



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

Consolidated Financial Statements

September 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

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

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

Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of Lakeland Regional Health Systems, Inc. and subsidiaries (the Health System), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lakeland Regional Health System, Inc. and subsidiaries as of September 30, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in note 1(u) to the consolidated financial statements, during 2016, the Health System adopted new accounting guidance including Accounting Standards Update (ASU) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, and ASU 2015-10, *Technical Corrections and Improvements – Readily Determinable Fair Value*. The Health System elected to retroactively adopt both ASU 2015-03 and ASU 2015-10. Our opinion is not modified with respect to this matter.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information in schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Tampa, Florida
December 21, 2016

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

Consolidated Balance Sheets

September 30, 2016 and 2015

(In thousands)

Assets	2016	2015
Current assets:		
Cash and cash equivalents	\$ 27,700	36,411
Short-term marketable securities	401	401
Current portion of assets limited as to use	109,456	76,035
Patient accounts receivable, less allowance for uncollectible accounts (\$94,146 in 2016 and \$118,213 in 2015)	106,473	106,062
Estimated third-party settlements, net	284	—
Inventories	11,736	10,716
Prepaid expenses and other current assets	14,415	21,381
Total current assets	270,465	251,006
Assets limited as to use, less current portion	93,028	170,683
Long-term marketable securities	13,389	12,487
Investments	348,785	346,892
Property and equipment, net	455,565	384,177
Pledges receivable, net	25,276	—
Other assets	21,478	5,489
Total assets	\$ 1,227,986	1,170,734
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 40,619	57,360
Employee compensation and benefits	44,350	43,315
State of Florida medical assistance assessment	8,641	8,089
Estimated third-party settlements	—	6,490
Current portion of long-term debt	6,020	7,375
Total current liabilities	99,630	122,629
Long-term debt, less current portion	350,760	361,090
Long-term liabilities	33,256	34,676
Total liabilities	483,646	518,395
Net assets:		
Unrestricted	709,956	640,428
Temporarily restricted	32,846	10,373
Permanently restricted	1,538	1,538
Total net assets	744,340	652,339
Total liabilities and net assets	\$ 1,227,986	1,170,734

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2016 and 2015

(In thousands)

	2016	2015
Unrestricted revenues and other support:		
Patient service revenue (net of contractual allowances and discounts)	\$ 826,528	802,527
Provision for bad debt	(87,994)	(90,266)
Net patient service revenue	738,534	712,261
Other revenues	11,886	18,422
Net assets released from restrictions used in operations	151	86
Total unrestricted revenues and other support	750,571	730,769
Expenses:		
Employee compensation and benefits	388,789	374,155
Supplies	153,303	149,784
General and administrative	89,037	93,056
Professional fees	22,908	21,893
State of Florida medical assistance assessment	8,658	8,292
Depreciation	50,115	45,182
Interest	8,409	7,673
Total expenses	721,219	700,035
Operating income	29,352	30,734
Nonoperating gains (losses):		
Investment income (loss)	31,271	(4,802)
Equity in earnings from interests in joint venture partnerships, net of applicable taxes	2,013	1,353
Losses on disposal of property and equipment	(238)	(7)
Gain from early extinguishment of debt	1,512	—
Total nonoperating gains (losses), net	34,558	(3,456)
Excess of revenues, gains, and other support over expenses and losses	\$ 63,910	27,278

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations and Changes in Net Assets

Years ended September 30, 2016 and 2015

(In thousands)

	2016	2015
Unrestricted net assets:		
Excess of revenues, gains, and other support over expenses and losses	\$ 63,910	27,278
Net assets released from restrictions used for capital	6,971	1,000
Pension related changes other than net periodic pension costs	(1,353)	—
Contributed capital	—	397
Increase in unrestricted net assets	69,528	28,675
Temporarily restricted net assets:		
Contributions	29,550	3,352
Investment income	45	(11)
Net assets released from restrictions	(7,122)	(1,086)
Increase in temporarily restricted net assets	22,473	2,255
Increase in net assets	92,001	30,930
Net assets, beginning of year	652,339	621,409
Net assets, end of year	\$ 744,340	652,339

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows
Years ended September 30, 2016 and 2015

(In thousands)

	2016	2015
Cash flows from operating activities:		
Increase in net assets	\$ 92,001	30,930
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Equity in earnings from joint venture partnerships, net of applicable taxes	(2,013)	(1,353)
Realized gains on investments	(10,290)	(3,621)
Change in unrealized gains and losses on investments	(22,834)	6,577
Loss on disposal of property and equipment	238	7
Restricted contributions and investment income	(29,595)	(3,341)
Depreciation	50,115	45,182
Amortization of bond premium	(1,383)	(800)
Amortization of debt issue costs	209	163
Gain on early extinguishment of debt	(1,512)	—
Provision for bad debts	87,994	90,266
Changes in operating assets and liabilities:		
Patient accounts receivable	(88,405)	(97,419)
Estimated third-party settlements	(6,774)	9,489
Inventories	(1,020)	(558)
Prepaid expenses and other current assets	6,966	(1,401)
Pledges receivable, net	(25,276)	—
Accounts payable and accrued expenses	(16,034)	(6,668)
Employee compensation and benefits	1,035	2,375
State of Florida medical assistance assessment	552	437
Long-term liabilities	2,764	3,631
Net cash provided by operating activities	36,738	73,896
Cash flows from investing activities:		
Purchases of property and equipment	(122,473)	(103,400)
Proceeds from sale of property and equipment	25	349
Dividends received from joint venture partnerships	2,154	1,611
Investments in joint venture partnerships	(900)	(30)
Purchases of investments and assets limited as to use	(1,232)	(206,179)
Proceeds from sale of investments	24,500	10,000
Proceeds from maturities of held-to-maturity securities	51,185	42,237
Proceeds from sale of long-term marketable securities	—	2,185
Payment on deposit for City Lease and Transfer Agreement (note 9)	(15,000)	—
Net change in other long-term assets	(120)	134
Net cash used in investing activities	(61,861)	(253,093)
Cash flows from financing activities:		
Restricted contributions and investment income	29,595	3,341
Proceeds from issuance of long-term debt	97,382	205,545
Payments for debt issue costs	(938)	(1,924)
Payments on capital lease obligations	(4,184)	(6,782)
Payments on long-term debt	(105,443)	(7,075)
Net cash provided by financing activities	16,412	193,105
(Decrease) increase in cash and cash equivalents	(8,711)	13,908
Cash and cash equivalents, beginning of year	36,411	22,503
Cash and cash equivalents, end of year	\$ 27,700	36,411
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 16,700	10,682
Cash paid during the year for federal and state income taxes	815	640
Equipment financed through capital lease obligations	—	41
Purchases of property and equipment included in accounts payable and accrued expenses	2,053	2,760

