



NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidated Financial Statements and Schedules

September 30, 2017 and 2016

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1100
One Jackson Place
188 East Capitol Street
Jackson, MS 39201-2127

Independent Auditors' Report

The Board of Directors
North Mississippi Health Services, Inc.:

We have audited the accompanying consolidated financial statements of North Mississippi Health Services, Inc. and subsidiaries (the System), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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 audits 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 North Mississippi Health Services, Inc. and subsidiaries as of September 30, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The information included 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 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Jackson, Mississippi
January 19, 2018

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

September 30, 2017 and 2016

(In thousands)

Assets	2017	2016
Current assets:		
Cash and cash equivalents	\$ 36,666	56,874
Investments	550,495	484,265
Net patient accounts receivable	161,517	199,791
Other current assets	31,771	30,087
Total current assets	780,449	771,017
Assets limited as to use	94,178	91,170
Property and equipment, net	267,816	289,476
Other assets	46,761	51,024
Total assets	\$ 1,189,204	1,202,687
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 39,691	37,190
Accrued expenses and other current liabilities	75,259	71,566
Current installments of long-term debt	81,336	85,172
Total current liabilities	196,286	193,928
Estimated professional and general liability costs	18,824	29,955
Long-term debt, excluding current installments	71,832	72,119
Fair value of interest rate swaps	5,663	7,658
Accrued pension cost	116,864	143,366
Other long-term liability	2,239	4,367
Total liabilities	411,708	451,393
Net assets:		
Unrestricted	770,508	743,990
Temporarily restricted	3,016	2,820
Permanently restricted	21	20
Total net assets attributable to North Mississippi Health Services, Inc.	773,545	746,830
Noncontrolling interests	3,951	4,464
Total net assets	777,496	751,294
Commitments and contingencies		
Total liabilities and net assets	\$ 1,189,204	1,202,687

See accompanying notes to consolidated financial statements.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended September 30, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Unrestricted revenues and other support:		
Net patient service revenue	\$ 1,031,498	998,991
Provision for uncollectible accounts	<u>(158,778)</u>	<u>(136,531)</u>
Net patient service revenue less provision for uncollectible accounts	872,720	862,460
Other revenue	<u>26,099</u>	<u>30,559</u>
Total unrestricted revenues and other support	<u>898,819</u>	<u>893,019</u>
Expenses:		
Salaries and wages	384,699	352,200
Employee benefits	120,813	131,417
Supplies	111,584	98,330
Drugs	76,546	75,700
Professional services	23,596	24,230
Purchased services	56,996	51,477
Administrative and general	86,265	91,484
Rent	3,947	3,495
Interest	5,001	4,675
Depreciation and amortization	<u>50,563</u>	<u>49,914</u>
Total expenses	<u>920,010</u>	<u>882,922</u>
(Loss) income from operations	(21,191)	10,097
Nonoperating gains, net	26,448	25,602
Loss on extinguishment of debt	<u>(376)</u>	<u>—</u>
Revenues, gains, and other support in excess of expenses and losses, before noncontrolling interests	4,881	35,699
Noncontrolling interests	<u>(4,067)</u>	<u>(5,165)</u>
Revenues, gains, and other support in excess of expenses and losses	814	30,534
Other changes in unrestricted net assets:		
Pension-related changes other than net periodic pension cost	25,658	(44,638)
Net assets released from restrictions and used for purchase of property and equipment	—	100
Other	<u>46</u>	<u>(413)</u>
Change in unrestricted net assets	\$ <u><u>26,518</u></u>	\$ <u><u>(14,417)</u></u>

See accompanying notes to consolidated financial statements.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended September 30, 2017 and 2016

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Noncontrolling interests</u>	<u>Total</u>
Balances at September 30, 2015	\$ 758,407	2,637	20	3,529	764,593
Revenues, gains, and other support in excess of expenses and losses	30,534	—	—	5,165	35,699
Distributions to noncontrolling interests	—	—	—	(4,636)	(4,636)
Pension-related changes other than net periodic pension cost	(44,638)	—	—	—	(44,638)
Net assets released from restrictions and used for purchase of property and equipment	100	—	—	—	100
Other	(413)	—	—	—	(413)
Increase due to acquisition	—	—	—	547	547
Acquired controlling interest	—	—	—	(141)	(141)
Increase in interest in net assets of affiliated foundation	—	183	—	—	183
Change in net assets	<u>(14,417)</u>	<u>183</u>	<u>—</u>	<u>935</u>	<u>(13,299)</u>
Balances at September 30, 2016	743,990	2,820	20	4,464	751,294
Revenues, gains, and other support in excess of expenses and losses	814	—	—	4,067	4,881
Distributions to noncontrolling interests	—	—	—	(4,580)	(4,580)
Pension-related changes other than net periodic pension cost	25,658	—	—	—	25,658
Other	46	—	—	—	46
Increase in interest in net assets of affiliated foundation	—	196	1	—	197
Change in net assets	<u>26,518</u>	<u>196</u>	<u>1</u>	<u>(513)</u>	<u>26,202</u>
Balances at September 30, 2017	\$ <u>770,508</u>	<u>3,016</u>	<u>21</u>	<u>3,951</u>	<u>777,496</u>

See accompanying notes to consolidated financial statements.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended September 30, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ 26,202	(13,299)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Unrealized and realized investment (gains) losses, net	(8,299)	(15,563)
Amortization of net premium/discount on bond issue	(563)	(645)
Change in fair value of interest rate swaps	(1,995)	1,281
Increase in interest in net assets of affiliated foundation	(197)	(183)
Pension-related changes other than net periodic pension cost	(25,658)	44,638
Equity in net income of equity investees	(813)	(818)
Depreciation and amortization	50,563	49,914
Distributions to noncontrolling interests	4,580	4,636
Loss on extinguishment of debt	376	—
Gain on disposal of assets	(256)	(58)
Changes in operating assets and liabilities, net of acquisition:		
Net patient accounts receivable	38,274	(4,194)
Other current assets	(1,677)	960
Other assets	5,273	(47)
Accrued pension cost	(844)	(2,810)
Accounts payable, accrued expenses, and other current liabilities	5,789	(15,744)
Estimated professional and general liability costs	(11,131)	708
Net cash provided by operating activities	<u>79,624</u>	<u>48,776</u>
Cash flows from investing activities:		
Capital expenditures	(31,050)	(31,644)
Sales of investments and assets limited as to use	513,797	480,245
Purchases of investments and assets limited as to use	(574,720)	(492,812)
Cash paid for other assets, acquisition of noncontrolling interest, and acquisition, net of cash acquired	—	(2,345)
Proceeds from sale of assets	2,530	141
Net cash used in investing activities	<u>(89,443)</u>	<u>(46,415)</u>
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	37,889	—
Defeasance of long-term debt	(37,500)	—
Bond issuance cost	(218)	—
Proceeds from line of credit	450	150
Repayment of line of credit	(150)	—
Repayment of long-term debt	(3,665)	(8,067)
Payment on other long-term liability	(2,023)	(1,453)
Repayment of capital lease obligations	(592)	(395)
Distributions to noncontrolling interests	(4,580)	(4,636)
Net cash used in financing activities	<u>(10,389)</u>	<u>(14,401)</u>
Net decrease in cash and cash equivalents	(20,208)	(12,040)
Cash and cash equivalents, beginning of year	<u>56,874</u>	<u>68,914</u>
Cash and cash equivalents, end of year	\$ <u>36,666</u>	<u>56,874</u>

See accompanying notes to consolidated financial statements.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies

North Mississippi Health Services, Inc. and subsidiaries (the System) is a not-for-profit, nonstock, multidimensional provider of healthcare services with corporate headquarters located in Tupelo, Mississippi. The significant accounting policies used by the System in preparing and presenting its consolidated financial statements follow:

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the System and its controlled subsidiaries. The following corporations are the more significant of the System's subsidiaries:

- North Mississippi Medical Center, Inc. (NMMC), a tertiary-care hospital complex in Tupelo;
- Corporations which operate acute-care hospital facilities of various sizes in West Point, Iuka, Pontotoc and Eupora, Mississippi, and Hamilton, Alabama;
- North Mississippi Medical Clinics, Inc. (NMMCI), which operates 27 clinics;
- Tupelo Service Finance, Inc. (TSF), a collection agency for not-for-profit and charitable institutions;
- Acclaim, Inc., which provides healthcare claims processing, claims payment and utilization management services; and
- North Mississippi Joint Ventures, LLC (NMJV), which serves as a holding company for the System's interests in North Mississippi Ambulatory Surgery Center, LLC (ASC), Medical Imaging, LLC (MI), Center for Digestive Health, LLC (CDH) and The Imaging Center at Gloster Creek Village, LLC (TIC) (note 20). All of the listed ventures are consolidated subsidiaries of NMJV. NMJV is the 51% controlling investor of ASC, MI and CDH and the 66.19% controlling investor of TIC.

All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, 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 the determination of the allowances for uncollectible accounts and contractual adjustments, liabilities for general and professional liability claims, liabilities for workers' compensation claims, liabilities for employee healthcare claims, estimated third-party payor settlements, and the actuarially determined accrued pension cost related to the System's pension plan. In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs will change by a material amount in the near-term.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(c) Cash Equivalents

The System considers investments in highly liquid debt instruments with an original maturity of three months or less to be cash equivalents.

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets.

