



OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES
Consolidated Financial Statements and Supplemental Schedules
May 31, 2017 and 2016
(With Independent Auditors' Report Thereon)

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

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KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Owensboro Health, Inc.:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Owensboro Health, Inc. and affiliated entities, which comprise the consolidated balance sheets as of May 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Managements' Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Owensboro Health, Inc. and affiliated entities as of May 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole. The supplementary information included in schedule 5 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Emphasis of Matter

As discussed in note 2(s) to the consolidated financial statements, in 2017, the System adopted new accounting guidance regarding the presentation of debt issuance costs. Our opinion is not modified with respect to this matter.

KPMG LLP

Nashville, Tennessee
September 28, 2017

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidated Balance Sheets

May 31, 2017 and 2016

(In thousands)

Assets	2017	2016
Current assets:		
Cash and cash equivalents	\$ 49,663	9,374
Investments	169,488	156,070
Patient accounts receivable, net of estimated uncollectibles of \$55,480 and \$48,050, respectively	87,527	90,568
Inventories	12,555	12,053
Prepaid expenses and other current assets	11,920	16,762
Assets limited as to use, current portion	24,016	23,843
Total current assets	355,169	308,670
Assets limited as to use, less current portion	38,121	105,041
Property and equipment, net	599,429	600,747
Deferred compensation plan assets	10,112	8,508
Other assets	13,747	13,441
Total assets	\$ 1,016,578	1,036,407
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt, net less debt issuance costs	\$ 6,816	6,586
Accounts payable	20,495	23,354
Accrued payroll and related liabilities	25,483	22,268
Other current liabilities	36,879	35,791
Due to third-party payors	23,585	22,984
Total current liabilities	113,258	110,983
Deferred compensation plan obligations	10,112	8,508
Long-term debt, less current maturities and debt issuance costs	600,419	551,846
Accrued pension cost	70,363	69,172
Contractual lease obligation	3,340	3,997
Other long-term liabilities	253	131
Total liabilities	797,745	744,637
Net assets:		
Unrestricted	217,611	290,650
Temporarily restricted	1,404	1,274
Total net assets attributable to Owensboro Health, Inc.	219,015	291,924
Noncontrolling interests	(182)	(154)
Total net assets	218,833	291,770
Commitments and contingencies		
Total liabilities and net assets	\$ 1,016,578	1,036,407

See accompanying notes to consolidated financial statements.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidated Statements of Operations

Years ended May 31, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Unrestricted revenue:		
Net patient service revenue	\$ 634,420	604,217
Provision for bad debts	<u>(37,628)</u>	<u>(36,441)</u>
Net patient service revenue less provision for bad debts	596,792	567,776
Other operating revenue	<u>12,909</u>	<u>15,147</u>
Total unrestricted revenue	<u>609,701</u>	<u>582,923</u>
Patient service and other expenses:		
Personnel	336,374	320,877
Professional fees	30,196	31,874
Drugs and supplies	116,162	109,235
Plant maintenance and operation	20,888	19,957
Kentucky provider tax	4,868	4,305
Other expenses	40,322	41,367
Depreciation and amortization	41,098	44,646
Interest expense	31,711	32,593
Loss on bond defeasance	<u>83,073</u>	<u>—</u>
Total patient service and other expenses	<u>704,692</u>	<u>604,854</u>
Operating loss	<u>(94,991)</u>	<u>(21,931)</u>
Nonoperating gains (losses):		
Investment income (losses), net	13,183	(780)
Contributions and other	<u>68</u>	<u>352</u>
Nonoperating gains (losses), net	<u>13,251</u>	<u>(428)</u>
Deficiency of revenue and gains over expenses and losses before noncontrolling interests	(81,740)	(22,359)
Noncontrolling interests	<u>(650)</u>	<u>(80)</u>
Deficiency of revenue and gains over expenses and losses	(82,390)	(22,439)
Accrued pension cost adjustment	<u>9,351</u>	<u>(17,161)</u>
Change in unrestricted net assets before changes related to Muhlenberg acquisition	(73,039)	(39,600)
Excess of net assets acquired in the Muhlenberg acquisition over consideration transferred	<u>—</u>	<u>7,276</u>
Change in unrestricted net assets	\$ <u><u>(73,039)</u></u>	\$ <u><u>(32,324)</u></u>

See accompanying notes to consolidated financial statements.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidated Statements of Changes in Net Assets

Years ended May 31, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Unrestricted net assets:		
Deficiency of revenue and gains over expenses and losses	\$ (82,390)	(22,439)
Accrued pension cost adjustment	9,351	(17,161)
Excess of net assets acquired in Muhlenberg acquisition over consideration transferred	<u>—</u>	<u>7,276</u>
Change in unrestricted net assets	<u>(73,039)</u>	<u>(32,324)</u>
Temporarily restricted net assets:		
Contributions	305	217
Net assets released from restrictions used for operations	<u>(175)</u>	<u>(153)</u>
Change in temporarily restricted net assets	<u>130</u>	<u>64</u>
Noncontrolling interests:		
Excess of revenue and gains over expenses and losses	650	80
Partnership investment	(158)	1
Distributions to minority shareholders	<u>(520)</u>	<u>(516)</u>
Change in noncontrolling interests	<u>(28)</u>	<u>(435)</u>
Change in total net assets	(72,937)	(32,695)
Net assets, beginning of year	<u>291,770</u>	<u>324,465</u>
Net assets, end of year	\$ <u><u>218,833</u></u>	<u><u>291,770</u></u>

See accompanying notes to consolidated financial statements.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidated Statements of Cash Flows

Years ended May 31, 2017 and 2016

(In thousands)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in total net assets	\$ (72,937)	(32,695)
Adjustments to reconcile change in total net assets to net cash provided by operating activities:		
Depreciation and amortization	41,098	44,646
Provision for bad debts	37,628	36,441
Loss on defeasance of bonds	83,073	—
Amortization of deferred financing costs	230	195
Distributions to noncontrolling interests	520	516
Net realized and unrealized (gains) losses on investments	(7,980)	3,109
Excess of net assets acquired in Muhlenberg acquisition over consideration transferred	—	(7,276)
Gain on disposal of property and equipment	(194)	(30)
Accrued pension cost adjustments	(9,351)	17,161
Increase (decrease) in cash due to changes in:		
Patient accounts receivable	(34,587)	(51,753)
Inventories	(502)	(723)
Prepaid expenses and other current assets	4,842	(6,486)
Other assets	(4,024)	(2,055)
Accounts payable	(6,889)	2,739
Accrued payroll and related liabilities	3,215	(1,156)
Accrued pension cost	10,542	3,620
Other liabilities	17,119	2,044
Due to third-party payors	601	888
Net cash provided by operating activities	<u>62,404</u>	<u>9,185</u>
Cash flows from investing activities:		
Acquisition and construction of property and equipment	(36,213)	(33,390)
Cash received in acquisition	—	1,997
Purchases of investment securities	(102,826)	(168,398)
Proceeds from sales and maturities of investment securities	97,388	180,939
Change in assets limited as to use	(11,285)	(68,824)
Net cash used in investing activities	<u>(52,936)</u>	<u>(87,676)</u>
Cash flows from financing activities:		
Payments on long-term debt	(6,550)	(32,635)
Proceeds from issuance of debt	501,227	97,567
Bond Defeasance	(453,810)	—
Payment for deferred financing costs	(9,526)	—
Other	—	(807)
Distributions to noncontrolling interests	(520)	(516)
Net cash provided by financing activities	<u>30,821</u>	<u>63,609</u>
Net increase (decrease) in cash and cash equivalents	40,289	(14,882)
Cash and cash equivalents, beginning of year	9,374	24,256
Cash and cash equivalents, end of year	\$ <u>49,663</u>	<u>9,374</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 19,606	33,801
Noncash activities:		
Acquisition of Owensboro Health Muhlenberg Community Hospital	—	10,555
Accrued but unpaid costs of property and equipment additions	4,030	323

See accompanying notes to consolidated financial statements.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

(1) Organization and Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Owensboro Health, Inc. (Owensboro Health), a Kentucky nonstock, nonprofit corporation, and its affiliated entities (the System). Owensboro Health's wholly owned and controlled affiliated entities include Owensboro Health Medical Group, Inc. (OHMG), Owensboro Health Muhlenberg Community Hospital (OHMCH) (note (1)(a) below in reference to acquisition), Owensboro Medical Center Laboratory, Inc. (OMCL), The Foundation for Health, Inc., The Health Network of Western Kentucky, LLC (HNWK), and Commonwealth Medical Management, LLC (CMM). Owensboro Ambulatory Surgical Facility Ltd. (OASF), a 65.7% owned affiliated entity, is also included in the consolidated financial statements.