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

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(1) Organization and Summary of Significant Accounting Policies

(a) Organization

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

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

(b) Mission Statement

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

(c) Use of Estimates

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

(d) Cash and Cash Equivalents

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

(e) Investments

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

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Investments include the assets internally designated for the Supplemental Executive Retirement Plan (SERP) (recorded at fair value) and certain investments of the Foundation. The Health System invests a significant portion of its portfolio in private placement funds that are managed by Russell Investments. The funds employ an approach whereby portions of the funds are allocated to different money managers who employ distinct investment styles. The earnings and losses of the fund result from the dividends, interest, and realized and unrealized gains or losses of the financial instruments held.

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

The Health System's investment securities are managed by external investment managers that are authorized to buy and sell investment securities in accordance with the Health System's approved investment policy. Since the Health System's investment securities, excluding those designated as held-to-maturity securities, are actively managed by outside investment managers, the Health System has classified its marketable securities, assets limited as to use and investments as trading securities. Investment income (including realized gains and losses on investments, unrealized gains and losses, interest, and dividends) is included in excess of revenues, gains, and other support over expenses and losses, unless such amounts are restricted by donor or law.

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

Management annually evaluates investments designated as held-to-maturity and recognizes any "other-than-temporary" losses as deductions from the performance indicator (as defined below). Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired as of September 30, 2016 or 2015.

(f) *Assets Limited as to Use*

Assets limited as to use include assets held by trustees under a malpractice funding arrangement and a bond indenture agreement. Additionally, assets limited as to use include assets internally designated by the board of directors for future capital improvements and self-insurance liability obligations. The board of directors retains control and may, at its discretion, subsequently use such assets for other purposes. Amounts expected to meet current obligations have been presented as current assets in the consolidated balance sheets at September 30, 2016 and 2015. Assets limited as to use designated as trading securities are included in the consolidated balance sheets at their fair values, which are based on quoted market prices, if available or estimated using quoted market prices for similar securities. Assets limited as to use that are designated as held-to-maturity securities are stated at amortized cost.

(g) *Inventories*

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

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(h) Property and Equipment

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

Buildings and improvements	5 to 50 years
Equipment	3 to 10 years

Interest costs incurred as part of related construction projects are capitalized during the period of construction. Net interest capitalized for the years ended September 30, 2016 and 2015 was approximately \$6,507,000 and \$5,467,000, respectively.

The Health System had outstanding contracts and other commitments of approximately \$167,000,000 relating to the purchase or construction of various fixed assets as of September 30, 2016. The estimated cost to complete construction in progress is approximately \$196,800,000 as of September 30, 2016 for various master facility expansion and other capital projects, including those financed through the issuance of bonds during 2015 (note 5).

(i) Temporarily and Permanently Restricted Net Assets

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

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

The Health System has agreements with third-party payers that provide for payments to the Health System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at estimated net realizable amounts due from patients, third-party payers, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Net patient service revenue was increased by approximately \$255,000 and \$1,056,000 for the years ended September 30, 2016 and 2015, respectively, for adjustments to prior year estimated third-party settlements.

For uninsured patients who do not qualify for charity care, the Health System recognizes revenue on the basis of its standard rates for services provided or on the basis of discounted rates. The Health

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System's policy is to provide an uninsured patient that did not qualify for financial assistance and whose income is greater than 400% of the Federal Poverty Guidelines a discount that is calculated using a 'look-back' method. By November 15 of each year, claims for services provided during the prior 12-month period ended September 30, which were paid in full by Medicare fee-for-service and private insurers are analyzed to compute the discount percentage. The amount of discount provided to the uninsured in 2016 and 2015 was 70% of standard rates for both years. On the basis of historical experiences, a significant portion of the Health System's uninsured patients will be unable or unwilling to pay for services provided. Thus, the Health System records a significant provision for bad debts in the period the services are provided.

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

	Year ended September 30	
	2016	2015
Third-party payers	\$ 772,638	737,280
Self-pay	53,890	65,247
Net patient service revenue before provision for bad debt	\$ 826,528	802,527

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

The provision for bad debts decreased by approximately \$2,272,000 and \$13,845,000 for the years ended September 30, 2016 and 2015, respectively, for adjustments to estimated allowances for uncollectible accounts. The decrease in fiscal years 2016 and 2015 was the result of efforts in properly identifying patients that qualified for charity care and the uninsured discount.