The System also has investments in alternative funds, which represent investments in hedge funds through fund-of-funds structures generally organized as corporations. The System's investments in alternative funds are recorded at net asset value (NAV) as a practical expedient to fair value. The estimated fair value of these alternative funds is based on the most recent valuations by external investment managers. The System reviews and evaluates the values provided by the managers and the valuation methods and assumptions used to determine those values. Therefore, the System believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because these assets are not readily marketable, their estimated fair value is subject to uncertainty and therefore, may differ from the fair value that would have been used had a ready market for such investments existed.

All investment income or loss (including realized and unrealized gains and losses, interest, and dividends) is included in the determination of revenues, gains, and other support in excess of expenses and losses, unless temporarily or permanently restricted by the donor. The System considers all of its investments to be trading securities.

Investment income from assets that are held by trustees is reported as other revenue. Investment income or loss from unrestricted or Board-designated investments is reported as nonoperating gains or losses.

(e) Equity Investments

Investments in jointly owned companies in which the System exercises significant influence are accounted for using the equity method.

(f) Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first-out method) or market value.

(g) Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets held by trustees under indenture and self-insurance funding agreements. Trusted amounts required to meet current liabilities are classified as current assets.

(h) Costs of Borrowing

Bond issuance costs and bond premiums and discounts are being amortized over the terms of the related bond issues using the effective interest method.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Bond issuance costs related to recognized debt liabilities are presented in the accompanying consolidated balance sheets as a direct deduction from the carrying amount of that debt liability.

The System capitalizes interest costs on qualified construction expenditures, net of income earned on related trusted assets, as a component of the cost of related projects.

(i) Property and Equipment

Property and equipment are stated at cost at the date of acquisition or fair value at the date of donation. Provisions for depreciation are computed using the straight-line method based on the estimated useful lives of the assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used, and are excluded from revenues, gains, and other support in excess of (less than) expenses and losses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used, and gifts of cash or other assets that must be used to acquire long-lived assets, are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed into service. Contributions restricted to the purchase of property and equipment for which restrictions are met within the same year as received are reported as increases in unrestricted net assets in the accompanying consolidated financial statements.

(j) Impairment of Long-lived Assets

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the use and eventual disposal of the asset, excluding interest. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the carrying amount of the asset exceeds its fair value. Assets to be disposed of are separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the asset and liability sections of the consolidated balance sheets.

No impairment adjustments were necessary in 2017 and 2016.

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 remaining lives.

(k) Derivative Instruments and Hedging Activities

The System follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815 for *Derivatives and Hedging*, which requires that all derivative instruments be recorded on the consolidated balance sheets at their respective fair values.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

All of the System's interest rate swaps are carried in the System's consolidated balance sheets at fair value, with related changes in fair value included in nonoperating gains or losses in the consolidated statements of operations. The System does not apply hedge accounting with respect to any of its derivatives.

(l) Consolidated Statements of Operations

For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as revenues and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

(m) Revenues, Gains, and Other Support in Excess of Expenses and Losses

The consolidated statements of operations include revenues, gains, and other support in excess of expenses and losses. Changes in unrestricted net assets which are excluded from revenues, gains, and other support in excess of expenses and losses, consistent with relevant accounting literature, include pension-related changes other than net periodic pension cost, net assets released from restriction and used for the purchase of property and equipment, and adjustments which may from time-to-time be required to apply new accounting standards.

(n) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered, and includes estimated retroactive revenue adjustments (if necessary) 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.

The System provides a standard discount from gross charges for uninsured patients. Such discounts are included in the provision for contractual and other adjustments.

For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts as determined by the System. An estimated provision for uncollectible accounts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The System has determined, based on an assessment at the combined entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts related to patient revenue is recorded as a deduction from patient service revenue in the accompanying consolidated statements of operations.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Patient receivables are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in healthcare coverage, major payor sources and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with TSF and collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the System.

(o) Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

(p) Income Taxes

The System and most of its subsidiaries qualify as tax-exempt under Internal Revenue Code (IRC) Section 501(a) as organizations described in IRC Section 501(c)(3), and their income is generally not subject to Federal or state income taxes. Three of the System's subsidiaries are subject to such income taxes, which have been recognized in the accompanying consolidated financial statements. The amount of income tax expense is not significant.

The System applies FASB ASC Topic 740, *Income Taxes (Topic 740)*, which clarifies the accounting for uncertainty in income tax positions and provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There has been no impact on the System's consolidated financial statements as a result of applying Topic 740.

(q) Functional Expense Classification

All expenses in the accompanying consolidated statements of operations were incurred for or related to the provision of healthcare services by the System.

(r) Temporarily and Permanently Restricted Net Assets

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

The System applies the provisions of FASB ASC Subtopic 958-205 for *Classification of Donor-Restricted Endowment Funds Subject to the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) (Subtopic 958-205)*. Subtopic 958-205 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of UPMIFA. The State of Mississippi enacted a version of UPMIFA effective July 1, 2012.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(s) Pension Accounting Standard

The System applies the recognition and disclosure provisions of FASB ASC Subtopic 715-20, *Defined Benefit Plans (Subtopic 715-20)*. Subtopic 715-20 requires (among other things) that a plan sponsor recognize the unfunded status of its defined benefit pension plan on its consolidated balance sheets. The System measures the plan at September 30 each year.

Subtopic 715-20 requires enhanced disclosures related to pension plan assets, including disclosures related to the fair value of plan assets. These enhanced disclosures are included in these consolidated financial statements.

(t) Fair Value Measurement

The System applies FASB ASC Topic 820, *Fair Value Measurement (Topic 820)*, which establishes an enhanced framework for measuring fair value and expands disclosures about fair value measurements.

(u) Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue From Contracts With Customers*. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry specific guidance. The core principle of the revenue model is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." In applying the revenue model to contracts within its scope, an entity will: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligation in the contract and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. Certain of the ASU's provisions also apply to transfers of nonfinancial assets, including in-substance nonfinancial assets that are not an output of an entity's ordinary activities (e.g., sales of (1) property, plant and equipment; (2) real estate; or (3) intangible assets). Entities may elect to use either full retrospective or a modified approach to adopt the ASU guidance. For public entities and certain not-for-profit entities, this ASU is effective for annual periods beginning after December 15, 2017. Early application of ASU 2014-09 is not permitted. The System is evaluating the impact of adopting ASU 2014-09 to its consolidated financial statements, which is effective in fiscal year 2019.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changes certain presentation requirements for not-for-profit entities' financial statements in an effort to make information more meaningful for users. This ASU removes the requirement to distinguish between resources with temporary and permanent restrictions on the face of the financial statements and replaces this with a requirement to present two classes of net assets – with and without donor restrictions. Additionally, the ASU requires expenses to be presented by their natural and functional classifications. The guidance also requires that investment returns be presented net of external and direct internal investment expenses and eliminates the requirements for disclosures of the components of investment return. Further, the ASU requires expanded disclosures about liquidity

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

and availability of financial assets. ASU 2016-14 is effective for fiscal year 2019. The System is evaluating the impact of adopting ASU 2016-14 to its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* which introduces a right-of-use model which requires lessees to recognize all leases, other than short-term leases with a maximum possible term of one year or less, on their balance sheet. Also, the amortization of these leases will be dependent of the portion of the underlying asset being utilized during the lease term. ASU 2016-02 is effective for the System in fiscal year 2020, with early adoption permitted. The System is evaluating the impact of adopting ASU 2016-02 to its consolidated financial statements.

(v) *Reclassifications*

The System has reclassified certain amounts relating to its prior period results to conform to its current period presentation. These changes have not changed the results of operations of prior periods.

(2) **Investments and Assets Limited as to Use**

The composition of investments follows (in thousands):

	<u>2017</u>	<u>2016</u>
Obligations of the U.S. government and its agencies	\$ 138,797	136,740
Corporate debt securities	164,153	171,939
Corporate equity securities	6,091	5,456
Mutual funds	222,144	152,569
Certificates of deposit	400	400
Hedge funds	17,725	15,977
Interest in Mississippi Hospital Association pooled investments	1,185	1,184
	<u>\$ 550,495</u>	<u>484,265</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

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

	<u>2017</u>	<u>2016</u>
Under indenture agreements – held by trustee:		
Obligations of the U.S. government and its agencies	\$ 1,839	1,832
Less deposits classified as other current assets	<u>7</u>	<u>6</u>
	<u>1,832</u>	<u>1,826</u>
Under professional and general liability funding arrangement – held by trustee:		
Cash and cash equivalents	645	583
Obligations of the U.S. government and its agencies	4,745	7,244
Corporate debt securities	9,026	7,431
Mutual funds	7,678	7,322
Accrued interest receivable	<u>910</u>	<u>827</u>
	<u>23,004</u>	<u>23,407</u>
By Board for capital improvements:		
Cash and cash equivalents	1,160	4,307
Obligations of the U.S. government and its agencies	17,193	17,405
Corporate debt securities	20,334	21,885
Corporate equity securities	754	693
Mutual funds	27,518	19,420
Hedge funds	2,195	2,034
Interest in Mississippi Hospital Association pooled investments	147	151
Accrued interest receivable	<u>41</u>	<u>42</u>
	<u>69,342</u>	<u>65,937</u>
Total noncurrent assets limited as to use	\$ <u>94,178</u>	<u>91,170</u>

The funds held by trustee under indenture agreements were established in accordance with the requirements of the indentures related to the various Mississippi Hospital Equipment and Facilities Authority revenue bond issues discussed in note 10. Deposits classified as current assets will be used to relieve obligations classified as current liabilities at September 30.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The composition of net investment income follows (in thousands):

	<u>2017</u>	<u>2016</u>
Interest and dividend income	\$ 14,813	10,055
Unrealized and realized investment gains, net	<u>8,299</u>	<u>15,563</u>
Net investment income	23,112	25,618
Less investment income included in other revenue	<u>2</u>	<u>2</u>
Investment income classified as a component of nonoperating gains, net	<u>\$ 23,110</u>	<u>25,616</u>

(3) Investment in Equity Investees

The System's investment in Healthcare Providers Insurance Company (HPIC), a reciprocal insurance exchange, is accounted for using the equity method and consists of a subscriber interest of approximately 41% at both years ended September 30, 2017 and 2016. The System recorded year-end investment activity related to HPIC based on financial data as of December 31, 2016 and 2015, respectively, which is the latest available data.

