

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

Orlando Health, Inc. and Controlled Affiliates
Years Ended September 30, 2019 and 2018
With Report of Independent Auditors

Ernst & Young LLP



Orlando Health, Inc. and Controlled Affiliates
Consolidated Financial Statements and Supplementary Information
Years Ended September 30, 2019 and 2018

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Report of Independent Auditors

The Board of Directors
Orlando Health, Inc. and Controlled Affiliates

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Orlando Health, Inc. and Controlled Affiliates (the System), which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Lakeland Regional Health Systems, Inc., a wholly-owned subsidiary for the period from October 1, 2017 to September 30, 2018, which statements reflect total unrestricted revenues and other support constituting 20% in 2018 of the related consolidated total. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Lakeland Regional Health Systems, Inc., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The financial statements of Lakeland Regional Health Systems, Inc. were not audited in accordance with *Government Auditing Standards*.

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

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

Opinion

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Orlando Health, Inc. and Controlled Affiliates as of September 30, 2019 and 2018, and the consolidated changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Change in Method of Accounting for Revenue

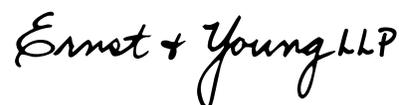
As discussed in Note 3 to the consolidated financial statements, the System changed its method for accounting for revenue effective October 1, 2018. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The System's consolidating balance sheet as of September 30, 2019, and the related consolidating statement of operations for the year then ended; Orlando Health Central, Inc.'s consolidating balance sheet as of September 30, 2019, and the related consolidating statement of operations for the year then ended; South Lake Hospital, Inc.'s balance sheet as of September 30, 2019, and the related statement of operations for the year then ended are 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated December 18, 2019 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.



December 18, 2019

Orlando Health, Inc. and Controlled Affiliates

Consolidated Balance Sheets (In Thousands)

	September 30	
	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 584,483	\$ 563,428
Assets limited as to use	49,581	34,062
Accounts receivable, less allowances for uncollectible accounts of \$248,797 in 2018	382,565	350,082
Other receivables	71,370	64,415
Inventory	64,045	55,135
Other current assets	40,364	41,872
Total current assets	1,192,408	1,108,994
Assets limited as to use:		
Debt service and reserve funds held by bond trustee	47,137	19,227
Construction funds held by bond trustee	89,999	–
Interest rate swap contract collateral	22,223	4,595
Designated by board for property and equipment	24,134	–
Malpractice self-insurance	16,119	13,304
	199,612	37,126
Less amount required to meet current obligations	(49,581)	(34,062)
	150,031	3,064
Long-term investments – without donor restrictions	1,891,200	1,635,560
Long-term investments – with donor restrictions	121,607	117,932
Investments in related parties	33,899	32,659
Other assets	244,828	237,686
Property and equipment, net	1,919,856	1,465,550
Total assets	\$ 5,553,829	\$ 4,601,445
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 397,375	\$ 291,121
Other current liabilities	182,498	174,469
Current portion of long-term debt	25,817	22,152
Total current liabilities	605,690	487,742
Long-term debt, less current portion	1,478,589	1,300,671
Accrued malpractice claims	122,868	109,728
Other noncurrent liabilities	151,957	108,439
Total liabilities	2,359,104	2,006,580
Net assets		
Net assets without donor restrictions:		
Orlando Health, Inc. and Controlled Affiliates	3,067,821	2,469,235
Noncontrolling interests in Controlled Affiliates	(890)	(440)
Total net assets without donor restrictions	3,066,931	2,468,795
Net assets with donor restrictions	127,794	126,070
Total net assets	3,194,725	2,594,865
Total liabilities and net assets	\$ 5,553,829	\$ 4,601,445

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

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

	Year Ended September 30	
	2019	2018
Revenues and other support without donor restrictions		
Net patient service revenue (net of contractual allowances and discounts)		\$ 4,054,219
Provision for bad debts		(421,614)
Net patient service revenue	\$ 3,197,660	3,632,605
Other revenue	219,552	174,483
Net assets released from donor restrictions	6,281	5,872
Total revenues and other support without donor restrictions	3,423,493	3,812,960
Expenses		
Salaries and benefits	1,698,491	1,945,932
Supplies and other	1,138,919	1,236,391
Professional fees	35,067	44,682
Depreciation and amortization	163,352	196,298
Interest	52,753	59,694
Total expenses	3,088,582	3,482,997
Income from operations	334,911	329,963
Nonoperating gains and (losses)		
Investment income	86,834	71,956
Change in fair value of interest rate swap agreements	(18,077)	10,179
Inherent contribution associated with business combination	181,885	526,815
Inherent distribution from deconsolidation of business combination	–	(548,685)
Nonoperating gain	2,130	2,976
Loss on early extinguishment of debt	(5,045)	(4,707)
Nonoperating gains, net	247,727	58,534
Excess of revenues, other support, and gains over expenses and losses	582,638	388,497
Deficit of revenues, other support, and gains over expenses and losses attributed to noncontrolling interests in Controlled Affiliates	450	816
Excess of revenues, other support, and gains over expenses and losses attributed to Orlando Health, Inc. and Controlled Affiliates	583,088	389,313

Continued on next page

Orlando Health, Inc. and Controlled Affiliates

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

	Year Ended September 30	
	2019	2018
Net assets without donor restrictions:		
Excess of revenues, other support, and gains over expenses and losses	\$ 582,638	\$ 388,497
Other changes in unrestricted net assets:		
Net assets released from restrictions for property and equipment	15,594	60,673
Other	(96)	1,758
Increase in net assets without donor restrictions	<u>598,136</u>	<u>450,928</u>
Net assets with donor restrictions:		
Contributions	21,412	20,887
Net assets released from restrictions	(21,875)	(66,545)
Inherent contribution associated with business combination	1,609	31,884
Inherent distribution from deconsolidation of business combination	—	(37,267)
Net realized and unrealized gains on investments	725	1,700
Other	(147)	(94)
Increase (decrease) in net assets with donor restrictions	<u>1,724</u>	<u>(49,435)</u>
Increase in net assets	599,860	401,493
Net assets at beginning of year	2,594,865	2,193,372
Net assets at end of year	<u>\$ 3,194,725</u>	<u>\$ 2,594,865</u>

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended September 30	
	2019	2018
Operating activities		
Increase in net assets	\$ 599,860	\$ 401,493
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	163,352	196,298
Change in fair value of interest rate swap agreements	18,077	(10,179)
Net realized, unrealized, and investment income gains	(86,834)	(69,914)
Loss on early extinguishment of debt	5,045	4,707
Loss on sale of assets	–	1,977
Inherent contribution associated with business combination	(183,494)	(558,699)
Inherent distribution from deconsolidation of business combination	–	585,952
Restricted contributions and investment income	(22,137)	(22,587)
Changes in operating assets and liabilities:		
Accounts receivable, net	(2,073)	(65,549)
Other operating assets	(16,704)	(12,319)
Accounts payable and accrued expenses	25,910	43,725
Other operating liabilities	79	71,009
Net cash provided by operating activities	501,081	565,914
Investing activities		
Purchases of property, equipment, and other noncurrent assets	(336,491)	(442,671)
Net cash (paid) acquired from business combinations	(40,273)	24,370
Cash disposed of in deconsolidation	–	(24,042)
Increase in assets limited as to use	(135,532)	(44,253)
Purchase of trading securities, net of sales	(130,734)	(240,374)
Other investing activities	16,540	(7,311)
Net cash used in investing activities	(626,490)	(734,281)
Financing activities		
Proceeds from issuance of long-term debt	362,566	475,000
Refunding and repayments of long-term debt	(260,745)	(161,093)
Proceeds from debt service reserve fund liquidation	6,887	14,509
Bond proceeds used for loan costs	(1,514)	(2,090)
Grant proceeds received for long-term purposes	17,133	24,037
Restricted contributions and investment income	22,137	22,587
Net cash provided by financing activities	146,464	372,950
Increase in cash and cash equivalents	21,055	204,583
Cash and cash equivalents at beginning of year	563,428	358,845
Cash and cash equivalents at end of year	\$ 584,483	\$ 563,428
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	\$ 56,300	\$ 69,588
Purchases of property and equipment accrued and not paid	83,979	20,116
	\$ 140,279	\$ 89,704

See accompanying notes.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements

September 30, 2019

1. Organization

Orlando Health, Inc. (Orlando Health or the System) and Orlando Health Central, Inc. (Health Central) comprise the Obligated Group. Orlando Health is a tax-exempt organization pursuant to Section 501(c)(3) of the Internal Revenue Code, which controls a diversified health care delivery system headquartered in Orlando, Florida. Orlando Health includes the following hospitals operating in Central Florida: Orlando Regional Medical Center (ORMC), Dr. P. Phillips Hospital, Arnold Palmer Hospital for Children (APH), Winnie Palmer Hospital for Women and Babies (WPH), South Seminole Hospital, and Orlando Health Central Hospital. Health Central includes a hospital and Health Central Park, a skilled nursing facility. Orlando Health also has a home health services division and eight medical residency programs.

Controlled Affiliates are those entities Orlando Health controls as the sole or majority member, sole shareholder, or through board appointment and approval of all major transactions. Controlled Affiliates operate a variety of health care-related services, including physician practice groups (Orlando Health Physician Group, Inc., Orlando Physician Network, Inc., Orlando Cancer Center, Inc., Physician Associates, LLC (PAL), ORHI, LLC (ORHI), which operates five imaging centers, a fund-raising organization (Orlando Health Foundation, Inc.), South Lake Hospital, Inc., and other health care-related services. Healthnet Services, Inc. and its subsidiaries are taxable corporations and are a part of the Controlled Affiliates. The Obligated Group, together with its Controlled Affiliates, is collectively referred to herein as the "System." These consolidated financial statements include the consolidated accounts of Orlando Health, Orlando Health Central, and their Controlled Affiliates. Significant transactions between entities have been eliminated.

