753	52,058,753	—	—	—
Mutual funds – equities	14,602,935	—	—	—	—
Mutual funds – mixed	1,248,798	—	—	—	—
Mutual funds – fixed income	25,831,262	9,981,248	4,132,513	11,717,501	—
	<u>\$ 93,741,748</u>	<u>62,040,001</u>	<u>4,132,513</u>	<u>11,717,501</u>	<u>—</u>

The Authority's assets whose use is limited held in the enterprise fund and investments held in the pension trust fund at June 30, 2016 and December 31, 2015, respectively, mature as follows:

	Fair value	Investment maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Enterprise funds:					
Cash and cash equivalents	\$ 568,926	568,926	—	—	—
Money market funds	17,972	17,972	—	—	—
Mutual funds – equities	50,821,495	—	—	—	—
Mutual funds – mixed	49,793,530	—	—	—	—
Mutual funds – fixed income	58,752,312	51,160,214	6,601,853	990,245	—
Corporate obligations and other	226,298	226,298	—	—	—
Pledges receivable	110,849	110,849	—	—	—
	<u>\$ 160,291,382</u>	<u>52,084,259</u>	<u>6,601,853</u>	<u>990,245</u>	<u>—</u>
Pension trust fund:					
Cash and cash equivalents	\$ 874,232	874,232	—	—	—
Mutual funds – equities	60,087,267	—	—	—	—
Mutual funds – fixed income	24,836,782	3,901,639	6,008,309	10,472,106	4,454,728
	<u>\$ 85,798,281</u>	<u>4,775,871</u>	<u>6,008,309</u>	<u>10,472,106</u>	<u>4,454,728</u>

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(a) Credit Risk

The Authority's bond indentures, and the investment policy adopted by the members, limit credit risk by restricting authorized investments to money market funds, equities, mutual funds, and U.S. government and agency obligations. As of June 30, 2017, the Authority's fixed income mutual funds had an average credit rating of BB or BBB. As of June 30, 2016 the Authority's U.S. government, agency obligations, and money market funds had a credit rating of A or AA and fixed income mutual funds had an average credit rating of BB or BBB.

(b) Interest Rate Risk

The Authority does not limit investment maturities as a means to managing its exposure to fair value losses arising from changing interest rates.

(c) Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in possession of a third party.

Fixed income investments and equity securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Authority, and are held by either the counterparty or the counterparty's trust department or agent, but not the Authority's name. As of June 30, 2017 and 2016, all of the Authority's fixed income investments and equity securities are held by the Authority's custodial bank in the Authority's name and are, therefore, not exposed to custodial credit risk.

(d) Concentration Risk

The Authority's investment policy restricts fixed income investments by any one issuer to be no more than 5% of the total portfolio with the exception of securities of the U.S. government and its agencies. No more than 20% of the portfolio may be invested in any one industry.

(e) Foreign Currency Risk

Up to 20% of the portfolio may be invested in investment-grade non-U.S. dollar denominated bonds. As of June 30, 2017 and 2016, the Authority did not have any significant exposure to foreign currency risks.

(f) Investment (Loss) Income, Net

Investment (loss) income, net, are comprised of the following amounts for the years ended June 30, 2017 and 2016:

	2017	2016
Interest and dividend income	\$ 4,128,669	6,579,478
Realized and unrealized gains (losses) on investments, net	14,563,454	(6,130,858)
Change in fair value of interest rate swap	1,389,989	(2,439,552)
	\$ 20,082,112	(1,990,932)

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June 30, 2017 and 2016

(g) Fair Value

The three levels of fair value hierarchy are as follows:

Level 1 – Quoted prices for identical assets or liabilities in active markets

Level 2 – Quoted prices for similar instruments in active markets; for identical instruments in markets that are not active; and model-driven valuations whose inputs are observable either indirectly or directly

Level 3 – Unobservable inputs that are significant to the fair value of the assets or liabilities

Investments that do not have a readily determinable fair value are reported using net asset value (NAV) as a “practical expedient” as outlined in GASB Statement No. 72.

Although the Authority’s management believes the fair value accounting estimates reflected in the Authority’s financial statements are reasonable, there can be no assurances that the Authority could ultimately realize these values.

The following table presents the Authority’s fair value hierarchy for assets whose use is limited held in the enterprise fund and investments held in the pension trust fund at June 30, 2017 and December 31, 2016, respectively:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Enterprise funds:				
Cash and cash equivalents	\$ 3,884,941	3,884,941	—	—
Mutual funds – equities	97,722,463	97,722,463	—	—
Mutual funds – mixed	16,297,990	16,297,990	—	—
Mutual funds – fixed income	28,155,194	28,155,194	—	—
Structured note	2,015,200	—	2,015,200	—
Corporate and other equities	270,738	270,738	—	—
Pledges receivable	162,332	—	162,332	—
	<u>\$ 148,508,858</u>	<u>146,331,326</u>	<u>2,177,532</u>	<u>—</u>
Total investments measured at NAV	<u>28,020,082</u>			
Total assets whose use is limited	<u>176,528,940</u>			
Pension trust fund:				
Cash and cash equivalents	\$ 52,058,753	52,058,753	—	—
Mutual funds – equities	14,602,935	14,602,935	—	—
Mutual funds – mixed	1,248,798	1,248,798	—	—
Mutual funds – fixed income	25,831,262	25,831,262	—	—
	<u>\$ 93,741,748</u>	<u>93,741,748</u>	<u>—</u>	<u>—</u>

