



PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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KPMG LLP
Suite 2000
303 Peachtree Street, N.E.
Atlanta, GA 30308-3210

Independent Auditors' Report

The Board of Directors
Piedmont Healthcare, Inc. and Affiliates:

We have audited the accompanying consolidated financial statements of Piedmont Healthcare, Inc. and Affiliates, which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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 Piedmont Healthcare, Inc. and Affiliates as of June 30, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Atlanta, Georgia
October 18, 2017

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Balance Sheets

June 30, 2017 and 2016

Assets	2017	2016
	(In thousands)	
Current assets:		
Cash and cash equivalents	\$ 565,999	512,131
Patient accounts receivable, net of allowance for doubtful accounts of \$307,597 and \$302,596 in 2017 and 2016, respectively	316,339	252,591
Bond proceeds receivable	47,985	26,610
Current portion of self-insurance investments	12,097	8,537
Other current assets	95,354	82,727
Total current assets	1,037,774	882,596
Investments and assets limited as to use	710,899	573,724
Property and equipment, net	1,220,789	821,535
Self-insurance investments, net of current portion	37,032	33,469
Beneficial interest in perpetual trust	7,694	7,298
Other assets	124,940	115,642
Total assets	\$ 3,139,128	2,434,264
Liabilities and Net Assets		
Current liabilities:		
Current portion of bonds payable	\$ 24,290	15,320
Accounts payable and accrued expenses	273,331	258,165
Estimated third-party payor settlements	33,847	27,024
Current portion of self-insurance reserves	30,812	23,376
Total current liabilities	362,280	323,885
Bonds payable, net of current portion	787,783	513,091
Medical office building financing obligation	43,358	43,121
Note payable to a bank	32,234	34,799
Self-insurance reserves, net of current portion	55,504	42,035
Accrued pension cost	77,768	109,997
Other long-term liabilities	108,195	101,552
Total liabilities	1,467,122	1,168,480
Net assets:		
Unrestricted	1,620,787	1,224,519
Temporarily restricted	27,537	18,033
Permanently restricted	23,682	23,232
Total net assets	1,672,006	1,265,784
Total liabilities and net assets	\$ 3,139,128	2,434,264

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Operations

Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
	(In thousands)	
Unrestricted revenue, gains, and other support:		
Patient service revenue	\$ 2,585,540	2,224,016
Provision for bad debt	<u>(163,681)</u>	<u>(321,683)</u>
Net patient service revenue	2,421,859	1,902,333
Other revenue	<u>87,681</u>	<u>80,863</u>
Total revenue, gains, and other support	<u>2,509,540</u>	<u>1,983,196</u>
Expenses:		
Salaries and benefits	1,330,355	1,044,062
Supplies and other	892,923	703,922
Depreciation and amortization	106,004	87,852
Interest	<u>33,479</u>	<u>27,729</u>
Total expenses	<u>2,362,761</u>	<u>1,863,565</u>
Operating income before loss on extinguishment of debt, acquisition costs and unrestricted contribution received in acquisition	146,779	119,631
Loss on extinguishment of debt	(28,416)	—
Acquisition cost	(6,418)	(1,717)
Contribution received in acquisition	<u>173,832</u>	<u>13,786</u>
Operating income	<u>285,777</u>	<u>131,700</u>
Nonoperating income (expense):		
Investment income (loss), net	77,406	(15,538)
Other components of pension expense	(688)	(8,739)
Loss from equity investment	—	(3,100)
Change in fair value of interest rate swaps	<u>8,855</u>	<u>(7,108)</u>
Total nonoperating income (expense)	<u>85,573</u>	<u>(34,485)</u>
Excess of revenue, gains, and other support over expenses	371,350	97,215
Net assets released from restrictions used for purchase of property and equipment	1,904	1,188
Pension adjustments	24,447	(46,097)
Other	<u>(1,433)</u>	<u>(468)</u>
Change in unrestricted net assets	\$ <u>396,268</u>	<u>51,838</u>

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
	(In thousands)	
Unrestricted net assets:		
Excess of revenue, gains, and other support over expenses	\$ 371,350	97,215
Net assets released from restrictions used for purchase of property and equipment	1,904	1,188
Pension adjustments	24,447	(46,097)
Other	<u>(1,433)</u>	<u>(468)</u>
Change in unrestricted net assets	<u>396,268</u>	<u>51,838</u>
Temporarily restricted net assets:		
Contributions	12,983	4,097
Restricted contribution received in acquisition	2,067	—
Net assets released from restrictions used for purchase of property and equipment	(1,904)	(1,188)
Net assets released from restrictions used for operations	(3,647)	(5,643)
Other	<u>5</u>	<u>(635)</u>
Change in temporarily restricted net assets	<u>9,504</u>	<u>(3,369)</u>
Permanently restricted net assets:		
Contributions	54	532
Change in beneficial interest in perpetual trust	<u>396</u>	<u>(620)</u>
Change in permanently restricted net assets	<u>450</u>	<u>(88)</u>
Change in net assets	406,222	48,381
Net assets at beginning of year	<u>1,265,784</u>	<u>1,217,403</u>
Net assets at end of year	\$ <u><u>1,672,006</u></u>	\$ <u><u>1,265,784</u></u>

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
	(In thousands)	
Cash flows from operating activities:		
Change in net assets	\$ 406,222	48,381
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	106,004	87,852
Contribution received in acquisitions, net of cash acquired	(115,208)	(13,183)
Net unrealized (gains) losses on investments	(25,871)	36,228
Net realized gains on investments	(41,575)	(7,303)
Change in beneficial interest in perpetual trust	(396)	620
Amortization of bond (premium) discount	(5,761)	38
Loss on extinguishment of debt	28,416	—
Provision for bad debt	163,681	321,683
Pension adjustments	(24,447)	46,097
Change in fair value of interest rate swaps	(8,855)	7,108
Contributions restricted for long-term investment	(15,104)	(4,629)
(Increase) decrease in:		
Patient accounts receivable	(171,823)	(327,274)
Other current assets	(7,843)	(14,654)
Other assets	(9,773)	(6,716)
(Decrease) increase in:		
Accounts payable and accrued expenses	(57,640)	11,735
Estimated third-party payor settlements	(3,445)	4,677
Self-insurance reserves	12,297	(8,644)
Accrued pension cost	(7,782)	5,739
Other long-term liabilities	14,780	(81)
Net cash provided by operating activities	<u>235,877</u>	<u>187,674</u>
Cash flows from investing activities:		
Purchases of investments and assets limited as to use	(970,011)	(94,988)
Proceeds from sale of investments and assets limited as to use	906,560	81,378
Capital expenditures	<u>(184,978)</u>	<u>(103,077)</u>
Net cash used in investing activities	<u>(248,429)</u>	<u>(116,687)</u>
Cash flows from financing activities:		
Contributions restricted for long-term investment	15,104	4,629
Repayments on note payable to a bank	(2,565)	(2,425)
Repayments of indebtedness	(12,800)	(10,510)
Proceeds from issuance of bonds	469,532	—
Bond redemptions	<u>(402,851)</u>	<u>—</u>
Net cash provided by (used in) financing activities	<u>66,420</u>	<u>(8,306)</u>
Net increase in cash and cash equivalents	53,868	62,681
Cash and cash equivalents at beginning of year	<u>512,131</u>	<u>449,450</u>
Cash and cash equivalents at end of year	\$ <u>565,999</u>	\$ <u>512,131</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 26,196	27,961
Income taxes (net of refunds)	(344)	485
Supplemental schedule of noncash investing and financing activities:		
Bond proceeds held by a trustee	\$ 39,448	—