Effective July 1, 2019, Orlando Health, South Lake Hospital, Inc. (South Lake), South Lake Memorial Hospital, Inc. and Live Well Foundation of South Lake, Inc. completed a transaction whereby Orlando Health became the sole member of South Lake and South Lake is now included as a controlled affiliate. The System recorded the South Lake assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$183.5 million. Prior to July 1, 2019, Orlando Health held 50% of the seats of the Board of Directors for South Lake. As Orlando Health did not hold a controlling interest in South Lake, it is excluded from these consolidated financial statements prior to July 1, 2019.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

1. Organization (continued)

Effective October 1, 2017, the System completed a transaction with Lakeland Regional Health Systems, Inc. (LRHS) to create an integrated regional health care system. The System obtained control through a member substitution arrangement whereby the System became the sole corporate member of LRHS without the transfer of consideration. LRHS is a private not-for-profit health system located in Lakeland, Florida. During 2018, the System recorded the LRHS assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$558.7 million. Effective September 30, 2018, the System and LRHS agreed to terminate their relationship and LRHS provided financial and strategic concessions to terminate the relationship. Upon termination of the relationship, the System deconsolidated the LRHS assets acquired and liabilities assumed at their net book values and recognized an inherent distribution from deconsolidation of business combination of approximately \$586 million.

The System owns a 20% interest in OsceolaSC, LLC (OsceolaSC), a for-profit limited liability corporation. The remaining 80% is owned by Central Florida HMA Holdings, LLC, a subsidiary of Community Health Systems, Inc., a publicly held company. OsceolaSC owns and operates St. Cloud Regional Medical Center, an 84-bed hospital in Osceola County. The System's 20% interest in OsceolaSC is accounted for using the equity method with the accounts of OsceolaSC excluded from these consolidated financial statements.

2. Significant Accounting Policies

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The FASB codified ASU 2014-09 in the FASB Accounting Standards Codification (ASC) as Topic 606 (ASC 606). The standard is a single, comprehensive revenue recognition model that requires revenue to be recognized in a manner depicting the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. On October 1, 2018, the System adopted the new revenue recognition standard using a modified retrospective method or application to all contracts existing on October 1, 2018. The adoption of ASC 606 resulted in changes to the presentation for revenue related to uninsured or underinsured patients. Prior to the adoption of ASC 606, a significant portion of the System's provision for bad debts related to self-pay patients, as well as co-pay and deductibles owed by patients with insurance. Under ASC 606, the estimated uncollectable amounts due from these patients are

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

generally considered implicit price concessions that are a direct reduction to net patient service revenue, rather than as a provision for bad debts. For the year ended September 30, 2019, the System recorded approximately \$429.1 million of implicit price concessions as a direct reduction of net patient service revenue that would have been recorded as a provision for bad debts prior to adoption of ASC 606. Other than these changes in presentation, the adoption of ASC 606 did not have a material impact on the consolidated balance sheet or statement of operations and changes in net assets as of and for the year ended September 30, 2019. Expanded disclosures required by ASC 606 are included within Note 3.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, as an update to ASC Topic 958, *Not-for-Profit Entities*. This update makes several changes to current reporting requirements that address complexities in the use of the currently required three classes of net assets and enhance required disclosures related to donor restrictions of net assets. The System adopted the guidance in ASU 2016-14 on September 30, 2019, using a retrospective approach. As a result of adoption, the System has reported two classes of net assets (net assets without donor restrictions and net assets with donor restrictions) within the September 30, 2019 and 2018, consolidated financial statements, and has also added additional liquidity and functional expense disclosures.

In May 2019, the FASB issued ASU 2019-06, *Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. This update simplifies the accounting for goodwill and certain identifiable intangible assets in a business combination. The System adopted the guidance in ASU 2019-06 on October 1, 2018, using a prospective approach. Adoption of ASU 2019-06 permits the amortization of goodwill on a straight-line basis of 10 years, or less than 10 years if the entity demonstrates a shorter useful life is more appropriate. ASU 2019-06 also permits the option to perform a test for impairment at the entity level or at the reporting unit level (accounting policy election) as well as to perform such a test only when there is a triggering event indicating that the fair value of the entity may be below its carrying amount. The System elected an amortization period of 10 years and also elected to perform its impairment test at the entity level when triggering events are present. See the goodwill and other intangible assets disclosure for further information on the impact on the System's consolidated financial statements.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. This update requires entities to classify gains and losses from certain equity investments within its performance indicator. As the System accounts for its equity investments as trading securities, this change does not have an impact on the recognition of income related to the System's equity investments. ASU 2016-01 contains an additional provision that eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for non-public business entities. The amendments of this ASU are applicable for fiscal years beginning after December 15, 2018, however, early adoption is permitted for the provision relating to the elimination of the requirement to disclose the fair value of financial instruments measured at amortized cost. As such, management has elected to early adopt this provision and will no longer disclose the fair value of debt within its financial statements.

In February 2017, the FASB issued ASU 2017-05, *Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. The amendments in ASU 2017-05 address the recognition of gains and losses on the transfer (sale) of nonfinancial assets to counterparties other than customers. ASU 2017-05 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Adoption of ASU 2017-05 did not materially impact the System's consolidated financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. The amendments in ASU 2018-08 clarify accounting guidance for contributions received and contributions made. The amendments will assist entities in: (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions), or as exchange (reciprocal) transactions, and (2) determining whether a contribution is conditional. For contributions received, ASU 2018-08 is effective for annual periods beginning after June 15, 2018, and interim periods within those annual periods. For contributions made, ASU 2018-08 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. Adoption of ASU 2018-08 did not materially impact the System's consolidated financial statements.

Pending Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-02, *Leases (ASU 2016-02)*. ASU 2016-02 aims to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information. ASU 2016-02 is effective for

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

annual reporting periods beginning after December 15, 2018, including interim periods within those years, for not-for-profit entities that have issued, or are conduit debt obligors for, securities that are traded, listed, or quoted on an exchange over an over-the-counter market. Early adoption is permitted. ASU 2016-02 requires the application using either a full retrospective approach to each prior reporting period presented in the financial statements or a modified retrospective approach at the beginning of the period of adoption.

The System will adopt ASU 2016-02 using a modified retrospective approach at the beginning of the period of adoption and, accordingly, prior period presentation will not be adjusted. The System expects to elect the package of practical expedients offered in the transition guidance which allows management to not reassess lease identification, lease classification and initial direct costs. The System also expects to elect the accounting policy practical expedients by class of underlying asset to: (i) combine associated lease and non-lease components into a single lease component; and (ii) exclude recording short-term leases as right-of-use assets and liabilities on the balance sheet.

The System has substantially completed its evaluation of the financial impact of the new standard as it relates to the System's lease portfolio, which primarily consists of real estate leases integral for facility operations. Management believes the effect of adopting the new standard will be to record material right-of-use assets and liabilities for current operating leases. Management continues to evaluate the impact ASU 2016-02 will have on the System's internal controls, policies and procedures. See Note 11 for the Company's aggregate minimum lease payments under non-cancelable operating leases under accounting guidance at September 30, 2019. The System is continuing to refine its approach under ASU 2016-02, including finalizing its transition calculations, controls and disclosure policies. The System will continue to monitor industry activities and any additional accounting guidance.

In June 2016, the FASB issued ASU 2016-13, *Financial instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The new standard requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected and separately measure an allowance for credit losses that is deducted from the amortized cost basis of the financial assets. ASU 2016-13 is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. The System is evaluating the impact that the adoption of this update will have on its consolidated financial statements.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. Current U.S. GAAP either is unclear or does not include specific guidance on eight cash flow classification issues. The amendments in ASU 2016-15 provide guidance for these eight issues, reducing the current and potential future diversity in practice. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The System is evaluating the impact that the adoption of this update will have on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. Current U.S. GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. The amendments in ASU 2016-16 require recognition of the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the test for goodwill impairment*, as an update to ASC 350, *Intangibles - Goodwill and Other*. This update eliminates step 2 of the goodwill impairment test, which required an entity to determine the fair value of individual assets and liabilities of the reporting unit. Under this updated guidance, the impairment amount will be determined using the step 1 comparison of fair value to carrying value. The updated guidance will be effective for the annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 2017. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in ASU 2018-13 modify the disclosure requirements on fair value measurements in Topic 820, *Fair Value Measurement*. ASU 2018-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. The System is evaluating the impact that the adoption of this ASU will have on its consolidated financial statements.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Use of Estimates

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

Cash and Cash Equivalents

Investments with maturities of three months or less when purchased are classified as cash equivalents. Cash deposits are federally insured in limited amounts.

Investments and Investment Income

Investments in marketable equity securities and all debt securities are stated at fair value in the consolidated balance sheets. All investments have been designated by management as trading securities. Investment income or loss, including realized and unrealized gains and losses, interest, and dividends, is included in excess of revenues, other support, and gains over expenses and losses, unless the income or loss is restricted by donor or law. The System classifies unrestricted investments, regardless of maturity date, as either short-term or long-term based on management's intent and ability to hold or reinvest the investments on a long-term basis.

Investments Without Readily Determinable Values

Investments without readily determinable values consist of funds-of-funds, investments in private equity companies, partnerships, and limited liability companies and are included with investments at fair value. Under U.S. GAAP, a reporting entity is permitted, as a practical expedient, to estimate the fair value of such an investment using the net asset value per share (or its equivalent, such as member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) of certain investments, if the net asset value per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of investment funds. At September 30, 2019 and 2018, the net asset value approximates the fair value of the funds as reported by the investment fund managers. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market of these investments existed, and the differences could be material.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Income Taxes

Orlando Health, Inc. and its non-profit affiliates are exempt from federal income taxes under Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and are also exempt from state income taxes. Healthnet Services, Inc. and its subsidiaries (owned by Orlando Health, Inc.) are taxable corporations and file a consolidated federal and state tax return. Income taxes for the System, on a consolidated basis, are immaterial.

At September 30, 2019 and 2018, the System has net deferred tax assets (before valuation allowance) of approximately \$28.5 million and \$27.1 million, respectively. Deferred tax assets are primarily composed of federal and state net operating loss carryforwards. At September 30, 2019 and 2018, the System has \$136.0 million and \$117.3 million, respectively, of federal net operating loss carryforwards and \$136.0 million and \$117.3 million, respectively, of state net operating carryforwards. The 2018 and prior portion of these net operating losses will expire starting in 2020. Under the Tax Cuts and Jobs Act of 2017 (Tax Act), net operating losses generated in 2019 and beyond can be carried forward indefinitely. A valuation allowance has been provided to offset the full amount of the System's net deferred tax asset as of September 30, 2019 and 2018, as management determined that it is more likely than not that the benefit of the deferred tax assets will not be realized in future periods.