(a) Acquisition of Operations of Owensboro Health Muhlenberg Community Hospital

On July 1, 2015, OHMCH acquired certain assets and operations of Muhlenberg Community Hospital (MCH) by way of an asset purchase agreement and long-term lease agreement of the facilities (Muhlenberg acquisition). The purchase price for this acquisition was approximately \$676 in the forgiveness of accrued management fees by Owensboro Health and the assumption of approximately \$4,199 of accounts payable.

The Muhlenberg acquisition was accounted for using the acquisition method of accounting. Under the acquisition method, the total purchase price of the acquired company is allocated to the assets acquired and the liabilities assumed based on their fair values. The operating results of the acquisition are included in the accompanying consolidated financial statements from the date of acquisition.

The following summarizes consideration paid and the allocation of purchase price to net assets acquired:

Consideration:		
Forgiveness of management fee	\$	<u>676</u>
Fair value of total consideration transferred	\$	<u><u>676</u></u>

The following table summarizes the fair value of the assets acquired and liabilities assumed as of the acquisition date:

Recognized amounts of assets acquired and liabilities assumed:

Current assets:		
Cash and cash equivalents	\$	1,997
Accounts receivable, net		6,047
Inventories		1,773
Other current assets		<u>3,514</u>
Total current assets		13,331

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

Noncurrent assets:	
Plant and equipment	\$ <u>3,420</u>
Total assets	<u>16,751</u>
Current liabilities:	
Accounts payables	(1,490)
Accrued expenses	(2,582)
Contractual lease obligation	<u>(4,600)</u>
Total current liabilities	(8,672)
Noncurrent liabilities:	
Capital expense obligation	—
Other liabilities	<u>(127)</u>
Total Liabilities	<u>(8,799)</u>
Excess of net assets acquired over purchase price	\$ <u><u>7,276</u></u>

OHMCH is committed to a lease, which requires \$600 of annual rent and to fund capital expenditure of \$2,200 per year; however, this amount can be renegotiated annually as expenditures are needed. The System has estimated the present value of this capital expenditure obligation at \$4,600 as of July 1, 2015. This amount is being accreted over the seven-year noncancelable lease term. Accretion was \$657 for the year ended May 31, 2017. The lease is for a period of 20 years with an option for the System to cancel after seven years.

The consolidated entity renders acute and other healthcare services in Daviess County and surrounding counties. The consolidated activities hereinafter are referred to as the System. All material intercompany balances and transactions have been eliminated in consolidation.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

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

(b) Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt investments with maturities of three months or less at date of purchase.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

(c) Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value at the consolidated balance sheet date. Investment income or loss (including both unrealized and realized gains and losses on investments, interest, and dividends) is included in the deficiency of revenue and gains over expenses and losses, unless the income or loss is restricted by donor or law, as all investments are considered trading securities.

(d) Inventories

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

(e) Assets Limited as to Use

Assets limited as to use include assets held by trustees under indenture and other funding agreements. Amounts required to meet current liabilities of the System are classified as current assets in the accompanying consolidated balance sheets.

(f) Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the accompanying consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the deficiency of revenue and gains over expenses and losses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long these long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(g) Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of

Long-lived assets, goodwill, and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less estimated costs to sell.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

(h) Other Assets

Other assets consist primarily of goodwill, which represents the excess of the purchase price over the actual fair value of assets acquired, and other assets. Goodwill was approximately \$13,195 at May 31, 2017 and 2016.

(i) Basis of Accounting

Net assets and revenue, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the System and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations. Such stipulations may be met either by actions of the System and/or by the passage of time.

Revenue is reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets. Donor-restricted net assets whose restrictions are met within the same year as received are reported as restricted net assets and as net assets released from restrictions in the accompanying consolidated financial statements.

(j) Deficiency of Revenue and Gains over Expenses and Losses

The accompanying consolidated statements of operations include deficiency of revenue and gains over expenses and losses. Changes in unrestricted net assets, which are excluded from deficiency of revenue and gains over expenses and losses, consistent with industry practice, include the recognition of pension liability adjustments arising during the current period, the cumulative effect of accounting principle changes, permanent transfers of assets to and from nonconsolidated affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions that were restricted for the purposes of acquiring such assets).

(k) Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

(l) Charity Care

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

(m) Income Taxes

Owensboro Health and its affiliated entities, OHMG and the Foundation for Health, Inc., are nonprofit corporations and have been recognized as tax exempt under Section 501(a) of the Internal Revenue Code (IRC) as entities described in Section 501(c)(3) of the IRC. HNWK is a single-member LLC with 100% of its profits and losses attributable to Owensboro Health. For OASF, a partnership, the liability for any income taxes is the responsibility of the OASF partners. OMCL is a for-profit corporation subject to federal income taxes. OMCL has incurred losses and has federal net operating loss carryforwards for income tax purposes, which have been fully reserved.

The System applies Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740 (Topic 740), *Accounting for Uncertainty in Income Taxes*. Topic 740 provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There is currently no impact on the System's consolidated financial statements as a result of the application of Topic 740.

(n) Computer Software Costs

Certain costs related to the development or purchase of internal-use software are capitalized and amortized over the estimated life of the software. In addition, costs related to the preliminary project stage and the postimplementation/operations stage in an internal-use computer software development project are expensed as incurred. The System capitalized approximately \$4,215 and \$2,589 in 2017 and 2016, respectively, of costs related to its development of new system software.

(o) Pension Accounting Standard

The System follows the recognition and disclosure provisions of FASB ASC Subtopic 715-20, *Defined Benefit Plans* (Subtopic 715-20). Subtopic 715-20 (among other things) requires that the System recognize the unfunded status of its defined-benefit pension plan on its consolidated balance sheets. The System measures the plan at May 31 each year.

Subtopic 715-20 also requires that the System provide enhanced disclosures related to pension plan assets, including disclosures related to the fair value of the plan assets. These enhanced disclosures are included in these consolidated financial statements at note 12.

(p) Fair Value Measurements

The System follows the following financial accounting and reporting literature regarding fair value measurements:

- FASB ASC Topic 820 (Topic 820), *Fair Value Measurement*, which defines fair value, establishes an enhanced framework for measuring fair value, and expands disclosures about fair value measurements;

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Notes to Consolidated Financial Statements

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(In Thousands)

(q) Noncontrolling Interests

The System follows Accounting Standards Update (ASU) No. 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions*, which amends ASC Topic 958, *Not-for-Profit Entities* (NFP Entities). The amendments in this standard provide guidance on accounting for consolidation of NFP Entities. It defines a merger of NFP Entities as one in which one NFP Entity cedes control to another NFP Entity. In the case of a merger, the carryover method applies, which requires combining the assets and liabilities as of the merger date. Combinations are accounted for as acquisitions when consideration is transferred to the former owner or designee. Acquisitions are accounted for by applying fair market values to acquired assets and liabilities, including identifiable intangible assets and the recognition of goodwill in the case of NFP Entities with operations not predominately supported by contributions. Any resulting goodwill is analyzed for impairment annually, or if business conditions indicate an analysis is necessary, and is no longer amortized. The guidance requires that noncontrolling ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated balance sheets within net assets, but separate from the parent's net assets. In addition, the standard requires that a consolidated schedule of changes in net assets attributable to the parent and noncontrolling interests be provided for each class of net assets for which a noncontrolling interest exists during the reporting period.

(r) Healthcare Industry Environment

The System's management monitors economic conditions closely, both with respect to potential impacts on the healthcare provider industry and from a more general business perspective. While the System was able to achieve certain objectives of importance in the current economic environment, management recognizes that economic conditions may continue to impact the System in a number of ways, including (but not limited to) uncertainties associated with U.S. financial system reform and rising self-pay patient volumes and corresponding increases in uncompensated care.

Additionally, the general healthcare industry environment is increasingly uncertain, especially with respect to the impacts of federal healthcare reform legislation, which was passed in the spring of 2010 and upheld by the Supreme Court in June 2012. Potential impacts of ongoing healthcare industry transformation include, but are not limited to, the following:

- Significant (and potentially unprecedented) capital investment in healthcare information technology (HCIT)
- Continuing volatility in the state and federal government reimbursement programs
- Lack of clarity related to the health benefit exchange framework mandated by reform legislation, including important open questions regarding the constitutionality of the legislation, exchange reimbursement levels, changes in combined state/federal disproportionate share payments, and impact on the healthcare "demand curve" as the previously uninsured enter the insurance system
- Significant potential business model changes throughout the healthcare ecosystem, including within the healthcare commercial payor industry

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

The business of healthcare in the current economic, legislative, and regulatory environment is volatile. Any of the above factors, along with others both currently in existence and/or, which may arise in the future, could have a material adverse impact on the System's financial position and operating results.