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(1) Organization and General

The Board of Directors of Piedmont Healthcare, Inc. and Affiliates (collectively, PHC) appoints the governing boards of:

- Piedmont Atlanta Hospital, Inc. (Atlanta). Atlanta, located in Atlanta, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of the Atlanta metropolitan area.
- Piedmont Fayette Hospital, Inc. (Fayette). Fayette, located in Fayetteville, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Fayette County.
- Piedmont Mountainside Hospital, Inc. (Mountainside). Mountainside, located in Jasper, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Pickens County and Gilmer County.
- Piedmont Newnan Hospital, Inc. (Newnan). Newnan, located in Newnan, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Coweta County.
- Piedmont Henry Hospital (Henry). Henry, located in McDonough, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Henry County.
- Piedmont Newton Hospital (Newton). Newton, located in Covington, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Newton County.
- Piedmont Athens Regional Hospital (Athens). Athens, located in Athens, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services for residents of northeast Georgia and provides a home care nursing service to patients residing in the five Georgia counties of Clarke, Oconee, Madison, Barrow, and Jackson.
- Piedmont Medical Care Corporation (PMCC). PMCC is a taxable, not-for-profit entity whose purpose is to develop a network of primary care, hospital-based and certain specialty physicians for the benefit of the PHC affiliates.
- Piedmont Heart Institute Physicians, Inc. (PHIP). PHIP is a taxable, not-for-profit entity whose purpose is to provide an integrated cardiovascular healthcare delivery program for the benefit of the PHC affiliates.
- Athens Regional Physician Services, Inc. (ARPS). ARPS is a not-for-profit corporation whose purpose is acquiring and operating primary care physician practices.
- Athens Regional Specialty Services Inc. (ARSS). ARSS is not-for-profit corporation whose purpose is acquiring and operating specialty physician practices.
- Regional FirstCare, Inc. (RFC). RFC is a not-for-profit corporation whose purpose is acquiring and operating urgent care centers and developing workers' compensation/occupational medicine programs.
- Athens Regional Health Resources, Inc. (ARHS). ARHS is a not-for-profit corporation whose purpose is to provide outpatient medical care and health services outside the Athens-Clarke County, Georgia area.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

- Piedmont Heart Institute, Inc. (PHI). PHI is a not-for-profit entity whose purpose is to provide cardiovascular research services for the benefit of the PHC affiliates.
- Amster-McRae Insurance Company (AMIC). AMIC was incorporated on December 10, 2003, under the laws of the Cayman Islands. AMIC insures the hospital professional liability and commercial general liability risks of PHC and certain PHC affiliates.
- Piedmont Clinic, Inc. (the Clinic). The Clinic is a physician-hospital organization whose purpose is to negotiate contracts with various managed care payors for the PHC affiliates.
- Piedmont Healthcare Foundation, Inc. (PHF). The Foundation's primary purpose is assisting PHC in fund-raising and related management, making grants, and soliciting gifts.
- Athens Regional Foundation, Inc. (ARF). ARF is a not-for-profit corporation whose purpose is assisting Athens, ARPS, ARSS and RFC in fund-raising and related management, making grants, and soliciting gifts.
- Athens Area Health Plan Select (HPS). HPS is a taxable not-for-profit health maintenance organization that is discontinuing operations and was only operational through January 2016. HPS provided healthcare services to its enrolled members. HPS operated under a health maintenance organization (HMO) license from, and was regulated by, the State of Georgia Department of Insurance.

(2) Significant Accounting and Reporting Policies

A summary of the significant accounting and reporting policies followed by PHC in the preparation of its consolidated financial statements is presented below:

(a) Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of PHC, Atlanta, Fayette, Mountainside, Newnan, Henry, Newton, Athens, PMCC, PHIP, ARPS, ARSS, RFC, ARHS, PHI, AMIC, the Clinic, PHF, ARF, and HPS. All significant intercompany transactions and accounts have been eliminated in consolidation.

(b) Use of Estimates

The preparation of consolidated financial statements in conformity with 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Significant items subject to such estimates and assumptions include the determination of the allowance for doubtful accounts, allowance for contractual adjustments, fair value of investments and assets limited as to use and interest rate swaps, reserves for general and professional liability, workers' compensation and health insurance claims, third-party payor settlements, and the actuarial determined liability related to PHC's defined-benefit pension plan.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, deposits with banks, and investments in highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use. PHC invests cash not required for immediate operating needs principally with major financial institutions with strong credit ratings. By policy, the amount of credit exposure to any one institution is limited, and such investments are generally not collateralized.

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including unrealized and realized gains and losses on investments, interest, and dividends) is included in the excess of revenue, gains, and other support over expenses unless the income or loss is restricted by donor or law. PHC accounts for investment transactions on a settlement-date basis. All of PHC's investment portfolio is classified as trading, with unrealized gains and losses included in excess of revenue, gains, and other support over expenses. Fair values are based on quoted market prices if available, or estimated using quoted market prices for similar securities. PHC invests in alternative investments, which provide PHC with a proportionate share of the fair value of the fund returns. PHC accounts for its ownership interests in the alternative investments based upon the equity method. Accordingly, PHC's share of the alternative investments' income or loss, both realized and unrealized, is recognized as investment income. Alternative investments held by the noncontributory defined-benefit plan are accounted for at estimated fair value. The cost of substantially all securities sold is based on the average-cost method.

PHC classifies investments with maturities of less than one year from the balance sheet date when purchased as short term and investments with maturities of greater than one year from the balance sheet date when purchased as long term.

(e) Assets Limited as to Use

These assets are limited as to use by debt instruments or designations by PHC's governing board for plant replacement, expansion of certain facilities, purchase of equipment, and payment of certain future debt service requirements.

(f) Inventory

Inventory is valued at average cost. Inventory consists primarily of pharmaceuticals and medical supplies and is recorded within other current assets in the accompanying consolidated balance sheets.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(g) Property and Equipment

Property and equipment acquisitions are recorded at cost, with the exception of donated items which are recorded at fair value at the date of donation. Expenditures for renewals and improvements are charged to the property accounts. For properties sold or retired, the cost and related accumulated depreciation are removed from the property accounts. Any resulting gains or losses are included in other revenue. Replacements, maintenance, and repairs that do not improve or extend the life of the respective assets are charged to operations. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The ranges of estimated useful lives are 10–25 years for land improvements, 15–40 years for buildings and fixtures, and 3–20 years for equipment.