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June 30, 2017 and 2016

The following table presents the Authority's fair value hierarchy for assets whose use is limited held in the enterprise fund and investments held in the pension trust fund at June 30, 2016 and December 31, 2015, respectively:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Enterprise funds:				
Cash and cash equivalents	\$ 568,926	568,926	—	—
Money market funds	17,972	17,972	—	—
Mutual funds – equities	50,821,495	50,821,495	—	—
Mutual funds – mixed	49,793,530	49,793,530	—	—
Mutual funds – fixed income	58,752,312	58,752,312	—	—
Corporate and other equities	226,298	226,298	—	—
Pledges receivable	110,849	—	110,849	—
	<u>\$ 160,291,382</u>	<u>160,180,533</u>	<u>110,849</u>	<u>—</u>
Pension trust fund:				
Cash and cash equivalents	\$ 874,231	874,231	—	—
Mutual funds – equities	60,087,267	60,087,267	—	—
Mutual funds – fixed income	24,836,783	24,836,783	—	—
	<u>\$ 85,798,281</u>	<u>85,798,281</u>	<u>—</u>	<u>—</u>

The table below discloses the unfunded commitments, redemption frequency and redemption notice period for investments measured at NAV as of June 30, 2017:

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Long/short equity hedge fund	\$ 11,238,234	—	Monthly/Quarterly	45 days
Long/short equity hedge fund	3,766,875	—	Monthly	15 days
Long/short equity hedge fund	10,102,991	—	Daily	10 – 30 days
Fund of funds	2,911,982	—	Quarterly	70 days
	<u>\$ 28,020,082</u>	<u>—</u>		

Long/short equity investments are hedge fund strategies that invest both long and short primarily in equities. The fair values of these investments have been determined using NAV per share of the investments.

Fund of funds investments are a global macro hedge fund strategy that bases their holdings primarily on macro economic data. The fair value of these investments have been determined using NAV per share of the investments.

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Notes to Financial Statements

June 30, 2017 and 2016

(5) Capital Assets

Capital assets and changes thereto, as of and for the year ended June 30, 2017, consisted of the following:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers and disposals</u>	<u>Ending balance</u>
Land improvements	\$ 6,933,521	421,313	(297,106)	7,057,728
Buildings	163,741,138	3,803,728	3,304,660	170,849,526
Equipment	294,595,877	11,468,770	(1,816,426)	304,248,221
	<u>465,270,536</u>	<u>15,693,811</u>	<u>1,191,128</u>	<u>482,155,475</u>
Less accumulated depreciation and amortization	<u>343,407,021</u>	<u>24,754,478</u>	<u>157,374</u>	<u>368,318,873</u>
	121,863,515	(9,060,667)	1,033,754	113,836,602
Land	1,752,471	—	993,444	2,745,915
Construction in progress	<u>1,361,339</u>	<u>8,385,196</u>	<u>(2,463,215)</u>	<u>7,283,320</u>
	<u>\$ 124,977,325</u>	<u>(675,471)</u>	<u>(436,017)</u>	<u>123,865,837</u>

Capital assets and changes thereto, as of and for the year ended June 30, 2016, consisted of the following:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers and disposals</u>	<u>Ending balance</u>
Land improvements	\$ 6,933,521	—	—	6,933,521
Buildings	162,320,704	1,371,940	48,494	163,741,138
Equipment	249,843,067	11,329,672	33,423,138	294,595,877
	<u>419,097,292</u>	<u>12,701,612</u>	<u>33,471,632</u>	<u>465,270,536</u>
Less accumulated depreciation and amortization	<u>319,202,976</u>	<u>24,204,045</u>	<u>—</u>	<u>343,407,021</u>
	99,894,316	(11,502,433)	33,471,632	121,863,515
Land	1,752,471	—	—	1,752,471
Construction in progress	<u>8,723,431</u>	<u>25,952,481</u>	<u>(33,314,573)</u>	<u>1,361,339</u>
	<u>\$ 110,370,218</u>	<u>14,450,048</u>	<u>157,059</u>	<u>124,977,325</u>

The estimated cost to complete construction in progress at June 30, 2017 is approximately \$29,316,000. This amount relates principally to phase II of the electronic medical record system conversion, renovations of the intensive care unit and operating rooms, and a Battlefield Boulevard project.

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Notes to Financial Statements

June 30, 2017 and 2016

(6) Long-Term Obligations

Long-term obligations, and changes thereto, as of and for the year ended June 30, 2017 are summarized below:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>
Hospital Facility Revenue Bonds:					
Series 2015A	\$ 43,185,000	—	650,000	42,535,000	645,000
Series 2015B	<u>39,348,986</u>	<u>6,212,836</u>	<u>—</u>	<u>45,561,822</u>	<u>2,965,000</u>
	82,533,986	6,212,836	650,000	88,096,822	3,610,000
Capital lease obligations	918,928	270,606	614,384	575,150	420,848
Deferred compensation obligation	657,523	—	—	657,523	—
SCC Monarch line of credit	—	200,000	—	200,000	200,000
SCC note payable – Old Point Monarch Bank	<u>3,496,773</u>	<u>—</u>	<u>173,519</u>	<u>3,323,254</u>	<u>181,143</u>
Total long-term obligations	\$ <u>87,607,210</u>	<u>6,683,442</u>	<u>1,437,903</u>	<u>92,852,749</u>	<u>4,411,991</u>

Long-term obligations, and changes thereto, as of and for the year ended June 30, 2016 are summarized below:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>
Hospital Facility Revenue Bonds:					
Series 2015A	\$ 43,185,000	—	—	43,185,000	650,000
Series 2015B	<u>16,408,588</u>	<u>22,940,398</u>	<u>—</u>	<u>39,348,986</u>	<u>—</u>
	59,593,588	22,940,398	—	82,533,986	650,000
Capital lease obligations	1,716,830	—	797,902	918,928	564,672
Deferred compensation obligation	702,765	—	45,242	657,523	—
SCC note payable – Old Point National Bank	3,562,803	—	3,562,803	—	—
SCC note payable – Old Point Monarch Bank	<u>—</u>	<u>3,538,691</u>	<u>41,918</u>	<u>3,496,773</u>	<u>173,518</u>
Total long-term obligations	\$ <u>65,575,986</u>	<u>26,479,089</u>	<u>4,447,865</u>	<u>87,607,210</u>	<u>1,388,190</u>