HPIC provides the System with a claims-made policy covering certain layers of general and professional liability risks as described in note 16. The costs associated with the policy were approximately \$2,135,000 and \$2,435,000 in 2017 and 2016, respectively, and were charged to administrative and general expenses in the accompanying consolidated statements of operations.

The carrying amount of the investment in HPIC was approximately \$19,560,000 and \$18,747,000 at September 30, 2017 and 2016, respectively, and is recorded in other assets in the accompanying consolidated balance sheets. The System's equity in the net income of HPIC was approximately \$813,000 and \$817,000 for the years ended September 30, 2017 and 2016, respectively.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Summary unaudited financial information for HPIC as of and for the years ended December 31, 2016 and 2015 follows (in thousands):

	<u>2016</u>	<u>2015</u>
Cash and invested assets	\$ 77,007	75,154
Other assets	2,006	2,240
	<u>\$ 79,013</u>	<u>77,394</u>
Total liabilities	\$ 31,696	31,719
Accumulated surplus	47,317	45,675
	<u>\$ 79,013</u>	<u>77,394</u>
Net underwriting gain	\$ 2,891	2,508
Investment gain	2,058	2,945
Other changes in accumulated surplus	(3,307)	(6,253)
Change in accumulated surplus	<u>\$ 1,642</u>	<u>(800)</u>

The System's other equity investees were insignificant at September 30, 2017 and 2016.

(4) Patient Accounts Receivable

The composition of net patient accounts receivable follows (in thousands):

	<u>2017</u>	<u>2016</u>
Gross patient accounts receivable	\$ 369,409	404,411
Less allowance for uncollectible accounts	207,892	204,620
	<u>\$ 161,517</u>	<u>199,791</u>

For patient receivables associated with self-pay patients, including patients with deductibles and copayment balances for which third-party coverage provides for a portion of the services provided, the System records an estimated provision for uncollectible accounts in the year of service. Changes from year to year in the allowance for uncollectible accounts are principally caused by a number of factors, including but not limited to, timing of write-offs from year to year, changes in unemployment in the System's service area, changes in employer-sponsored insurance plans and rising patient responsibility balances. The System does not maintain a material allowance for uncollectible accounts from third-party payors.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(5) Business and Credit Concentrations

The System grants credit to patients, substantially all of whom reside in the service areas of the related subsidiaries. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, preferred provider arrangements, and commercial insurance policies).

The mix of receivables, net of contractual adjustments, from patients and third-party payors follows:

	<u>2017</u>	<u>2016</u>
Medicare	21 %	19 %
Self-pay	37	35
Commercial and other third party payors	24	32
Blue Cross	11	8
Medicaid	7	6
	<u>100 %</u>	<u>100 %</u>

(6) Other Current Assets

The composition of other current assets follows (in thousands):

	<u>2017</u>	<u>2016</u>
Assets limited as to use – required for current liabilities	\$ 7	6
Due from third-party payors	199	346
Other receivables	2,586	3,576
Inventories	24,142	21,610
Prepaid expenses and other current assets	4,837	4,549
	<u>\$ 31,771</u>	<u>30,087</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(7) Other Assets

The composition of other assets follows (in thousands):

	<u>2017</u>	<u>2016</u>
Investment in equity investees	\$ 19,560	18,747
Interest in net assets of affiliated foundation	3,037	2,840
Prepaid software maintenance and training costs, net (note 18)	3,497	5,245
Insurance receivables	2,131	7,815
Deferred compensation 457(b)	17,511	14,857
Other	1,025	1,520
	<u>\$ 46,761</u>	<u>51,024</u>

(8) Property and Equipment

A summary of property and equipment follows (in thousands):

	<u>2017</u>	<u>2016</u>
Land and improvements	\$ 33,539	32,603
Buildings and improvements	385,126	373,595
Fixed equipment	135,571	131,829
Movable equipment, including computer hardware and software	447,165	435,598
Construction in progress	1,134	3,680
	<u>1,002,535</u>	<u>977,305</u>
Less accumulated depreciation	<u>734,719</u>	<u>687,829</u>
	<u>\$ 267,816</u>	<u>289,476</u>

Construction in progress at September 30, 2017 is principally comprised of costs incurred for renovations of the NMMC main hospital facility, with the most significant portions of the renovation and construction projects planned for completion through the year ending September 30, 2018. The estimated total remaining cost to complete renovation and construction projects in progress at September 30, 2017 is approximately \$3 million. The System expects to fund a portion of the projects through operations and unrestricted assets.

Depreciation expense was approximately \$50,446,000 in 2017 and \$49,798,000 in 2016.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(9) Accrued Expenses and Other Current Liabilities

The composition of accrued expenses and other current liabilities follows (in thousands):

	<u>2017</u>	<u>2016</u>
Accrued payroll costs	\$ 16,929	13,265
Accrued compensated absences	18,453	17,496
Deferred compensation 457(b)	17,511	14,857
Accrued workers' compensation costs	3,360	3,751
Due to third-party payors	8,441	5,133
Accrued interest	2,154	2,139
Current portion of other long-term liability (note 18)	2,128	2,023
Other	6,283	12,902
	<u>\$ 75,259</u>	<u>71,566</u>

(10) Long-term Debt

A summary of long-term debt follows (in thousands):

	<u>2017</u>	<u>2016</u>
Mississippi Hospital Equipment and Facilities Authority		
Revenue Bonds:		
2017 Series 1	\$ 37,889	—
2010 Series 1	34,130	71,630
2003 Series 2	29,175	29,175
2001 Series 1	37,815	40,000
1997 Series 1	13,925	15,405
	<u>152,934</u>	<u>156,210</u>
Unamortized net discount/premium, net	(61)	436
Unamortized debt issuance costs	(943)	(1,161)
	<u>151,930</u>	<u>155,485</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Notes payable of NMJV and subsidiaries, payable in monthly installments at varying amounts through May 2017 at interest rates ranging from 3.25% to 3.5%, secured by certain fixed assets and accounts receivable at each subsidiary	\$ —	154
Capital lease obligations of NMJV and subsidiaries, payable in monthly installments at varying amounts through September 2020, at interest rates ranging from 0% to prime plus 3%, secured by leased equipment	<u>1,238</u>	<u>1,652</u>
	153,168	157,291
Less current installments	<u>81,336</u>	<u>85,172</u>
	\$ <u><u>71,832</u></u>	\$ <u><u>72,119</u></u>

In September 2017, the 2017 Series 1 revenue bonds were authorized in an amount not to exceed \$50,000,000. The bond indenture is between NMMC, Clay County Medical Center, and Webster Health Services, Inc. (collectively, the Obligated Group) and Mississippi Hospital Equipment and Facilities Authority. The 2017 Series 1 revenue bonds are secured by a pledge of the net revenues of the Obligated Group as established under the Obligated Group's Master Trust Indenture. The 2017 Series 1 revenue bonds are tax-exempt variable rate debt and were placed directly with Banc of America Public Capital Corp.

In September 2017, the Obligated Group drew down approximately \$37,889,000 of the available 2017 Series 1 revenue bonds and used \$37,500,000 of these proceeds to advance refund \$37,500,000 of principal maturity of the 2010 Series 1 revenue bonds, which was due on October 1, 2017. Of the remaining \$389,000 of proceeds received, approximately \$218,000 were used for debt issuance costs with the remaining amount used to reimburse NMMC for eligible project costs.

The remaining \$34,130,000 of the 2010 Series 1 revenue bonds will mature in accordance with the original bond agreement.

The remaining available debt under the 2017 Series 1 revenue bonds will fund routine capital expenditures. The remaining 2017 Series 1 revenue bonds will maintain a draw-down feature, in which the Obligated Group has up to 18 months to draw on any remaining available proceeds to fund routine capital expenditures. The Obligated Group will not pay interest on the un-drawn funds but will pay Banc of America Public Capital Corp 10 basis points annually on undrawn funds. The interest rate on all issued debt under the 2017 Series 1 revenue bonds is 70 percent of LIBOR plus 40 basis points.

In July 2003, the Obligated Group issued the 2003 Series 2 revenue bonds for \$98,400,000. A portion of the 2003 Series revenue bonds was used to refund the outstanding bonds from the 1993 bond series. The bond indenture between the Obligated Group and Mississippi Hospital Equipment and Facilities Authority has been released and the Obligated Group no longer has any obligations associated with the refunded issue.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

In April 2008, the Obligated Group converted, as permitted under the original indenture agreement, the 2003 Series revenue bonds through a mandatory tender option from auction rate securities to variable rate demand obligations. Since the market liquidity of the 2003 Series revenue bonds is supported solely by the Obligated Group, the bonds are classified as current liabilities in the accompanying consolidated balance sheets.