Property and equipment under capital leases is stated at the lower of the present value of minimum lease payments at the beginning of the lease term or fair value at inception of the lease. All property and equipment under capital leases is amortized using the straight-line method over the shorter of the asset life or term of the lease.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from excess of revenue, gains, and other support over expenses, 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 those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

(h) Software and Software Development Costs

Software and software development costs include costs incurred by PHC to develop software for internal use in medical records maintenance, physician order entry, and clinical documentation.

Costs of software developed for internal use are accounted for in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350-40, *Internal-Use Software*. In accordance with ASC 350-40, internal and external costs incurred to develop internal-use computer software during the application development stage are capitalized. Application development stage costs generally include software configuration, coding, installation of hardware, and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized.

All other costs incurred in connection with an internal software project, including maintenance, minor upgrades, enhancements, and training, are expensed as incurred. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the related software applications (3–12 years).

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(i) Long-Lived Assets

PHC periodically reviews long-lived assets, such as property and equipment, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized to the extent that the carrying amount of an asset exceeds its fair value. Assets to be disposed of are separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the appropriate asset and liability sections of the consolidated balance sheet. In the period in which the disposal group is sold or classified as held-for-sale, the results of its operations are classified as discontinued operations in the consolidated statements of operations. Management believes that the long-lived assets in the accompanying consolidated balance sheets are appropriately valued at June 30, 2017 and 2016 and no related impairment losses were recognized during the years then ended.

(j) Other Assets

Other assets include goodwill of \$62,133,000 at June 30, 2017 and 2016. In accordance with ASC 350, *Intangibles – Goodwill and Other*, PHC evaluates its goodwill annually for potential impairment. No impairment losses on goodwill were recognized for the years ended June 30, 2017 or 2016.

(k) Beneficial Interest in Perpetual Trust

PHC is the beneficiary of six separate endowments held in trust by a local bank, with fair values at June 30, 2017 and 2016 aggregating \$7,694,000 and \$7,298,000, respectively. The beneficial interest at June 30, 2017 and 2016 has been recorded in long-term assets at fair value and the change in value for the years then ended has been recorded as a change in permanently restricted net assets.

(l) Vacation Policy

PHC accrues employee vacation pay as earned by the employee.

(m) Advertising Costs

Advertising costs are expensed as incurred and approximated \$10,886,000 and \$8,438,000 for the years ended June 30, 2017 and 2016, respectively, and are included in supplies and other expenses in the accompanying consolidated statements of operations.

(n) Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and are included in self-insurance reserves on the accompanying consolidated balance sheets.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(o) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by PHC is restricted by donors for a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by PHC in perpetuity, with related investment earnings generally available for unrestricted or donor-restricted purposes.

(p) Net Patient Service Revenue, Patient Accounts Receivable, and Allowance for Doubtful Accounts

PHC has agreements with third-party payors that provide for payments to PHC at amounts different from their 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, and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Net patient service revenue is summarized below (in thousands):

	Year ended June 30	
	2017	2016
Patient service charges	\$ 10,135,557	7,998,670
Less contractual adjustments and other deductions	7,550,017	5,774,654
Patient service revenue	2,585,540	2,224,016
Less provision for bad debt	163,681	321,683
Net patient service revenue	\$ 2,421,859	1,902,333

Recognition of patient service revenue (gross patient service charges less contractual adjustments and other deductions) is dependent on factors such as proper completion of medical charts following a patient visit, medical coding of charts and processing charts through PHC's billing systems, and verification of patient representations at the time services are rendered with the payors responsible for payment of PHC's services. Patient service revenue is recorded based on the information known at the time of billing, which is subject to change. For example, patient payor information may change following an initial attempt to bill for services due to a change in payor status. Such changes in payor status have an impact on recorded net revenue due to different contractual agreements among payors. These changes in patient revenue are recognized in the period that the changes in payor become known.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

The provision for bad debt is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in healthcare coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience by payor category. The results of this review are then used to make any modifications to the provision for bad debt to establish an appropriate allowance for uncollectible receivables.

Patient service revenue, net of contractual adjustments and other discounts and before the provision for bad debt, recognized from major payor sources are as follows (in thousands):

	Year ended June 30	
	2017	2016
Third-party payors, net of contractual allowances	\$ 2,245,460	1,959,796
Self-pay patients	340,080	264,220
Patient service revenue	\$ 2,585,540	2,224,016

PHC records a provision for bad debt in the period services are provided related to self-pay patients. For receivables associated with patients who have third-party coverage, PHC analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debt, if necessary. Accounts receivable are written off after collection efforts have been undertaken in accordance with PHC's policies. The allowance for doubtful accounts was 49% and 55% of patient accounts receivable after contractual allowances as of June 30, 2017 and 2016, respectively.

(q) Charity Care

PHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as patient service revenue.

(r) Excess of Revenue, Gains, and Other Support over Expenses

The consolidated statements of operations include excess of revenue, gains, and other support over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue, gains, and other support over expenses, consistent with industry practice, include pension adjustments and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction, are to be used for the purposes of acquiring such assets).

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(s) Pledges Receivable and Donor-Restricted Gifts

Unconditional promises to give cash and other assets to PHC 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 date the donor conditions are substantially met. Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

In February 2016, PHC was awarded a conditional grant by The Marcus Foundation, Inc. totaling \$75,000,000 to support a portion of the construction of the Marcus Heart and Vascular Center. The grant is conditional upon incurring qualified expenditures toward and completion of the donor-stipulated construction project. As of June 30, 2017, PHC had not recognized any contribution revenue related to the grant.

(t) Interest Expense

PHC incurred interest expense totaling approximately \$33,479,000 and \$27,729,000 for the years ended June 30, 2017 and 2016, respectively. There was no interest capitalized in 2017 or 2016.

(u) Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 for eligible hospitals and professionals that adopt and meaningfully use certified electronic health record (EHR) technology. PHC has recognized approximately \$2,695,000 and \$5,553,000 of Medicare incentive payments in other revenue in the accompanying consolidated statements of operations for the years ended June 30, 2017 and 2016, respectively. PHC recognizes income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when eligible hospitals have demonstrated meaningful use of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

(v) Income Taxes

Piedmont Healthcare, Inc., Atlanta, Fayette, Mountainside, Newnan, Henry, Newton, Athens, ARPS, ARSS, RFC, ARHS, PHI, PHF, and ARF are organizations exempt from federal income tax pursuant to U.S. Internal Revenue Code (IRC) Section 501(a), as organizations described in Section 501(c)(3) of the IRC of 1986, as amended, and state income tax. AMIC is exempt from federal and local income tax pursuant to the laws of the Government of the Cayman Islands. There is currently no taxation imposed on income or capital gains by the Government of the Cayman Islands. If any form of tax legislation were to be enacted, AMIC has been granted an exemption until the year 2024. PMCC and PHIP are taxable, not-for-profit entities that operated in a net loss position for financial reporting and tax purposes during the years ended June 30, 2017 and 2016. The Clinic is a taxable, not-for-profit entity that operated in a net loss position for financial reporting and tax purposes during the year ended June 30, 2017 and a net income position for financial reporting and tax purposes during the year ended

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

June 30, 2016. HPS is a taxable, not-for-profit entity that operated in a net income position for financial reporting and tax purposes during the period from October 1, 2016 through June 30, 2017. Due to previous operating losses and other factors, historical and current income tax effects associated with HPS are immaterial to the accompanying consolidated financial statements.