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Notes to Financial Statements

June 30, 2017 and 2016

(a) Hospital Facility Revenue Bonds and Notes Payable

On March 31, 2015, the Hospital Facility Refunding Revenue Bond (Chesapeake General Hospital) Series 2015A (the Series 2015A Bond) was authorized and issued totaling \$43,685,000 pursuant to Chapter 271, Virginia Acts of Assembly of 1966, as amended, to refund the outstanding principal amount of the Authority's (i) Series 2004B Bonds, and (ii) Series 2012 Bond, and to pay costs of issuance. The Series 2015A Bond is repayable in annual installments ranging from \$650,000 to \$4,135,000 due July 1, 2016 through July 1, 2031. Interest is due semiannually in July and January at a rate of 2.9% per annum.

Contemporaneously with the issuance of the Series 2015A Bond, the Authority issued Hospital Facility Revenue Bond (Chesapeake General Hospital) Series 2015B (the Series 2015B Bond), with a maximum borrowing of up to \$80,000,000, to (1) finance certain capital projects at the Authority's facilities and (2) pay costs of issuance. The Series 2015B Bond is repayable in annual installments ranging from \$2,695,000 to \$4,795,000 due July 1, 2017 through July 1, 2037. Interest is payable monthly at a per annum rate equal to 67% of the sum of LIBOR plus 1.71%, multiplied, prior to the occurrence of any event of taxability, by the margin rate factor. The average interest rate during 2017 was 1.62%. As of June 30, 2017, the Authority has drawn \$45,561,822 against the Series 2015B Bond and \$34,438,178 remains available for drawdown in future periods.

On November 2, 2015, the Authority executed a revolving line of credit agreement (line of credit) totaling \$20,000,000, to finance working capital needs. The line of credit expires on November 2, 2017 and will not be renewed. As of June 30, 2017 no funds have been drawn against the line of credit.

On March 22, 2016, SCC executed a business loan agreement with Monarch Bank (loan agreement) totaling \$3,538,691, to refund the outstanding note with Old Point National Bank. Contemporaneously with the execution of the loan agreement, SCC signed a promissory note to pay Monarch Bank the principal amount of the loan agreement. The promissory note is payable in equal monthly installments of \$26,734 due April 22, 2016 through March 22, 2021. The monthly installments include interest at a rate of 4.25% per annum.

On June 14, 2017, SCC executed a revolving line of credit agreement with Monarch Bank (SCC line of credit) totaling \$500,000, to finance major capital expenditures. The SCC line of credit is payable in full immediately upon the lender's demand. As of June 30, 2017, SCC has drawn \$200,000 against the SCC line of credit.

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Notes to Financial Statements

June 30, 2017 and 2016

Debt service requirements on the Hospital Facility Revenue Bonds and Surgery Center of Chesapeake Note for the next five years and thereafter are as follows at June 30, 2017:

		<u>Principal</u>	<u>Interest</u>
2018	\$	3,991,143	2,084,080
2019		4,024,105	2,005,448
2020		5,637,080	1,900,571
2021		8,385,926	1,740,872
2022		5,840,000	1,526,729
2023–2027		32,425,000	5,540,078
2028–2032		<u>31,316,822</u>	<u>1,693,044</u>
Total	\$	<u>91,620,076</u>	<u>16,490,822</u>

Approximately \$2,128,000 and \$1,200,000 in interest was paid during the years ended June 30, 2017 and 2016, respectively.

(b) Interest Rate Swap

In connection with the issuance of the Series 2015B Bond, the Authority entered into an interest rate swap (the Swap) agreement which will become effective on July 1, 2017 and continue through July 1, 2025. The Swap will constitute a qualified hedge during such term with respect to a \$40,000,000 portion of the Series 2015B Bond. The Swap's fair value of \$731,800 and \$2,121,789 are reported as a liability on the balance sheets as of June 30, 2017 and 2016, respectively.

The significant terms and features of the above transaction as of and for the year ended June 30, 2017 are summarized in the below table. The notional amount of the Swap effectively matches the principal amount of the associated debt. The Swap contains scheduled reductions to the outstanding notional amount that is expected to follow scheduled or anticipated reductions in the associated bond.

		<u>2015B</u>
Notional amount	\$	40,000,000
Swap type		Floating-to-fixed
Origination date		March 31, 2015
Effective date		July 1, 2017
Termination date		April 1, 2025
The Authority pays		2.78%
The Authority receives		67% of LIBOR + 1.15%
Fair value at June 30, 2017	\$	(731,800)
Fair value at June 30, 2016		(2,121,789)

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Notes to Financial Statements

June 30, 2017 and 2016

Net payments under the terms of the Swap will be as follows as of June 30, 2017:

	Interest rate swap – net	
	<hr/>	
2018	\$	162,432
2019		156,566
2020		149,486
2021		142,770
2022		135,885
2023–2026		<hr/> 345,636
Total	\$	<hr/> <hr/> 1,092,775

The fair value of the Swap is the estimated amount that the Authority would receive or pay to terminate the Swap agreement at the reporting date, taking into account current interest rates. The Swap is valued based on readily observable market parameters for all substantial terms of the contract and is, therefore, categorized as a Level 2 liability. The change in the fair value of the Swap for the years ended June 30, 2017 and 2016 was \$1,389,989 and \$(2,439,552), respectively, and is included in investment (loss) income, net, in the accompanying statements of revenues, expenses, and changes in net position.