FASB ASC Topic 740, *Income Taxes*, prescribes the accounting for uncertainty in income tax positions recognized in the financial statements. ASC Topic 740 provides guidance and measurement of a tax position taken or expected to be taken in a tax return. There were no material uncertain tax positions as of September 30, 2019 and 2018.

On December 22, 2017, the Tax Act was signed into law making significant changes to the Internal Revenue Code. From a tax-exempt perspective, the Act imposes an excise tax on compensation paid in excess of \$1.0 million to certain executives, subjects certain fringe benefits to taxation as unrelated business income, requires organizations to separately compute Unrelated Business Income (UBI) for each trade or business, and repeals the exempt status of advance refunding bond issuances. From a for-profit perspective, the Act reduces the federal statutory rate reduction from 34% to 21%. With the filing of the System's 2017 (FY18) tax returns during 2019, there were no material adjustments. Accordingly, the System's accounting for the Tax Cuts and Jobs Act ("the Act") is now complete.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture agreement, assets whose use is limited due to statutory requirements of the state of Florida for future malpractice claims, assets whose use is limited by board for property and equipment and collateral held for an interest rate swap agreement. Amounts required to meet related current liabilities are reported as current.

Restricted Investments

Restricted investments consist of investments held by the Orlando Health Foundation that are restricted as to use by donors for a specific time period or purpose.

Inventory

Inventory which consists primarily of medical and drug supplies, is stated at the lower of cost or market value. Cost is determined using the first-in, first-out method.

Property and Equipment

Property and equipment are recorded at cost, except for donated items, which are recorded at fair value at the date of the contribution. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized, as are interest costs during periods of construction. Depreciation is computed utilizing the straight-line method at rates estimated by management to amortize the cost of the various assets within the periods of expected use.

Goodwill and Other Intangible Assets

Goodwill results from the excess of the purchase price over the fair value of net assets of investments accounted for under the equity method and acquisitions accounted for as business combinations. The gross carrying amount of goodwill is \$76.6 million at September 30, 2019 and 2018, the accumulated amortization is \$7.6 million and \$0 as of September 30, 2019 and 2018, respectively, and the total amortization expense for 2019 and 2018 is \$7.6 million and \$0, respectively. The net goodwill balance is included in other assets on the consolidated balance sheets. Prior to the adoption of ASU 2019-06, the System prepared its annual impairment analysis as of March 31 of each fiscal year. Subsequent to the adoption of ASU 2019-06, an impairment

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

test is only required when there is a triggering event indicating that the fair value of the entity may be below its carrying amount. The impairment test results in 2018 did not identify any impairment, and the analysis performed in 2019 did not identify a triggering event indicating that the fair value of the entity was below its carrying amount.

Investments in Related Parties

Investments in related parties in which the System owns or controls at least a 20% interest and less than a 50% voting interest are recorded using the equity method. Investments in related parties of less than a 20% interest are recorded using the cost method, and income is recognized only when cash dividends are received. Income or losses from equity investments and cash dividends received from cost method investments are included in other revenue.

Impairment of Long-Lived Assets

If indicators of impairment are present, the System evaluates the financial recoverability of long-lived assets by comparing their carrying value to the expected future undiscounted cash flows. If such evaluations indicate that the carrying value of the assets has been impaired, the assets are adjusted to their fair values. Additionally, long-lived assets held for sale are similarly evaluated by comparison of the carrying value to fair value less costs to sell. If the carrying value exceeds fair value less costs to sell, the assets are adjusted to fair value less costs to sell. Adjustments are reported as impairment expense. There was no impairment of long-lived assets in the years ended September 30, 2019 and 2018.

Unrestricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value as of the date the promise is received. Unrestricted gifts are recognized in other revenue.

Net Assets with Donor Restrictions

Net assets with donor restrictions reflect the portion of the System's net assets whose use is subject to donor-imposed restrictions. Donor imposed restrictions may be temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the assets have been restricted by donors to be maintained by the System in perpetuity.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or the condition has been met. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions.

Estimated Malpractice Costs

The provision for estimated medical malpractice expense is an estimate of the ultimate cost of reported claims and claims incurred, but not reported.

Derivative Instruments and Hedging Activities

The System has entered into derivative transactions in the form of interest rate swap agreements which it uses to manage the relative amounts of fixed and variable rate long-term debt exposure. The interest rate swap agreements are contracts between the System and a third-party (counterparty) that provide for economic payments between the parties based on specified notional amounts and defined interest rates. The interest rate swap agreements are exposed to counterparty credit risk, which is the risk that contractual obligations of the counterparty will not be fulfilled. All realized and unrealized interest rate swap agreement gains and losses are included in nonoperating gains and losses on the consolidated statements of operations and changes in net assets. Collateral posted under interest rate swap contracts is recorded gross of the related asset or liability and classified as assets limited as to use when held by the counterparty and as other noncurrent liability when held by the System.

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

The consolidated statements of operations and changes in net assets include excess of revenues, other support, and gains over expenses and losses, which is analogous to income from continuing operations for a for-profit enterprise. Nonoperating gains and losses represent activities peripheral to direct patient care services and include investment income, change in fair value of interest rate

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

swap agreements, and loss on early extinguishment of debt. Changes in unrestricted net assets that are excluded from excess of revenues, other support, and gains over expenses and losses, consistent with industry practice, primarily include contributions of long-lived assets, including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

3. Revenue Recognition

The System recognizes net patient service revenue in the period in which performance obligations under its contracts are satisfied by transferring services to patients. The System measures the performance obligation for inpatient services from admission to the System facility to the point when it is no longer required to provide services to the patient, which is generally at the time of discharge. Performance obligations for inpatient services are satisfied over time during the patient's stay at the applicable facility. For in-house patients, revenue is recognized based on the amount of actual charges incurred as of the end of the reporting period, reduced by an estimate of contractual and other adjustments based on a combination of negotiated rates and historical experience for the payor class. Performance obligations for outpatient services are generally satisfied on the date of the outpatient visit. Bills to patients and third-party payors are generally sent within a few days or weeks of the inpatient discharge or outpatient visit.

Effective October 1, 2018, upon adoption of ASC 606, net patient service revenue is reported at amounts that reflect the consideration to which the System expects to be entitled for providing patient care. The System's patients include those covered under Medicare, Medicaid, managed care health plans and commercial insurance companies, as well as uninsured patients. The System has entered into payment agreements with certain commercial insurance carriers, health maintenance organization, and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and negotiated daily rates. Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient diagnosis-related group classification system that is based on clinical, diagnostic, and other factors. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid under prospectively determined rates per discharge and

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition (continued)

prospectively determined rates per service. The System uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios primarily consist of the major payor classes as described above.

The initial transaction price for each patient is based on the gross charges for services provided, reduced by contractual adjustments and discounts determined based on contractual or negotiated rates as described above. The transaction price is further reduced by implicit price concessions, which is estimated using historical collection percentages, which reduce the amount of revenue recognized to amounts the System expects to collect.

Revenue under certain third-party payor agreement is subject to audit, retroactive adjustments and significant regulatory actions. Provision for third-party payor settlement and adjustments are estimated and recorded in the period the related services are rendered and adjusted in future periods as final settlements are determined. At September 30, 2019 and 2018, the System has estimated third-party settlements of \$22.6 million and \$14.7 million, respectively, recorded in accounts payable and accrued expenses in the consolidated balance sheets. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. Patient service revenue includes variable consideration for these retroactive revenue adjustments resulting from the settlement of audits, review and investigation. Such amounts are estimated using the most likely outcome method. For fiscal year 2019 revenue decreased \$2.4 million and for fiscal year 2018 revenue increased \$4.2 million, related to changes in estimates for cost report reopenings, appeals, and tentative and final cost report settlements on filed cost reports, of which some are still subject to audit, additional reopening, and/or appeal. Of the increase in 2018, \$3.3 million was attributed to LRHS.

The transaction price for patient services provided depends greatly upon the System's payor mix, as collections on gross charges can vary significantly, depending on a patient's insurance coverage, or lack thereof, and the extent of amounts due from patients for copays, coinsurance and deductibles. Various factors affect collection trends within each major class of payors. These include general economic conditions, including unemployment rates, which may influence the number of uninsured and underinsured patients; regulatory changes that affect reimbursement rates from governmental programs such as Medicare and Medicaid; and ongoing contract negotiations with managed care health plans and commercial insurance providers.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition (continued)

Consistent with the System's mission, care is provided to patients regardless of their ability to pay. Therefore, the System has determined that it has provided implicit price concessions to uninsured patients and patients with other uninsured balances such as copays and deductibles. The difference between amounts billed to patients and the amounts expected to be collected based on the System's collection history with those patients is recorded as implicit price concessions, or as a direct reduction to net patient revenue. Subsequent adjustments that are determined to be the result of an adverse change in the patient or payor's ability to pay are recognized as bad debt expense. Bad debt expense is recorded as a component of other operating expenses in the accompanying consolidated statements of operations and changes in net assets. Bad debt expense for the year ended September 30, 2019 was not significant for the System.

The following table summarizes the amount of net patient service revenue recognized by payor during the year ended September 30, 2019 (in thousands):

	<u>2019</u>	<u>% of Total</u>
Medicare	\$ 795,123	25%
Medicaid	288,058	9
Managed care	2,091,525	65
Self-pay	22,954	1
Net patient service revenue	<u>\$ 3,197,660</u>	<u>100%</u>

As substantially all of its performance obligations relate to contracts with a duration of less than one year, the System has elected to apply the optional exemption provided in ASC 606 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period for patients who remain admitted at that time (in-house patients). The performance obligations for in-house patients are generally completed when the patients are discharged, which for the majority of the System's in-house patients occurs within days or weeks after the end of the reporting period.

The System also receives payments through state supplemental payment programs, which includes Disproportionate Share (DSH) payments and Low-Income Pool (LIP) payments. Such amounts are recorded as other revenue. Refer to the other revenue section below for further details.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition (continued)

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, participation requirements of government health care programs, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Termination of the System's participation in the Medicare or Medicaid programs could have a material impact on the consolidated financial statements.