At June 30, 2017 and 2016, Atlanta (as it relates to unrelated business income), PMCC, the Clinic, and PHIP had net operating loss carryforwards totaling approximately \$752,692,000 and \$623,444,000, respectively, which expire at various dates between 2019 and 2034. PMCC, the Clinic, and PHIP had deferred income tax assets totaling approximately \$287,820,000 and \$236,039,000 at June 30, 2017 and 2016, respectively. The deferred income tax assets, which consist primarily of net operating loss carryforwards and differences relating to allowances for doubtful accounts and accruals, were offset by a full valuation allowance.

PHC accounts for income taxes under the provisions of the *Income Taxes* Topic of ASC (ASC 740). Under the requirements of ASC 740, tax-exempt organizations may be required to record an obligation as the result of a tax position they have historically taken on various uncertain tax exposure items. There were no material uncertain tax positions at June 30, 2017 or 2016.

(w) Prior-Year Reclassifications

Certain reclassifications have been made to the fiscal year 2016 consolidated financial statements to conform to the fiscal year 2017 presentation. These reclassifications had no impact on the results of operations, change in net assets, or cash flows in the accompanying consolidated financial statements.

(x) Defined-Benefit Pension Plan

PHC accounts for its defined-benefit pension plan in accordance with ASC 715, *Compensation – Retirement Benefits*. ASC 715 requires an entity to recognize in its balance sheet an asset for a defined-benefit postretirement plan's overfunded status or a liability for a plan's underfunded status; measure a defined-benefit postretirement plan's assets and obligations that determine its funded status at the end of the employer's fiscal year; and recognize changes in the funded status of a defined-benefit postretirement plan as a separate line item or items within changes in unrestricted net assets, apart from expenses, in the year in which the changes occur. Certain PHC employees participate in PHC's trustee noncontributory defined-benefit pension plan (the Plan). The Plan's benefits are based on a combination of years of service and the employee's compensation. PHC's funding policy is to contribute annually to the Plan an amount sufficient to meet the minimum funding standards of Employee Retirement Income Security Act (ERISA) or an amount sufficient to maintain the Plan on a sound actuarial basis, as certified by an enrolled actuary. Plan assets consist primarily of common stocks, alternative investments, fixed-income investments, and cash equivalents. On September 20, 2012, the PHC Board of Directors and PHC management approved a freeze of the Plan effective December 31, 2014, whereby participants cease to accrue further benefits for service rendered subsequent to December 31, 2014. See note 2(z) regarding presentation of pension cost.

(y) Subsequent Events

PHC evaluated events and transactions occurring subsequent to June 30, 2017 through October 18, 2017, the date the consolidated financial statements were available to be issued. During this period, there were no additional subsequent events that required recognition in the accompanying consolidated financial statements. See note 18 for related disclosures.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(z) Recent Accounting Pronouncements

The FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, in May 2014. ASU No. 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity should also disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for annual reporting periods beginning after December 15, 2017. PHC will implement the provisions of ASU No. 2014-09 as of July 1, 2018. PHC has not yet determined the impact of the new standard on its current policies for revenue recognition.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which supersedes FASB ASC Topic 840, *Leases*, and makes other conforming amendments to U.S. GAAP. ASU No. 2016-02 requires, among other changes to the lease accounting guidance, lessees to recognize most leases on balance sheet via a right-of-use asset and lease liability, and additional qualitative and quantitative disclosures. ASU No. 2016-02 is effective for annual periods in fiscal years beginning after December 15, 2019, permits early adoption, and mandates a modified retrospective transition method. PHC is required to adopt ASU No. 2016-02 on July 1, 2019. PHC expects ASU No. 2016-02 to add significant right-of-use assets and lease liabilities to its consolidated balance sheet and it is evaluating other effects that the new standard will have on the consolidated financial statements.

The FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, in August 2016. ASU No. 2016-14 is intended to improve the presentation of net asset classification as well as the information presented in the financial statements and financial statement notes regarding liquidity, financial performance, and cash flows for not-for-profit entities. ASU No. 2016-14 is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. PHC is required to adopt ASU No. 2016-14 as of June 30, 2019. PHC has not determined the impact of ASU No. 2016-14 on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments – a consensus of the Emerging Issues Task Force*. ASU No. 2016-15 amends ASC Topic 230, *Statement of Cash Flows*, to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows with the intent of reducing diversity in practice with respect to eight types of cash flows. ASU No. 2016-15 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted and entities must apply the guidance retrospectively to all periods presented. PHC has not determined the impact of ASU No. 2016-15 on its consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Restricted Cash*, which requires companies to present amounts generally described as restricted cash and restricted cash equivalents in cash and cash equivalents on the statement of cash flows. ASU No. 2016-18 is effective for annual periods in fiscal years beginning after December 15, 2017 and requires retrospective application. PHC elected to early adopt ASU No. 2016-18 as of July 1, 2016. The adoption of ASU No. 2016-18 had no impact on PHC's consolidated financial statements.

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June 30, 2017 and 2016

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which requires companies to present the service cost component of net benefit cost in the income statement line items where they report compensation cost, and all other components of net benefit cost in the income statement separately from the service cost component and outside of operating income, if this subtotal is presented. Additionally, the service cost component will be the only component that can be capitalized. ASU No. 2017-07 is effective in annual periods in fiscal years beginning after December 15, 2018. The standard requires retrospective application for the amendments related to the presentation of the service cost component and other components of net benefit cost, and prospective application for the amendments related to the capitalization requirements for the service cost components of net benefit cost. PHC adopted the provisions of ASU No. 2017-07 as of July 1, 2016. As a result of adopting the standard, PHC reclassified \$8,739,000 from salaries and wages expense to other components of pension expense within nonoperating expense in the consolidated statement of operations for the year ended June 30, 2016.

(3) Acquisitions

Effective October 1, 2016, PHC entered into an affiliation agreement with Athens Regional Health Services, Inc. and Piedmont Athens Regional Hospital, Inc. (f/k/a Athens Regional Medical Center, Inc.) whereby PHC became the sole corporate member of the entity and its affiliates (collectively, The Athens Entities). Although no consideration was transferred, PHC assumed all the assets and liabilities of The Athens Entities as of the affiliation date. As part of the affiliation, PHC assumed Athens' lease with the Hospital Authority of Clarke County, Georgia (the Clarke County Authority). The lease covers certain land, buildings, fixtures, improvements, mechanical systems, and parking areas. At the termination of the lease, the assets and liabilities revert back to the Clarke County Authority. In connection with the affiliation and PHC's assumption of the lease, the lease term was extended to expire in 40 years. The total cost of affiliation with the Athens Entities has been allocated to the assets acquired and liabilities assumed based upon their respective fair values in accordance with ASC 958-805, *Not-for-Profit Entities – Business Combinations*.