(c) Capital Lease

During 2015, the Hospital entered into a second capital lease covering certain medical equipment that expires in July 2017. Ownership of the equipment will transfer to the Hospital at the end of the agreement. The Hospital also entered into a capital lease covering software that expires in April 2018. At the end of the lease, the Hospital will have the option to purchase the software for \$1.

During 2017, the SCC entered into a capital lease for medical equipment for which ownership of the equipment will transfer to SCC at the end of the lease. The payments for this lease extend through March 2019.

At June 30, 2017, the gross amount of the medical equipment and related accumulated amortization recorded under the capital leases were as follows:

	2017	
	<hr/>	
Equipment	\$	3,970,254
Less accumulated amortization		<hr/> (1,702,968)
Total	\$	<hr/> <hr/> 2,267,286

Amortization of the asset held under the capital lease is included in depreciation and amortization expense on the statements of revenues, expenses and changes in net position.

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Notes to Financial Statements

June 30, 2017 and 2016

Future minimum capital lease payments as of June 30, 2017 are:

	Capital leases
Year ending June 30:	
2018	\$ 438,256
2019	107,365
2020	52,217
Total minimum lease payments	597,838
Less amount representing interest	(22,688)
Present value of net minimum capital lease payments	575,150
Less current installments of obligation under capital leases	(420,848)
Obligations under capital leases, excluding current installments	\$ 154,302

(d) Deferred Compensation

The Authority maintains a deferred compensation plan which was established to provide an opportunity for select employees, whose contributions are typically restricted under a qualified plan, to save for retirement needs on a tax-deferred basis. All deferred compensation amounts are invested in mutual funds that are actively traded and are, therefore, categorized as Level 1. These assets are recorded in other assets on the Authority's balance sheet as they are subject to the claims of Authority's creditors in the event of corporate insolvency. The corresponding liability represents amounts deferred by the plan participants plus or minus any earnings or losses on the trust assets and is recorded in long-term obligations on the Authority's balance sheet. The assets and associated deferred compensation liability totaled \$657,523 at June 30, 2017 and 2016.

(7) Pension Plan

Prior to January 1, 1988, the Authority had a noncontributory, single employer defined contribution pension plan (the Plan) that covered substantially all full-time employees of the Authority who had at least 12 months of service and had reached the age of 25.

Effective January 1, 1988, the Plan was amended and converted to a noncontributory, single employer defined benefit pension plan. Separate financial statements for the Plan have not been issued. All covered employees who work 1,000 hours a year or more are eligible to participate in the amended Plan on the January 1 or July 1 following their attainment of age 21 and the completion of one qualifying year of service. Members generally become vested as to benefits upon the completion of 5 years of service.

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Notes to Financial Statements

June 30, 2017 and 2016

The Plan provides retirement, disability, and death benefits to plan members and their beneficiaries. Retirement benefits are calculated as the sum of (a) 1% multiplied by Average Compensation (as defined in the Plan) multiplied by Years of Accrual Service (as defined in the Plan) (not to exceed 30), and (b) 0.65% multiplied by Average Compensation greater than Covered Compensation (as defined in the Plan) multiplied by Years of Accrual Service (not to exceed 30). Disability retirement benefits are determined in the same manner as retirement benefits but reduced one-fifteenth for each of the first five years and one-thirtieth for each of the next five years by which the payment date precedes the normal retirement date and actuarially reduced for each additional year. If a vested participant dies prior to their annuity starting date, the participant's beneficiary will receive a life annuity equal to the actuarial equivalent of the participant's vested accrued benefit as of the date of the participant's death. If a participant dies after the annuity starting date, payments shall be made in accordance with the method of payment elected by the participant. Cost-of-living adjustments are provided only at the discretion of the Board. The Board has the authority to establish and amend the benefit provisions of the Plan.

(a) Employees Covered by Benefit Terms

The total pension liability at June 30, 2017 and 2016 was based on Plan membership data as of January 1, 2016 and 2015 and rolled forward to the measurement date, or June 30, 2016 and 2015, respectively as follows:

	2017*	2016**
Retirees and beneficiaries receiving benefits	\$ 355	331
Terminated plan members entitled to but not yet receiving benefits	683	643
Active plan members	1,602	1,724
Total members	\$ 2,640	2,698

* Based on June 30, 2016 measurement date

** Based on June 30, 2015 measurement date

(b) Contributions

Contribution requirements are established and may be amended by the Board. Administrative costs of the Plan are paid by the Authority. Currently, employee contributions are neither required nor permitted. The Authority's funding policy is to contribute such actuarially determined amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members and to meet the minimum actuarially determined funding requirements. The Authority's contribution rates for the years ended June 30, 2017 and 2016 equaled 4.14% and 6.38% of covered payroll, respectively. These contribution rates are determined based on a measurement date of June 30, 2016 and 2015, respectively.

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Notes to Financial Statements

June 30, 2017 and 2016

(c) Investments

Policies pertaining to the allocation of investments within the Plan are established and may be amended by the Investment Committee of the Board (the Investment Committee). It is the policy of the Investment Committee to invest pension assets in securities that provide a balanced portfolio approach whose overall return comes from both capital appreciation and dividend and interest income. The following table illustrates the approved asset allocation policy as of the pension plan years ended December 31, 2016 and 2015:

Investment type	% Range of allocation		
	Minimum	Target	Maximum
Equity securities	40 %	65 %	85 %
Equity alternatives	—	10	20
Diversifying alternatives	—	10	25
Fixed income	—	14	50
Cash	—	1	15

Permitted securities in which assets of the Plan may be invested include any of the following:

Cash equivalents:

- Treasury bills
- Money market funds
- STIF funds
- Certificates of deposit

Equity securities:

- Common stocks
- Convertible notes and bonds
- Convertible preferred stocks
- American Depository Receipts (ADRs) of non-U.S. companies
- Ordinary shares of non-U.S. companies
- Commingled funds that invest in securities allowed in the policy

Fixed income securities:

- U.S. government and agency securities
- Corporate notes and bonds
- Mortgage backed bonds
- Preferred stock
- Collateralized mortgage obligations
- U.S. dollar-denominated Euro and Yankee bonds
- Fixed income securities of foreign governments and corporations

Derivatives:

- Options
- Futures

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

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Notes to Financial Statements

June 30, 2017 and 2016

At December 31, 2016 and 2015, the following investments represented 5% or more of the Plan's fiduciary net position:

	2016	2015
Commingled funds:		
Doubleline Total Return Bond Fund **	\$ 7,000,000	\$ —
Sun America Focused Dividend Strategy Fund Class A	5,619,212	4,870,307
Lord Abbett Growth Lead Class A *	—	5,412,284
Pimco Rae Fundamental Plus Fund Class A Fd*	—	4,756,069
First Eagle Global Fund Class A*	—	4,696,688

* This investment represented 5% or more of the Plan's fiduciary net position for the 2015 plan year but not the 2016 plan year, however, it is presented for comparability purposes.

** This investment represented 5% or more of the Plan's fiduciary net position for the 2016 plan year but not the 2015 plan year, however, it is presented for comparability purposes.

For the years ended December 31, 2016 and 2015, the annual money-weighted rate of return on investments of the Plan, net of investment expense, was 9.05% and (0.79)%, respectively. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for changing amounts actually invested.

The fiduciary net position of the Plan at December 31, 2016 and 2015 was invested as follows:

	2016	2015
Cash equivalents	\$ 52,058,753	874,231
Commingled equity funds	14,602,935	60,087,267
Commingled equity alternatives	1,248,798	—
Commingled fixed income funds	25,831,262	24,836,783
Total	\$ 93,741,748	85,798,281

(d) Actuarial Method

The actuarial cost method used to determine the normal cost and actuarial accrued liabilities of the Plan is the Entry Age Normal Cost Method. Under this method, benefits are projected to retirement (or earlier termination) for each plan participant based upon the assumptions as to future compensation increases. The annual normal cost is determined as a level percentage of pay necessary to fund a participant's benefits over the entire period of active participation in the Plan. The actuarial accrued liability is the excess of the present value of future benefits over the present value of future normal costs.

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The normal cost and accrual accrued liability of the Plan is the sum of the corresponding amounts for each participant. Deviations in actual experience from the experience anticipated by the actuarial assumptions result in actuarial gains or losses which reduce or increase, respectively, the total pension liability. Each year's deviation will be amortized over the average future working lifetime of all participants for purposes of calculating the Authority's pension cost.

All employees who are plan participants on the valuation date are included in the actuarial valuation.

(e) Actuarial Assumptions

The total pension liability at June 30, 2017 and 2016 was determined using the following actuarial assumptions:

	<u>2017*</u>	<u>2016**</u>
Inflation	2.10 %	2.10 %
Salary increases	3.00	3.00
Investment rate of return (net of pension plan investment expense, including inflation)	7.00	7.00

* Based on a June 30, 2016 measurement date

** Based on a June 30, 2015 measurement date

During 2017, the Authority made a change in pension plan actuaries; however, the actuarial assumptions used to determine the total pension liability at June 30, 2017 and 2016 remained unchanged, with the exception of the mortality table. The actuarial assumptions were based on the results of an actuarial experience study that was conducted using data through January 1, 2012. In 2017 and later, the expectation of retired life mortality was based on RP-2014 Employee and Healthy Annuitant tables projected forward with Scale MP-2015 rather than the RP-2014 table with MP-2014 Generational Projection, which was used prior to 2017.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimated ranges of expected real rates of return are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset class</u>	<u>Target allocation</u>	<u>Long-term expected rate of return</u>
Equity	60 %	6.90%–7.40%
Fixed income	40	3.50%–4.60%

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June 30, 2017 and 2016

(f) Discount Rate

The discount rate used to measure the total pension liability as of June 30, 2016 and 2015 was 7.00%. The projection of cash flows used to determine the discount rate assumed that Authority contributions will be made based on rates determined by the Actuary. Based on those assumptions, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on Plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

(g) Changes in the Net Pension Liability

	Increase (decrease)		
	Total pension liability	Plan fiduciary net position	Net pension liability
	(a)	(b)	(a) – (b)
Balance recognized at July 1, 2016*	\$ 104,661,672	88,972,236	15,689,436
Changes recognized for the fiscal year:			
Service cost	2,738,302	—	2,738,302
Interest	7,396,726	—	7,396,726
Differences between expected and actual experience	3,422,214	—	3,422,214
Changes of assumptions	(1,053,973)	—	(1,053,973)
Contributions from the employer	—	5,800,000	(5,800,000)
Net investment income	—	(1,698,176)	1,698,176
Benefit payments	(3,524,534)	(3,524,534)	—
Net changes	8,978,735	577,290	8,401,445
Balance recognized at June 30, 2017**	\$ 113,640,407	89,549,526	24,090,881

* Based on June 30, 2015 measurement date

** Based on June 30, 2016 measurement date

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

	Increase (decrease)		
	Total pension liability (a)	Plan fiduciary net position (b)	Net pension liability (a) – (b)
Balance recognized at July 1, 2015*	\$ 101,335,016	88,643,559	12,691,457
Changes recognized for the fiscal year:			
Service cost	2,807,227	—	2,807,227
Interest	7,114,608	—	7,114,608
Differences between expected and actual experience	(1,499,018)	—	(1,499,018)
Contributions from the employer	—	3,470,632	(3,470,632)
Net investment income	—	1,954,206	(1,954,206)
Benefit payments	(5,096,161)	(5,096,161)	—
Net changes	<u>3,326,656</u>	<u>328,677</u>	<u>2,997,979</u>
Balance recognized at June 30, 2016**	\$ <u>104,661,672</u>	<u>88,972,236</u>	<u>15,689,436</u>