The Health System's allowance for doubtful accounts for self-pay patients was 95.8% and 91.9% of self-pay accounts receivable at September 30, 2016 and 2015, respectively. In addition, the Health System's self-pay write-offs increased approximately \$31,700,000 and decreased \$34,800,000 in fiscal years 2016 and 2015, respectively. The increase in 2016 was due to increases in self-pay charges

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and the decline in the self-pay collection rate. The decrease in 2015 was due to the efforts in properly identifying patients that qualified for charity care and the uninsured discount. The Health System does not maintain a material allowance for doubtful accounts from third-party payers, nor did it have significant write-offs from third-party payers.

(k) Charity Care

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

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

Accounting Standards Update (ASU) No. 2010-23, *Measuring Charity Care for Disclosure*, requires healthcare entities to identify costs for providing care as direct or indirect, and disclose the method used to make this distinction. The Health System estimates its cost by calculating a ratio of cost to charges, and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. Charges foregone, based on established rates for charity totaled approximately \$167,335,000 and \$143,271,000 for the years ending September 30, 2016 and 2015, respectively. The estimated cost of providing these services totaled approximately \$30,338,000 and \$26,935,000 during the years ending September 30, 2016 and 2015, respectively.

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

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

(m) Income Taxes

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

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U.S. GAAP requires the Health System's management to evaluate tax positions taken by the Health System and recognize a tax liability (or asset) if the Health System has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service. The Health System has analyzed its tax positions and has concluded that as of September 30, 2016 and 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) in the consolidated financial statements or disclosure in the notes to the consolidated financial statements. The Health System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Health System believes it is no longer subject to income tax examinations for tax years prior to 2012.

(n) Debt Issue Costs

Costs incurred in connection with the issuance of long-term debt are capitalized and amortized over the life of the debt. Amortization of debt issue costs of approximately \$209,000 and \$163,000, respectively, is included in interest expense in the accompanying consolidated statements of operations and changes in net assets for the years ended September 30, 2016 and 2015, respectively. Accumulated amortization of debt issue costs is approximately \$467,000 and \$640,000 at September 30, 2016 and 2015, respectively.

(o) Bond Premiums

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

(p) Nonoperating Gains (Losses)

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

(q) Donor-Restricted Gifts

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

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equipment. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

(r) *Impairment of Long-Lived Assets*

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate an impairment of the value of long-lived assets. If there is an indication that the carrying amount of an asset is not recoverable, the Health System estimates the projected undiscounted cash flows from the use and eventual disposition of the asset, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss, if any, is determined by comparing the historical carrying value of the asset to its estimated fair value. There were no such impairment losses recorded during the years ended September 30, 2016 and 2015.

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

(s) *Collective Bargaining Agreements*

The Medical Center's registered nurses and technical employees are represented by the United Food and Commercial Workers Union. The registered nurse and technical employee contracts expire on April 30, 2017. Approximately 36% of the Medical Center's total employees are represented by the union contracts. The registered nurses represent 78% of the employees under union contract.

(t) *Electronic Health Records Incentive Amounts*

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

Hospitals may be eligible for both Medicare and Medicaid EHR incentive payments, however, physicians and other professionals may be eligible for either Medicare or Medicaid incentive payments but not both. Medicaid EHR incentive payments to providers are 100% federally funded and administered by the states; however, the states are not required to offer EHR incentive payments to providers. Revenue is recognized for Medicare and Medicaid incentive payments when the Health System complies with applicable EHR meaningful use grant requirements and payment is reasonably assured. During the year ended September 30, 2012, the Health System was entitled to receive the first year incentive payment from Medicaid by demonstrating to the state that a certified EHR system was being implemented and that the Health System had the intent to complete the implementation. During 2016 and 2015, the Health System received EHR incentive payments of approximately \$1,305,000 and \$2,547,000, respectively, from Medicare. During the years ending September 30, 2016

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and 2015, the Health System recognized revenue from EHR incentive payments of approximately \$394,000 and \$1,362,000, respectively, and included such revenues as part of other revenues in the consolidated statements of operations and changes in net assets.

(u) Adoption of New Accounting Standards

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. The Health System elected to retroactively adopt ASU 2015-03 in 2016.

During 2016, the Health System adopted ASU 2015-10, *Technical Corrections and Improvements – Readily Determinable Fair Value*. The tables presented in note 12 related to investments measured at net asset value (NAV) have been updated to remove the investments that have readily available daily net asset value. Additionally, these investments have been updated within the fair value hierarchy tables to reflect the appropriate level. Prior year amounts have been reclassified for consistency with current year presentation.

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

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

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

	September 30	
	2016	2015
Cash equivalents	\$ 3,385	3,376
Mutual funds	13,273	12,371
Common stock	672	662
Private placement funds:		
Fixed income	170,209	177,530
Equity securities	213,884	203,067
Hedge fund	43,954	45,557
	445,377	442,563
Held-to-maturity securities recorded at amortized cost	119,682	163,935
Less amount included in current assets	(109,857)	(76,436)
	\$ 455,202	530,062

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The composition of assets limited as to use is as follows (in thousands):

	September 30	
	2016	2015
Under malpractice funding arrangement	\$ 2,983	2,975
Under bond indenture agreement for capital acquisitions	119,682	163,935
Internally designated by the board of directors:		
Capital improvement fund	47,046	43,591
Self-insurance funds	32,773	36,217
Total assets limited as to use	202,484	246,718
Less amount included in current assets	(109,456)	(76,035)
Assets limited as to use, less current portion	\$ 93,028	170,683