Based on the purchase price allocation as of June 30, 2017, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in a contribution of approximately \$175,899,000 being recorded as a contribution received in affiliation on the accompanying 2017 consolidated statement of operations.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

A summary of the purchase price allocation, including assumed liabilities, is as follows (in thousands):

Assets:		
Cash	\$	58,624
Net patient accounts receivable		55,609
Other current assets		26,159
Assets limited as to use		12,976
Property and equipment		306,864
Other assets		1,743
Liabilities:		
Current liabilities		(78,551)
Long-term debt		(200,264)
Other liabilities		<u>(9,328)</u>
Unrestricted contribution received in affiliation		
		173,832
Restricted contribution received in affiliation		
		<u>2,067</u>
Total contribution received in affiliation		
	\$	<u><u>175,899</u></u>

Effective October 1, 2015, PHC entered into an affiliation agreement with Piedmont Newton Hospital (f/k/a Newton Health System, Inc.) whereby it became the sole corporate member of the entity. Although no consideration was transferred, PHC assumed all the assets and liabilities of Newton as of the affiliation date. As part of the affiliation, PHC assumed Newton's lease with the Newton County Hospital Authority (the Newton County Authority). The lease covers all the assets and liabilities of Newton at the inception of the lease. At the termination of the lease, the assets and liabilities revert back to the Newton County Authority. In connection with the affiliation and PHC's assumption of the lease, the lease term was extended to expire in 40 years. The total cost of the Newton affiliation has been allocated to the assets acquired and liabilities assumed based upon their respective fair values in accordance with ASC 958-805.

Based on the purchase price allocation as of June 30, 2016, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in a contribution of approximately \$13,786,000 being recorded as a contribution received in affiliation on the accompanying 2016 consolidated statement of operations.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

A summary of the purchase price allocation, including assumed liabilities, is as follows (in thousands):

Assets:		
Cash	\$	603
Net patient accounts receivable		10,656
Other current assets		3,222
Assets limited as to use		5,072
Property and equipment		22,424
Other assets		2,631
Liabilities:		
Current liabilities		(11,938)
Long-term debt		(17,388)
Other liabilities		<u>(1,496)</u>
Contribution received in affiliation	\$	<u><u>13,786</u></u>

The operating results of The Athens Entities and Newton have been included in the consolidated statements of operations since their respective acquisition dates. The revenue, gains, and other support; operating income; and change in unrestricted net assets attributable to PHC related to the acquired operations of The Athens Entities for the period from October 1, 2016 through June 30, 2017 were approximately \$554,031,000, \$198,762,000, and \$260,867,000, respectively. The revenue, gains, and other support; operating loss; and change in unrestricted net assets attributable to PHC related to the acquired Newton operations for the period from July 1, 2016 through June 30, 2017 were approximately \$74,014,000, \$1,190,000, and \$19,409,000, respectively. The revenue, gains, and other support; operating loss; and change in unrestricted net assets attributable to PHC related to the acquired Newton operations for the period from October 1, 2015 through June 30, 2016 were approximately \$56,135,000, \$6,369,000, and \$19,793,000, respectively. The unaudited pro forma combined summary of operations, which gives effect to including the acquired operating results of The Athens Entities and Newton as if the acquisitions had occurred as of July 1, 2015, is as follows (in thousands):

	<u>Year ended June 30</u>	
	<u>2017</u>	<u>2016</u>
Revenue, gains, and other support	\$ 2,810,106	2,490,811
Operating income	108,663	124,550
Change in unrestricted net assets	406,685	48,238

Pro forma adjustments to operating income and change in unrestricted net assets include adjustments to record The Athens Entities' and Newton's operating results on a consolidated basis, to record depreciation expense based on the estimated fair value assigned to the long-lived assets acquired, and to remove loss on extinguishment of debt relating to The Athens Entities' acquired debt. These pro forma results are not necessarily indicative of the actual results of operations that would have occurred if these acquisitions had occurred on July 1, 2015.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(4) Net Patient Service Revenue

PHC has agreements with third-party payors that provide for payments to PHC at amounts different from its established rates. A summary of payment arrangements with major third-party payors is as follows:

(a) Medicare and Medicaid

PHC renders care to patients covered by the Medicare and Medicaid programs. Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicare reimburses for outpatient services based on a prospective outpatient payment system similar to the inpatient system.

Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective payment reimbursement methodology. Outpatient services are reimbursed under a cost-based methodology. PHC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by PHC and audits thereof by the Medicaid fiscal intermediary.

Services rendered under these programs are recorded at established rates and reduced to the estimated amount due from the third-party payors through recording of contractual adjustments and other discounts. Because PHC cannot pursue collections for the contractual or discounted amounts, they are not reported as revenue.

Net patient service revenue from the Medicare and Medicaid programs accounted for approximately 36% and 4%, respectively, of PHC's net patient service revenue for the year ended June 30, 2017. Net patient service revenue from the Medicare and Medicaid programs accounted for approximately 32% and 4%, respectively, of PHC's net patient service revenue for the year ended June 30, 2016. 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 is reported at the estimated net realizable amounts from the Medicare and Medicaid programs for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations.

Final settlement has been reached for all Medicare and Medicaid cost reports prior to fiscal year 2010. PHC has recorded amounts due to Medicare and Medicaid of \$33,847,000 and \$27,024,000 at June 30, 2017 and 2016, respectively, as an estimate of final third-party payor settlements for open cost report years. Management recorded a favorable change in estimate to net patient service revenue in the accompanying consolidated statements of operations related to third-party settlements of \$7,590,000 and \$4,689,000 for the years ended June 30, 2017 and 2016, respectively. The amounts due to Medicare and Medicaid represent management's best estimates of final settlements.

(b) Managed Care and Other Payors

PHC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations (HMOs), and preferred provider organizations. The bases for payments to PHC under these agreements include prospectively determined rates per discharge, discounts from established charges, and daily rates.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(c) Self-Pay

PHC incurred bad debt expense, valued at established charges, of \$163,681,000 and \$321,683,000 for the years ended June 30, 2017 and 2016, respectively. In an effort to improve amounts collected from uninsured patients that do not apply and/or qualify for charity assistance, PHC offered discounted prices to the uninsured under a policy that was revised in June 2016, as described below. In addition to charity care and bad debt write-offs, PHC provided discounts to the uninsured of \$268,060,000 and \$19,459,000 (recorded as deductions from net patient service revenue) for the years ended June 30, 2017 and 2016, respectively. The decrease in bad debt expense is due to the following changes in PHC's policies:

- Implementation of a 70% uninsured discount offered to self-pay patients (implemented June 2016)
- Further automation of charity care determination with revised scoring methodologies (implemented January 2017)

(d) Georgia Provider Payment Agreement Act

Effective July 1, 2010, the State of Georgia imposed a fee on not-for-profit hospitals based on net revenue levels as defined by the State of Georgia. Included in supplies and other expenses in the accompanying consolidated statements of operations for the years ended June 30, 2017 and 2016 is approximately \$23,852,000 and \$18,751,000, respectively, relating to this fee.