* Based on June 30, 2014 measurement date

** Based on June 30, 2015 measurement date

(h) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following table presents the net pension liability of the Authority as of June 30, 2017 and 2016, calculated using the discount rate of 7.00%, as well as what the Authority's net pension liability as of June 30, 2017 and 2016, would be if it were calculated using a discount rate that is one percentage-point lower or one percentage-point higher than the current rate:

	1% decrease (6.00%)	Current rate (7.00%)	1% increase (8.00%)
Authority's net pension liability at June 30, 2017*	\$ 36,265,123	24,090,881	13,842,103
Authority's net pension liability at June 30, 2016**	27,923,929	15,689,436	5,455,620

* Based on June 30, 2016 measurement date

** Based on June 30, 2015 measurement date

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(i) Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources

For the years ended June 30, 2017 and 2016, the Authority recognized pension expense of \$6,012,958 and \$3,756,699, respectively. At June 30, 2017 and 2016, the Authority reported deferred outflows of resources and deferred inflows or resources related to pension from the following sources:

	<u>Deferred outflows of resources*</u>	<u>Deferred inflows of resources*</u>	<u>Net deferred (inflows) outflows*</u>
Differences between expected and actual experience	\$ 3,427,462	(875,726)	2,551,736
Assumption changes	—	(820,494)	(820,494)
Net difference between expected and actual earnings on pension plan investments	8,890,541	(1,869,440)	7,021,101
Contributions made after measurement date	<u>3,706,786</u>	<u>—</u>	<u>3,706,786</u>
Total	<u>\$ 16,024,789</u>	<u>(3,565,660)</u>	<u>12,459,129</u>

* Based on a June 30, 2016 measurement date

At June 30, 2016, the Authority reported deferred outflow of resources and deferred inflows of resources related to pension from the following sources:

	<u>Deferred outflows of resources*</u>	<u>Deferred inflows of resources*</u>	<u>Net deferred (inflows) outflows*</u>
Differences between expected and actual experience	\$ 1,177,086	(1,187,372)	(10,286)
Net difference between expected and actual earnings on pension plan investments	3,378,302	(2,804,160)	574,142
Contributions made after measurement date	<u>5,800,000</u>	<u>—</u>	<u>5,800,000</u>
Total	<u>\$ 10,355,388</u>	<u>(3,991,532)</u>	<u>6,363,856</u>

* Based on a June 30, 2015 measurement date

Deferred outflows of resources resulting from employer contributions made after the measurement date in the amount of \$3,706,786 as of June 30, 2017 will be recognized as a reduction of the net pension liability in the year ending June 30, 2018. Other amounts reported as deferred outflows of resources

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

and deferred inflows of resources as of June 30, 2017 will be recognized in pension expense for each of the years ended June 30 as follows:

	Amount
2018	\$ 2,125,772
2019	2,061,644
2020	2,705,968
2021	1,858,959
	\$ 8,752,343

(8) Commitments and Contingencies

(a) Shared Laundry Commitment

As a member of Shared Hospital Services (a not-for-profit, shared laundry facility), the Hospital has agreed that it will use the services of that facility for all of its laundry requirements, insofar as such services are available, until 2018. For the years ended June 30, 2017 and 2016, the Authority recognized expenses of \$1,176,284 and \$1,159,176, respectively.

(b) Malpractice Insurance

The Authority's malpractice insurance coverage is on a claims-made basis. The Authority is insured for losses up to \$2,300,000 per claim and \$6,900,000 in the aggregate, and beginning January 1, 1994, the insurance coverage includes a \$50,000 deductible per claim for all claims reported after the effective date (\$400,000 annual limit). The Authority also is insured under a \$12,000,000 umbrella policy. Should the Authority not renew its policy or replace it with equivalent insurance, occurrences during its term but asserted after its term will be uninsured unless the Authority obtains tail coverage. The Authority's management is of the opinion that the accompanying financial statements will not be materially affected by retrospective adjustments or the ultimate cost related to unasserted claims, if any, at the balance sheet date.

(c) Industry and Regulatory Environment

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Authority, through its compliance program, seeks to ensure compliance with such laws and regulations and to rectify instances of noncompliance. Compliance with such laws and regulations is subject to future government review and interpretation as well as significant regulatory action, which can include fines, penalties, and exclusion from the Medicare and Medicaid programs.

In August 2016, the Hospital self-disclosed potential compliance violations to relevant regulatory authorities. The Hospital expects to work collaboratively with these authorities to determine what, if any, fines and penalties might be due. Based upon the information available to date, it is probable that some monies will have to be paid by the Hospital to relevant regulatory authorities; however, management believes, based on the information available to date, that the ultimate outcome to these matters will not have a material effect on the Hospital's financial position or results of operations.