(s) Recently Issued Accounting Pronouncements

In April 2015, the FASB issued ASU No 2015-03, *Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*. Under the new guidance, debt issuance costs related to a recognized debt liability are presented on the balance sheet as a direct deduction from the liability rather than as an asset. This treatment is consistent with the presentation of debt discounts. The System has adopted this treatment and applied it retrospectively in accordance with the guidance. The implementation did not have a material impact on the System's consolidated balance sheet and had no impact on the System's consolidated statements of operations, changes in net assets, or cash flows. The consolidated balance sheet at May 31, 2016 has been restated to reclassify \$3,513, of debt issuance costs from Other Assets to a reduction of Long-Term Debt. On the May 31, 2017 consolidated balance sheet, debt issuance costs in the amount of \$9,627 are presented as a reduction of Long-Term Debt.

(3) Charity Care

Self-pay revenue is primarily derived from patients who do not have any form of healthcare coverage and from patient responsibility after insurances have paid their obligations. The revenue associated with self-pay patients is generally reported at the System's gross charges. The System evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid, or other governmental assistance programs, as well as the System's policy for charity care. The System provides assistance in applying for Medicaid and/or other governmental assistance programs if the evaluation determines they may be eligible for such a program.

The System provides care without charge to patients that qualify under the System's charity care policy. The policy takes into consideration family size, income, and medical indigence in determining eligibility. Patients at 225% and below the Federal Poverty Income Level are eligible for 100% financial assistance with a sliding scale up to 375% of Federal Poverty Guidelines for eligibility of 70% financial assistance.

The System's management estimates its costs of care provided under its charity care programs utilizing a calculated ratio of total costs (less bad debt expense) to gross charges multiplied by the System's gross charity care charges provided to charity patients for the period. The System's gross charity care charges include only services provided to patients who are unable to pay and qualify under the charity care policy. The System does not report a charity care patient's charges in net patient service revenue or in the estimated uncollectibles as it is the System's policy not to pursue collection of amounts related to these patients.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

The following information measures the level of charity care provided during the years ended May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Charges forgone, based on established rates	\$ 11,594	12,061
Estimated costs and expenses incurred to provide charity care	4,788	4,259
Equivalent percentage of charity care charges to all charges	0.8 %	0.9 %

The System received approximately \$2,867 and \$2,055 in 2017 and 2016, respectively, from the Commonwealth of Kentucky as a Disproportionate Share Hospital (DSH) payment for the provision of care to indigent citizens.

(4) Business and Credit Concentration

The System provides healthcare service through its inpatient and outpatient care facilities located primarily in Owensboro, Kentucky. The System grants credit to its patients and generally does not require collateral or other security in extending credit to patients. However, the System routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations, and commercial insurance policies).

Patient accounts receivable include net receivables from the federal government (Medicare), the Commonwealth of Kentucky (Medicaid), and Blue Cross at May 31, 2017 and 2016 as follows:

	<u>2017</u>	<u>2016</u>
Medicare	\$ 28,062	27,260
Medicaid	15,170	12,844
Blue Cross	<u>27,167</u>	<u>20,763</u>
Total	<u>\$ 70,399</u>	<u>60,867</u>

At May 31, 2017 and 2016, the System had deposits at financial institutions of approximately \$46,953 and \$6,701, respectively, in excess of the Federal Deposit Insurance Corporation limits. Further, investments in U.S. government and U.S. government agency securities are not guaranteed by the U.S. government or otherwise insured.

(5) Investments and Assets Limited as to Use

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

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When available, the System generally uses quoted market prices to determine fair value, and classifies such items as Level 1. The System's Level 2 securities are bonds whose fair values are determined by independent vendors. The vendors compile prices from various sources and may apply matrix pricing for similar bonds or loans where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued. The System had no significant transfers of assets and liabilities into or out of Levels 1 and 2 during 2017 or 2016.

The System's Level 3 securities comprise alternative investments that have less liquidity, a stale quoted price, or varying price from independent sources. The System's Level 3 alternative investments' prices are obtained from the related fund manager. For the System's funds of funds, the manager receives account statements directly from independent administrators or the underlying hedge fund managers, who are responsible for the pricing of these funds. Before relying on these valuations, the System evaluates the fair value estimation processes and control environment, the investee fund's policies and procedures in estimating the fair value of underlying investments, the investee fund's use of independent third-party valuation experts, the portion (approximately 100% for the System) of the underlying securities traded on active markets and the professional reputation and standing of the investee fund's auditor.

Investments, stated at fair value, at May 31, 2017 and 2016 include the following:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 3,607	13,645
U.S. Treasury obligations	14,218	8,941
Federal mortgage-backed securities	2,003	3,735
Corporate bonds	35,617	26,938
Equity securities	24,383	20,804
Mutual funds	84,011	76,495
Certificates of deposit	5,354	5,320
Accrued interest receivable	295	192
Total investments	<u>\$ 169,488</u>	<u>156,070</u>

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The fair value hierarchy of investments is as follows:

	2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 3,607	—	—	3,607
U.S. Treasury obligations	14,218	—	—	14,218
Federal mortgage-backed securities:				
Residential	—	2,003	—	2,003
Corporate bonds:				
Domestic	—	24,031	—	24,031
International	—	11,586	—	11,586
Equity securities:				
Consumer discretionary	2,509	—	—	2,509
Consumer staples	—	—	—	—
Energy	2,139	—	—	2,139
Financial	6,763	—	—	6,763
Healthcare	4,012	—	—	4,012
Industrials	2,199	—	—	2,199
Information technology	4,729	—	—	4,729
Materials	1,524	—	—	1,524
Telecommunication services	361	—	—	361
Utilities	147	—	—	147
Mutual funds:				
Large cap equity securities	16,064	—	—	16,064
Small and mid cap equity securities	15,416	—	—	15,416
International equity securities	23,713	—	—	23,713
Bond funds	28,818	—	—	28,818
Certificates of deposit	5,354	—	—	5,354
Accrued interest receivable	295	—	—	295
	<u>\$ 131,868</u>	<u>37,620</u>	<u>—</u>	<u>169,488</u>

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	2016			Total
	Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 13,645	—	—	13,645
U.S. Treasury obligations	8,941	—	—	8,941
Federal mortgage-backed securities:				
Residential	—	3,735	—	3,735
Corporate bonds:				
Domestic	—	18,494	—	18,494
International	—	8,444	—	8,444
Equity securities:				
Consumer discretionary	2,242	—	—	2,242
Consumer staples	182	—	—	182
Energy	2,161	—	—	2,161
Financial	6,092	—	—	6,092
Healthcare	3,444	—	—	3,444
Industrials	1,826	—	—	1,826
Information technology	2,477	—	—	2,477
Materials	1,203	—	—	1,203
Telecommunication services	949	—	—	949
Utilities	228	—	—	228
Mutual funds:				
Large cap equity securities	—	—	—	—
Small and mid cap equity securities	27,609	—	—	27,609
International equity securities	21,201	—	—	21,201
Bond funds	27,685	—	—	27,685
Certificate of deposit	5,320	—	—	5,320
Accrued interest receivable	192	—	—	192
	\$ <u>125,397</u>	<u>30,673</u>	<u>—</u>	<u>156,070</u>

The rollforward of Level 3 investments is as follows:

	2017	2016
Beginning of year	\$ —	21,462
Net realized and unrealized gains	—	42
Purchases, sales, dividends, contributions, and withdrawals	—	(21,504)
Transfers into and/or out of Level 3	—	—
End of year	\$ <u>—</u>	<u>—</u>

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Assets limited as to use, stated at fair value, at May 31, 2017 and 2016 include the following:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 62,115	128,883
Accrued interest receivable	22	1
Total assets limited as to use	<u>62,137</u>	<u>128,884</u>
Less amounts required to meet current obligations	<u>24,016</u>	<u>23,843</u>
	<u>\$ 38,121</u>	<u>105,041</u>

As of May 31, 2017 and 2016, all of assets limited as to use were considered Level 1 investments.

Assets limited as to use in the accompanying consolidated balance sheets were established in accordance with the requirements of the indentures related to the various revenue bond issues discussed in note 9, which require the following funds:

	<u>2017</u>	<u>2016</u>
Debt service reserve funds	\$ —	41,434
Principal and interest funds	24,017	23,843
Construction funds	37,950	63,187
Expense funds	<u>170</u>	<u>420</u>
	<u>\$ 62,137</u>	<u>128,884</u>

The interest funds are used to pay interest on the various bond issues. The debt service reserve funds secure any potential deficiencies in the interest funds. Expense funds are used to pay for expenses related to the issuance of the bonds.