In addition, government agencies may review the System's compliance with various payment regulations and conduct audits under CMS's Recovery Audit Contractor (RAC), as well as other programs. The RAC program has been made permanent and was required to be expended broadly to health care providers pursuant to the Tax Relief and Health Care Act of 2006. The results of the enhanced medical necessity reviews and the RAC program audits could have an adverse effect on the System's consolidated financial statements. To the extent these reviews result in an adverse finding, the System may appeal the adverse finding, though it may incur significant legal expense.

Prior to the adoption of ASC 606, net patient service revenue was reported at estimated net realizable amounts due from patients and third-party payors for medical services rendered and included adjustments resulting from reviews and audits of prior year Medicare and Medicaid cost reports, as described above. Such adjustments were considered in the recognition and estimation of revenue in the current and future periods as the adjustments became known or as cost report years were no longer subject to such reviews and audits. Additionally, the System recorded an allowance for doubtful accounts that was based on expected net collections, after contractual adjustments, primarily from patients. The provision for bad debts for the year ended September 30, 2018 was approximately \$421.6 million. Allowances for doubtful accounts increased approximately \$88.4 million during the year ended September 30, 2018 and totaled \$248.8 million at September 30, 2018. The allowance for doubtful accounts includes approximately \$78.1 million in amounts due from third-party payors, including the patient responsibility portion included in these accounts at September 30, 2018. The allowance for doubtful accounts for self-pay hospital patients as a percent of related self-pay accounts receivable was 96% at September 30, 2018.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition (continued)

The percentage of estimated net patient service revenue (net of contractual allowances and discounts) by payor type based on primary insurance for the year ended September 30, 2018 is presented below. Patient deductibles and co-pays, as well as accounts whose qualification for the Medicaid program is pending, are included in third-party payors amounts.

	<u>2018</u>
Third-party payors	94%
Patients	<u>6%</u>
	<u>100%</u>

Approximately 23% of net patient service revenue was earned under the Medicare and Medicare HMO programs for the year ended September 30, 2018 and 10% was earned under state Medicaid and Medicaid HMO programs (including estimated revenue for patients whose qualification for the Medicaid program is pending) for the year ended September 30, 2018.

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy at no charge or at amounts less than its established charges. Because the System does not pursue collection of amounts determined to qualify as charity care and does not expect payment for such amounts, they are excluded from net patient service revenue. Patients are eligible for charity care if their documented household income is less than 225% of the federal poverty level guidelines, or the amount of their medical bill is more than 25% of their annual household income and their household income does not exceed 400% of the federal poverty level guidelines. Charity care is provided to all patients meeting these criteria. Charity care provided was approximately 5% of total services rendered during both years ended September 30, 2019 and 2018, respectively, based on total charges for all services in those years. The estimated cost of charity care delivered was approximately \$115.8 million and \$123.6 million during the years ended September 30, 2019 and 2018, respectively. Cost is estimated based on the System's ratio of expenses to established patient service charges.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition (continued)

Patient Accounts Receivable

The System grants credit without collateral to its patients, most of whom are local residents of the geographies of the various System health care centers and are insured under third-party payor agreements. The mix of accounts receivable, net of applicable allowances, from patient and third-party payors at September 30 was as follows:

	<u>2019</u>	<u>2018</u>
Medicare	20%	23%
Medicaid	12	10
Managed care organizations	66	66
Self-pay	2	1

Other Revenue

The System earns other revenue from various sources. The majority of such revenue, outside of state supplemental programs revenue which is described below, is earned at the point of sale and recognized as incurred in accordance with ASC 606. The System's other operating revenue also includes unrestricted donation revenue and rental income that are not within the scope of ASC 606. Amounts from these sources are not significant.

As noted above, the System receives payments through state supplemental payment programs, which includes DSH and LIP payments. Federal law permits state Medicaid programs to make DSH payments to hospitals that serve a disproportionate large number of Medicaid and low-income patients. These funds are not tied to specific services for Medicaid-eligible patients. The federal government distributes federal Medicaid DSH and LIP funds to each state based on a statutory formula. Revenue under the DSH and LIP programs is recognized as a component of other revenue over the benefit period when information is received from the states regarding the amount and timing of DSH and LIP payments to be received for the applicable period. The System believes that its performance obligations are generally satisfied ratably over the applicable period and recognizes revenue on a monthly basis, or when the amount is known if the state makes only one payment for DSH or LIP. The System recorded approximately \$75.9 million and \$43.6 million in other revenue during fiscal years 2019 and 2018, respectively, related to the DSH and LIP programs.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements

The System follows ASC 820, which provides a framework for measuring the fair value of certain assets and liabilities and disclosures about fair value measurements. As defined in ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

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

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities as of the reporting date.

Level 2 – Observable pricing inputs other than quoted prices included within Level 1, including quoted market prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable or are derived principally from, or corroborated by, observable market data by correlation or other means.

Level 3 – Unobservable pricing inputs that are supported by little or no market activity, are significant to the fair value of the assets or liabilities, and reflect our own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument in accordance with the provisions of ASC 820:

Cash and cash equivalents: The carrying amount reported in the consolidated balance sheets approximates fair value.

Long-term investments and assets limited as to use: The carrying amount reported in the consolidated balance sheets is fair value, based on quoted market prices, or estimated using quoted market prices for similar securities.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

Investments in related parties: The fair value of investments in related parties is not practicable to estimate due to the uncertainty regarding the timing of future payments.

Interest rate swap agreements: Assets are included in other assets, and liabilities are included in other noncurrent liabilities. Estimates are based on quoted market prices or estimated based on derivative pricing models that involve adjusting the periodic mid-market values to incorporate nonperformance risk of the System when the financial instrument is a liability or the nonperformance risk of the counterparty when the financial instrument is an asset.

Deferred compensation plans: Investments held in conjunction with the System's 457(b) and 409(a) deferred compensation plans amount to approximately \$45.8 million and \$35.3 million as of September 30, 2019 and 2018, respectively, and are included in other assets. These investments are valued using unadjusted quoted prices in active markets and are considered Level 1 assets.

The derivative valuations determined by mid-market quotations are considered Level 2 assets or liabilities since quoted prices can be obtained from a number of dealer counterparties and other independent market sources based on observable interest rates and yield curves for the full term of the asset or liability.

The estimated fair value of interest rate swap agreements that hedge interest rate fluctuations on variable rate bonds and loans is presented below. These amounts are included in other noncurrent liabilities in the accompanying consolidated balance sheets.

	<u>Asset (Liability)</u>	
	<u>September 30</u>	
	<u>2019</u>	<u>2018</u>
	<i>(In Thousands)</i>	
2011 swaps	\$ (39,128)	\$ (22,397)
2008E swap	(4,687)	(3,341)

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

The following table represents the fair value hierarchy of the System's financial assets and liabilities measured at fair value using the market approach as of September 30, 2019 (in thousands):

	Level 1	Level 2	Level 3	Total
Financial assets				
Mutual funds	\$ 1,075,806	\$ –	\$ –	\$ 1,075,806
Equity securities	57,449	–	–	57,449
U.S. corporate bonds	–	117,631	–	117,631
U.S. Treasury and agency obligations	–	234,925	–	234,925
Mortgage-backed obligations	–	69,549	–	69,549
Municipal bonds	–	645	–	645
Auction rate securities	–	–	4,764	4,764
Cash and cash equivalents	106,113	–	–	106,113
	<u>\$ 1,239,368</u>	<u>\$ 422,750</u>	<u>\$ 4,764</u>	<u>\$ 1,666,882</u>
Investments measured at net asset value				523,314
Interest rate swap contract collateral				22,223
Total financial assets at fair value				<u>\$ 2,212,419</u>
Financial liabilities				
Interest rate swap agreements	\$ –	\$ 43,815	\$ –	\$ 43,815
	<u>\$ –</u>	<u>\$ 43,815</u>	<u>\$ –</u>	<u>\$ 43,815</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

The following table represents the fair value hierarchy of the System's financial assets and liabilities measured at fair value using the market approach as of September 30, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Financial assets				
Mutual funds	\$ 826,347	\$ –	\$ –	\$ 826,347
Equity securities	120	–	–	120
U.S. corporate bonds	–	112,723	–	112,723
U.S. Treasury and agency obligations	–	108,600	–	108,600
International bonds	–	646	–	646
Mortgage-backed obligations	–	182,398	–	182,398
Municipal bonds	–	888	–	888
Cash and cash equivalents	191,025	–	–	191,025
	<u>\$ 1,017,492</u>	<u>\$ 405,255</u>	<u>\$ –</u>	<u>\$ 1,422,747</u>
Investments measured at net asset value				363,276
Interest rate swap contract collateral				4,595
Total financial assets at fair value				<u>\$ 1,790,618</u>
Financial liabilities				
Interest rate swap agreements	\$ –	\$ 25,738	\$ –	\$ 25,738
	<u>\$ –</u>	<u>\$ 25,738</u>	<u>\$ –</u>	<u>\$ 25,738</u>

Total financial assets at fair value of \$2.2 million and \$1.8 million as of September 30, 2019 and 2018, respectively, is composed of the following financial statement captions within the consolidated balance sheets: Debt service and reserve funds held by bond trustee, Construction funds held by bond trustee, Interest rate swap contract collateral, Designated by board for property and equipment, Malpractice self-insurance, Long-term investments – without donor restrictions and Long-term investments – with donor restrictions.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

The following table shows the System's investments in commingled funds by asset class along with commitments and redemption ability as of September 30, 2019 (in thousands):

	Net Asset Value	Redemption Frequency	Redemption Notice Period
Equity Fund – Large Cap Core ^(a)	\$ 288,382	Daily	2 days
Equity Fund – International Large Cap ^(b)	126,732	Daily	30 days
Real Estate – Real Assets ^(c)	29,275	Quarterly	45 days
Real Estate – Real Assets ^(c)	1,382	Quarterly	60 days
International Small Cap – Ltd Partnership ^(d)	32,836	Monthly	30 days
Small/Mid-Cap LLC ^(e)	44,707	Monthly	5 days
	<u>\$ 523,314</u>		

The following table shows the System's investments in commingled funds by asset class along with commitments and redemption ability as of September 30, 2018 (in thousands):

	Net Asset Value	Redemption Frequency	Redemption Notice Period
Equity Fund – Large Cap Core ^(a)	\$ 173,492	Daily	2 days
Equity Fund – International Large Cap ^(b)	89,336	Daily	30 days
Real Estate – Real Assets ^(c)	28,873	Quarterly	45 days
Real Estate – Real Assets ^(c)	1,649	Quarterly	60 days
International Small Cap – Ltd Partnership ^(d)	27,908	Monthly	30 days
Small/Mid-Cap LLC ^(e)	42,018	Monthly	5 days
	<u>\$ 363,276</u>		

^(a) This fund provides passive exposure to the U.S. equity market and is a low-cost index replicator. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this fund.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

- (b) This fund invests in international large cap equities and seeks to diversify the growth portfolio beyond U.S. macro-economic factors. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this fund.
- (c) These real asset funds have holdings including but not limited to apartment building and office building properties. These properties are located throughout the U.S. They are intended to protect the real value of the portfolio. When inflation increases the nominal value of the dollar, assets in this category should also increase in value. The funds portfolio construction makes them a diversifier to other core funds. The fair value of the investments in these groups have been estimated using the net asset values of the System's interest in these funds.
- (d) This international small-cap stock limited partnership has a value-aware approach to stock picking. The fair value of the investments in this fund has been estimated using the net asset value of the System's interest in this limited partnership.
- (e) This small-mid-cap fund enhances returns by focusing on smaller cap U.S. companies. The fair value of the investment in this fund has been estimated using the net asset value of the System's interest in this LLC.