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

	September 30	
	2016	2015
Cash and cash equivalents	\$ 19,204	2,663
U.S. government agency securities	100,009	160,572
Accrued interest	469	700
	\$ 119,682	163,935

Held-to-maturity securities had gross unrealized gains and losses of approximately \$44,000 and \$1,468,000, respectively, as of September 30, 2016. Held-to-maturity securities had gross unrealized gains and losses of approximately \$96,000 and \$912,000, respectively, as of September 30, 2015. At September 30, 2016, the Health System held securities with a cost of approximately \$52,000,000 and unrealized losses of \$1,400,000 within the held-to-maturity portfolio which had been in an unrealized loss position for over one year. There were no securities held within the held-to-maturity portfolio which had been in an unrealized loss position for over one year at September 30, 2015. Management has the intent to hold such maturities to maturity and does not consider such securities to be other than temporarily impaired. At September 30, 2016, the contractual maturities of held-to-maturity securities were approximately \$79,839,000 due in one year or less and approximately \$20,170,000 due between October 2017 and January 2018.

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

	September 30	
	2016	2015
Nonoperating gains (losses):		
Interest and dividend income	\$ 8	48
Realized gains, net of investment fees	8,429	1,727
Unrealized gains (losses), net	22,834	(6,577)
Total	\$ 31,271	(4,802)
Changes in temporarily restricted net assets:		
Interest income	\$ 27	48
Unrealized gains (losses), net	18	(59)
Total	\$ 45	(11)

(3) Property and Equipment

The components of property and equipment are as follows (in thousands):

	September 30	
	2016	2015
Land	\$ 28,161	28,115
Land improvements	18,615	17,788
Building and improvements	287,103	264,618
Equipment	666,033	621,856
	999,912	932,377
Less accumulated depreciation	(629,346)	(588,621)
	370,566	343,756
Construction in progress	84,999	40,421
Total	\$ 455,565	384,177

Included in equipment are assets leased under capital leases with a net book value of approximately \$8,479,000 and \$13,827,000 at September 30, 2016 and 2015, respectively.

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(4) Estimated Third-Party Settlements

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

(a) Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on diagnosis and other factors. Also, capital costs and outpatient services are reimbursed at prospectively determined rates. The Health System is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after audit by the fiscal intermediary. The Health System's Medicare cost reports have been audited and a Notice of Program Reimbursement was issued by the Fiscal Intermediary through September 30, 2013.

(b) Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology, subject to certain limitations. The Health System's payment rates are calculated based on allowable costs included in the most recently filed cost report available at the time of the payment calculation. The Health System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Medicaid regulations provide for retroactive settlements between the Health System and the Medicaid program if differences exist in allowable costs between the filed cost report and the audited cost reports. The Health System's Medicaid settlements have been audited by the Medicaid fiscal intermediary through September 30, 2009; however, the Health System has not received final settlements on amounts since September 30, 2002.

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

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(5) Long-Term Debt and Capital Lease Obligations

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

	September 30	
	2016	2015
City of Lakeland, Florida, Hospital Revenue Refunding Bonds, Series 2016, including \$83,245 of serial bonds due in varying amounts through November 2032, with interest rates from 3.00% to 5.00%	\$ 83,245	—
City of Lakeland, Florida, Hospital Revenue Bonds, Series 2015, including \$31,815 of 5.00% serial bonds due in varying amounts through November 2035, \$64,875 of 5.00% term bonds due November 2040, and \$83,310 of 5.00% term bonds due November 2045	180,000	180,000
City of Lakeland, Florida, Hospital Revenue Refunding Bonds, Series 2011, refunding of the Refunded 1996, 1997 and 1999 bonds including \$77,580 of serial bonds due in varying amounts through November 2025, with interest rates from 2.00% to 5.00%	56,170	60,975
City of Lakeland, Florida, Hospital Revenue Refunding Bonds, Series 2006, including \$52,485 of serial bonds due in varying amounts, through November 2026, with interest rates from 4.00% to 5.00%, and \$60,520 of 5.00% term bonds due November 2032	—	99,930
	<u>319,415</u>	<u>340,905</u>
Unamortized premiums and debt issue costs, net	37,365	27,560
	<u>356,780</u>	<u>368,465</u>
Less current portion	(6,020)	(7,375)
	<u><u>\$ 350,760</u></u>	<u><u>361,090</u></u>

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Maturities of long-term debt as of September 30, 2016 are as follows (in thousands):

2017	\$	6,020
2018		7,670
2019		8,040
2020		8,425
2021		8,850
Thereafter		280,410
		319,415
Unamortized premiums and debt issue costs, net		37,365
	\$	356,780

In 2016, the Health System issued \$83,245,000 in Hospital Revenue Refunding Bonds through the City of Lakeland, Florida (Series 2016 Bonds) for the purpose of refunding the outstanding indebtedness of the Series 2006 Bonds. The Series 2016 Bonds include serial bonds with maturities ranging from November 15, 2017 to November 15, 2032, with fixed rate coupons ranging from 3.00% and 5.00%. The Health System incurred approximately \$938,000 in debt issuance costs as part of the issuance of the Series 2016 Bonds. The proceeds from the Series 2016 Bonds were placed in an irrevocable trust in order to satisfy remaining scheduled principal and interest payments of the Series 2006 Bonds. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust account have contractually relieved the Health System of any future obligations with respect to the Series 2006 Bonds, and the debt is not considered a liability of the Health System as of September 30, 2016. Therefore, such debt has been derecognized. Debt outstanding and not recognized in the consolidated balance sheet at September 30, 2016 due to the refunding totaled approximately \$99,700,000. The assets placed in an irrevocable trust totaled approximately \$99,700,000 and are also not recognized as assets of the Health System in the consolidated balance sheet at September 30, 2016. The Health System recognized a gain on early extinguishment of debt of \$1,512,000 from the refunding of the Series 2006 Bonds and is included as part of nonoperating gains (losses) in the 2016 consolidated statement of operations and changes in net assets.