(6) Investment Income (Loss)

Investment income (loss) comprised the following for the years ended May 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Investment income (loss):		
Interest and dividend income	\$ 4,140	4,010
Net realized (losses) gains on sales of securities	1,464	(667)
Net unrealized gains (losses) on trading securities	7,980	(3,617)
Management fees and other	<u>(401)</u>	<u>(506)</u>
Investment income (loss), net	<u>\$ 13,183</u>	<u>(780)</u>

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(7) Property and Equipment

A summary of property and equipment at May 31, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Land	\$ 16,415	14,355
Land improvements	3,710	2,458
Buildings	618,389	614,772
Fixed equipment	41,777	40,558
Major movable equipment and capitalized software costs	<u>247,914</u>	<u>235,420</u>
	928,205	907,563
Less accumulated depreciation and amortization	<u>372,063</u>	<u>330,452</u>
	556,142	577,111
Construction in progress	<u>43,287</u>	<u>23,636</u>
	<u>\$ 599,429</u>	<u>600,747</u>

Construction in progress at May 31, 2017 consists primarily of costs incurred for new Healthplexes and improvements related to various buildings. The Healthplex projects are expected to be completed in the last quarter of 2017. At May 31, 2017, the remaining commitments on construction contracts approximated \$39,418.

Capitalized interest expenses for 2017 was approximately \$3,457. Capitalized interest expenses for 2016 was approximately \$2,669.

There was no property and equipment under capital lease obligations at May 31, 2017 and 2016.

(8) Net Patient Service Revenue

The System participates in the Medicare and Medicaid programs (the Programs). The Programs reimburse the System at amounts different from the established billing rates. Contractual adjustments under the Programs represent the difference between the System's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors is as follows:

Medicare – The System is paid for substantially all services rendered to inpatient Medicare Program beneficiaries under prospectively determined rates per discharge. Those rates vary according to a classification system that is based on clinical, diagnostic, and other factors. The Medicare Program reimburses the System on a prospective payment system for hospital outpatient services known as the Ambulatory Payment Classification (APC) system. Under the APC system, outpatient services are classified into an APC category based on the CPT-4 Code for the service provided, and payment for the APC category is determined using prospectively determined federal payment rates adjusted for regional wage differences. Depreciation and other defined capital costs are reimbursed under a capital

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prospective payment system. Reimbursement is calculated based on a federal capital payment rate per discharge. The System receives cash payments at a tentative rate with final settlement determined after the System's submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The System's classification of patients under the Medicare Prospective Payment System and the appropriateness of the patients' admissions are subject to validation reviews by the Medicare peer review organization with which the System is required by law to contract for the performance of such reviews. Revenue from the Medicare program totals approximately 39.2% and 33% of the System's net patient service revenue for the years ended May 31, 2017 and 2016, respectively.

Medicaid – The System is paid for substantially all services rendered to inpatient Medicaid Program beneficiaries under prospectively determined rates per discharge. Those rates vary according to a classification system that is based on clinical, diagnostic, and other factors. Outpatient services, except for lab services, are reimbursed by the Medicaid program based upon a cost-reimbursement methodology. Final reimbursement rates are determined after submission of annual cost reports by the System and audits by third-party intermediaries. Lab services are reimbursed on a predetermined fee schedule based upon the CPT-4 Code for the service provided. Revenue from the Medicaid program totals approximately 14.9% and 11.0% of the System's net patient service revenue for the years ended May 31, 2017 and 2016, respectively. Kentucky Medicaid began to contract with managed care organizations in late 2011. Approximately 90% of Kentucky Medicaid enrollees are in a managed care plan.

Other – The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred-provider organizations. The bases for payment to the System under these agreements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

The Kentucky General Assembly enacted a temporary tax on all healthcare providers beginning July 1, 1993. The tax on hospitals is 2.5% of net patient service revenue and contributions received. The tax expense recognized was approximately \$6,605 and \$6,510 at 2017 and 2016, respectively. The legislation also provided payments to qualifying hospitals for the care of indigent patients. The System's tax was reduced by approximately \$1,999 and \$2,852 of such payments for 2017 and 2016, respectively.

Amounts due to third-party payors represent the excess of interim payments received or receivable over estimated final payment rates. In the opinion of management, adequate provision has been made in the accompanying consolidated financial statements for the effects of estimated final settlements on open years. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue increased approximately \$1,713 and \$1,582 for the years ended May 31, 2017 and 2016, respectively, as a result of prior year final settlements in excess of amounts previously estimated and the removal of liabilities related to prior years that are no longer necessary as such years are no longer subject to audits, reviews, and investigations. The increase for the year ended May 31, 2017 consisted of third-party estimates that were above actual amounts paid.

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The composition of net patient service revenue is as follows:

	<u>2017</u>	<u>2016</u>
Gross patient service revenue	\$ 1,726,414	1,585,654
Less provision for contractual and other adjustments	<u>1,091,994</u>	<u>981,437</u>
Net patient service revenue	<u>\$ 634,420</u>	<u>604,217</u>

Patient accounts receivable are reduced by an allowance for bad debts. In evaluating the collectibility of accounts receivable, the System analyzes historical collections and write-offs and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for bad debts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluation of the sufficiency of the allowance for bad debts. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for bad debts, allowance for contractual adjustments, provision for bad debts, and contractual adjustments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely. For receivables associated with self-pay patients or with balances remaining after the third-party coverage has already been paid, the System records a significant provision for bad debts in the period of service on the basis of its historical collections, which indicates that many patients decline to pay the portion of their bill for which they are financially responsible. The difference between the discounted rate and the amounts collected after all reasonable collection efforts have been exhausted is written off against the allowance for bad debts. The System's self-pay write-offs increased approximately \$1,187 from \$36,441 for fiscal year 2016 to approximately \$37,628 for fiscal year 2017. The System has changed its charity care during fiscal year 2017 to meet the new requirements as described in Section 501(r) of the IRC and has adjusted the write-off percentages to comply with the Section 501(r) regulations. The System maintains an allowance for estimated uncollectible accounts from other third-party payors, which is not material.

In the spring of 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the Health Care Acts) were signed into law by President Obama. The impact of the Health Care Acts is complicated and difficult to predict, but the System anticipates its reimbursement in the future will be affected by major elements of the Health Care Acts designed to (1) increase insurance coverage, (2) change provider and payor behavior, and (3) encourage alternative payment and delivery models. Many healthcare reform variables remain unknown and are, among other things, dependent on implementation by federal and state governments and reactions by providers, payors, employers, and individuals. The System continues to monitor developments in healthcare reform and participates actively in contemplating and designing new programs that are encouraged and/or required by the Health Care Acts.

The Health Information Technology for Economic and Clinical Health (HITECH) Act was enacted as part of the American Recovery and Reinvestment Act of 2009 and signed into law in February 2009. In the context of the HITECH Act, the System must implement a certified Electronic Health Record (EHR) in an effort to promote the adoption and "meaningful use" of health information technology. The HITECH Act includes significant monetary incentives and payment penalties meant to encourage the adaptation of EHR

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technology. The System anticipates that its current enterprise-wide EHR will enable its compliance with the meaningful use objectives mandated in the HITECH legislation. The System has recorded approximately \$1,346 and \$1,326 in other revenue as of May 31, 2017 and 2016, respectively, related to the HITECH Act.

(9) Long-Term Debt

A summary of long-term debt and capital lease obligations at May 31, 2017 and 2016 is as follows (in thousands):

	<u>2017</u>	<u>2016</u>
2010 revenue bonds, Series A, under a Master Trust Indenture, interest from 5.00% to 6.50%, through March 2045	\$ 24,095	446,235
2010 revenue bonds, Series B, under a Master Trust Indenture, interest from 4.00% to 6.40%, through March 2040	—	36,975
2015 revenue bonds, Series A, under a Master Trust Indenture, interest from 4.50% to 5.25%, through June 2050	67,585	67,585
2015 revenue bonds, Series B, under a Master Trust Indenture, interest from 3.00% to 5.00%, through June 2031	23,730	24,885
2017 revenue bonds, Series A, under a Master Trust Indenture, interest from 4.00% to 5.25%, through June 2045	433,620	—
2017 revenue bonds, Series B, under a Master Trust Indenture, interest from 3.75% to 5.00%, through June 2040	39,015	—
	<u>588,045</u>	<u>575,680</u>
Total contractual long-term debt		
Unamortized premiums and (discounts), net	28,817	(13,735)
Unamortized debt issuance costs, net	(9,627)	(3,513)
	<u>607,235</u>	<u>558,432</u>
Total long-term debt		
Less current portion	6,816	6,586
	<u>\$ 600,419</u>	<u>551,846</u>

In May 2017, the System, through the Kentucky Economic Development Finance Authority, issued Hospital Revenue Refunding Bonds, Series 2017A and Hospital Revenue Refunding Bonds, Series 2017B (collectively, 2017 revenue bonds) in the amount of \$433,620 and \$39,015, totaling \$472,635. The proceeds from the issuance were used to partially advance refund the Series 2010A and to fully advance refund the Series 2010B. The portion of the Series 2010A Bonds maturing prior to June 1, 2021 were not refunded in the principal amount of approximately \$24,095. As a result of the issuance of the Series 2017 Bonds and the defeasance of the Refunded 2010 Bonds, OHI recorded a noncash loss on bond defeasance of approximately \$83,073 primarily from the difference between the purchase prices and the par values of the purchased securities of approximately \$63,727 and write-off of the unamortized bond discounts and issuance costs of approximately \$19,346. The remaining net proceeds were used to pay the premium for the Surety Bond, to fund the Debt Service Reserve Requirement, pay the premium for the Policy insuring payment, and pay certain expenses incurred in connection with the issuance.