5. Investments

Investment income consists of the following:

	Year Ended September 30	
	2019	2018
	<i>(In Thousands)</i>	
Interest and dividend income	\$ 54,450	\$ 35,060
Change in unrealized gains and losses	27,784	(3,940)
Net realized gains on sales of securities	4,600	40,836
	<u>\$ 86,834</u>	<u>\$ 71,956</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

6. Investments in Related Parties

OsceolaSC, LLC

On February 1, 2006, the System sold the property and equipment of St. Cloud Hospital to OsceolaSC partnership, in which the System holds a 20% interest. The System's equity investment in OsceolaSC is included in investments in related parties and amounted to \$15.1 million and \$13.1 million at September 30, 2019 and 2018, respectively. Earnings on the investment before cash distributions are included in other revenue and amounted to approximately \$2.8 million and \$2.2 million for the years ended September 30, 2019 and 2018, respectively.

CareSpot

On September 1, 2017, the System entered into a joint venture with CareSpot Urgent Care to provide urgent/non-emergent care throughout Orlando and Central Florida. There are currently ten locations. The System holds a 49.9% interest in the joint venture. The System's equity investment in CareSpot is included in investments in related parties and amounted to approximately \$9.6 million and \$8.7 million at September 30, 2019 and 2018, respectively. Earnings on the investment before cash distributions are included in other revenue and amounted to approximately \$0.9 million and \$0.5 million for the years ended September 30, 2019 and 2018, respectively.

The remaining balance consists of various smaller investments in related parties that aggregate to a total of approximately \$9.2 million and \$10.8 million for the years ended September 30, 2019 and 2018, respectively.

7. Property and Equipment

Property and equipment consist of the following:

	September 30	
	2019	2018
	<i>(In Thousands)</i>	
Land and improvements	\$ 232,046	\$ 179,642
Buildings	1,286,232	1,053,823
Equipment	2,204,119	1,896,951
	3,722,397	3,130,416
Less: Accumulated depreciation	(1,975,422)	(1,824,596)
	1,746,975	1,305,820
Construction-in-progress	172,881	159,730
	\$ 1,919,856	\$ 1,465,550

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

7. Property and Equipment (continued)

Construction

Construction-in-progress represents numerous construction and renovation projects. Estimated costs to complete these projects as of September 30, 2019, are approximately \$864 million, which includes \$124.7 million for freestanding emergency departments, \$503.8 million for new bed towers, \$68.9 million for bed tower expansion, \$134.5 million for a medical pavilion, and \$31.7 million for parking expansion. Projects will be funded through operating cash flows and pledges received.

Leases

The System leases property and equipment for a variety of purposes under operating leases. Operating lease expense is classified as supplies and other expenses and amounted to \$32.6 million and \$36.8 million for the years ended September 30, 2019 and 2018, respectively.

Assets capitalized under capital leases as reflected in the accompanying consolidated balance sheets were \$24.9 million and \$21.0 million of buildings and fixed equipment at September 30, 2019 and 2018, respectively. The accumulated depreciation related to assets under capital leases was \$5.8 million and \$2.2 million at September 30, 2019 and 2018, respectively. Depreciation of assets under capital leases is included in depreciation and amortization expense.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt

Long-term debt consists of the following:

	September 30	
	2019	2018
	<i>(In Thousands)</i>	
Fixed Rate Hospital Revenue Bonds – secured		
Series 2019A (Orlando Health Central) – plus unamortized premium of \$4,522,000 and \$0 at September 30, 2019 and September 30, 2018, respectively; interest rates from 4.0% to 5.0%, payable 2047 through 2049	\$ 104,522	\$ –
Series 2019B – plus net unamortized premium and issuance costs of \$10,447,000 and \$0 at September 30, 2019 and September 30, 2018, respectively; interest rates from 4.0% to 5.0%, payable through 2026	154,497	–
Series 2019C – less unamortized issuance costs of \$0 and \$0 at September 30, 2019 and September 30, 2018, respectively; interest rate of 4.461%, payable through 2049	100,000	–
Series 2018 – less net unamortized issuance costs of \$2,750,000 and \$2,873,000 at September 30, 2019 and September 30, 2018, respectively; interest rates from 2.278% to 4.089%, payable through 2049	457,250	472,127
Series 2016A – plus unamortized premium and issuance costs of \$24,173,000 and \$25,755,000 at September 30, 2019 and September 30, 2018, respectively; interest rates from 3.0% to 5.0%, payable through 2041	197,888	199,470
Series 2016B (Orlando Health Central) – plus net unamortized premium and issuance costs of \$3,608,000 and \$3,747,000 at September 30, 2019 and September 30, 2018, respectively; interest rates from 4.0% to 5.0%, payable 2045 through 2046	70,183	70,322
Series 2016C (Orlando Health Central) – less net unamortized issuance costs of \$1,038,000 and 1,088,000 at September 30, 2019 and September 30, 2018 respectively; interest rate of 4.416%, payable 2044 through 2045	73,427	73,387
Series 2012A and B – plus net unamortized premium and issuance costs of \$2,980,000 and \$3,141,000 at September 30, 2019 and September 30, 2018, respectively; interest rates from 4.0% to 5.0%, payable through 2043	187,855	187,984
Series 2009 – less net unamortized premium and issuance costs of \$0 and \$79,000 at September 30, 2019 and September 30, 2018, respectively; interest rates from 5.0% to 5.375%, payable through 2027. Series 2009 were advance refunded as of July 2019	–	158,081
Variable rate hospital revenue bonds – secured		
Series 2011 – interest rates of 2.0520% and 2.0721% at September 30, 2019 and September 30, 2018, respectively, less unamortized issuance costs of \$231,000 and \$244,000 at September 30, 2019 and September 30, 2018, respectively, payable 2027 through 2041	82,944	82,931
Series 2008E – interest rates of 1.53% and 1.58% at September 30, 2019 and September 30, 2018, respectively, less unamortized issuance costs of \$154,000 and \$176,000 at September 30, 2019 and September 30, 2018, respectively, payable through 2026	46,855	48,359
Notes payable and other indebtedness		
Capital lease obligations and other notes	28,985	30,162
Total debt, net of unamortized premiums, discounts and issuance costs	1,504,406	1,322,823
Less current portion	(25,817)	(22,152)
Total long-term debt	\$ 1,478,589	\$ 1,300,671

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Aggregate principal amounts of long-term debt outstanding, excluding premiums, discounts, and issuance costs are due during the following years ending September 30: \$25.8 million in 2020, \$23.6 million in 2021, \$25.5 million in 2022, \$26.6 million in 2023, \$27.7 million in 2024, and \$1.3 billion thereafter.

Master Trust Indenture

Orlando Health along with Health Central comprise the Obligated Group created under the Master Trust Indenture. The Obligated Group is obligated for the payment of principal and premium, if any, and interest on any outstanding bonds or debt issued under the Master Trust Indenture, and is subject to any other obligation or restriction set forth in any agreement, note, or indenture entered into or issued by the Obligated Group in connection with the issuance of any debt or related obligations issued under the Master Trust Indenture.

An Amended and Restated Master Indenture (Master Indenture), dated as of August 1, 1999, was executed by Orlando Health. All obligations issued under the Master Indenture are equally and ratably secured by a pledge of the accounts (as defined in Article 9 of the Florida Uniform Commercial Code) and the Gross Revenue of the Obligated Group. The Master Indenture provides for specific restrictive covenants, including a debt service coverage requirement. Financial information of the Obligated Group is included in the Supplementary Information appearing on pages 48 and 49.

Hospital Revenue Bonds, Series 2019A, B, and C

On February 1, 2019, Orlando Health, Inc. issued \$100 million tax-exempt fixed rate hospital revenue bonds on behalf of the Obligated Group through its Series 2019A Bonds and \$100 million taxable fixed rate hospital revenue bonds through its Series 2019C Bonds. The proceeds of the Series 2019A Bonds will be used by Health Central to finance construction and equipping of a new acute care hospital to be known as Horizon West. The proceeds of the Series 2019C Bonds were applied for general corporate purposes including construction and renovation of facilities. On February 1, 2019, Orlando Health, Inc. issued \$144.1 million tax-exempt fixed rate hospital revenue refunding bonds through its Series 2019B Bonds to provide advance refunding of all of the outstanding Series 2009 Bonds as part of a forward delivery that closed on July 3, 2019. The System recorded a loss from early extinguishment of debt of \$3.2 million, which is included in nonoperating gains and losses in the consolidated statement of operations and changes in net assets.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Hospital Revenue Bonds, Series 2018

On February 1, 2018, Orlando Health, Inc. issued \$475.0 million taxable fixed rate hospital revenue bonds on behalf of the Obligated Group through its Series 2018 Bonds. The proceeds of the Series 2018 Bonds were applied for general corporate purposes including construction and renovation of facilities and used to advance refund all of the outstanding Series 1996A, Series 1996C, Series 2008A, and Series 2008B Bonds. The System recorded a loss from early extinguishment of debt of \$4.7 million, which is included in nonoperating gains and losses in the consolidated statement of operations and changes in net assets.