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

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

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balance sheets. The Health System made eligible draws on the escrow account of approximately \$45,133,000 and \$42,237,000 during the years ending September 30, 2016 and 2015, respectively.

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

The Health System has capital lease arrangements primarily comprised of medical equipment. These capital lease arrangements incur interest at rates ranging between 2.02% and 6.83% with maturities through November 2018. Future minimum capital lease payments under these arrangements as of September 30, 2016 are as follows (in thousands):

Year ending September 30:	\$	
2017		3,489
2018		1,394
2019		65
		4,948
Less amounts representing interest		(566)
Present value of minimum lease payments		4,382
Current installments of obligations under capital leases (included as a component of accounts payable and accrued expenses)		(3,129)
Obligations under capital leases, excluding current installments	\$	1,253

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(6) Long-Term Liabilities

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

	September 30	
	2016	2015
State of Florida medical assistance assessment	\$ 4,397	4,317
Section 457(f) defined benefit plan liability	5,579	3,663
Section 457(f) defined contribution plan liability	422	163
Workers' compensation claims	1,350	564
Capital lease obligations	1,253	4,364
Accrued malpractice liability	19,631	20,785
Pledge commitments	300	500
Rent abatement liability	324	320
	\$ 33,256	34,676

(7) Employee Benefits

The Health System provides retirement and other benefits to substantially all employees through several benefit plans. Under the defined-contribution plans (the Plans), for all employee groups who meet minimum service requirements, the Health System provides a contribution of 3% of eligible employee wages up to the taxable wage base for Social Security tax purposes for each plan year and 6% of eligible employee wages in excess of the taxable wage base for each plan year up to IRS limits. Additionally, the Health System provides a matching contribution of 50% of employee deferred contributions not to exceed 2% of the taxable wage base for Social Security. In addition to the calculated annual contributions, the board of directors may establish an additional discretionary contribution to be made to the Plans for each year. Employees are fully vested after completing three years of service with at least 1,000 hours of service in each year.

The Health System provides a Supplemental Executive Retirement Plan (SERP) under Section 457(f) of the Internal Revenue Code. The SERP is a nonqualified defined-benefit plan limited to generally certain management or highly compensated employees as determined by the Health System. Upon vesting, the SERP provides participants with deferred compensation annually for 20 years, equal to 2% of the participant's final average compensation multiplied by his/her years of service (up to a maximum of 25 years of service). Compensation is based on participants' average compensation during the last three complete calendar years. Only calendar years beginning on or after January 1, 2004 are considered. Full vesting is generally effective after a participant completes 10 years of service with the Health System; however, the initial participants had individual vesting schedules. The SERP also provides for certain death or disability benefits. The Health System is accounting for the SERP in accordance with relevant accounting literature and has recognized credit for past service costs. The actuarially computed net periodic benefit cost for the Health System's SERP for the years ended September 30, 2016 and 2015 totaled approximately \$857,000 and \$731,000, respectively. The net periodic benefit cost was determined based on a discount rate of 4.00%, with an assumed rate of compensation increase of 5.00% for the years ending September 30, 2016 and 2015.

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The SERP's accrued benefit cost at September 30, 2016 and 2015 was approximately \$5,867,000 and \$4,682,000, respectively. Of these amounts, approximately \$5,579,000 and \$3,663,000 is included in long-term liabilities in the accompanying consolidated balance sheets at September 30, 2016 and 2015, respectively. At September 30, 2016, the SERP's accrued benefit cost expected to be paid in 2017 is \$287,000 and is included in employee compensation and benefits in the accompanying consolidated balance sheets. These amounts were actuarially determined using a discount rate of 3.50% and an assumed rate of compensation increase of 5.00% at September 30, 2016 and 2015. The accumulated benefit obligation for the SERP was \$4,388,000 and \$3,611,000 at September 30, 2016 and 2015, respectively.

The benefits expected to be paid in each year from 2018 through 2021 are approximately \$292,000, \$2,974,000, \$256,000 and \$3,338,000 respectively. The aggregate benefits expected to be paid in the five years from 2022 through 2026 are approximately \$2,689,000. The expected benefits are based on the same assumptions used to measure the Health System's benefit obligations at September 30, 2016 and include estimated future employee service.

In 2015, the Health System implemented a new Supplemental Executive Defined Contribution Plan (DC SERP) under Section 457(f) of the Internal Revenue Code. The DC SERP is limited to certain members of management as determined by the Health System. The DC SERP provides annual contributions equal to 15% of eligible compensation, as defined by the plan, over a ten year period. The contributions will also be credited with a discretionary fixed interest rate (5.00% in 2016 and 2015) as determined by the board of directors. Participants are vested 20% after two years of plan participation, and increases 10% per year of participation thereafter. The DC SERP's accrued benefit cost at September 30, 2016 and 2015 was approximately \$260,000 and \$163,000, respectively.

Expenses incurred for all employee retirement plans were \$12,298,000 and \$11,326,000 for the years ended September 30, 2016 and 2015, respectively, which is included in employee compensation and benefits expense in the accompanying consolidated statements of operations and changes in net assets.