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In July 2015, the System, through the Kentucky Economic Development Finance Authority, issued Hospital Revenue Bonds, Series 2015A and Hospital Revenue Refunding Bonds, Series 2015B (collectively, 2015 revenue bonds) in the amount of \$67,585 and \$24,885, totaling \$92,470. The proceeds from the issuance were used to provide funding to finance the cost of acquiring, constructing, and equipping the Healthplexes project, refund \$26,758 for portion of the Series 2010B bonds, fund a portion of the interest on the 2015 Series A bonds, and pay certain expenses incurred in connection with the issuance.

In March 2010, the System, through the Kentucky Economic Development Finance Authority, issued Hospital Revenue Bonds, Series 2010A and Hospital Revenue Refunding Bonds, Series 2010B (collectively, 2010 revenue bonds) in the amount of \$460,645 and \$66,695, totaling \$527,340. The proceeds from the issuance were used to provide funding to finance the cost of acquiring, constructing, and equipping a new nine-story replacement acute care hospital and related service buildings, refund \$152,000 in aggregate principal amount of the 2001 revenue bonds, fund a debt service reserve fund to be used to pay down future debt service, fund a portion of the interest on the 2010 Series A bonds, and pay certain expenses incurred in connection with the issuance. In May 2017, the 2010 Series A bonds was partially refunded by 2017 Series A bonds with current outstanding amount of \$24,095 and 2010 Series B bonds outstanding balance of \$66,695 was fully advanced refunded through the use of proceeds of the 2017 Series B bonds described above.

In June 2001, the System, through the City of Owensboro, Kentucky, issued Health System Variable Revenue Bonds Auction Rate Securities, 2001 Series A, B, and C (collectively, 2001 revenue bonds) in the amount of \$70,400, \$65,500, and \$65,525, respectively, totaling \$201,425. The funds were designated to reimburse the System for the cost of certain capital expenditures, certain future capital expenditures, certain advance refunding, and principal payments of the Series 1992 and 1996 bonds, and to pay the costs of issuance of the 2001 revenue bonds. The 2001 revenue bonds had interest at a variable rate following a 35-day auction period. The outstanding balance of \$152,000 was refunded in March 2010 through the use of proceeds of the 2010 revenue bonds described above.

The 2010 revenue bonds are collateralized by related bond trust funds and pledged revenue. The System has also agreed under the Master Trust Indenture to subject the Obligated Group to various operational and financial covenants typical of such agreements. The Obligated Group includes Owensboro Health and OHMG, excluding its subsidiary, OMCL. In addition, the System has granted to the Master Trustee, a deed of trust lien on the land and buildings owned by Owensboro Health and a security interest in Owensboro Health's accounts receivable to secure payment of the outstanding revenue bonds.

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Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows (in thousands):

	<u>Long-term debt</u>
Year ending May 31:	
2018	\$ 6,816
2019	8,755
2020	9,205
2021	9,685
2022	10,190
Thereafter	<u>543,394</u>
	<u>\$ 588,045</u>

Debt issuance costs of approximately \$9,627 and \$3,513 at May 31, 2017 and 2016, respectively, are being amortized over the term of the bonds using the effective-interest method. Accumulated amortization was approximately \$456 and \$337 at May 31, 2017 and 2016, respectively.

(10) Operating Leases

The System leases certain buildings and equipment under noncancelable operating leases with terms ranging from 2 to 10 years. Rent expense under these leases approximated \$1,186 and \$1,055 for the years ended May 31, 2017 and 2016, respectively. Rental expense, including short-term cancelable rentals was \$2,358 and \$1,641 for the years ended May 31, 2017 and 2016, respectively.

Future minimum lease payments under these noncancelable operating leases with initial or remaining terms in excess of one year are as follows (in thousands):

Year ending May 31:	
2018	\$ 984
2019	887
2020	826
2021	600
2022	600
Thereafter	<u>—</u>
Total minimum lease payments	<u>\$ 3,897</u>

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(11) Temporarily Restricted Net Assets

Temporarily restricted net assets at May 31, 2017 and 2016 are available for use as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Breast cancer	\$ 54	49
Cancer center	324	319
Cancer Center Transportation	20	20
Gains Scholarship	24	13
HOPE fund	345	223
Hospitality House	118	124
Kuhlin Endowment Fund	22	22
Lifespring	28	26
McAuley Clinic	195	194
Medicus	73	73
NICU	50	44
Other	151	167
	<u>1,404</u>	<u>1,274</u>
Total temporarily restricted net assets	\$ <u>1,404</u>	<u>1,274</u>

(12) Retirement Plan

The System has a defined-benefit pension plan, the Owensboro Health Retirement Plan (the Plan), a single-employer pension trust fund. The Plan is available to employees age 21 or older who have completed one year of continuous service and have 1,000 hours of annual service. The benefits are based upon years of service and the employee's average monthly earnings.

The funding policy of the System is to contribute amounts to the Plan at least equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and subsequent amendments. The System expects to contribute approximately \$18,595 to the Plan during fiscal year 2018.

The following table summarizes the allocation of the assets available for plan benefits at May 31:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	— %	— %
Equities	—	—
Mutual Funds	100	100

The Plan utilizes an investment strategy that focuses on maximizing total return and places limited emphasis on generating income. The Plan's average asset allocation target is 60% equities, 38% fixed income, and 2% cash. The Plan's diversification offers the expectation of higher and more stable returns that will meet the obligations of the Plan.

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The actuarially computed net periodic pension cost for 2017 and 2016 included the following components (in thousands):

	<u>2017</u>	<u>2016</u>
Service cost – benefits earned during the year	\$ 9,519	9,013
Interest cost on projected benefit obligation	5,415	5,122
Expected return on plan assets	(4,697)	(6,171)
Net amortization and deferral	<u>3,432</u>	<u>2,058</u>
Net periodic pension cost	\$ <u>13,669</u>	<u>10,022</u>

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

Amortization of prior service cost	\$ —
Amortization of loss	<u>2,601</u>
	\$ <u>2,601</u>

The following tables set forth the Plan's funded status (measured at May 31, 2017 and 2016) and amounts recognized in the System's accompanying consolidated financial statements at May 31, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Accumulated benefit obligation	\$ (124,302)	(118,630)
Change in projected benefit obligation:		
Projected benefit obligation at the beginning of measurement year	\$ (162,475)	(145,005)
Service cost	(9,519)	(9,013)
Interest cost	(5,415)	(5,122)
Actuarial loss	(226)	(10,377)
Benefits paid	<u>10,710</u>	<u>7,042</u>
Projected benefit obligation at the end of measurement year	\$ <u>(166,925)</u>	<u>(162,475)</u>

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	<u>2017</u>	<u>2016</u>
Change in plan assets:		
Fair value of plan assets at the beginning of measurement year	\$ 93,303	96,615
Actual return on plan assets	10,842	(1,475)
Employer contributions	3,127	5,205
Benefits paid	<u>(10,710)</u>	<u>(7,042)</u>
Fair value of plan assets at the end of measurement year	\$ <u>96,562</u>	<u>93,303</u>
Funded status	\$ (70,363)	(69,172)
Unrecognized net actuarial loss	—	—
Unrecognized prior service cost	<u>—</u>	<u>—</u>
Accrued pension cost	\$ <u>(70,363)</u>	<u>(69,172)</u>
	<u>2017</u>	<u>2016</u>
Amounts recognized in unrestricted net assets:		
Net actuarial loss	\$ 43,898	53,249
Prior service costs	<u>—</u>	<u>—</u>
	\$ <u>43,898</u>	<u>53,249</u>
	<u>2017</u>	<u>2016</u>
Employer contributions	\$ 3,127	5,205
Plan participants' contributions	—	—
Benefits paid	10,710	7,042

The benefits expected to be paid from the Plan in each year from 2018 to 2022 are approximately \$25,474, \$11,094, \$12,086, \$11,760, and \$11,682, respectively. The aggregate expected benefits to be paid in the five years from 2023 to 2027 are approximately \$70,734. The expected benefits to be paid are based on the same assumptions used to measure the Plan's benefit obligation at May 31 and include estimated future employee service.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

Weighted average assumptions used to determine benefit obligation at May 31, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	3.65 %	3.63 %
Rate of compensation increase	4.00	4.00

Weighted average assumptions used to determine net periodic pension cost for the years ended May 31, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	3.63 %	3.83 %
Expected long-term rate of return on plan assets	5.75	7.00
Rate of compensation increase	4.00	4.00

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. This assumption is based on historical returns of the Plan. Unrecognized gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets are amortized on a straight-line basis over the average remaining service period of participants expected to receive benefits under the Plan, which is 10 years at May 31, 2017 and 2016.