(5) Charity Care and Community Benefits

PHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts significantly less than its established rates. Amounts determined to qualify as charity care are not reported as revenue or patient accounts receivable in the accompanying consolidated financial statements.

PHC maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services furnished under its charity care policy. The cost of providing this charity care was estimated to be approximately \$81,564,000 and \$36,226,000 for years ended June 30, 2017 and 2016, respectively. PHC estimates the direct and indirect costs of providing charity care by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients.

PHC offers many other wellness and educational services to the community at low and, in some cases, no cost. PHC also partners with five charitable clinics to provide supportive services for low-income patients, including the provision of free laboratory and diagnostic services to clinic patients at no charge. PHC operates 24-hour emergency rooms that provide care to all patients, regardless of ability to pay. The costs for these services are included in operating expenses in the accompanying consolidated statements of operations.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(6) Investments

(a) Investments and Assets Limited as to Use

The composition of investments and assets limited as to use is set forth in the following table (in thousands):

	June 30	
	2017	2016
Investments internally designated for capital acquisition:		
Cash and short-term investments	\$ 13,318	8,298
Corporate obligations	49	18,782
Fixed-income securities	152,504	94,748
Corporate stocks	16,789	55,760
Mutual funds	324,400	220,661
Alternative investments	176,444	153,206
	<u>683,504</u>	<u>551,455</u>
Assets limited as to use:		
Cash and short-term investments	1,399	335
Corporate obligations	2	758
Fixed-income securities	5,912	3,826
Corporate stocks	590	2,252
Mutual funds	13,126	8,911
Alternative investments	6,366	6,187
	<u>27,395</u>	<u>22,269</u>
Totals	<u>\$ 710,899</u>	<u>573,724</u>

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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June 30, 2017 and 2016

(b) Alternative Investments

Alternative investments included in investments and assets limited as to use at June 30, 2017 and 2016 and related net unrealized gains and losses for the years then ended consist of the following (in thousands):

	Estimated fair value, year ended June 30		Net unrealized gains (losses), year ended June 30	
	2017	2016	2017	2016
Lighthouse Diversified Fund	\$ —	28,211	—	(3,465)
Archipelago Holdings Ltd Offshore Fund	—	31,260	—	(1,523)
Titan Masters International Fund	—	26,808	—	(2,997)
Clarion Lion Properties ING Fund	17,726	25,468	(988)	1,906
LSV Emerging Markets Equity Fund	—	19,538	—	(3,232)
Harvest MLP Income II Fund	15,386	28,108	74	(4,833)
Golub Capital Investment Corporation	1,556	—	—	—
IFP Global Equity, L.P.	20,029	—	1,629	—
Chatham Asset High Yield Offshore Fund, Ltd.	24,627	—	1,214	—
Canyon Balanced Fund	18,537	—	1,537	—
PHC Fund, Ltd.	84,949	—	343	—
	<u>\$ 182,810</u>	<u>159,393</u>	<u>3,809</u>	<u>(14,144)</u>

Redemption frequency and redemption notice periods for alternative investments held at June 30, 2017 are as follows:

	Redemption frequency	Redemption notice period
Clarion Lion Properties ING Fund	Quarterly	90 Days
Harvest MLP Income II Fund	Monthly	30 Days
Golub Capital Investment Corporation	Upon IPO	N/A
IFP Global Equity L.P.	Bi-weekly	3 Days
Chatham Asset High Yield Offshore Fund, Ltd.	Quarterly	45 Days
Canyon Balanced Fund	Quarterly	90 Days
PHC Fund, Ltd.	Monthly	90 Days

As of June 30, 2017, PHC had an unfunded commitment with Golub Capital Investment Corporation of \$15,470,000.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(c) Investment Income (Loss), Net

Investment income (loss), net related to investments and assets limited as to use is comprised of the following (in thousands):

	Year ended June 30	
	2017	2016
Interest income	\$ 11,112	13,009
Net realized and unrealized gains (losses) on investments	67,446	(28,925)
Other	(1,152)	378
Investment income (loss), net	\$ 77,406	(15,538)

(7) Property and Equipment

A summary of property and equipment, net is as follows (in thousands):

	June 30	
	2017	2016
Land and land improvements	\$ 101,417	66,898
Buildings and fixtures	1,281,943	982,782
Equipment	901,870	760,989
	2,285,230	1,810,669
Less accumulated depreciation	1,140,488	1,038,609
	1,144,742	772,060
Construction in progress	76,047	49,475
Property and equipment, net	\$ 1,220,789	821,535

Construction in progress at June 30, 2017 primarily relates to ongoing construction at Atlanta. Construction in progress at June 30, 2016 primarily relates to ongoing construction at Fayette completed in 2017.

Depreciation and amortization expense for the years ended June 30, 2017 and 2016 totaled approximately \$106,004,000 and \$87,852,000, respectively. Amortization of capitalized software costs of approximately \$13,284,000 and \$9,899,000 are included in depreciation and amortization expense in the accompanying consolidated statements of operations for the years ended June 30, 2017 and 2016, respectively.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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June 30, 2017 and 2016

Capitalized software and software development costs included in property and equipment were as follows (in thousands):

	June 30	
	2017	2016
Capitalized software and software development costs	\$ 109,658	82,468
Less accumulated amortization	46,744	35,748
Capitalized software and software development costs, net	\$ 62,914	46,720

Based on the amortizable capitalized software and software development costs that have been placed into service at June 30, 2017, the estimated amortization expense for the succeeding five fiscal years and thereafter is as follows (in thousands):

Year ending June 30:	
2018	\$ 14,337
2019	11,953
2020	9,805
2021	8,248
2022	6,901
Thereafter	11,670
	\$ 62,914

At June 30, 2017 and 2016, PHC's remaining commitment for software and construction contracts approximated \$351,901,000 and \$49,263,000, respectively, primarily relating to ongoing construction at Atlanta expected to be completed by 2021.

During fiscal year 2012, PHC completed construction of a new Piedmont Newnan hospital. In May 2012, the operations of Newnan were transferred to the new hospital. At that time, the replaced hospital building and certain assets that were not transferred to the new hospital were written down to fair value less estimated cost to sell. The building and related assets of \$3,050,000 are classified as held-for-sale and are included in other current assets in the accompanying consolidated balance sheets as of June 30, 2017 and 2016. Sale of the assets is expected to occur within one year.