In December 2008, the outstanding portions of the 1997 Series 1 and 2001 Series 1 revenue bonds of \$26,795,000 and \$40,000,000, respectively, were remarketed by the Obligated Group due to the expiration of the original Liquidity Facility on December 29, 2008. The revenue bonds as currently structured are not supported by an external liquidity facility or a financial institution credit facility, but are secured solely by the Obligated Group through notes issued between the Obligated Group and The Bank of New York Mellon Trust Company, N.A., trustee for the bondholders. The notes are the joint and several obligations of the Obligated Group and are secured by the pledge of the net revenues of each Obligated Group member, subject to permitted liens. The notes are equal to the principal amounts of the 1997 Series 1 and 2001 Series 1 revenue bonds and have terms and conditions requiring payments thereon sufficient to pay the contractual maturities of the bonds when due. Since the market liquidity of the 1997 Series 1 and 2001 Series 1 revenue bonds is supported solely by the Obligated Group, the bonds are classified as current liabilities in the accompanying consolidated balance sheets.

In August 2010, the System issued the 2010 Series 1 revenue bonds for \$71,630,000 (interest fixed at coupon rates ranging from 4.75% to 5.00%) with an original issue net premium of \$4,388,658. Proceeds from the bonds were used for certain renovations of the NMMC main hospital facility and for the payment of costs incurred in connection with the issuance of the bonds.

Certain trusteed assets as described in note 2 and the future net revenues of the Obligated Group are pledged as security for payment of the various revenue bonds. Additionally, the Obligated Group is required to comply with certain financial and nonfinancial covenants customary of such obligations.

Except for the 2010 Series 1 fixed rate bonds, all other currently outstanding revenue bonds bear interest at variable rates and are supported by remarketing agreements and the Obligated Group's institutional commitment to provide market liquidity. Interest rates are periodically adjusted based upon prevailing rates for the contract period related to the remarketed tranche. In the event a market for variable rate instruments is not sustained, the Obligated Group would be required, if necessary, to provide sustaining liquidity to honor the "put" feature of the then-existing bondholders. The maximum annual interest rate which the 2003, 2001 and 1997 bonds may bear is 13%. The average annual interest rate paid on the 2003, 2001 and 1997 revenue bonds approximated 1.1% and 1.2% for the years ended September 30, 2017 and 2016, respectively.

Interest is periodically due on the variable rate revenue bonds at the end of related contract periods, while interest on the fixed rate bonds is due semi-annually.

The notes payable are guaranteed by the System and the other members of each respective joint venture at their proportionate interests in each entity.

The System paid interest on long-term debt of approximately \$4,246,000 in 2017 and \$3,931,000 in 2016, which included capitalized interest of \$131,000 and \$194,000 in 2017 and 2016, respectively.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

Principal is due in varying amounts each May 15 until the year 2033. Future maturities of long-term debt, excluding the capital lease obligations and assuming the demand bonds are not called prior to the stated maturities, by year and in the aggregate, follow (in thousands):

2018	\$	3,810
2019		3,965
2020		42,009
2021		4,290
2022		4,455
Thereafter		<u>94,405</u>
	\$	<u><u>152,934</u></u>

(11) Derivative Financial Instruments

The Obligated Group has executed interest rate swap agreements for the purpose of synthetically converting certain variable rate debt obligations to fixed rate instruments. Accordingly, notional swap amounts are tied to related revenue bond principal balances. A summary of information related to these instruments at September 30, 2017 and 2016 follows:

2017						
<u>Related bond issuance</u>	<u>Notional amount (in thousands)</u>	<u>Maturity date</u>	<u>Rate paid</u>	<u>Average rate received</u>	<u>Net settlement amount (in thousands)</u>	<u>Swap fair value liability (in thousands)</u>
2003 Series 2	\$ 23,875	5/15/2033	3.437 %	0.6094 %	\$ (673)	\$ <u><u>(5,663)</u></u>
2016						
<u>Related bond issuance</u>	<u>Notional amount (in thousands)</u>	<u>Maturity date</u>	<u>Rate paid</u>	<u>Average rate received</u>	<u>Net settlement amount (in thousands)</u>	<u>Swap fair value liability (in thousands)</u>
2003 Series 2	\$ 23,875	5/15/2033	3.437 %	0.2692 %	\$ (755)	\$ <u><u>(7,658)</u></u>

The Obligated Group's interest rate swaps are executed over the counter and are valued using the net present value of cash flow streams, adjusted for risk associated with credit default, as no quoted market prices exist for such instruments. NMHS also employs an independent third party to perform mark to market valuation assessments on the swaps to assess the valuations otherwise received by NMHS. The Obligated Group has categorized its interest rate swap fair value estimates as Level 2, as defined in note 19, in the fair value hierarchy.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(12) Net Patient Service Revenue

Certain subsidiaries of the System have agreements with governmental and other third-party payors that provide for reimbursement to such subsidiaries at amounts different from established rates. Contractual adjustments under third-party reimbursement programs represent the difference between billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

- Medicare – Substantially all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Certain types of exempt services and other defined payments related to Medicare program beneficiaries are paid based upon cost reimbursement or other retroactive-determination methodologies. As applicable, subsidiaries of the System are paid for retroactively determined items at a tentative rate with final settlement determined after submission of annual cost reports by the related subsidiaries and audits by the Medicare fiscal intermediary. Related cost reports have been audited and substantially settled for all fiscal years through September 30, 2013.
- Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are generally paid based upon prospective reimbursement methodologies established by the State of Mississippi and the State of Alabama.

The System participates in certain supplemental Medicaid reimbursement programs for the purpose of offsetting the cost of providing care to Medicaid patients. These programs are funded with a combination of state and federal resources, including fees or taxes paid by the providers. Amounts received by certain subsidiaries of the System in excess of amounts paid into the programs were approximately \$24,732,000 and \$26,203,000 for the years ended September 30, 2017 and 2016, respectively, and have been recognized as reductions in related contractual adjustments in the accompanying consolidated statements of operations. There can be no assurance that applicable subsidiaries of the System will continue to qualify for future participation in these programs or that the programs will not ultimately be discontinued or materially modified.

- Blue Cross and Blue Shield of Mississippi (Blue Cross) – All acute care services rendered to Blue Cross program beneficiaries are reimbursed at prospectively determined rates.

Related subsidiaries of the System have also entered into other reimbursement arrangements providing for payment methodologies which include prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

The composition of net patient service revenue before the provision for uncollectible accounts follows (in thousands):

	<u>2017</u>	<u>2016</u>
Gross patient service revenue	\$ 3,246,084	2,847,299
Less provision for contractual and other adjustments	<u>2,214,586</u>	<u>1,848,308</u>
Net patient service revenue	<u>\$ 1,031,498</u>	<u>998,991</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The composition of net patient service revenue before the provision for uncollectible accounts by major payor source follows (in thousands):

	<u>2017</u>	<u>Percentage</u>	<u>2016</u>	<u>Percentage</u>
Medicare	\$ 374,683	36 %	\$ 367,917	37 %
Managed care and commercial	257,058	25	249,995	25
Blue Cross	161,925	16	141,317	14
Medicaid	136,718	13	119,613	12
Self-pay	101,114	10	120,149	12
	<u>\$ 1,031,498</u>	<u>100 %</u>	<u>\$ 998,991</u>	<u>100 %</u>

Changes in estimates related to prior cost reporting periods resulted in (decrease) increase of approximately \$(459,000) and \$6,544,000 in net patient service revenue for the years ended September 30, 2017 and 2016, respectively.

(13) Service to the Community

The mission of the System is to continuously improve the health of its service population. In carrying out its mission and in being an active, caring member of the community, the System serves the community in a variety of ways.

One of the primary ways the System serves the community is by providing care to various populations for which it receives little or no compensation, or for which it receives compensation at rates significantly less than established rates. This is a critical matter of community service which is further described below.

Based on gross charges, for the year ended September 30, 2017 approximately 7% of the System's total services and 20% of total emergency room services were provided to patients with no insurance. For the year ended September 30, 2016 approximately 8% of the System's total services and 20% of total emergency room services were provided to patients with no insurance. Historically, the System collects only a small percentage of amounts otherwise due from uninsured patients; a significant portion of these uncollectible accounts ultimately meet the charity requirements described below and the remaining uncollectible accounts result in write-offs to bad debt.

The System applies the community benefit reporting guidance provided in *A Guide for Planning and Reporting Community Benefit* published by the Catholic Health Association of the United States in 2006 and, therefore, does not formally consider bad debt to be a part of the community benefit it provides. Nevertheless bad debt is an important component of the System's overall uncompensated care burden.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The Board of Directors of the System has established a policy under which the System provides care, without charge, to needy members of its community. The charity care policy states that the System will provide necessary hospital services free of charge to patients at threshold household income levels, which are based on the federal poverty guidelines. The policy applies to individuals who reside in the System's 24-county service area, as defined by the policy. Patients from outside the service area may also be granted charity care based on the judgment of System management and depending on individual circumstances. The policy also requires patients to cooperate fully with the System's requests for information to verify patient eligibility.

Following that policy, the System maintains records to identify and monitor the level of charity care it provides. The net cost of charity care provided by the System was approximately \$20,367,000 and \$20,337,000 in 2017 and 2016, respectively. The total cost estimate is based on the ratio of operating costs, less the provision for uncollectible accounts, to charges.