(8) Functional Expenses

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

(9) Commitments and Contingencies

(a) City Lease Obligation

Under the terms of the Agreement prior to fiscal year 2016, annual rent of \$1.00 per operating year plus additional payments were made to the City of Lakeland (the City) based on a formula, which took into consideration the net revenues of the Medical Center, and net income of certain affiliated organizations, as defined in the Agreement. Expenses under the terms of the Agreement, included in general and administrative expenses in the accompanying 2015 consolidated statement of operations and changes in net assets, was capped at \$12,900,000 for the year ended September 30, 2015.

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In 2015, an amendment to the Agreement was reached and became effective October 1, 2015. The amendment provided a lump sum payment of \$15,000,000 to the City on October 1, 2015, with fixed annual additional payments due beginning in fiscal year ending September 30, 2016 through fiscal year ending September 30, 2040. The additional payment for fiscal year ending September 30, 2016 was \$13,254,750 and will increase by 2.75% per operating year through the duration of the Agreement. The Health System recognized the lump sum payment of \$15,000,000 to the City as a deferred charge included as part of other assets in the accompanying consolidated balance sheet as of September 30, 2016 and is amortizing on a straight-line basis over the 25 year term. Expenses under the terms of the amended Agreement, included in general and administrative expenses in the accompanying 2016 consolidated statement of operations and changes in net assets, was approximately \$13,855,000.

(b) Operating Leases

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

2017	\$	2,848
2018		1,794
2019		1,563
2020		846
2021		634
Thereafter		1,393
	\$	9,078

Rental expense under operating leases amounted to approximately \$6,153,000 and \$5,269,000 for the years ended September 30, 2016 and 2015, respectively, and is included in general and administrative expenses in the consolidated statements of operations and changes in net assets.

(c) Litigation

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

(d) Professional Malpractice Insurance

As a provider of healthcare services, the Health System is subject to malpractice claims.

The Health System is substantially self-insured for malpractice and general liability claims and related expenses. The Health System's current malpractice insurance policy provides for claims-made coverage. Under its current insurance coverage, the Health System's limit is \$50 million (inclusive of defense costs) with a self-insured retention of \$3 million per claim and an inner-aggregate deductible

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of \$2 million. The Health System's self-insured retention exposure is capped by a single annual aggregate of \$18 million (inclusive of defense costs).

Losses from both asserted and unasserted claims are accrued based on estimates that incorporate the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of incurred but not reported amounts. The Health System has engaged an independent actuary to estimate ultimate losses to be accrued. The Health System has internally designated certain funds for the payment of professional liability claim settlements. The balances of the internally designated funds were approximately \$30,503,000 and \$29,508,000 as of September 30, 2016 and 2015, respectively, and are included in assets limited as to use in the accompanying consolidated balance sheets.

Estimated losses of approximately \$28,442,000 and \$29,576,000 for medical malpractice claims are included in accounts payable and accrued expenses and other long-term liabilities in the accompanying consolidated balance sheets as of September 30, 2016 and 2015, respectively. The Health System may be liable for losses in excess of amounts accrued, but within the deductible provisions.

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

The Health System is self-insured for workers' compensation claims and employee medical claims. Workers' compensation losses for asserted and unasserted claims are accrued based on estimates provided by an independent actuary. Estimated costs accrued for incurred but not reported workers' compensation claims and employee medical claims of approximately \$5,251,000 and \$4,620,000, respectively, are included in employee compensation and benefits and other long-term liabilities in the accompanying consolidated balance sheets as of September 30, 2016 and 2015, respectively. The estimates are based on the Health System's past experience, as well as other considerations, including the nature of each claim or incident, relevant trend factors, and estimates of amounts incurred but not reported. The Health System has established internally designated self-insurance funds for the payment of workers' compensation liability claim settlements. The balances of these funds totaled approximately \$2,270,000 and \$4,086,000 as of September 30, 2016 and 2015, respectively, and are included in assets limited as to use in the accompanying consolidated balance sheets. The Health System had established internally designated funds for the payment of self-insured employee medical claims which totaled \$2,623,000 at September 30, 2015 and are included in assets limited as to use in the accompanying consolidated balance sheets. In 2016, management released the funds from their internally designated restriction for use in operations.

(f) *Healthcare Industry*

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

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(10) Concentration of Credit Risk

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

The table below summarizes the percentage of net patient accounts receivable due from major payers as of September 30, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Medicare	29%	33%
Medicaid	7	7
Commercial	41	41
Self-pay/other	23	19

(11) Investments in Joint Venture Partnerships

As of September 30, 2016 and 2015, the Health System had a 44.75% ownership interest in the Lakeland Surgical and Diagnostic Center, LLP (the Surgical Center). The ownership interest is accounted for using the equity method. The equity in earnings of the Surgical Center was approximately \$1,205,000 and \$1,142,000 for the years ended September 30, 2016 and 2015, respectively. These amounts are net of federal and state income taxes of approximately \$729,000 and \$516,000 for the years ended September 30, 2016 and 2015, respectively. The carrying value of the Health System's investment in the Surgical Center was approximately \$4,537,000 and \$4,618,000 as of September 30, 2016 and 2015, respectively, and is included in other assets in the accompanying consolidated balance sheets.

The Health System also has partnership interests in other joint ventures accounted for using the equity method. The equity in earnings from these joint ventures was approximately \$808,000 and \$211,000 for the years ended September 30, 2016 and 2015, respectively. The carrying value of these joint ventures were approximately \$2,328,000 and \$662,000 at September 30, 2016 and 2015, respectively, and is included in other assets in the accompanying consolidated balance sheets.