In August 2006, Fayette entered into a ground lease with Piedmont Fayette Medical Office Building, LLC (PFB), whereby Fayette is leasing real property to PFB. In accordance with ASC 840, *Leases*, Fayette is considered the owner of the Medical Office Building (Fayette MOB) during the construction period and thereafter due to Fayette's continuing involvement in the Fayette MOB. Accordingly, the value of the building and the construction notes paid by the developer are included in the accompanying consolidated balance sheets. At June 30, 2017 and 2016, the net book value of the Fayette MOB included in buildings and fixtures totaled approximately \$12,384,000 and \$13,516,000, respectively, and the related Medical Office Building financing obligation approximated \$13,708,000 and \$14,242,000, respectively.

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In August 2005, Atlanta entered into a ground lease with Piedmont Physicians Plaza, L.P. (PPP), whereby Atlanta is leasing real property to PPP. In accordance with ASC 840, Atlanta is considered the owner of the Medical Office Building (Piedmont MOB) during the construction period and thereafter due to Atlanta's continuing involvement in the Piedmont MOB. Accordingly, the cost of the building and the related financing obligation are included in PHC's consolidated balance sheets. At June 30, 2017 and 2016, the net book value of the Piedmont MOB included in buildings and fixtures totaled approximately \$14,277,000 and \$15,264,000, respectively, and the related Medical Office Building financing obligation approximated \$29,650,000 and \$28,878,000, respectively.

(8) Long-Term Debt

(a) Bonds Payable

Bonds payable consists of the following (in thousands):

	June 30	
	2017	2016
Series 2006, fixed interest rate of 4.50%, interest payments due semiannually, payable through 2024	\$ 4,380	4,905
Series 2007, fixed interest rate of 2.47%, interest payments due semiannually, payable through 2024	9,929	11,131
Series 2009A, fixed interest rates ranging from 4.375% to 5.25%, interest payments due semiannually, payable through 2024	35,895	208,140
Series 2009C, variable interest rates (1.15% and 0.76% at June 30, 2017 and 2016, respectively), interest payments due monthly, payable through 2019	17,465	25,650
Series 2010, fixed interest rates ranging from 4.50% to 5.00%, interest payments due semiannually, payable through 2045	100,000	100,000
Series 2014A, fixed interest rates ranging from 3.00% to 5.00%, interest payments due semiannually, payable through 2044	86,885	87,125
Series 2014B, variable interest rates (1.35% and 0.96% at June 30, 2017 and 2016, respectively) interest payments due monthly, payable through 2034	89,590	92,270
Series 2016A, fixed interest rates ranging from 3.00% to 5.00%, interest payments due semiannually, payable through 2046	423,360	—
Unamortized original issue premium, net	51,982	4,383
Unamortized debt issuance costs	(7,413)	(5,193)
	812,073	528,411
Less current maturities	(24,290)	(15,320)
	\$ 787,783	513,091

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June 30, 2017 and 2016

In connection with the acquisition of Athens effective October 1, 2016, PHC assumed responsibility for payment of the Clarke Authority's outstanding revenue certificates through the lease agreement described in note 3.

On October 27, 2016, the Development Authority of Fulton County, the Hospital Authority of Fayette County, and the Hospital Authority of Clarke County, Georgia issued \$197,555,000, \$47,580,000, and \$178,225,000, respectively (\$423,360,000 collectively), in Revenue Bonds Series 2016A (the Series 2016 Bonds) on behalf of PHC. The proceeds of the Series 2016 Bonds were used to redeem previously outstanding Series 2009A and Athens Series 2007 and 2012 Revenue Bonds and for certain construction projects. PHC recognized a \$28,416,000 loss on extinguishment resulting from the write-off of associated unamortized bond issuance costs, premium and discount related to the Series 2009A and Athens Series 2007 and 2012 revenue bonds. The Series 2016 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group (Piedmont Healthcare, Inc. and all of its affiliates exclusive of AMIC, ARPS, ARSS, RHC, ARHS, ARF, and HPS), which provides for, among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property, and limitations on additional borrowings.

Included in bond proceeds receivable on the accompanying June 30, 2017 consolidated balance sheet is \$30,927,000 of bond proceeds from the Series 2016 Bonds, currently being held by a trustee that is remitted to PHC upon completion of certain construction projects.

On November 19, 2014, the Development Authority of Fulton County, the Hospital Authority of Fayette County, and the Hospital Authority of Henry County issued \$87,730,000, \$42,060,000, and \$53,420,000, respectively (\$183,210,000 collectively), in Revenue Bonds Series 2014A and 2014B (the Series 2014 Bonds) on behalf of PHC. The proceeds of the Series 2014 Bonds were used to redeem previously outstanding Series 2004 and Series 2009B Revenue Bonds and for certain construction projects. The Series 2014 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group, which provides for, among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property, and limitations on additional borrowings.

Included in bond proceeds receivable on the accompanying June 30, 2017 and 2016 consolidated balance sheets is \$6,758,000 and \$24,861,000, respectively, of bond proceeds from the Series 2014 Bonds, being held by a trustee which is remitted to PHC upon completion of certain construction projects.

On October 27, 2010, the Coweta County Development Authority issued \$100,000,000 in Revenue Bonds Series 2010 (the Series 2010 Bonds) on behalf of PHC. The proceeds of the Series 2010 Bonds were used to construct a replacement hospital for Newnan. The Series 2010 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group, which provides for, among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property, and limitations on additional borrowings.

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On November 24, 2009, the Development Authority of Fulton County and the Hospital Authority of Fayette County issued \$304,345,000 and \$79,540,000, respectively (\$383,885,000 collectively), in Revenue Bonds Series 2009A, 2009B, and 2009C (the Series 2009 Bonds) on behalf of PHC. The proceeds of the Series 2009 Bonds were used primarily to redeem previously outstanding Series 2007, Series 2005, Series 2001, and Series 1999 Revenue Bonds and fully repay a line of credit totaling approximately \$65,000,000. The Series 2009 Bonds have been issued on a tax-exempt basis and are secured under a master trust indenture with all members of the Obligated Group, which provides for, among other things, the deposit of revenue with the master trustee in the event of certain defaults, pledges of accounts receivable, pledges not to encumber property, and limitations on additional borrowings. The Series 2009A Bonds were partially repaid (\$172,245,000) with proceeds from the Series 2016 Bonds. The Series 2009B Bonds were repaid in full (\$94,735,000) with proceeds from the Series 2014 Bonds.

In connection with the acquisition of Newton effective October 1, 2015, PHC assumed responsibility for payment of the Newton Authority's outstanding revenue certificates through the lease agreement described in note 3.