CHESAPEAKE HOSPITAL AUTHORITY

Notes to Financial Statements

June 30, 2017 and 2016

(9) Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents insured under third-party payor agreements. The mix of net receivables from patients and third-party payors is as follows as of June 30:

	<u>2017</u>	<u>2016</u>
Anthem	31 %	27 %
Medicare	25	34
Other	21	19
Optima	10	8
Self pay	7	6
Medicaid	6	6
	<u>100 %</u>	<u>100 %</u>

REQUIRED SUPPLEMENTARY INFORMATION

CHESAPEAKE HOSPITAL AUTHORITY

Schedule of Changes in Net Pension Liability and Related Ratios (unaudited)

June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Total pension liability:		
Service cost	\$ 2,738,302	2,807,227
Interest cost	7,396,726	7,114,608
Differences between expected and actual experiences	3,422,214	(1,499,018)
Changes of assumptions	(1,053,973)	—
Benefit payments, including refunds of employee contributions	<u>(3,524,534)</u>	<u>(5,096,161)</u>
Net change in total pension liability	8,978,735	3,326,656
Total pension liability – beginning	<u>104,661,672</u>	<u>101,335,016</u>
Total pension liability – ending (a)	<u>113,640,407</u>	<u>104,661,672</u>
Plan fiduciary net position:		
Contributions – employer	5,800,000	3,470,632
Net investment income	(1,698,176)	1,954,206
Benefit payments, including refunds of employee contributions	<u>(3,524,534)</u>	<u>(5,096,161)</u>
Net change in plan fiduciary net position	577,290	328,677
Plan fiduciary net position – beginning	<u>88,972,236</u>	<u>88,643,559</u>
Plan fiduciary net position – ending (b)	<u>89,549,526</u>	<u>88,972,236</u>
Authority's net pension liability – ending (a) – (b)	<u>\$ 24,090,881</u>	<u>15,689,436</u>
Plan fiduciary net position as a percentage of the total pension liability	78.80 %	85.01 %
Covered-employee payroll	\$ 89,564,423	90,949,571
Authority's net pension liability as a percentage of covered-employee payroll	26.90 %	17.25 %
Note to schedule:		
Measurement date is June 30 of prior fiscal year.		

See accompanying independent auditors' report.

CHESAPEAKE HOSPITAL AUTHORITY

Schedule of Contributions (unaudited)

Last 10 Fiscal years

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Actuarially determined contribution	\$ 3,706,786	3,853,646	3,926,838	4,434,020	3,576,088	4,390,091	3,380,554	4,634,361	3,714,164	3,355,514
Contributions made in relation to the actuarially determined contribution	3,706,786	5,800,000	3,470,632	4,434,020	3,576,088	4,390,091	3,380,554	4,634,361	4,501,467	3,355,514
Contribution (excess) deficiency	\$ —	(1,946,354)	456,206	—	—	—	—	—	(787,303)	—
Covered-employee payroll	89,564,423	90,949,571	95,108,825	97,962,090	94,517,987	98,342,460	93,019,970	92,996,427	78,566,887	69,618,857
Contributions as a percentage of covered-employee payroll	4.14 %	6.38 %	3.65 %	4.53 %	3.78 %	4.46 %	3.63 %	4.98 %	5.73 %	4.82 %

Notes to schedule:

Valuation date: Actuarially determined contribution rates are calculated as of July 1, one year prior to the end of the fiscal year in which contributions are reported

Methods and assumptions used to determine contribution rates:

Actuarial cost method:	Entry Age Normal with 20-year closed amortization period for unfunded liability
Asset valuation method:	5 year smoothing
IRS Limit increases:	3.00 %
Salary increases:	3.00 %
Investment rate of return:	7.00%, net of pension plan investment expense, including inflation
Retirement age:	Varies by age and service
Mortality age:	Based on the RP-2014 Employee and Healthy Annuitant tables projected forward with Scale MP-2015

See accompanying independent auditors' report.

CHESAPEAKE HOSPITAL AUTHORITY
Schedule of Investment Returns (unaudited)

The annual money-weighted rate of return, net of investment expense, is as follows:

Plan year ended September 30	Rate
2016	9.05 %
2015	(0.79)%

See accompanying independent auditors' report.

SUPPLEMENTARY INFORMATION

CHESAPEAKE HOSPITAL AUTHORITY

Combining Schedule of Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Net Position