In addition to community services directly associated with providing clinical care, the System seeks to strengthen community relationships through developing and maintaining a proactive involvement and outreach program aimed at creating an inclusive and lasting relationship with the community. Examples of the System's community involvement include the following:

School Nurses – The System employs registered nurses and certified health educators and provides their services to schools in its service area at no cost to the school systems. These nurses and educators provide basic healthcare and instructional services to the students in the schools they serve. The cost of providing these services was approximately \$596,000 and \$674,000 for the years ended September 30, 2017 and 2016, respectively.

Athletic Trainers – The System employs certified athletic trainers who provide services to high schools in its service area at no cost. The trainers work with the sports teams at these schools on a daily basis during practice and training, as well as at in-season competitions. The cost of providing these services was approximately \$657,000 and \$575,000 for the years ended September 30, 2017 and 2016, respectively.

Community Health Outreach Activities – The System has a commitment to a wide variety of community health outreach activities, which are coordinated by the Community Health department and are staffed by employees of that department as well as by System employees who volunteer their time to help with these events and activities. The Community Health department assists in educating the community on health-related issues by organizing and presenting various health fairs and seminars. These events are held at local businesses, schools, and community organizations and address such issues as cancer care, heart health, bone and joint care, sinus and allergy issues, newborn and child care, and other health-related topics. In addition, the Community Health department sponsors cholesterol, blood pressure, vision, memory, and heart-risk screening events, through which tests are made available to the public for a nominal fee or at no charge with the majority of the costs incurred absorbed by the System. The cost associated with the outreach activities provided by the Community Health department was approximately \$370,000 and \$306,000 for the years ended September 30, 2017 and 2016, respectively.

Nurse Link – Nurse Link is a free community telephone service that assists callers with health information, offers triage for symptom-based calls, and makes recommendations for care by utilizing a physician approved, computerized protocol system and reference materials. Nurse Link is staffed by registered nurses and is available from 4 p.m. until midnight on weekdays and from 8 a.m. until midnight on weekends

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

and holidays, and also includes The Appointment Desk and Physician Consult Line. The Appointment Desk is a free community health information and physician referral service. Physician Consult Line is a free service that provides regional physicians and their staff access to all System departments, specialists and clinics. In addition, Nurse Link provides after-hours coverage for physician clinics throughout northeast Mississippi and for the branch offices of NMMC Home Health Agency and Hospice. Nurse Link has also teamed with various System clinical services departments to provide a call-back service to their discharged patients. The cost of providing these services was approximately \$640,000 and \$546,000 for the years ended September 30, 2017 and 2016, respectively.

Donations to Charitable Organizations – The System makes cash donations to a wide variety of community charitable organizations involved in local schools, the arts, public health, and community development activities. The System contributed approximately \$182,000 and \$251,000 in charitable corporate donations to these organizations for the years ended September 30, 2017 and 2016, respectively.

Although the System has estimated the cost of each of these efforts to serve north Mississippi and the surrounding area, management and the Board of Directors believe that such costs represent only one facet of the many ways the System serves the community. The above examples relate only to certain measurable benefits that the System provides to its service area. This presentation is not intended to measure all such community benefits, many of which are intangible in nature or otherwise not quantifiable.

(14) Leases

Rental expense for all operating leases was approximately \$3,947,000 and \$3,495,000 in 2017 and 2016, respectively. There were no significant noncancelable operating leases at September 30, 2017.

(15) Employee Benefit Plans

(a) Pension Plan

The System sponsors a defined benefit pension plan covering all permanent employees who make application to become participants, have attained the age of 21 and completed one year of service as defined in the plan. Participants are required to contribute 1% of their annual compensation. The System contributes an amount equal to the difference between employees' contributions and the amount required to fund the plan as determined by consulting actuaries. Effective March 31, 2014, the plan was closed to new participants. Effective January 1, 2016, the Plan was frozen.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The pension plan's funded status (measured at September 30, 2017 and 2016) and amounts recognized in the System's consolidated financial statements follow (in thousands):

	<u>2017</u>	<u>2016</u>
Change in projected benefit obligation:		
Projected benefit obligation at the beginning of year	\$ 495,185	450,031
Service cost	10,950	10,871
Interest cost	16,998	18,106
Plan participants' contributions	722	1,098
Benefits paid	(11,035)	(35,443)
Actuarial loss	3,878	50,522
Projected benefit obligation at the end of year	\$ <u>516,698</u>	<u>495,185</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 351,819	348,493
Actual return on plan assets	47,632	26,976
Employer contributions	10,696	10,695
Plan participants' contributions	722	1,098
Benefits paid	(11,035)	(35,443)
Fair value of plan assets at end of year	\$ <u>399,834</u>	<u>351,819</u>
	<u>2017</u>	<u>2016</u>
Funded status:		
Projected benefit obligation	\$ 516,698	495,185
Fair value of plan assets	<u>399,834</u>	<u>351,819</u>
Funded status at end of year	\$ <u>(116,864)</u>	<u>(143,366)</u>
Accumulated benefit obligation	\$ 476,776	461,155

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Amounts recognized in the consolidated balance sheets consist of:		
Accrued pension cost	\$ (116,864)	(143,366)
Unrestricted net assets	(118,341)	(143,999)
Amounts not yet reflected in net periodic benefit cost and included in unrestricted net assets:		
Prior service cost	\$ —	—
Accumulated loss	(118,341)	(143,999)
	<u>\$ (118,341)</u>	<u>(143,999)</u>
Components of net periodic pension cost:		
Service cost	\$ 10,950	10,871
Interest cost	16,998	18,106
Expected return on plan assets	(25,999)	(25,848)
Amortization of prior service cost	—	1
Amortization of net loss	7,902	4,755
Net periodic pension cost	<u>\$ 9,851</u>	<u>7,885</u>
Other changes recognized in unrestricted net assets:		
Net loss (gain) arising during period	\$ (17,756)	49,394
Amortization of prior service cost	—	(1)
Amortization of net loss	(7,902)	(4,755)
Total recognized in unrestricted net assets	<u>\$ (25,658)</u>	<u>44,638</u>

The following are the estimated amounts that will be amortized from unrestricted net assets over the next fiscal year:

Amortization of prior service cost	\$ —
Amortization of loss	<u>6,156</u>
	<u>\$ 6,156</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Weighted average assumptions used to determine benefit obligations in the accompanying consolidated balance sheets at September 30:		
Discount rate	4.06 %	4.01 %
Rate of compensation increase	3.00	3.00
Measurement date	September 30, 2017	September 30, 2016
Weighted average assumptions used to determine net periodic benefit cost:		
Discount rate	4.01 %	4.73 %
Expected long-term rate of return on plan assets	7.25	7.40
Rate of compensation increase	3.00	3.00

The plan's expected long-term rate of return on assets is determined by reviewing the historical returns of each asset category comprising the plan's target asset allocation. This review produces an annual return assumption for each asset category. The product of the annual return assumption and the plan's target asset allocation percentage for each asset category equals the annual return attribution by asset category. The target asset allocation for the portfolio is 40% to 60% equity securities, 20% to 50% debt securities, 0% to 10% alternative investments and 0% to 10% cash.

(i) *Plan Assets*

The System's pension plan weighted average asset allocations follow:

	<u>Plan assets at September 30,</u>	
	<u>2017</u>	<u>2016</u>
Asset category:		
Equities:		
Large cap equity securities	16 %	16 %
Small and mid cap equity securities	2	2
International equity securities	16	16
Global equity securities	17	18
Debt securities	40	38
Cash and cash equivalents	1	1
Alternative investments	8	9
Total	<u>100 %</u>	<u>100 %</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The Plan's investment objectives are to protect long-term asset values by applying prudent, low risk, high quality investment disciplines and to enhance the values by maximizing investment returns through active security management within the framework of the investment policy. Asset allocation strategies and investment management structure are designed to meet the Plan's investment objectives.

(ii) *Cash Flows*

The System expects to contribute approximately \$13,000,000 to the Plan in 2018.

(iii) *Expected Future Benefit Payments*

The following benefit payments, which reflect future services as appropriate, are expected to be paid (in thousands):

	Pension benefits	
	<hr/>	
2018	\$	12,881
2019		14,333
2020		15,975
2021		17,638
2022		19,528
2023–2027		127,015

(iv) *Fair Value of Plan Assets*

The composition of plan assets follows (in thousands):

	2017		2016	
	<hr/>		<hr/>	
Mutual funds:				
Large cap equity securities	\$	64,683		56,861
Small and mid cap equity securities		7,954		6,917
International equity securities		65,304		57,412
Global equity securities		69,290		62,200
Debt securities		158,071		134,757
Cash and cash equivalents		1,801		1,412
Hedge funds		32,731		32,260
		<hr/>		<hr/>
	\$	399,834		351,819
		<hr/>		<hr/>

All of the Plan assets are categorized as Level 1 in the fair value hierarchy as described in note 19, except hedge funds which are not categorized because fair value is measured using the net asset value practical expedient.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(b) Defined Contribution Plans

The System also sponsors a contributory savings plan, North Mississippi Health Services, Inc. Employer Savings Plan, which covers most employees aged 21 and older who have completed one year of service as defined in the plan. Eligible employees may contribute up to 20% of compensation in any one year, subject to a regulatory limit. The System makes matching contributions equal to 50% of the employees' contributions, not to exceed 2% of total compensation. Effective April 1, 2014, employees hired on or after April 1, 2013, are eligible for a supplemental employer contribution ranging from 5–200% (based on years of service) of the employee's contribution to the contributory savings plan, not to exceed 6% of compensation. The System contributed approximately \$12,714,000 and \$9,146,000 to this plan during the years ended September 30, 2017 and 2016, respectively.