In accordance with Subtopic 715-20, the System has categorized its plan assets, based on Topic 820 and the priority of inputs used in related valuation techniques, into a three-level fair value hierarchy as explained in note 5. All plan assets at May 31, 2017 and 2016 include the following (in thousands):

	<u>2017</u>	<u>2016</u>
Mutual funds	\$ 96,562	93,303
Total	\$ <u>96,562</u>	<u>93,303</u>

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

The fair value hierarchy of plan assets is as follows:

		2017			
		Level 1	Level 2	Level 3	Total
Mutual funds:					
Large cap equity securities	\$	18,504	—	—	18,504
Small and mid cap equity securities		14,229	—	—	14,229
International equity securities		18,304	—	—	18,304
Debt securities		27,529	17,996	—	45,525
	\$	<u>78,566</u>	<u>17,996</u>	<u>—</u>	<u>96,562</u>
		2016			
		Level 1	Level 2	Level 3	Total
Mutual funds:					
Large cap equity securities	\$	22,617	—	—	22,617
Small and mid cap equity securities		12,707	—	—	12,707
International equity securities		14,728	—	—	14,728
Debt securities		25,318	17,933	—	43,251
	\$	<u>75,370</u>	<u>17,933</u>	<u>—</u>	<u>93,303</u>

Effective January 2006, the System adopted the Owensboro Health, Inc. Nonqualified Supplemental Retirement Plan (Supplemental Retirement Plan). The Supplemental Retirement Plan was formed under Section 457(f) of the IRC of 1986, and management believes that it complies with all provisions applicable to a nonqualified deferred compensation plan under IRC Section 409A. Participants are eligible for employer contributions from 12% to 15% based on their position with the System. The employer contribution for each year is 100% vested after five years. Employer contributions occur each December 31. The System has accrued expenses related to the Supplemental Retirement Plan of approximately \$250 and \$259 as of May 31, 2017 and 2016, respectively, and is included in accrued payroll and related liabilities in the consolidated balance sheets.

(13) Risk Management and Self-Insured Liabilities

Effective January 1, 2003, the System maintains malpractice liability insurance with a commercial carrier on a claims-made basis for losses in excess of \$250 per occurrence. The System is self-insured for the first \$250 per occurrence. On January 1, 2004, the self-insured amount increased from \$250 to \$500 per occurrence. On January 1, 2005, the self-insured amount increased from \$500 to \$1,000 per occurrence. On December 1, 2010, the self-insured amount increased from \$1,000 to \$1,500 per occurrence. Accordingly, the System has made a provision in the accompanying consolidated financial statements for estimated unpaid malpractice claims, including incurred but not reported claims. The current retention for

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

claims and incidents reported is \$1,500 per claim with a \$7,000 policy retention aggregate. The overall retroactive application date is January 1, 1978.

Through December 31, 2002, the System had professional liability insurance coverage with Reciprocal of America (ROA) on a claims-made basis. On April 30, 2003, the Commonwealth of Virginia filed an application to order ROA into liquidation. On June 20, 2003, the Virginia State Corporation Commission entered an Order of Liquidation declaring that ROA should be liquidated. Management believes that only a portion of all claims reported to ROA through December 31, 2002 will be paid through the ROA liquidation process. Management also believes that the System has adequately accrued for any potential shortfall for the payment of these reported claims and any incurred but not reported claims.

The System is self-insured up to the stop-loss amount of \$500 annually per individual for its medical and other healthcare benefits provided to its employees and their families. Contributions by the System and participating employees are based on actual claims experience. A provision for known claims and estimated incurred but not reported claims for those employees in the self-insured plan has been provided in the accompanying consolidated financial statements.

The System is self-insured up to \$500 per occurrence for workers' compensation claims and has purchased insurance to provide coverage for claims in excess of the self-insured retention. Such insurance coverage is on an occurrence basis. The System has made a provision in the accompanying consolidated financial statements for estimated workers' compensation claims known and estimated incurred but not reported claims.

The System is subject to various claims and lawsuits arising in the normal course of business. In the opinion of management, the ultimate resolution of these matters will not have a material adverse effect in the System's accompanying consolidated financial statements. Additionally, management is unaware of any unasserted claims that would have a material impact on the accompanying consolidated financial statements.

(14) Functional Expenses

The System provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended May 31, 2017 and 2016 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Healthcare services	\$ 404,244	387,629
General and administrative	<u>300,448</u>	<u>217,225</u>
Total functional expenses	<u>\$ 704,692</u>	<u>604,854</u>

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Notes to Consolidated Financial Statements

May 31, 2017 and 2016

(In Thousands)

(15) Financial Instruments

The carrying amounts of all applicable asset and liability financial instruments reported in the consolidated balance sheets, excluding long-term debt, approximate their fair values at May 31, 2017 and 2016. Fair value of financial instruments is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties.

The fair value of the System's long-term debt has been estimated using discounted cash flow analyses, based on the System's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the System's long-term debt was approximately \$609,217 and \$626,780 at May 31, 2017 and 2016, respectively.

(16) Related-Party Transactions

Owensboro Health has a 50% ownership in Owensboro Community Health Network, Inc. (OCHN); the other 50% owner is Ohio Valley Physicians Association, Inc. OCHN was incorporated in August 1999 and operates a preferred provider organization in the Commonwealth of Kentucky by contracting with various providers to provide medical services to the employees of contracted employers. Owensboro Health accounts for their OCHN investment on the equity method based on its ownership percentage and equal control. Owensboro Health is an employer utilizing OCHN's network. For the year ended May 31, 2017, Owensboro Health paid OCHN approximately \$101 in network administration fees. For the year ended May 31, 2016, Owensboro Health paid OCHN approximately \$134 in network administration fees. Owensboro Health leases employees to OCHN for an amount equal to the employees' salaries plus benefits. For the years ended May 31, 2017 and 2016, OCHN reimbursed Owensboro Health approximately \$224 and \$228, respectively, for the salaries and benefits of these leased employees. Owensboro Health provides accounting functions to OCHN for a fee. Fees charged for the years ended May 31, 2017 and 2016 were approximately \$10.

Owensboro Health has a 65.7% and 66.5% ownership in OASF as of May 31, 2017 and 2016, respectively, with the remaining 34.3% and 33.5%, respectively, owned by individual physicians and co-general partner Surgical Care Affiliates (SCA). OASF pays a management fee to SCA of 5.0% of net revenue, less bad debt expense. This management fee was approximately \$379 and \$400 for the years ended May 31, 2017 and 2016, respectively.

(17) Subsequent Events

The System has evaluated events subsequent to September 28, 2017 and through the date on which the consolidated financial statements were issued and identified no items.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidating Schedule – Balance Sheet Information

May 31, 2017

(In thousands)