(12) Fair Value Measurements

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

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

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

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

The table below summarizes the fair values of the Health System's cash, marketable securities, assets limited as to use and investments, excluding held-to-maturity securities, as of September 30, 2016 (in thousands):

	September 30, 2016	Fair value measurements at reporting date using		
		(Level 1)	(Level 2)	(Level 3)
Assets:				
Cash and cash equivalents	\$ 27,700	27,700	—	—
Marketable securities, assets limited as to use and investments:				
Cash equivalents	3,385	3,385	—	—
Common stock	672	672	—	—
Mutual funds	13,273	13,273	—	—
Private placed funds:				
Fixed income	170,209	170,209	—	—
Equity securities	213,884	213,884	—	—
Hedge funds	43,954	—	—	43,954
Total	<u>\$ 473,077</u>	<u>429,123</u>	<u>—</u>	<u>43,954</u>

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The table below summarizes the fair values of the Health System's cash, marketable securities, assets limited as to use and investments, excluding held-to-maturity securities, as of September 30, 2015 (in thousands):

	September 30, 2015	Fair value measurements at reporting date using		
		(Level 1)	(Level 2)	(Level 3)
Assets:	<u>Balance Sheet Value</u>			
Cash and cash equivalents	\$ 36,411	36,411	—	—
Marketable securities, assets limited as to use and investments:				
Cash equivalents	3,376	3,376	—	—
Common stock	662	662	—	—
Mutual funds	12,371	12,371	—	—
Private placed funds:				
Fixed income	177,530	177,530	—	—
Equity securities	203,067	203,067	—	—
Hedge funds	45,557	—	—	45,557
Total	\$ 478,974	433,417	—	45,557

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

The Health System's Level 3 assets include a hedge fund with a fair value determined using the net asset value of the fund as provided by the fund custodian.

The Health System's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers of financial assets between Level 1, Level 2, or Level 3 during the years ended September 30, 2016 and 2015.

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The following table sets forth the change in the fair value of investments measured using significant unobservable inputs (Level 3):

		<u>Level 3</u>
Balance, September 30, 2014	\$	45,683
Unrealized losses		(126)
Balance, September 30, 2015		45,557
Unrealized losses		(1,603)
Balance, September 30, 2016	\$	<u>43,954</u>

The fair values of the following investments without a readily determinable fair value have been estimated using the net asset value per share of the investments as of September 30, 2016 and 2015 (in thousands). There are no unfunded commitments on any of these funds at September 30, 2016 and 2015.

	<u>September 30</u>		<u>Fair value measurements at reporting date using</u>	
<u>Fair value net asset per share</u>	<u>2016</u>	<u>2015</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
Asset category:				
Total Return Fund (a)	\$ 43,954	45,557	Quarterly	65 calendar days

- (a) The Total Return Fund objective is to offer low correlation to traditional assets and aims to provide diversification, lower volatility, and higher risk-adjusted returns at the portfolio level.

The fair value of financial instruments has been estimated by the Health System using available market information as of September 30, 2016 and 2015, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Health System could realize in a current market exchange. Estimates of fair values are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could affect the estimates.

The estimated fair value of the Health System's held-to-maturity securities at September 30, 2016 and 2015 is approximately \$100,124,000 and \$163,423,000, respectively. Fair values of the Health System's held-to-maturity securities are based upon quoted market prices for the same or similar securities as determined by the custodian bank.

163,935 (000)
is the value on
PDF Page 16,
not (duh...)
163,423 (000)
(WAKE UP!!!)

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

Notes to Consolidated Financial Statements

September 30, 2016 and 2015

Fair values of the Health System's debt are based upon the quoted market prices for the same or similar issues or on the current rates offered to the Health System for debt of the same remaining maturities and are considered Level 2 measurements. The table below summarizes the carrying amount and fair value of the Health System's debt as of September 30, 2016 and 2015 (in thousands):

	2016		2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt	\$ 356,780	352,739	368,465	365,199

(13) Pledges Receivable, Net

Pledges receivable, net of discounts, ranging from 0.74% and 2.50%, include the following unconditional promises to give:

	September 30	
	2016	2015
Capital campaign	\$ 31,185	2,679
Less unamortized discount	(2,770)	(195)
	\$ 28,415	2,484
Amounts due in:		
Less than one year	\$ 3,139	
One to five years	17,352	
More than five years	10,694	
	\$ 31,185	

(14) Subsequent Events

The Health System has evaluated events and transactions occurring subsequent to September 30, 2016 as of December 21, 2016 which is the date the consolidated financial statements were issued. The Health System believes that no material events have occurred since September 30, 2016 that require recognition or disclosure in the accompanying consolidated financial statements and notes to consolidated financial statements.

OTHER FINANCIAL INFORMATION

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

Consolidating Schedule – Balance Sheet Information

September 30, 2016

(In thousands)