June 30, 2017

Assets and Deferred Outflows of Resources	Obligated group			Subtotal	Nonobligated group	Eliminations	Total reporting entity
	Chesapeake Hospital Authority	Chesapeake General Hospital	Chesapeake Hospital Authority Foundation				
Current assets:							
Cash and cash equivalents	\$ 20,755,770	20,624,448	—	41,380,218	6,797,397	—	48,177,615
Patient accounts receivable – net	—	29,918,804	—	29,918,804	1,484,490	—	31,403,294
Supplies inventories	—	5,274,744	—	5,274,744	451,022	—	5,725,766
Settlements due from third-party payors	—	1,147,378	—	1,147,378	—	—	1,147,378
Current portion of assets whose use is limited	—	—	—	—	68,609	—	68,609
Other	430,488	3,538,797	—	3,969,285	355,241	—	4,324,526
Total current assets	21,186,258	60,504,171	—	81,690,429	9,156,759	—	90,847,188
Assets whose use is limited, less current portion:							
Internally designated by the board for capital acquisition	—	2,581,711	167,580,524	170,162,235	5,173,140	—	175,335,375
Externally restricted by donors	—	4,574	—	4,574	1,120,382	—	1,124,956
Total assets limited as to use	—	2,586,285	167,580,524	170,166,809	6,293,522	—	176,460,331
Capital assets:							
Land	2,402,035	268,880	—	2,670,915	75,000	—	2,745,915
Buildings, equipment, and land improvements, less accumulated depreciation and amortization	5,020,098	100,872,193	—	105,892,291	7,944,311	—	113,836,602
Intangible asset	—	2,450,000	—	2,450,000	—	(2,450,000)	—
Construction in progress	—	7,283,320	—	7,283,320	—	—	7,283,320
	7,422,133	110,874,393	—	118,296,526	8,019,311	(2,450,000)	123,865,837
Other assets:							
Property held for future use	16,208,405	—	—	16,208,405	—	—	16,208,405
Investment in The Outer Banks Hospital, Inc.	24,149,772	—	—	24,149,772	—	—	24,149,772
Due from affiliates	30,496,873	44,376,764	—	74,873,637	—	(74,873,637)	—
Other investments	3,972,911	6,848,251	—	10,821,162	818,181	—	11,639,343
Total assets	103,436,352	225,189,864	167,580,524	496,206,740	24,287,773	(77,323,637)	443,170,876
Deferred outflows of resources – pension	16,024,789	—	—	16,024,789	—	—	16,024,789
Total assets and deferred outflows of resources	\$ 119,461,141	225,189,864	167,580,524	512,231,529	24,287,773	(77,323,637)	459,195,665
Liabilities, Deferred Inflows of Resources, and Net Position							
Current liabilities:							
Accounts payable	\$ 26,110	9,624,582	—	9,650,692	290,479	—	9,941,171
Employee compensation	—	9,029,180	—	9,029,180	1,230,701	—	10,259,881
Settlements due to third-party payors	—	3,800,000	—	3,800,000	—	—	3,800,000
Accrued interest	—	635,154	—	635,154	—	—	635,154
Other accrued expenses	30,344	3,997,727	—	4,028,071	355,040	—	4,383,111
Current portion of long-term obligations	—	3,916,185	—	3,916,185	495,806	—	4,411,991
Total current liabilities	56,454	31,002,828	—	31,059,282	2,372,026	—	33,431,308
Pension liability	24,090,881	—	—	24,090,881	—	—	24,090,881
Interest rate swap liability	—	731,800	—	731,800	—	—	731,800
Due to affiliates	—	—	24,852,296	24,852,296	50,021,341	(74,873,637)	—
Long-term obligations, less current portion	—	84,486,822	—	84,486,822	3,953,936	—	88,440,758
Other long-term liabilities	—	494,976	—	494,976	—	—	494,976
Total liabilities	24,147,335	116,716,426	24,852,296	165,716,057	56,347,303	(74,873,637)	147,189,723
Deferred inflows of resources – pension	3,565,660	—	—	3,565,660	—	—	3,565,660
Net position:							
Net investment in capital assets	32,265,408	—	—	32,265,408	—	—	32,265,408
Unrestricted	59,482,738	108,473,438	142,133,588	310,089,764	(33,285,451)	(2,450,000)	274,354,313
Restricted – minority interest	—	—	—	—	105,539	—	105,539
Restricted	—	—	594,640	594,640	1,120,382	—	1,715,022
Total net position	91,748,146	108,473,438	142,728,228	342,949,812	(32,059,530)	(2,450,000)	308,440,282
Total liabilities, deferred inflow of resources, and net position	\$ 119,461,141	225,189,864	167,580,524	512,231,529	24,287,773	(77,323,637)	459,195,665

See accompanying independent auditors' report.

CHESAPEAKE HOSPITAL AUTHORITY

Combining Schedule of Revenues, Expenses, and Changes in Net Position

Year ended June 30, 2017

	Obligated group			Subtotal	Nonobligated group	Eliminations	Subtotal
	Chesapeake Hospital Authority	Chesapeake General Hospital	Chesapeake Hospital Authority Foundation				
Operating revenues:							
Net patient service revenue	\$ —	285,237,432	—	285,237,432	20,004,165	—	305,241,597
Other operating revenue	5,731,333	7,720,310	—	13,451,643	2,226,412	(2,771,728)	12,906,327
	<u>5,731,333</u>	<u>292,957,742</u>	<u>—</u>	<u>298,689,075</u>	<u>22,230,577</u>	<u>(2,771,728)</u>	<u>318,147,924</u>
Operating expenses:							
Salaries	—	108,208,631	—	108,208,631	14,402,423	(158,555)	122,452,499
Fringe benefits	6,012,958	21,735,392	—	27,748,350	2,834,572	(45,287)	30,537,635
Medical supplies	—	61,844,213	—	61,844,213	3,263,416	—	65,107,629
Professional fees	65,303	15,061,486	—	15,126,789	587,586	(43,200)	15,671,175
Purchased services	105,582	20,922,744	—	21,028,326	994,273	—	22,022,599
Other expenses	478,993	36,165,168	138,967	36,783,128	4,894,496	(2,524,686)	39,152,938
Interest	—	2,019,266	—	2,019,266	132,509	—	2,151,775
Depreciation and amortization	602,592	22,945,500	—	23,548,092	1,206,386	—	24,754,478
	<u>7,265,428</u>	<u>288,902,400</u>	<u>138,967</u>	<u>296,306,795</u>	<u>28,315,661</u>	<u>(2,771,728)</u>	<u>321,850,728</u>
Operating income (loss)	(1,534,095)	4,055,342	(138,967)	2,382,280	(6,085,084)	—	(3,702,804)
Nonoperating income:							
Investment income, net	69,600	1,885,386	17,467,001	19,421,987	660,125	—	20,082,112
Excess (deficit) of revenues over (under) expenses before other changes in net position	(1,464,495)	5,940,728	17,328,034	21,804,267	(5,424,959)	—	16,379,308
Affiliate transfers	3,778,105	(3,778,105)	—	—	—	—	—
Other changes in net position	119,236	—	2,400	121,636	(1,031,950)	—	(910,314)
Change in net position	2,432,846	2,162,623	17,330,434	21,925,903	(6,456,909)	—	15,468,994
Net position:							
Beginning of the year	89,315,300	106,310,815	125,397,794	321,023,909	(25,602,621)	(2,450,000)	292,971,288
End of the year	\$ <u>91,748,146</u>	<u>108,473,438</u>	<u>142,728,228</u>	<u>342,949,812</u>	<u>(32,059,530)</u>	<u>(2,450,000)</u>	<u>308,440,282</u>

See accompanying independent auditors' report.