Assets	Owensboro Health	The Foundation for Health, Inc.					Elimination entries	Owensboro Health subtotal	OASF consolidation and elimination entries		Consolidated	
		OHMG	OMCL	HNWK	CIN	Muhlenberg		OASF				
Current assets:												
Cash and cash equivalents	\$ 43,280	1,782	2,309	711	—	—	756	—	48,838	825	—	49,663
Investments	168,903	—	585	—	—	—	—	—	169,488	—	—	169,488
Patient accounts receivable, net	74,977	6,824	—	161	—	—	4,679	—	86,641	886	—	87,527
Inventories	10,682	84	—	—	—	—	1,787	—	12,553	2	—	12,555
Prepaid expenses and other current assets	255,614	174	3	108	—	431	5,142	(249,611)	11,861	59	—	11,920
Assets limited as to use, current portion	24,016	—	—	—	—	—	—	—	24,016	—	—	24,016
Total current assets	577,472	8,864	2,897	980	—	431	12,364	(249,611)	353,397	1,772	—	355,169
Assets limited as to use, less current portion	38,121	—	—	—	—	—	—	—	38,121	—	—	38,121
Property and equipment, net	556,087	37,038	5	—	—	—	5,231	—	598,361	1,068	—	599,429
Deferred compensation plan assets	10,112	—	—	—	—	—	—	—	10,112	—	—	10,112
Other assets	34,655	1,430	56	—	—	—	—	(21,343)	14,798	1,181	(2,232)	13,747
Total assets	\$ 1,216,447	47,332	2,958	980	—	431	17,595	(270,954)	1,014,789	4,021	(2,232)	1,016,578
Liabilities and Net Assets (Define)												
Current liabilities:												
Current maturities of long-term debt	\$ 6,795	—	—	—	—	—	21	—	6,816	—	—	6,816
Accounts payable	17,131	1,940	30	47	—	—	1,305	—	20,453	42	—	20,495
Accrued payroll and related liabilities	21,380	3,383	—	—	—	—	499	—	25,262	221	—	25,483
Other current liabilities	36,685	224,029	77	6,488	1,670	2,744	14,518	(249,596)	36,615	264	—	36,879
Due to third-party payors	22,578	1,007	—	—	—	—	—	—	23,585	—	—	23,585
Total current liabilities	104,569	230,359	107	6,535	1,670	2,744	16,343	(249,596)	112,731	527	—	113,258
Deferred compensation plan obligations	10,112	—	—	—	—	—	—	—	10,112	—	—	10,112
Long-term debt, less current maturities	600,419	—	—	—	—	—	—	—	600,419	—	—	600,419
Other noncurrent liabilities	—	—	—	—	—	—	—	—	—	253	—	253
Contractual lease obligation	—	—	—	—	—	—	3,340	—	3,340	—	—	3,340
Accrued pension cost	70,363	—	—	—	—	—	—	—	70,363	—	—	70,363
Total liabilities	785,463	230,359	107	6,535	1,670	2,744	19,683	(249,596)	796,965	780	—	797,745
Net assets (deficit):												
Unrestricted	430,984	(183,027)	1,447	(5,555)	(1,670)	(2,313)	(2,088)	(21,358)	216,420	3,241	(2,050)	217,611
Temporarily restricted	—	—	1,404	—	—	—	—	—	1,404	—	—	1,404
Total net assets (deficit) attributable to Owensboro Health, Inc.	430,984	(183,027)	2,851	(5,555)	(1,670)	(2,313)	(2,088)	(21,358)	217,824	3,241	(2,050)	219,015
Noncontrolling interests	—	—	—	—	—	—	—	—	—	—	(182)	(182)
Total net assets (deficit)	430,984	(183,027)	2,851	(5,555)	(1,670)	(2,313)	(2,088)	(21,358)	217,824	3,241	(2,232)	218,833
Total liabilities and net assets (deficit)	\$ 1,216,447	47,332	2,958	980	—	431	17,595	(270,954)	1,014,789	4,021	(2,232)	1,016,578

See accompanying independent auditors' report.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Consolidating Schedule – Statement of Operations and Changes in Net Assets Information

Year ended May 31, 2017

(In thousands)

	Owensboro Health	OHMG	The Foundation for Health, Inc.	OMCL	HNWK	CIN	Muhlenberg	Elimination entries	Owensboro Health subtotal	OASF	OASF consolidation and elimination entries	Consolidated
Unrestricted revenue:												
Net patient service revenue	\$ 527,143	64,030	—	2,418	—	91	34,644	(2,051)	626,275	8,145	—	634,420
Provision for bad debts	(27,658)	(3,149)	—	(2,094)	—	—	(4,604)	—	(37,505)	(123)	—	(37,628)
Net patient service revenue less provision for bad debts	499,485	60,881	—	324	—	91	30,040	(2,051)	588,770	8,022	—	596,792
Other operating revenue	8,847	11,554	1,172	232	—	143	1,213	(9,790)	13,371	4	(466)	12,909
Total unrestricted revenue	508,332	72,435	1,172	556	—	234	31,253	(11,841)	602,141	8,026	(466)	609,701
Patient service and other expenses:												
Personnel	208,935	100,571	415	—	—	2,233	22,872	(1,175)	333,851	2,523	—	336,374
Professional fees	21,186	9,877	27	196	—	2	2,499	(4,016)	29,771	425	—	30,196
Drugs and supplies	103,021	4,668	4	2,584	—	107	6,356	(2,456)	114,284	1,878	—	116,162
Plant maintenance and operations	16,056	5,820	34	—	—	5	2,846	(4,109)	20,652	704	(468)	20,888
Kentucky provider tax	3,993	—	—	—	—	—	875	—	4,868	—	—	4,868
Other expenses	33,302	3,678	463	122	—	223	2,879	(799)	39,868	454	—	40,322
Depreciation and amortization	36,571	3,450	4	—	—	—	783	—	40,808	290	—	41,098
Interest expense	31,702	—	—	—	—	—	4	—	31,706	5	—	31,711
Loss on bond defeasance	83,073	—	—	—	—	—	—	—	83,073	—	—	83,073
Total patient service and other expenses	537,839	128,064	947	2,902	—	2,570	39,114	(12,555)	698,881	6,279	(468)	704,692
Operating (loss) income	(29,507)	(55,629)	225	(2,346)	—	(2,336)	(7,861)	714	(96,740)	1,747	2	(94,991)
Nonoperating gains (losses):												
Investment income (loss), net	13,169	—	—	—	—	—	14	—	13,183	—	—	13,183
Contributions and other	(1,021)	18	—	—	—	23	41	1,631	692	149	(773)	68
Nonoperating gains (losses), net	12,148	18	—	—	—	23	55	1,631	13,875	149	(773)	13,251
(Deficiency) excess of revenue and gains over expenses and losses before noncontrolling interests	(17,359)	(55,611)	225	(2,346)	—	(2,313)	(7,806)	2,345	(82,865)	1,896	(771)	(81,740)
Noncontrolling interests	—	—	—	—	—	—	—	—	—	—	(650)	(650)
(Deficiency) excess of revenue and gains over expenses and losses	(17,359)	(55,611)	225	(2,346)	—	(2,313)	(7,806)	2,345	(82,865)	1,896	(1,421)	(82,390)
Accrued pension cost adjustment	9,351	—	—	—	—	—	—	—	9,351	—	—	9,351
Excess of net assets acquired in Muhlenberg acquisition	—	—	—	—	—	—	—	—	—	—	—	—
Change in unrestricted net assets	(8,008)	(55,611)	225	(2,346)	—	(2,313)	(7,806)	2,345	(73,514)	1,896	(1,421)	(73,039)
Temporarily restricted net assets:												
Contributions	—	—	305	—	—	—	—	—	305	—	—	305
Net assets released from restrictions used for operations	—	—	(175)	—	—	—	—	—	(175)	—	—	(175)
Change in temporarily restricted net assets	—	—	130	—	—	—	—	—	130	—	—	130
Noncontrolling interests:												
Excess of revenue and gains over expenses and losses	(1,001)	—	—	—	—	—	—	—	(1,001)	—	650	650
Partnership investment	—	—	—	—	—	—	—	—	—	—	843	(158)
Distributions to minority shareholders	—	—	—	—	—	—	—	—	—	(1,516)	996	(520)
Change in noncontrolling interests	(1,001)	—	—	—	—	—	—	—	(1,001)	(1,516)	2,489	(28)
Change in total net assets	(9,009)	(55,611)	355	(2,346)	—	(2,313)	(7,806)	2,345	(74,385)	380	1,068	(72,937)
Net assets (deficit), beginning of year	439,993	(127,416)	2,496	(3,209)	(1,670)	—	5,718	(23,703)	292,209	2,861	(3,300)	291,770
Net assets (deficit), end of year	\$ 430,984	(183,027)	2,851	(5,555)	(1,670)	(2,313)	(2,088)	(21,358)	217,824	3,241	(2,232)	218,833

See accompanying independent auditors' report.

OBLIGATED GROUP

Combining Schedule – Balance Sheet Information

May 31, 2017

(In thousands)

Assets	Owensboro Health	OHMG	Combination and elimination entries	Obligated Group
Current assets:				
Cash and cash equivalents	\$ 43,280	1,782	—	45,062
Investments	168,903	—	—	168,903
Patient accounts receivable, net	74,977	6,824	—	81,801
Inventories	10,682	84	—	10,766
Prepaid expenses and other current assets	255,614	174	(221,801)	33,987
Assets limited as to use, current portion	24,016	—	—	24,016
Total current assets	577,472	8,864	(221,801)	364,535
Assets limited as to use, less current portion	38,121	—	—	38,121
Property and equipment, net	556,087	37,038	—	593,125
Deferred compensation plan assets	10,112	—	—	10,112
Other assets	34,655	1,430	(26,906)	9,179
Total assets	\$ 1,216,447	47,332	(248,707)	1,015,072
Liabilities and Net Assets				
Current liabilities:				
Current maturities of long-term debt	\$ 6,795	—	—	6,795
Accounts payable	17,131	1,940	—	19,071
Accrued payroll and related liabilities	21,380	3,383	—	24,763
Other current liabilities	36,685	224,029	(221,801)	38,913
Due to third-party payors	22,578	1,007	—	23,585
Total current liabilities	104,569	230,359	(221,801)	113,127
Deferred compensation plan obligations	10,112	—	—	10,112
Long-term debt, less current maturities	600,419	—	—	600,419
Other long-term liabilities	—	—	—	—
Accrued pension cost	70,363	—	—	70,363
Total liabilities	785,463	230,359	(221,801)	794,021
Unrestricted net assets	430,984	(183,027)	(26,906)	221,051
Total liabilities and net assets	\$ 1,216,447	47,332	(248,707)	1,015,072

See accompanying independent auditors' report.