Assets	Lakeland Regional Health Systems, Inc.	Lakeland Regional Medical Center, Inc.	Eliminations	Obligated Group	Lakeland Regional Health Ventures, Inc.	Lakeland Regional Medical Center Foundation, Inc.	Eliminations	Total
Current assets:								
Cash and cash equivalents	\$ 25,502	1,257	—	26,759	174	767	—	27,700
Short-term marketable securities	—	—	—	—	401	—	—	401
Current portion of assets limited as to use	10,414	99,042	—	109,456	—	—	—	109,456
Patient accounts receivable, net	11,276	95,197	—	106,473	—	—	—	106,473
Estimated third-party settlements, net	—	284	—	284	—	—	—	284
Inventories	95	11,641	—	11,736	—	—	—	11,736
Prepaid expenses and other current assets	832	10,293	—	11,125	7	3,283	—	14,415
Due from affiliates	—	10,414	(10,414)	—	—	—	—	—
Total current assets	48,119	228,128	(10,414)	265,833	582	4,050	—	270,465
Assets limited as to use, less current portion	72,388	20,640	—	93,028	—	—	—	93,028
Due to affiliates, less current portion	—	69,405	(69,405)	—	—	—	—	—
Long-term marketable securities	—	13,273	—	13,273	—	116	—	13,389
Investments	335,280	—	—	335,280	2	13,503	—	348,785
Property and equipment, net	38,286	417,279	—	455,565	—	—	—	455,565
Beneficial interest in net assets of the Foundation	707	42,205	—	42,912	—	—	(42,912)	—
Pledges receivable, net	—	—	—	—	—	25,276	—	25,276
Other assets	7,366	14,412	—	21,778	—	—	(300)	21,478
Total assets	\$ 502,146	805,342	(79,819)	1,227,669	584	42,945	(43,212)	1,227,986
Liabilities and Net Assets								
Current liabilities:								
Accounts payable and accrued expenses	\$ 1,909	38,608	—	40,517	84	18	—	40,619
Employee compensation and benefits	6,443	37,895	—	44,338	—	12	—	44,350
State of Florida medical assistance assessment	—	8,641	—	8,641	—	—	—	8,641
Estimated third-party settlements, net	—	—	—	—	—	—	—	—
Current portion of long-term debt	—	6,020	—	6,020	—	—	—	6,020
Total current liabilities	8,352	91,164	—	99,516	84	30	—	99,630
Long-term debt, less current portion	—	350,760	—	350,760	—	—	—	350,760
Due to affiliates, less current portion	79,616	—	(79,819)	(203)	200	3	—	—
Long-term liabilities	—	33,256	—	33,256	—	—	—	33,256
Total liabilities	87,968	475,180	(79,819)	483,329	284	33	—	483,646
Net assets:								
Unrestricted	413,601	296,355	—	709,956	300	9,968	(10,268)	709,956
Temporarily restricted	577	32,269	—	32,846	—	31,406	(31,406)	32,846
Permanently restricted	—	1,538	—	1,538	—	1,538	(1,538)	1,538
Total net assets	414,178	330,162	—	744,340	300	42,912	(43,212)	744,340
Total liabilities and net assets	\$ 502,146	805,342	(79,819)	1,227,669	584	42,945	(43,212)	1,227,986

See accompanying independent auditors' report.

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

Consolidating Schedule – Statement of Operations Information
For the Twelve Months ended September 30, 2016

(In thousands)

	Lakeland Regional Health Systems, Inc.	Lakeland Regional Medical Center, Inc.	Obligated Group	Lakeland Regional Health Ventures, Inc.	Lakeland Regional Medical Center Foundation, Inc.	Eliminations	Consolidated for the year ended September 30, 2016
Unrestricted revenues and other support:							
Net patient service revenue (net of contractual allowances and discounts)	\$ 56,497	770,031	826,528	—	—	—	826,528
Provision for bad debt	—	(87,994)	(87,994)	—	—	—	(87,994)
Net patient service revenue	56,497	682,037	738,534	—	—	—	738,534
Other revenues	4,078	11,840	15,918	—	157	(4,189)	11,886
Net assets released from restrictions used for operations	—	—	—	—	151	—	151
Contributions from affiliate	—	—	—	—	868	(868)	—
Total unrestricted revenues and other support	<u>60,575</u>	<u>693,877</u>	<u>754,452</u>	<u>—</u>	<u>1,176</u>	<u>(5,057)</u>	<u>750,571</u>
Expenses:							
Employee compensation and benefits	77,406	311,016	388,422	—	367	—	388,789
Supplies	6,504	146,790	153,294	—	9	—	153,303
General and administrative	11,407	78,602	90,009	—	2,541	(3,513)	89,037
Professional fees	7,193	17,259	24,452	—	—	(1,544)	22,908
State of Florida medical assistance assessment	—	8,658	8,658	—	—	—	8,658
Depreciation	3,092	47,023	50,115	—	—	—	50,115
Interest	—	8,409	8,409	—	—	—	8,409
Total expenses	<u>105,602</u>	<u>617,757</u>	<u>723,359</u>	<u>—</u>	<u>2,917</u>	<u>(5,057)</u>	<u>721,219</u>
Operating income (loss)	<u>(45,027)</u>	<u>76,120</u>	<u>31,093</u>	<u>—</u>	<u>(1,741)</u>	<u>—</u>	<u>29,352</u>
Nonoperating gains (losses):							
Investment income	28,753	1,011	29,764	—	1,507	—	31,271
Equity in earnings from interests in joint venture partnerships, net of applicable taxes	2,131	(118)	2,013	—	—	—	2,013
Loss on disposal of property and equipment	(2)	(236)	(238)	—	—	—	(238)
Gain from early extinguishment of debt	—	1,512	1,512	—	—	—	1,512
Total nonoperating gains (losses), net	<u>30,882</u>	<u>2,169</u>	<u>33,051</u>	<u>—</u>	<u>1,507</u>	<u>—</u>	<u>34,558</u>
Excess (deficit) of revenues, gains, and other support over expenses and losses	<u>\$ (14,145)</u>	<u>78,289</u>	<u>64,144</u>	<u>—</u>	<u>(234)</u>	<u>—</u>	<u>63,910</u>

See accompanying independent auditors' report.