Hospital Revenue Bonds, Series 2016A, B, and C

On April 27, 2016, the Orange County Health Facilities Authority (Authority) issued \$173.7 million and \$66.6 million tax-exempt fixed rate bond obligations on behalf of the Obligated Group through its Series 2016A Bonds and Series 2016B Bonds, respectively. The proceeds of the Series 2016A Bonds were used to currently refund all of the outstanding Series 2006B Bonds, advance refund \$11.6 million of the outstanding Series 2008A Bonds, advance refund \$43.9 million of the Series 2008B Bonds, and advance refund all of the Series 2008C Bonds. The proceeds of the Series 2016B Bonds were used by Health Central to refinance \$70.6 million of the \$141.1 million outstanding on the note payable to the West Orange Healthcare District. At the same time, the Obligated Group issued \$74.5 million of taxable fixed rate bond obligations through its Series 2016C Bonds. The proceeds of this bond obligation issue were used to refinance the remaining balance of the note payable to the West Orange Healthcare District.

Hospital Revenue Bonds, Series 2012A and 2012B

On May 23, 2012, the Authority issued \$184.9 million tax-exempt fixed rate hospital revenue bonds on behalf of the Obligated Group through its Series 2012 Bonds. The proceeds of the Series 2012 Bonds were used to pay off a construction loan, establish a project fund for ORMC redesign and redevelopment project, and pay costs of issuance. Separately, the interest rate swap that hedged the risk of interest rate fluctuations on the construction loan was terminated. The proceeds of the Series 2012B Bonds were used to repay the construction loan on May 23, 2012.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Hospital Revenue Bonds, Series 2009

On December 16, 2009, the Authority issued \$241.1 million tax-exempt fixed rate hospital revenue bonds on behalf of the Obligated Group through its Series 2009 Bonds. The proceeds of the Series 2009 Bonds were used to currently refund the following: Series 1999D Bonds, Series 1999E Bonds, Series 2004 Bonds, Series 2008D Bonds, Series 2008F Bonds, and Series 2008G Bonds. The proceeds were also used to pay the costs of issuance, including swap termination payments related to some of the refunded bonds. Series 2009 were advance refunded as of July 3, 2019.

Hospital Revenue Bonds, Series 2008E

The Series 2008E bonds are supported by an irrevocable letter of credit with TD Bank, which has an expiration date of July 3, 2024.

Hospital Revenue Bonds, Series 2011

On September 15, 2011, the Authority issued \$83.2 million of variable rate Hospital Revenue Bonds (2011 Bonds) on behalf of Orlando Health. The proceeds from the sale of the 2011 Bonds and \$7.2 million of remaining 2007A Bonds debt service reserve funds were used to currently refund the 2007A Bonds and pay the costs of issuance of the 2011 Bonds. The 2011 Bonds were issued as tax-exempt, multi-modal bonds, initially operating in bank purchase mode, and privately placed with SunTrust Bank (the Bank). As initially issued, the 2011 Bonds bear interest at a variable index interest rate which approximates 68% of 30-day London Inter-bank Offered Rate (LIBOR), plus 84 basis points.

The initial interest rate may be adjusted due to changes in the maximum individual federal income tax rate, and other regulatory changes affecting the cost of the loan to the Bank. On September 22, 2015, the Bank notified Orlando Health and the trustee that it elected not to tender the bonds on the scheduled mandatory purchase date in September 2016, and the next mandatory purchase date will be the first business day of June 2023. Upon mandatory tender for purchase, Orlando Health may convert to another available interest rate mode.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

During the initial interest rate period, the 2011 Bonds are subject to optional redemption at the direction of Orlando Health at par on each interest payment date. Interest is payable monthly.

Capital Lease Obligations

Capital lease obligations account for approximately \$23.6 million and \$23.7 million of the capital lease obligations and other notes caption within the table above at September 30, 2019 and 2018, respectively. During 2017, the System recognized a capital lease commitment for a new ambulatory building.

Interest Rate Swap Agreements

In an effort to reduce costs of issuance and take advantage of low interest rates in effect at various times, Orlando Health has entered into interest rate swap arrangements that fix the interest rate on portions of variable rate bonds. The notional amounts under interest rate swap agreements hedging bonds are substantially the same as the principal maturities of the respective outstanding bond series. The construction loan swap hedged the majority of the construction loan at the maximum loan amount. Net interest receipts and payments are recognized as an adjustment to interest expense or as capitalized interest during periods of construction. The interest rate swap agreements are not accounted for under hedge accounting criteria. Therefore, changes in the value of these swaps are included in changes in fair value of interest rate swap agreements on the consolidated statements of operations and changes in net assets.

Collateral was required and posted on the 2011 swaps in the amount of approximately \$22.2 million and \$4.6 million at September 30, 2019 and 2018, respectively, and is included in the interest rate swap contract collateral in assets limited as to use.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

The following summarizes outstanding swap positions as of September 30, 2019:

	2008E Swap	2011 Swaps
	<i>(Dollars in Thousands)</i>	
Initial notional amount	\$ 54,130	\$ 90,000
Notional amount at September 30, 2019	\$ 47,010	\$ 90,000
Current bond or loan hedged	2008E Bonds	2011 Bonds
Original bond or loan hedged	2006A Bonds	2007A1A2 Bonds
Maturity date	10/1/2026	10/1/2041
Fixed rate paid	3.57%	3.86%
Floating rate received	68% 30-day USD-LIBOR-BBA	68% 30-day USD-LIBOR-BBA

The following summarizes swap liability positions held during each year recorded within other noncurrent liabilities in the accompanying consolidated balance sheets:

	2008E Swap	2011 Swap	Total
	<i>(In Thousands)</i>		
Cumulative position at September 30, 2017	\$ (5,358)	\$ (30,559)	\$ (35,917)
Net gains during the year ended September 30, 2018	2,016	8,163	10,179
Cumulative position at September 30, 2018	(3,342)	(22,396)	(25,738)
Net losses during the year ended September 30, 2019	(1,345)	(16,732)	(18,077)
Cumulative position at September 30, 2019	\$ (4,687)	\$ (39,128)	\$ (43,815)

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

Interest Costs

During periods of construction, interest costs on construction borrowings are capitalized to the respective property accounts. Capitalized interest is reduced by earnings on the investments held by the bond trustee for construction. Capitalized interest costs amounted to approximately \$7.0 million and \$1.4 million for the years ended September 30, 2019 and 2018, respectively. The total of interest cost expensed and capitalized approximates interest paid.

9. Employee Retirement Plans

The System has defined contribution retirement plans. Certain employees of the System are eligible to participate in 401(a) and 403(b) plans, and certain PAL employees are eligible to participate in a 401(k) plan. Most plan participants may elect to contribute up to the lesser of \$19,000 or 50% of their annual compensation. For most plan participants, upon completion of one year of continuous service and having worked 1,000 hours or more, the System contributes 1.25% of the participants' compensation plus 50% of the participants' contributions up to 3% of the participants' compensation. The System's expense under the employee retirement plans amounted to approximately \$32.3 million and \$43.8 million, for the years ended September 30, 2019 and 2018, respectively. Expense of \$14.6 million is attributed to LRHS for the year ended September 30, 2018. The System maintains deferred compensation plans for key management or highly compensated employees. The plans are intended to be nonqualified and unfunded and provide for the deferral of salary as well as additional discretionary system matching contributions.

10. Malpractice Insurance

The System is self-insured for medical malpractice risk not covered under a commercial malpractice policy. Losses are accrued based on estimates provided by an independent actuary, and, are based on actuarial assumptions that incorporate the System's past experience and other considerations, including the nature of each claim or incident, and relevant trends. The accrued liability for self-insured claims amounted to approximately \$144.9 million and \$137.2 million at September 30, 2019 and 2018, respectively, of which approximately \$22.0 million and \$27.4 million are included in other current liabilities. The System has on deposit, in a revocable trust, cash and investments totaling approximately \$16.1 million and \$13.3 million at September 30, 2019 and 2018, respectively, to be used for the payment of self-insured claims in the future. The System does not have any claims that are discounted.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

10. Malpractice Insurance (continued)

For claims occurring after April 1, 2012, Health Central is covered under the System's medical malpractice policy and self-insured malpractice fund. Any liabilities associated with the operations of Health Central subsequent to April 1, 2012, are included in the amounts noted above. The West Orange Healthcare District (District) has retained the medical malpractice liability for Health Central events occurring prior to closing of the Health Central transaction. The District is a governmental entity and is protected to a large extent by sovereign immunity protection against liability claims, a legal doctrine that protects a sovereign body from being held liable for civil wrongs committed by its departments, agencies, or employees, unless consent to be sued is expressly granted by the sovereign body itself. The System is not liable for any Health Central events occurring prior to April 1, 2012.

For claims occurring after July 1, 2019, South Lake is covered under the System's medical malpractice policy and self-insured malpractice fund. Any liabilities associated with the operations of South Lake subsequent to July 1, 2019, are included in the amounts noted above. Prior to July 1, 2019, South Lake is protected to a large extent by sovereign immunity protection against liability claims.

11. Commitments

The System leases equipment and space under operating leases with various lease terms. Aggregate future minimum lease payments, anticipated future lease payments on optional renewals, and estimated variable costs under these leases total approximately \$161.1 million and are payable during the following years ending September 30: approximately \$23.9 million in 2020, \$21.0 million in 2021, \$19.0 million in 2022, \$18.3 million in 2023, \$15.8 million in 2024, and \$63.0 million thereafter.

As part of the transaction entered into with South Lake as further detailed in Note 12, the System has committed an amount of approximately \$99.4 million in capital improvements at the South Lake hospital campus. In accordance with this commitment, the System will cause South Lake to spend at least an average of \$19.88 million per year for a period of five years towards capital improvements in the South Lake hospital campus and off-campus locations within Lake County.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combinations

South Lake Hospital, Inc.