OBLIGATED GROUP

Combining Schedule – Statement of Operations and Changes in Net Assets Information

Year ended May 31, 2017

(In thousands)

	Owensboro Health	OMHG	Combination and elimination entries	Obligated Group
Unrestricted revenue:				
Net patient service revenue	\$ 527,143	64,030	—	591,173
Provision for bad debts	(27,658)	(3,149)	—	(30,807)
Net patient service revenue less provision for bad debts	499,485	60,881	—	560,366
Other operating revenue	8,847	11,554	(4,675)	15,726
Total unrestricted revenue	508,332	72,435	(4,675)	576,092
Patient service and other expenses:				
Personnel	208,935	100,571	(1,131)	308,375
Professional fees	21,186	9,877	(283)	30,780
Drugs and supplies	103,021	4,668	(802)	106,887
Plant maintenance and operation	16,056	5,820	(2,447)	19,429
Kentucky provider tax	3,993	—	—	3,993
Other expenses	33,302	3,678	(12)	36,968
Depreciation and amortization	36,571	3,450	—	40,021
Interest expense	31,702	—	—	31,702
Loss on bond defeasance	83,073	—	—	83,073
Total patient service and other expenses	537,839	128,064	(4,675)	661,228
Operating loss	(29,507)	(55,629)	—	(85,136)
Nonoperating gains:				
Investment income net	13,169	—	—	13,169
Contributions and other	(1,021)	18	—	(1,003)
Nonoperating gains, net	12,148	18	—	12,166
Excess (deficiency) of revenue and gains over expenses and losses	(17,359)	(55,611)	—	(72,970)
Accrued pension cost adjustment	9,351	—	—	9,351
Partnership investment	(1,001)	—	—	(1,001)
Change in unrestricted net assets	(9,009)	(55,611)	—	(64,620)
Net assets, beginning of year	439,993	(127,416)	(26,906)	285,671
Net assets, end of year	\$ 430,984	(183,027)	(26,906)	221,051

See accompanying independent auditors' report.

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Hospital Utilization Statistics (Unaudited)

Years ended May 31

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Patient days:											
Acute patient days	71,770	75,943	70,289	65,456	68,845	71,587	72,788	70,016	71,950	71,662	72,403
TCC patient days	8,129	7,038	7,288	7,163	8,823	8,757	9,334	7,960	7,801	8,626	8,736
Rehab patient days	4,418	4,754	3,675	3,645	3,455	3,701	3,845	3,854	3,725	3,738	4,145
Total patient days	84,317	87,735	81,252	76,264	81,123	84,045	85,967	81,830	83,476	84,026	85,284
Average adult daily census	231	240	223	209	222	230	236	224	229	230	234
Licensed beds	477	477	477	477	477	477	477	477	477	477	477
Average number of available beds	380	352	352	354	366	377	372	364	359	372	374
Average adult occupancy	61 %	68 %	63 %	59 %	61 %	61 %	63 %	62 %	64 %	62 %	63 %
Adult discharges:											
Acute discharges	16,145	17,073	15,909	15,176	16,638	17,144	17,388	17,479	17,725	16,936	17,771
TCC discharges	741	698	744	662	669	642	645	569	585	551	587
Rehab discharges	380	426	326	323	300	317	311	307	314	315	304
Total adult discharges	17,266	18,197	16,979	16,161	17,607	18,103	18,344	18,355	18,624	17,802	18,662
Average adult length of stay:											
Acute length of stay	4.5	4.4	4.4	4.3	4.1	4.2	4.2	4.0	4.1	4.2	4.1
TCC length of stay	11.0	10.1	9.8	10.8	13.2	13.6	14.5	14.0	13.3	15.7	14.9
Rehab length of stay	11.5	11.2	11.3	11.3	11.5	11.7	12.4	12.6	11.9	11.9	13.6
Total average adult length of stay	4.9	4.8	4.8	4.7	4.6	4.6	4.7	4.5	4.5	4.7	4.6
Number of deliveries	2,059	2,123	1,961	1,926	1,815	1,863	1,820	1,766	1,860	1,811	1,908
Surgical cases:											
Inpatient	3,832	4,224	3,888	3,806	3,795	4,683	4,342	4,714	4,331	4,224	4,202
Outpatient	8,975	8,746	8,186	7,311	7,195	7,710	8,933	8,856	9,011	9,336	9,235
Endoscopy	4,650	4,939	4,978	4,981	4,930	4,395	5,190	5,254	5,362	5,600	5,684
ASC	6,249	6,068	5,918	5,605	6,140	7,000	6,103	5,784	5,085	5,148	4,909
Total surgical cases	23,706	23,977	22,970	21,703	22,060	23,788	24,568	24,608	23,789	24,308	24,030
Emergency room visits	73,129	73,074	68,718	64,081	65,851	63,901	63,043	63,592	63,298	65,185	66,217
Average number of visits per day	200	200	188	176	180	175	173	174	173	179	181

OWENSBORO HEALTH, INC. AND AFFILIATED ENTITIES

Hospital Utilization Statistics (Unaudited)

Years ended May 31

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Outpatient visits:											
Hospital physician clinics	537,026	527,444	430,817	249,894	220,301	206,951	191,907	143,311	96,048	83,002	N/A
Work Health	18,081	18,117	17,493	9,457	8,499	9,810	17,279	13,737	N/A	N/A	N/A
Outpatient ED visits	62,826	62,220	58,373	54,538	55,205	54,126	52,928	54,116	53,689	55,755	56,031
Convenient care visits	33,327	29,672	30,121	27,577	29,739	27,507	29,976	29,630	26,789	25,593	27,001
Observation visits	3,778	3,059	3,526	3,435	3,696	6,024	6,593	6,513	6,573	7,566	7,212
Outpatient surgery cases:											
Hospital	8,975	8,746	8,186	7,311	7,195	7,710	8,933	8,856	9,011	8,948	9,235
ASC	6,249	6,068	5,918	5,605	6,140	7,000	6,103	5,784	5,085	5,148	4,909
Total outpatient surgery visits	15,224	14,814	14,104	12,916	13,335	14,710	15,036	14,640	14,096	14,096	14,144
Ancillary visits:											
Lab	129,803	109,421	90,497	91,083	87,812	85,032	87,384	86,306	81,472	78,854	78,344
Physical therapy*	30,502	28,417	24,340	20,789	16,260	16,719	16,294	15,568	7,242	7,174	7,116
Wound care	3,432	3,113	3,086	4,658	2,952	2,914	1,262	1,105	908	784	755
Total ancillary visits	163,737	140,951	117,923	116,530	107,024	104,665	104,940	102,979	89,622	86,812	86,215
Diagnostic visits:											
Radiology	128,816	125,855	110,768	115,524	116,512	118,265	117,720	116,316	90,355	87,226	83,599
Cath lab:											
Inpatient cases	1,174	1,035	1,119	1,027	1,094	1,423	1,458	1,534	N/A	N/A	N/A
Outpatient cases	2,216	1,732	1,864	2,124	1,928	1,776	1,805	1,877	N/A	N/A	N/A
Total cath lab cases	3,390	2,767	2,983	3,151	3,022	3,199	3,263	3,411	2,936	3,470	3,534
Total diagnostic visits	132,206	128,622	113,751	118,675	119,534	121,464	120,983	119,727	93,291	90,696	87,133
Total outpatient visits	965,031	923,864	784,989	591,995	556,239	543,834	538,184	483,119	380,108	363,520	277,736
Employees only:											
Hospital	2,861	3,016	2,966	2,652	2,765	2,844	2,850	2,776	2,774	N/A	N/A
System	4,195	4,292	3,518	3,245	3,348	3,365	3,357	3,205	3,131	N/A	N/A
FTE's with contract:											
Hospital	2,628	2,684	2,604	2,569	2,598	2,544	2,466	2,323	2,289	N/A	N/A
System	3,831	3,887	3,246	3,113	3,020	3,038	2,881	2,695	2,598	N/A	N/A

* For the year ended May 31, 2010, these statistics were compiled utilizing visits versus billing units for the years ended May 31, 2005 through 2009.

See accompanying independent auditors' report.