NMMCI sponsors a defined contribution retirement plan covering all of its employees. Participants are not eligible to make contributions to this plan. NMMCI makes contributions equal to 5.7% of each participant's base compensation, plus 11.4% of each participant's excess compensation, as defined in the plan. Contributions are subject to regulatory limits. NMMCI contributed approximately \$485,000 and \$4,860,000 to this plan during the years ended September 30, 2017 and 2016, respectively. Effective January 1, 2017, the assets of this plan were merged into The North Mississippi Health Services, Inc. Employer Savings Plan which is noted above.

NMMCI also sponsors a contributory savings plan covering all of its employees. Participating employees may contribute up to 20% of compensation in any one year, subject to regulatory limits. While NMMCI may make discretionary contributions to this plan, no such contributions were made during the years ended September 30, 2017 and 2016. Effective January 1, 2017, the assets of this plan were merged into The North Mississippi Health Services, Inc. Employer Savings Plan which is noted above.

(16) Insurance Programs

The System has substantial claims-made basis excess insurance coverage in place for general and professional liability risks. The insurance program is made up of a combination of self-insurance retention and claims-made excess insurance coverage. As of and for the year ended September 30, 2017, the self-insurance retention was \$5 million per claim for professional liability and \$5 million per occurrence for general liability, subject to a combined \$10 million aggregate. Effective October 1, 2017, the System's excess insurance coverage was renewed at the same levels of retention.

The System's employed physicians are covered by a first-dollar claims-made physician liability policy with a \$1 million per professional incident limit and a \$3 million aggregate limit.

Incurred losses identified under the System's incident reporting system and incurred but not reported losses are accrued based on estimates that incorporate the System's past experience, as well as other considerations such as the nature of each claim or incident, relevant trend factors, and advice from consulting actuaries. Because the terms of the System's general and professional liability program provide for first-dollar claims-made coverage at the affiliate level, reserves and related insurance receivables related to general and professional liability exposures are held at the System consolidated level and not allocated to individual affiliates.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The System has established a self-insurance trust fund for payment of liability claims and makes deposits to the fund in amounts determined by consulting actuaries. The System also has substantial excess liability coverage available under the provisions of certain claims-made policies, currently expiring on October 1, 2018. To the extent that any claims-made coverage is not renewed or replaced with equivalent insurance, claims based on occurrences during the term of such coverage, but reported subsequently, would be uninsured. Management believes, based on incidents identified through the System's incident reporting system, that any such claims would not have a material effect on the System's results of operations or financial position. In any event, management anticipates that the claims-made coverage currently in place will be renewed or replaced with equivalent insurance as the term of such coverage expires.

The System is also self-insured with respect to employee health coverage and workers' compensation (up to a limit of \$1,000,000 per individual claim, \$300,000 prior to October 1, 2012). Substantial excess insurance coverage is maintained for potential excess losses under the workers' compensation program.

(17) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets (currently held at Health Care Foundation of North Mississippi, an affiliated foundation) are available for the following purposes at September 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Patient assistance	\$ 1,016	1,016
Purchase of equipment and other property	230	227
Education	395	370
Employee benevolent fund	36	32
Time-restricted	<u>1,339</u>	<u>1,175</u>
	<u>\$ 3,016</u>	<u>2,820</u>

Permanently restricted net assets are to be held in perpetuity, the income from which is expendable for scholarships.

(18) Information Technology Contract

NMMC has entered into a ten-year software and services agreement with a major information technology vendor. The agreement generally commits NMMC to the purchase of a variety of information technology products and services from this vendor for a defined payment stream over the term of the contract. Certain software license and support fees and related implicit maintenance and training costs (totaling approximately \$37,670,000) were capitalized during fiscal 2010 with recognition of an associated liability related to NMMC's acquisition of these intangible assets. Software costs placed in service and transferred to affiliate hospitals of NMHS during 2012 were \$10,806,000. All remaining software costs were placed into service during 2013. Such costs are amortized as the software was placed in service. Implied maintenance costs of approximately \$17,483,000 are being amortized over the estimated useful life of the implicit maintenance period of ten years. Such costs are included in other assets in the accompanying consolidated balance sheets (note 7). Other contract costs are evaluated for capitalization or expense recognition under relevant accounting literature as associated products and/or services are provided.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The following table summarizes the future payment commitments under the contract as of September 30, 2017 (in thousands):

	Capitalized software and implicit maintenance costs obligation
2018	\$ 2,311
2019	<u>2,310</u>
Total	4,621
Less amounts representing interest at 5%	<u>254</u>
Total obligation	4,367
Less current portion (included in accrued expenses and other current liabilities – see note 9)	<u>2,128</u>
Long-term obligation (included as other long-term liability in the accompanying 2017 consolidated balance sheet)	\$ <u><u>2,239</u></u>

Interest paid under the agreement in fiscal 2017 and 2016 was approximately \$254,000 and \$786,000, respectively.

(19) Fair Value Hierarchy of Investments and Assets Limited as to Use

In accordance with Topic 820, the System has categorized its financial instruments, based on the priority of inputs used in related valuation techniques, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets (Level 1), inputs other than quoted market prices that are observable, either directly or indirectly (Level 2), and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within multiple levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

When available, the System uses quoted market prices to determine fair value, and classifies such items as Level 1. The System's Level 2 securities are bonds whose fair values are determined by independent vendors, or nontraded funds whose underlying securities would otherwise be considered Level 1. The vendors compile prices from various sources and may apply matrix pricing for similar bonds or loans where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued.

Alternative investments are not categorized within the fair value hierarchy because fair value is measured using the NAV per share practical expedient. The System's alternative investments' NAV's are obtained from the fund manager. For the System's hedge funds, the manager receives account statements directly from independent administrators or the underlying hedge funds managers, who are responsible for the

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

valuation of these funds. Before reliance on these valuations, the managers evaluate the investee fund's fair value estimation processes and control environment, the investee fund's policies and procedures for estimating fair value of underlying investments, the investee fund's use of independent third party valuation experts, the portion of the underlying securities traded on active markets, and the professional reputation and standing of the investee fund's auditor.

The System is subject to limitation on redemption of their hedge fund investments and assets limited as to use as follows:

	Fair value at September 30, 2017 (in thousands)	Unfunded commitment	Redemption frequency	Redemption notice period
Hedge fund – Fund of funds (a)	\$ 9,888	—	Three-year lock-up	95 days
Hedge fund – Fund of funds (b)	<u>10,032</u>	<u>—</u>	One-year lock-up	90 days
	\$ <u><u>19,920</u></u>	<u><u>—</u></u>		

	Fair value at September 30, 2016 (in thousands)	Unfunded commitment	Redemption frequency	Redemption notice period
Hedge fund – Fund of funds (a)	\$ 9,043	—	Three-year lock-up	95 days
Hedge fund – Fund of funds (b)	<u>8,968</u>	<u>—</u>	One-year lock-up	90 days
	\$ <u><u>18,011</u></u>	<u><u>—</u></u>		

- (a) This category includes investments in hedge funds that invest primarily in a diversified group of long/short equity investment funds. The underlying investment funds may invest in U.S. and non U.S. equity securities, debt securities, derivatives and other financial instruments, in both long and short positions. The hedge funds investments in investment funds are comprised of funds with various investment strategies.
- (b) This category includes investments in hedge funds that invest primarily all of its assets into the Master Feeder Fund. The Master Feeder Fund invests primarily through pooled investment vehicles, and assets to reduce volatility and enhance return by allocating primarily to fundamental long/short equity managers with a diversifying component in opportunistic managers.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The fair value hierarchy of investments at September 30, 2017 and 2016 follows (in thousands):

	2017		Total
	Level 1	Level 2	
Obligations of the U.S. government and its agencies	\$ —	138,797	138,797
Corporate debt securities:			
Corporate bonds:			
Financials	—	53,161	53,161
Industrials	—	50,389	50,389
Utilities	—	13,336	13,336
Other	—	14,056	14,056
Foreign bonds and notes	—	33,211	33,211
Corporate equity securities:			
Consumer discretionary	1,484	—	1,484
Financial services	764	—	764
Foreign equities	618	—	618
Health care	368	—	368
Industrials	1,974	—	1,974
Information technology	164	—	164
Materials and processing	102	—	102
Telecommunication services	617	—	617
Mutual funds:			
Large cap equity securities	30,492	—	30,492
Small and mid cap equity securities	7,347	—	7,347
Core value equity securities	9,470	—	9,470
International equity securities	26,287	—	26,287
Debt securities	135,692	—	135,692
Other	12,856	—	12,856
Interest in Mississippi Hospital Association pooled investments	—	1,185	1,185
Certificates of deposit	400	—	400
	<u>\$ 228,635</u>	<u>304,135</u>	532,770
Hedge funds at net asset value			<u>17,725</u>
			<u>\$ 550,495</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	2016		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Obligations of the U.S. government and its agencies	\$ —	136,740	136,740
Corporate debt securities:			
Corporate bonds:			
Financials	—	57,959	57,959
Industrials	—	61,225	61,225
Utilities	—	7,927	7,927
Other	—	15,102	15,102
Foreign bonds and notes	—	29,726	29,726
Corporate equity securities:			
Consumer discretionary	1,651	—	1,651
Consumer staples	95	—	95
Energy	33	—	33
Financial services	541	—	541
Foreign equities	298	—	298
Health care	418	—	418
Industrials	1,264	—	1,264
Information technology	317	—	317
Materials and processing	105	—	105
Telecommunication services	734	—	734
Mutual funds:			
Large cap equity securities	28,050	—	28,050
Small and mid cap equity securities	7,804	—	7,804
Core value equity securities	8,301	—	8,301
International equity securities	22,603	—	22,603
Debt securities	68,270	—	68,270
Other	17,541	—	17,541
Interest in Mississippi Hospital Association pooled investments	—	1,184	1,184
Certificates of deposit	400	—	400
	<u>\$ 158,425</u>	<u>309,863</u>	<u>468,288</u>
Hedge funds at net asset value			<u>15,977</u>
			<u>\$ 484,265</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