South Lake

Effective October 1, 1995, the System entered into an arrangement with South Lake County Hospital District (the South Lake District), whereby the two entities formed South Lake, a Section 501(c)(3) not-for-profit corporation. Under the terms of the joint venture, the South Lake District leased its hospital assets to South Lake for 99 years. The System received an option to purchase the leased assets and transfer them to South Lake at any time throughout the 99-year lease period. The System had no rights to the profits or obligations for the losses of South Lake prior to July 1, 2019. The System provided management services to South Lake in the amount of approximately \$5.7 million and \$6.5 million during 2019 and 2018, respectively, at cost plus a nominal fee according to the terms of a Management Agreement.

On May 14, 2010, South Lake issued \$34.3 million of Revenue Bonds, Series 2010 (2010 Bonds), and used the proceeds to refund its Revenue Bonds, Series 1999 (1999 Bonds), for the purpose of reducing future debt service. The System guaranteed the 2010 Bonds as it did the 1999 Bonds. As of September 30, 2019, the 2010 Bonds were legally defeased and the System recorded a loss on the bond defeasance of \$1.9 million, which is included in nonoperating gains and losses in the consolidated statement of operations and changes in net assets.

Effective July 1, 2019, Orlando Health, South Lake Hospital, Inc., South Lake Memorial Hospital, Inc. and Live Well Foundation of South Lake, Inc. completed a transaction whereby Orlando Health became the sole member of South Lake. The transaction was accounted for using the acquisition method of accounting.

During 2019, the System recorded the South Lake assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$183.5 million.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combination (continued)

In accordance with ASC 958-805, *Not-for-Profit Mergers and Acquisitions*, the System recognized an inherent contribution as the excess of the acquisition date fair values of the assets acquired and liabilities assumed over the consideration transferred. The fair values assigned are summarized as follows (in thousands):

Consideration transferred	\$ 128,000
Fair values of assets acquired and liabilities assumed:	
Cash and investments	87,727
Accounts receivable	30,410
Other current assets	15,782
Investments	42,195
Property and equipment	197,188
Other noncurrent assets	44,921
Accounts payable and other current liabilities	(26,210)
Long-term debt	(76,231)
Other liabilities	(4,288)
Inherent contribution	\$ 183,494
Classification of inherent contribution:	
Without donor restrictions	\$ 181,885
With donor restrictions	1,609
	\$ 183,494

The System used valuation techniques to determine the fair value of real and personal property (property and equipment) and long-term debt (long-term debt). Acquired land was valued using the sales comparison approach which relied on recent market transactions of similar tracts of land adjusted for individual characteristics. Other real and personal property were valued using the cost approach which relied on market data for similar assets. Long-term debt was valued based on market quotes based on current market rates available to the System.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combination (continued)

The following table summarizes amounts attributable to the System from the acquisition date through September 30, 2019, that are included in the accompanying 2019 consolidated statement of operations and changes in net assets (in thousands):

Total revenues and other support without donor restrictions	\$ 75,277
Total expenses	<u>62,839</u>
Income from operations	12,438
Non-operating losses, net	<u>(1,490)</u>
Excess of revenues, other support, and gains over expenses and losses	<u><u>\$ 10,948</u></u>
Change in net assets:	
Without donor restrictions	\$ 10,965
With donor restrictions	<u>(46)</u>
Total change in net assets	<u><u>\$ 10,919</u></u>

For the current fiscal year, assuming the acquisition had taken place on October 1, 2018, the following table summarizes the fiscal year 2019 consolidated statement of operations and statement of changes in net assets (in thousands):

Total revenues and other support without donor restrictions	\$ 3,638,958
Total expenses	<u>3,261,154</u>
Income from operations	377,804
Non-operating gains, net	<u>250,230</u>
Excess of revenues, other support, and gains over expenses and losses	<u><u>\$ 628,034</u></u>
Change in net assets:	
Without donor restrictions	\$ 643,562
With donor restrictions	<u>1,703</u>
Total change in net assets	<u><u>\$ 645,265</u></u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combination (continued)

For the prior fiscal year, assuming the acquisition had taken place on October 1, 2017, the following table summarizes the fiscal year 2018 consolidated statement of operations and statement of changes in net assets (in thousands):

Total revenues and other support without donor restrictions	\$ 4,048,778
Total expenses	<u>3,689,939</u>
Income from operations	358,839
Non-operating gains, net	<u>63,512</u>
Excess of revenues, other support, and gains over expenses and losses	<u>\$ 422,351</u>
Change in net assets:	
Without donor restrictions	\$ 484,970
With donor restrictions	<u>(49,323)</u>
Total change in net assets	<u>\$ 435,647</u>

Lakeland Regional Health Systems, Inc.

Effective October 1, 2017, the System completed a transaction with LRHS to create an integrated regional health care system. The System obtained control through a member substitution arrangement whereby the System became the sole corporate member of LRHS without the transfer of consideration. The transaction was accounted for using the acquisition method of accounting.

During 2018, the System recorded the LRHS assets acquired and liabilities assumed at fair value and recognized an inherent contribution associated with business combination of approximately \$558.7 million. Effective September 30, 2018 the System and LRHS agreed to terminate their relationship and LRHS provided financial and strategic concessions to terminate the relationship. Upon termination of the relationship, the System deconsolidated the LRHS assets and liabilities at their net book values and recognized an inherent distribution from deconsolidation of business combination of approximately \$586.0 million.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combination (continued)

In accordance with ASC 958-805, the System recognized an inherent contribution as the excess of the acquisition date fair values of the assets acquired and liabilities assumed over the consideration transferred. The fair values assigned are summarized as follows (in thousands):

Consideration transferred	\$ —
Fair values of assets acquired and liabilities assumed:	
Cash and investments	458,104
Patient accounts receivable	118,381
Other current assets	110,359
Property and equipment	601,820
Other noncurrent assets	46,268
Accounts payable and other current liabilities	(96,039)
Long-term debt	(647,716)
Other liabilities	(32,478)
Inherent contribution	\$ 558,699
 Classification of inherent contribution:	
Without donor restrictions	\$ 526,815
With donor restrictions	31,884
	\$ 558,699
 Classification of inherent distribution:	
Without donor restrictions	\$ 548,685
With donor restrictions	37,267
	\$ 585,952

The System used valuation techniques to determine the fair value of real and personal property (property and equipment), lease liability and long-term debt (long-term debt). Acquired land was valued using the sales comparison approach which relied on recent market transactions of similar tracts of land adjusted for individual characteristics. Other real and personal property were valued using the cost approach which relied on market data for similar assets. The lease liability was valued using the income approach which relied on scheduled future cash payments expected in future periods. Long-term debt was valued based on market quotes based on current market rates available to the System.

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

12. Business Combination (continued)

The following table summarizes amounts attributable to the System from the acquisition date through September 30, 2018, that are included in the accompanying 2018 consolidated statement of operations and changes in net assets (in thousands):

Total unrestricted revenues and other support	\$ 775,841
Total expenses	<u>766,328</u>
Income from operations	9,513
Non-operating losses, net	<u>(10,427)</u>
Deficit of revenues, other support, and gains over expenses and losses	<u>\$ (914)</u>
Change in net assets:	
Without donor restrictions	\$ (914)
With donor restrictions	<u>-</u>
Total change in net assets	<u>\$ (914)</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

13. Functional Expenses

The System's primary activities involve providing general healthcare services to its patients. Expenses related to providing these services for the year ended September 30, 2019 and 2018 are as follows (in thousands):

	2019		
	Healthcare Services	General and Administrative	Total
Salaries and benefits	\$ 1,341,162	\$ 357,329	\$ 1,698,491
Supplies and other	913,985	224,934	1,138,919
Professional fees	34,896	171	35,067
Depreciation and amortization	132,836	30,516	163,352
Interest	52,160	593	52,753
Total expenses	<u>\$ 2,475,039</u>	<u>\$ 613,543</u>	<u>\$ 3,088,582</u>

	2018		
	Healthcare Services	General and Administrative	Total
Salaries and benefits	\$ 1,518,492	\$ 427,440	\$ 1,945,932
Supplies and other	974,192	262,199	1,236,391
Professional fees	44,546	136	44,682
Depreciation and amortization	168,152	28,146	196,298
Interest	48,627	11,067	59,694
Total expenses	<u>\$ 2,754,009</u>	<u>\$ 728,988</u>	<u>\$ 3,482,997</u>

Orlando Health, Inc. and Controlled Affiliates

Notes to Consolidated Financial Statements (continued)

14. Liquidity

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following as of September 30, 2019 (in thousands):

Cash and cash equivalents	\$ 584,483
Accounts receivable	382,565
Other receivables	71,370
Long-term investments – without donor restrictions	<u>1,891,200</u>
	<u>\$ 2,929,618</u>

The System has the ability to structure certain of its financial assets to be available as its general expenditures and other obligations come due. As described in Note 2, Long-term investments – without donor restrictions are classified as such based on management’s intent and ability to hold or reinvest the investments on a long-term basis. However, these investments do not have any liquidity restrictions and can be made available for general expenditure within one year and are therefore reflected in the amounts above. The System has certain assets limited to use for various purposes as more fully described in Note 2. These assets limited as to use are not available for general expenditure within the next year and are not reflected in the amounts above.