The fair value hierarchy of assets limited as to use at September 30, 2017 and 2016 follows (in thousands):

	2017		
	Level 1	Level 2	Total
Under indenture agreements – held by trustee:			
Obligations of the U.S. government and its agencies	\$ —	1,839	1,839
Under professional and general liability funding arrangement – held by trustee:			
Cash and cash equivalents	\$ 645	—	645
Obligations of the U.S. government and its agencies	—	4,745	4,745
Corporate debt securities:			
Corporate bonds:			
Financials	—	2,625	2,625
Industrials	—	3,170	3,170
Utilities	—	647	647
Other	—	1,504	1,504
Foreign bonds and notes	—	1,080	1,080
Mutual funds:			
Large cap equity securities	1,052	—	1,052
Small and mid cap equity securities	691	—	691
Core value equity securities	455	—	455
International equity securities	1,231	—	1,231
Debt securities	3,084	—	3,084
Other	1,165	—	1,165
Accrued interest receivable	910	—	910
	<u>\$ 9,233</u>	<u>13,771</u>	<u>23,004</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	2017		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
By Board for capital improvements:			
Cash and cash equivalents	\$ 1,160	—	1,160
Obligations of the U.S. government and its agencies	—	17,193	17,193
Corporate debt securities:			
Corporate bonds:			
Financials	—	6,585	6,585
Industrials	—	6,242	6,242
Utilities	—	1,652	1,652
Other	—	1,741	1,741
Foreign bonds and notes	—	4,114	4,114
Corporate equity securities:			
Consumer discretionary	184	—	184
Financial services	94	—	94
Foreign equities	76	—	76
Health care	46	—	46
Industrials	245	—	245
Information technology	20	—	20
Materials and processing	15	—	15
Telecommunication services	74	—	74
Mutual funds:			
Large cap equity securities	3,777	—	3,777
Small and mid cap equity securities	910	—	910
Core value equity securities	1,173	—	1,173
International equity securities	3,256	—	3,256
Debt securities	16,809	—	16,809
Other	1,593	—	1,593
Interest in Mississippi Hospital Association pooled investments	—	147	147
Accrued interest receivable	41	—	41
	<u>\$ 29,473</u>	<u>37,674</u>	<u>67,147</u>
Hedge funds at net asset value			<u>2,195</u>
			<u>\$ 69,342</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	2016		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Under indenture agreements – held by trustee:			
Obligations of the U.S. government and its agencies	\$ —	1,832	1,832
Under professional and general liability funding arrangement – held by trustee:			
Cash and cash equivalents	\$ 583	—	583
Obligations of the U.S. government and its agencies	—	7,244	7,244
Corporate debt securities:			
Corporate bonds:			
Financials	—	3,601	3,601
Industrials	—	2,200	2,200
Utilities	—	416	416
Other	—	486	486
Foreign bonds and notes	—	728	728
Mutual funds:			
Large cap equity securities	1,115	—	1,115
Small and mid cap equity securities	688	—	688
Core value equity securities	400	—	400
International equity securities	896	—	896
Debt securities	2,879	—	2,879
Other	1,344	—	1,344
Accrued interest receivable	827	—	827
	<u>\$ 8,732</u>	<u>14,675</u>	<u>23,407</u>

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

	2016		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
By Board for capital improvements:			
Cash and cash equivalents	\$ 4,307	—	4,307
Obligations of the U.S. government and its agencies	—	17,405	17,405
Corporate debt securities:			
Corporate bonds:			
Financials	—	7,377	7,377
Industrials	—	7,793	7,793
Utilities	—	1,009	1,009
Other	—	1,922	1,922
Foreign bonds and notes	—	3,784	3,784
Corporate equity securities:			
Consumer discretionary	210	—	210
Consumer staples	12	—	12
Energy	4	—	4
Financial services	69	—	69
Foreign equities	38	—	38
Health care	53	—	53
Industrials	161	—	161
Information technology	40	—	40
Materials and processing	13	—	13
Telecommunication services	93	—	93
Mutual funds:			
Large cap equity securities	3,570	—	3,570
Small and mid cap equity securities	993	—	993
Core value equity securities	1,057	—	1,057
International equity securities	2,877	—	2,877
Debt securities	8,690	—	8,690
Other	2,233	—	2,233
Interest in Mississippi Hospital Association pooled investments	—	151	151
Accrued interest receivable	42	—	42
	<u>\$ 24,462</u>	<u>39,441</u>	<u>63,903</u>
Hedge funds at net asset value			<u>2,034</u>
			<u>\$ 65,937</u>

There were no significant transfers into or out of Level 1 and Level 2 during fiscal 2017 and 2016.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

September 30, 2017 and 2016

(20) Acquisition

On August 5, 2016, NMJV purchased a 66.19% membership interest in TIC, for a purchase price of approximately \$1,163,000. Accordingly, the assets and liabilities of TIC are included in the System's 2017 and 2016 consolidated balance sheets and the results of operations of TIC since August 5, 2016 have been included in the fiscal 2017 and 2016 consolidated statements of operations.

The following summarizes the allocation of the assets acquired and liabilities assumed on August 5, 2016, as well as the fair value of the noncontrolling interest acquired.

Cash	\$	167,920
Prepaid expenses		58,163
Property, plant and equipment, net		691,772
Other assets		951,485
Accounts payable		(75,800)
Accrued expenses		(83,540)
Noncontrolling interest		<u>(547,100)</u>
Total purchase price		1,162,900
Less cash acquired		<u>(167,920)</u>
Cash paid in acquisition	\$	<u><u>994,980</u></u>

(21) Subsequent Events

The System has evaluated subsequent events from the balance sheet date through January 19, 2018, the date the consolidated financial statements were issued, and determined there are no additional subsequent events to be recognized in the consolidated financial statements and related notes.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidating Schedule – Balance Sheet Information

September 30, 2017

(with comparative 2016 consolidated information)

(In thousands)

	North Mississippi Health Services, Inc.	North Mississippi Medical Center, Inc.	North Mississippi Medical Clinics, Inc. and subsidiaries	Tupelo Service Finance, Inc.	Clay County Medical Corporation	Webster Health Services, Inc.	Marion Regional Medical Center, Inc.	Tishomingo Health Services, Inc.	North Mississippi Joint Ventures, LLC and subsidiaries
Assets									
Current assets:									
Cash and cash equivalents	\$ 3,554	21,857	1,179	3	389	581	1,469	230	4,972
Investments	—	550,095	—	—	—	—	—	—	—
Net patient accounts receivable	—	102,606	7,065	41,331	5,478	2,536	2,626	1,836	5,476
Other current assets	550	26,283	851	—	1,003	463	304	349	1,335
Total current assets	4,104	700,841	9,095	41,334	6,870	3,580	4,399	2,415	11,783
Assets limited as to use	23,004	71,174	—	—	—	—	—	—	—
Property and equipment, net	1,112	211,645	18,801	—	10,276	5,315	5,131	5,994	5,331
Other assets	26,382	46,329	4,439	—	1,055	920	1,305	166	961
Total assets	\$ 54,602	1,029,989	32,335	41,334	18,201	9,815	10,835	8,575	18,075
Liabilities and Net Assets (Deficit)									
Current liabilities:									
Accounts payable	\$ 1,283	30,409	1,779	71	1,014	645	1,287	491	1,363
Accrued expenses and other current liabilities	10,219	40,143	9,272	14,459	5,753	3,599	19,289	11,053	1,173
Current installments of long-term debt	—	71,071	—	—	3,202	6,590	—	—	473
Total current liabilities	11,502	141,623	11,051	14,530	9,969	10,834	20,576	11,544	3,009
Estimated professional and general liability costs	18,824	—	—	—	—	—	—	—	—
Long-term debt, excluding current installments	—	71,067	—	—	—	—	—	—	765
Fair value of interest rate swaps	—	5,663	—	—	—	—	—	—	—
Accrued pension cost	13,117	83,455	—	500	6,382	2,498	3,657	3,059	—
Other long-term liability	—	2,239	—	—	—	—	—	—	—
Deferred collection fee revenue	—	—	—	2,824	—	—	—	—	—
Total liabilities	43,443	304,047	11,051	17,854	16,351	13,332	24,233	14,603	3,774
Common stock	—	—	—	1	—	—	—	—	—
Additional paid-in capital	—	—	—	—	—	—	—	—	—
Net assets (deficit):									
Unrestricted	11,157	723,505	21,094	23,479	1,770	(3,603)	(13,480)	(6,072)	10,350
Temporarily restricted	2	2,437	190	—	80	65	82	44	—
Permanently restricted	—	—	—	—	—	21	—	—	—
Total net assets (deficit) attributable to North Mississippi Health Services, Inc.	11,159	725,942	21,284	23,480	1,850	(3,517)	(13,398)	(6,028)	10,350
Noncontrolling interests	—	—	—	—	—	—	—	—	3,951
Total net assets (deficit)	11,159	725,942	21,284	23,480	1,850	(3,517)	(13,398)	(6,028)	14,301
Commitments and contingencies									
Total liabilities and net assets (deficit)	\$ 54,602	1,029,989	32,335	41,334	18,201	9,815	10,835	8,575	18,075

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidating Schedule – Balance Sheet Information

September 30, 2017

(with comparative 2016 consolidated information)

(In thousands)

Assets	Pontotoc Health Services, Inc.	Acclaim, Inc.	North Mississippi Enterprises, Inc.	North Mississippi Emergency Services, Inc.	Connected Care, LLC	North Mississippi Grand Ambulance	Eliminations	Total	
								2017	2016
Current assets:									
Cash and cash equivalents	\$ 1,026	379	337	186	—	504	—	36,666	56,874
Investments	—	400	—	—	—	—	—	550,495	484,265
Net patient accounts receivable	3,300	—	1,112	530	—	1,895	(14,274)	161,517	199,791
Other current assets	303	163	—	109	—	58	—	31,771	30,087
Total current assets	4,629	942	1,449	825	—	2,457	(14,274)	780,449	771,017
Assets limited as to use	—	—	—	—	—	—	—	94,178	91,170
Property and equipment, net	2,758	11	—	31	—	1,411	—	267,816	289,476
Other assets	675	—	—	—	—	—	(35,471)	46,761	51,024
Total assets	\$ 8,062	953	1,449	856	—	3,868	(49,745)	1,189,204	1,202,687
Liabilities and Net Assets (Deficit)									
Current liabilities:									
Accounts payable	\$ 586	13	—	375	4	371	—	39,691	37,190
Accrued expenses and other current liabilities	2,111	540	719	388	92	3,358	(46,909)	75,259	71,566
Current installments of long-term debt	—	—	—	—	—	—	—	81,336	85,172
Total current liabilities	2,697	553	719	763	96	3,729	(46,909)	196,286	193,928
Estimated professional and general liability costs	—	—	—	—	—	—	—	18,824	29,955
Long-term debt, excluding current installments	—	—	—	—	—	—	—	71,832	72,119
Fair value of interest rate swaps	—	—	—	—	—	—	—	5,663	7,658
Accrued pension cost	3,029	—	—	—	—	1,167	—	116,864	143,366
Other long-term liability	—	—	—	—	—	—	—	2,239	4,367
Deferred collection fee revenue	—	—	—	—	—	—	(2,824)	—	—
Total liabilities	5,726	553	719	763	96	4,896	(49,733)	411,708	451,393
Common stock	—	1	10	—	—	—	(12)	—	—
Additional paid-in capital	—	—	—	—	—	—	—	—	—
Net assets (deficit):									
Unrestricted	2,220	399	720	93	(96)	(1,028)	—	770,508	743,990
Temporarily restricted	116	—	—	—	—	—	—	3,016	2,820
Permanently restricted	—	—	—	—	—	—	—	21	20
Total net assets (deficit) attributable to North Mississippi Health Services, Inc.	2,336	400	730	93	(96)	(1,028)	(12)	773,545	746,830
Noncontrolling interests	—	—	—	—	—	—	—	3,951	4,464
Total net assets (deficit)	2,336	400	730	93	(96)	(1,028)	(12)	777,496	751,294
Commitments and contingencies									
Total liabilities and net assets (deficit)	\$ 8,062	953	1,449	856	—	3,868	(49,745)	1,189,204	1,202,687

See accompanying independent auditors' report.

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES

Consolidating Schedule – Revenues and Expenses Information

September 30, 2017

(with comparative 2016 consolidated information)

(In thousands)

	North Mississippi Health Services, Inc.	North Mississippi Medical Center, Inc.	North Mississippi Medical Clinics, Inc. and subsidiaries	Tupelo Service Finance, Inc.	Clay County Medical Corporation	Webster Health Services, Inc.	Marion Regional Medical Center, Inc.	Tishomingo Health Services, Inc.	North Mississippi Joint Ventures, LLC and subsidiaries
Unrestricted revenues and other support:									
Net patient service revenue	\$ —	792,460	54,319	—	38,351	24,070	23,015	15,795	33,770
Provision for uncollectible accounts	—	(117,969)	(3,313)	—	(7,414)	(4,292)	(4,511)	(4,334)	(2,708)
Net patient service revenue less provision for uncollectible accounts	—	674,491	51,006	—	30,937	19,778	18,504	11,461	31,062
Other revenue	332	15,011	7,872	2,809	327	701	76	522	8
Management fees from affiliates	31,319	—	—	—	—	—	—	—	—
Total unrestricted revenues and other support	31,651	689,502	58,878	2,809	31,264	20,479	18,580	11,983	31,070
Expenses:									
Salaries and wages	14,227	266,516	43,229	601	13,362	11,853	9,742	6,487	—
Employee benefits	6,220	84,705	11,065	420	4,709	3,468	3,272	2,611	—
Supplies	3	96,028	1,691	—	1,876	959	977	580	6,483
Drugs	—	65,415	3,993	—	3,709	1,133	428	1,047	—
Professional services	23	18,938	—	—	2,031	816	1,009	900	4,262
Purchased services	1,279	28,049	6,856	—	1,853	2,307	1,916	1,325	6,892
Administrative and general	6,269	89,901	5,382	680	2,832	2,262	2,690	1,449	2,870
Rent	431	2,592	656	64	319	142	26	32	1,467
Interest	—	4,854	—	—	18	50	—	—	79
Depreciation and amortization	158	40,618	1,927	—	1,449	1,469	1,252	986	1,205
Total expenses	28,610	697,616	74,799	1,765	32,158	24,459	21,312	15,417	23,258
Income (loss) from operations	3,041	(8,114)	(15,921)	1,044	(894)	(3,980)	(2,732)	(3,434)	7,812
Nonoperating gains (losses), net	123	27,316	753	—	261	14	50	7	47
Loss on extinguishment of debt	—	(376)	—	—	—	—	—	—	—
Revenues, gains, and other support in excess of (less than) expenses and losses, before noncontrolling interests	3,164	18,826	(15,168)	1,044	(633)	(3,966)	(2,682)	(3,427)	7,859
Noncontrolling interests	—	—	—	—	—	—	—	—	(4,067)
Revenues, gains, and other support in excess of (less than) expenses and losses	\$ 3,164	18,826	(15,168)	1,044	(633)	(3,966)	(2,682)	(3,427)	3,792

NORTH MISSISSIPPI HEALTH SERVICES, INC. AND SUBSIDIARIES
 Consolidating Schedule – Revenues and Expenses Information
 September 30, 2017
 (with comparative 2016 consolidated information)
 (In thousands)

	Pontotoc Health Services, Inc.	Acclaim, Inc.	North Mississippi Enterprises, Inc.	North Mississippi Emergency Services, Inc.	Connected Care, LLC	North Mississippi Grand Ambulance	Eliminations	Total	
								2017	2016
Unrestricted revenues and other support:									
Net patient service revenue	\$ 28,544	—	—	4,638	—	16,536	—	1,031,498	998,991
Provision for uncollectible accounts	(5,467)	—	—	(2,690)	—	(6,080)	—	(158,778)	(136,531)
Net patient service revenue less provision for uncollectible accounts	23,077	—	—	1,948	—	10,456	—	872,720	862,460
Other revenue	391	2,884	10,845	588	—	50	(16,317)	26,099	30,559
Management fees from affiliates	—	—	—	—	—	—	(31,319)	—	—
Total unrestricted revenues and other support	23,468	2,884	10,845	2,536	—	10,506	(47,636)	898,819	893,019
Expenses:									
Salaries and wages	11,543	—	53	1,141	1	5,624	320	384,699	352,200
Employee benefits	3,320	—	16	—	—	2,209	(1,202)	120,813	131,417
Supplies	778	—	—	1,994	—	215	—	111,584	98,330
Drugs	757	—	—	—	—	34	—	76,546	75,700
Professional services	1,678	—	—	—	32	—	(6,093)	23,596	24,230
Purchased services	1,602	652	10,558	—	—	509	(6,802)	56,996	51,477
Administrative and general	2,366	1,990	162	—	62	1,209	(33,859)	86,265	91,484
Rent	289	—	—	—	—	70	(2,141)	3,947	3,495
Interest	—	—	—	—	—	—	—	5,001	4,675
Depreciation and amortization	1,008	2	—	4	—	485	—	50,563	49,914
Total expenses	23,371	2,644	10,789	3,139	95	10,355	(49,777)	920,010	882,922
Income (loss) from operations	97	240	56	(603)	(95)	151	2,141	(21,191)	10,097
Nonoperating gains (losses), net	15	—	4	—	—	—	(2,142)	26,448	25,602
Loss on extinguishment of debt	—	—	—	—	—	—	—	(376)	—
Revenues, gains, and other support in excess of (less than) expenses and losses, before noncontrolling interests	112	240	60	(603)	(95)	151	(1)	4,881	35,699
Noncontrolling interests	—	—	—	—	—	—	—	(4,067)	(5,165)
Revenues, gains, and other support in excess of (less than) expenses and losses	\$ 112	240	60	(603)	(95)	151	(1)	814	30,534

See accompanying independent auditors' report.