15. Subsequent Events

In preparing these consolidated financial statements, the System has evaluated events and transactions for potential recognition and disclosure through December 18, 2019, the date the consolidated financial statements were available to be issued. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

Supplementary Information

Orlando Health, Inc. and Controlled Affiliates

Consolidating Balance Sheet (In Thousands)

September 30, 2019

	Consolidated	Eliminations	Controlled Affiliates	Combined Obligated Group	Obligated Group Eliminations	Obligated Group Component	Orlando Health Central Obligated Group Component
Assets							
Current assets:							
Cash and cash equivalents	\$ 584,483	\$ -	\$ 125,134	\$ 459,349	\$ -	\$ 438,086	\$ 21,263
Assets limited as to use	49,581	-	1,845	47,736	-	47,736	-
Accounts receivable, net	382,565	-	61,885	320,680	-	289,183	31,497
Other receivables	71,370	(64,661)	24,531	111,500	(11,636)	85,933	37,203
Inventory	64,045	-	6,418	57,627	-	55,141	2,486
Other current assets	40,364	-	1,700	38,664	-	34,872	3,792
Total current assets	1,192,408	(64,661)	221,513	1,035,556	(11,636)	950,951	96,241
Assets limited as to use:							
Debt service and reserve funds held by bond trustee	47,137	-	-	47,137	-	41,824	5,313
Construction funds held by bond trustee	89,999	-	-	89,999	-	-	89,999
Interest rate swap contract collateral receivable	22,223	-	-	22,223	-	22,223	-
Designated by board for property and equipment	24,134	-	24,134	-	-	-	-
Malpractice self-insurance	16,119	-	1,845	14,274	-	14,274	-
	199,612	-	25,979	173,633	-	78,321	95,312
Less amount required to meet current obligation	(49,581)	-	(1,845)	(47,736)	-	(47,736)	-
	150,031	-	24,134	125,897	-	30,585	95,312
Long-term investments – without donor restrictions	1,891,200	-	41,858	1,849,342	-	1,785,258	64,084
Long-term investments – with donor restrictions	121,607	-	121,607	-	-	-	-
Investments in related parties	33,899	(71,173)	104,645	427	-	427	-
Other assets	244,828	(229,687)	122,195	352,320	-	352,320	-
Property and equipment, net	1,919,856	-	251,418	1,668,438	-	1,363,723	304,715
Total assets	\$ 5,553,829	\$ (365,521)	\$ 887,370	\$ 5,031,980	\$ (11,636)	\$ 4,483,264	\$ 560,352
Liabilities and net assets							
Current liabilities:							
Accounts payable and accrued expenses	\$ 397,375	\$ -	\$ 64,366	\$ 333,009	\$ -	\$ 320,700	\$ 12,309
Other current liabilities	182,498	(64,184)	70,622	176,060	(11,636)	159,471	28,225
Current portion of long-term debt	25,817	-	676	25,141	-	25,141	-
Total current liabilities	605,690	(64,184)	135,664	534,210	(11,636)	505,312	40,534
Long-term debt, less current portion	1,478,589	-	4,598	1,473,991	-	1,225,859	248,132
Accrued malpractice claims	122,868	-	3,778	119,090	-	119,090	-
Other noncurrent liabilities	151,957	(110,522)	137,322	125,157	-	124,997	160
Total liabilities	2,359,104	(174,706)	281,362	2,252,448	(11,636)	1,975,258	288,826
Net assets							
Net assets without donor restrictions:							
Orlando Health, Inc. and Controlled Affiliates	3,067,821	(71,173)	474,204	2,664,790	-	2,393,516	271,274
Noncontrolling interests in Controlled Affiliates	(890)	-	(890)	-	-	-	-
Total net assets without donor restrictions	3,066,931	(71,173)	473,314	2,664,790	-	2,393,516	271,274
Net assets with donor restrictions	127,794	(119,642)	132,694	114,742	-	114,490	252
Total net assets	3,194,725	(190,815)	606,008	2,779,532	-	2,508,006	271,526
Total liabilities and net assets	\$ 5,553,829	\$ (365,521)	\$ 887,370	\$ 5,031,980	(11,636)	\$ 4,483,264	\$ 560,352

Orlando Health, Inc. and Controlled Affiliates

Consolidating Statement of Operations
(In Thousands)

Year Ended September 30, 2019

	Consolidated	Eliminations	Controlled Affiliates	Combined Obligated Group	Obligated Group Eliminations	Orlando Health Obligated Group Component	Orlando Health Central Obligated Group Component
Revenues and other support without donor restrictions							
Net patient service revenue	\$ 3,197,660	\$ –	\$ 435,213	\$ 2,762,447	\$ –	\$ 2,496,295	\$ 266,152
Other revenue	219,552	(79,175)	90,847	207,880	(1,861)	201,802	7,939
Net assets released from donor restrictions	6,281	(6,478)	6,503	6,256	–	6,256	–
Total revenues and other support without donor restrictions	3,423,493	(85,653)	532,563	2,976,583	(1,861)	2,704,353	274,091
Expenses							
Salaries and benefits	1,698,491	–	517,879	1,180,612	–	1,061,016	119,596
Supplies and other	1,138,919	(80,068)	142,941	1,076,046	(1,861)	990,782	87,125
Professional fees	35,067	(8,253)	7,682	35,638	–	28,971	6,667
Depreciation and amortization	163,352	–	18,269	145,083	–	126,421	18,662
Interest	52,753	–	1,446	51,307	–	47,241	4,066
Total expenses	3,088,582	(88,321)	688,217	2,488,686	(1,861)	2,254,431	236,116
Income (loss) from operations	334,911	2,668	(155,654)	487,897	–	449,922	37,975
Nonoperating gains and losses							
Investment income	86,834	–	3,107	83,727	–	81,242	2,485
Change in fair value of interest rate swap agreements	(18,077)	–	–	(18,077)	–	(18,077)	–
Inherent contribution associated with business combination	181,885	–	181,885	–	–	–	–
Nonoperating gain	2,130	–	1,416	714	–	714	–
Loss on early extinguishment of debt	(5,045)	–	(1,862)	(3,183)	–	(3,183)	–
Nonoperating gains, net	247,727	–	184,546	63,181	–	60,696	2,485
Excess of revenues, other support, and gains over expenses and losses	\$ 582,638	\$ 2,668	\$ 28,892	\$ 551,078	\$ –	\$ 510,618	\$ 40,460

Orlando Health, Inc. and Controlled Affiliates

Orlando Health Central, Inc. Consolidating Balance Sheet
(In Thousands)

September 30, 2019

	Orlando Health Central	Health Central	Health Central Park	Other Non- Hospital Health Services
Assets				
Current assets:				
Cash and cash equivalents	\$ 21,227	\$ 16,307	\$ 4,956	\$ (36)
Accounts receivable, net	31,497	29,359	2,138	–
Other receivables	37,203	37,163	40	–
Inventory	2,486	2,486	–	–
Other current assets	3,794	3,714	78	2
Total current assets	96,207	89,029	7,212	(34)
Long-term investments – without donor restrictions	64,084	64,084	–	–
Other assets	95,313	95,313	–	–
Property and equipment, net	304,715	296,160	8,555	–
Total assets	<u>\$ 560,319</u>	<u>\$ 544,586</u>	<u>\$ 15,767</u>	<u>\$ (34)</u>
Liabilities and net assets				
Current liabilities:				
Accounts payable and accrued expenses	\$ 12,502	\$ 10,288	\$ 1,995	\$ 219
Other current liabilities	28,254	28,079	175	–
Total current liabilities	40,756	38,367	2,170	219
Long-term debt, less current portion	248,132	248,132	–	–
Other noncurrent liabilities	414	160	–	254
Total liabilities	289,302	286,659	2,170	473
Net assets:				
Without donor restrictions	270,765	257,776	13,496	(507)
With donor restrictions	252	151	101	–
Total net assets	271,017	257,927	13,597	(507)
Total liabilities and net assets	<u>\$ 560,319</u>	<u>\$ 544,586</u>	<u>\$ 15,767</u>	<u>\$ (34)</u>

Orlando Health, Inc. and Controlled Affiliates

Orlando Health Central, Inc. Consolidating Statement of Operations
(In Thousands)

Year Ended September 30, 2019

	Orlando Health Central	Health Central	Health Central Park	Other Non- Hospital Health Services
Revenues and other support without donor restrictions				
Net patient service revenue	\$ 266,300	\$ 237,619	\$ 20,677	\$ 8,004
Other revenue	7,943	6,420	109	1,414
Total revenues and other support without donor restrictions	274,243	244,039	20,786	9,418
Expenses				
Salaries and benefits	119,599	104,697	13,393	1,509
Supplies and other	87,254	76,598	6,860	3,796
Professional fees	6,667	6,640	26	1
Depreciation and amortization	18,667	17,203	436	1,028
Interest	4,066	4,066	–	–
Total expenses	236,253	209,204	20,715	6,334
Income from operations	37,990	34,835	71	3,084
Nonoperating gains				
Investment income	2,485	2,484	1	–
Nonoperating gain	–	–	–	–
Nonoperating gains, net	2,485	2,484	1	–
Excess of revenues other support, and gains over expenses and losses	\$ 40,475	\$ 37,319	\$ 72	\$ 3,084

Orlando Health, Inc. and Controlled Affiliates

South Lake Hospital, Inc. Balance Sheet
(In Thousands)

September 30, 2019

Assets

Current assets:

Cash and cash equivalents	\$ 100,283
Assets limited as to use	1,845
Accounts receivable, net	31,521
Other receivables	5,250
Inventory	3,996
Other current assets	1,083
Total current assets	<u>143,978</u>

Assets limited as to use:

Designated by board for property and equipment	24,134
Malpractice self-insurance	1,845
	<u>25,979</u>
Less amount required to meet current obligations	<u>(1,845)</u>
	24,134

Long-term investments – without donor restrictions	41,858
Other assets	11,249
Property and equipment, net	204,839
Total assets	<u>\$ 426,058</u>

Liabilities and net assets

Current liabilities:

Accounts payable and accrued expenses	\$ 25,870
Other current liabilities	7,745
Current portion of long-term debt	324
Total current liabilities	<u>33,939</u>

Long-term debt, less current portion	632
Accrued malpractice claims	3,778
Other noncurrent liabilities	70,427
Total liabilities	<u>108,776</u>

Net assets

Net assets without donor restrictions	315,719
Net assets with donor restrictions	1,563
Total net assets	<u>317,282</u>
Total liabilities and net assets	<u>\$ 426,058</u>

Orlando Health, Inc. and Controlled Affiliates

South Lake Hospital, Inc. Statement of Operations
(In Thousands)

Three Months Ended September 30, 2019

Revenues and other support without donor restrictions

Net patient service revenue	\$ 72,950
Other revenue	<u>2,327</u>
Total revenues and other support without donor restrictions	<u>75,277</u>

Expenses

Salaries and benefits	30,705
Supplies and other	25,384
Professional fees	1,525
Depreciation and amortization	4,053
Interest	<u>1,172</u>
Total expenses	<u>62,839</u>

Income from operations 12,438

Nonoperating gains and (losses)

Investment income	372
Loss on early extinguishment of debt	<u>(1,862)</u>
Nonoperating losses, net	<u>(1,490)</u>

Excess of revenues, other support, and gains over expenses and losses \$ 10,948

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