In April 2006, the Newton County Hospital Authority issued \$8,930,000 Revenue Certificates, Series 2006 (the Series 2006 Bonds). The certificates were issued for the purpose of financing certain capital additions and improvements to Newton's facilities and paying costs of issuance of the Series 2006 Bonds. The Series 2006 bonds have been issued on a tax-exempt basis and are secured by a pledge of and lien on the gross revenues derived by Newton and payments made by Newton County, Georgia to Newton pursuant to a contract between Newton and Newton County. Under the terms of the Series 2006 Bonds, Newton is required to maintain certain deposits with a trustee for payment of bond principal and interest. Such deposits are included in investments and assets limited as to use on the accompanying June 30, 2016 and 2017 consolidated balance sheets. At the acquisition date, the stated value of the Series 2006 Bonds approximated \$5,405,000; however, they were recorded at their fair value upon acquisition. At June 30, 2017 and 2016, the stated value and carrying value of the Series 2006 Bonds approximated \$4,380,000 and \$4,905,000, respectively.

In May 2007, the Newton County Hospital Authority issued \$17,225,000 Revenue Refunding Certificates, Series 2007 (the Series 2007 Bonds). The certificates were issued for the purpose of advance refunding Piedmont Newton's Series 1999 bonds and paying costs of issuance of the 2007 bonds. The Series 2007 Bonds have been issued on a tax-exempt basis and are secured by a pledge of and lien on the gross revenues derived by Newton and payments made by Newton County, Georgia to Newton pursuant to a contract between Newton and Newton County. Under the terms of the 2007 Bonds, Newton is required to maintain certain deposits with a trustee for payment of bond principal and interest. Such deposits are included in investments and assets limited as to use on the accompanying June 30, 2017 and 2016 consolidated balance sheets. At the acquisition date, the stated value of the Series 2007 Bonds approximated \$11,985,000; however, they were recorded at their fair value upon acquisition. At June 30, 2017 and 2016, the stated value of the Series 2007 Bonds approximated \$9,690,000 and \$10,860,000, respectively, and the carrying value approximated \$9,929,000 and \$11,131,000, respectively.

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Notes to Consolidated Financial Statements

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Scheduled principal repayments on the Series 2016, Series 2014, Series 2010, Series 2009, Series 2007, and Series 2006 Bonds are as follows (in thousands):

Year ending June 30:	
2018	\$ 24,290
2019	20,795
2020	22,705
2021	25,065
2022	26,210
Thereafter	<u>648,200</u>
	<u>\$ 767,265</u>

(b) Note Payable to a Bank

Effective February 1, 2012, PHC entered into a note payable with a bank. The proceeds of the note totaling approximately \$44,819,000 were used to fully repay Henry's Series 1999 Bonds during fiscal year 2013. Amounts outstanding at June 30, 2017 and 2016 totaled \$32,234,000 and \$34,799,000, respectively. Effective June 29, 2016, the note was refinanced and certain terms were amended. Previous to June 29, 2016, the note bore interest at a rate of 1.8% per annum, payable monthly. Effective June 29, 2016, the note bears interest at a rate of the London InterBank Offered Rate (LIBOR) floating rate plus 0.650% (1.876% as of June 30, 2017) and the payment terms are as follows: \$2,715,000 due on July 1, 2018, \$1,950,000 due on July 1, 2019, \$2,065,000 due on July 1, 2020, and the remaining principal of \$25,504,000 due on July 1, 2021.

(c) Line of Credit

During fiscal year 2010, PHC entered into a line of credit for \$70,000,000 with a local bank with an interest rate based on 30-day LIBOR plus 0.75% and a maturity date of December 31, 2011. During fiscal year 2012, PHC entered into an amendment to the line of credit, which reduced available borrowings to \$1,000,000 and extended the maturity to December 31, 2012. On December 17, 2012, PHC entered into an amendment to the line of credit, which extended the maturity to December 31, 2015 and revised the interest rate to LIBOR plus 0.60%. On October 7, 2013, PHC entered into an amendment to the line of credit, which increased available borrowing, to \$70,000,000. On December 7, 2015, PHC entered into an amendment to the line of credit that reduced available borrowings to \$1,000,000 and extended the maturity to December 31, 2018. There were no outstanding borrowings on the line of credit at June 30, 2017 or 2016.

(d) Interest Rate Swap Agreements

PHC has seven interest rate swap agreements that are not accounted for as cash flow hedges. These interest rate swaps are primarily utilized to economically hedge PHC's exposure to variable interest rates under its debt obligations. The change in value of the interest rate swaps is reported as a component of nonoperating income (expense) in the period it occurs. At June 30, 2017 and 2016, the total notional amount of PHC's interest rate swaps was approximately \$121,820,000 and \$125,520,000, respectively.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

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These interest rate swap agreements expose PHC to credit losses in the event of nonperformance by the counterparty to the financial instruments. The counterparty is a creditworthy financial institution and PHC management believes the counterparty will be able to fully satisfy its obligations under the contracts.

PHC's interest rate swaps are reported at estimated fair value in the accompanying consolidated balance sheets, as follows (in thousands):

	June 30	
	2017	2016
Other long-term liabilities	\$ 24,743	33,537

The effects of PHC's interest rate swaps on the accompanying consolidated statements of operations are as follows (in thousands):

	Year ended June 30	
	2017	2016
Loss recognized in nonoperating income (expense)	\$ 8,855	7,108
Loss recognized in supplies and other expenses	3,866	4,325
	<u>\$ 12,721</u>	<u>11,433</u>

(9) Medical Office Buildings

As discussed in note 7, PHC is considered the owner of the Fayette MOB and the Piedmont MOB for financial reporting purposes. In accordance with ASC 840, *Leases*, PHC has reflected the operations of the Piedmont and Fayette MOBs in its consolidated financial statements, which resulted in other revenue of approximately \$6,279,000, interest expense of approximately \$5,184,000, and supplies and other expenses of approximately \$2,322,000 for the year ended June 30, 2017 and other revenue of approximately \$6,011,000, interest expense of approximately \$5,305,000, and supplies and other expenses of approximately \$2,141,000 for the year ended June 30, 2016.

(10) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets available primarily for capital purchases, education, and geriatric services were approximately \$27,537,000 and \$18,033,000 at June 30, 2017 and 2016, respectively.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

Permanently restricted net assets are summarized as follows, whose investment income is to be used according to the purpose description below (in thousands):

	June 30	
	2017	2016
Support of education	\$ 1,064	1,064
Beneficial interest in perpetual trust	7,694	7,298
Support of specific services	14,924	14,870
	<u>\$ 23,682</u>	<u>23,232</u>

(11) Employee Benefits

(a) Pension Plan

PHC has a trustee, noncontributory defined-benefit pension plan (the Plan) covering certain PHC employees. The Plan's benefits are based on a combination of years of service and the employee's compensation. PHC's funding policy is to contribute annually to the Plan an amount sufficient to meet the minimum funding standards of ERISA or an amount sufficient to maintain the Plan on a sound actuarial basis, as certified by an enrolled actuary. Plan assets consist primarily of common stocks, alternative investments, guaranteed investment contracts, and cash equivalents.

In fiscal year 2008, the PHC's Board of Directors approved the freezing of the Plan for participation purposes, so that employees hired or rehired on and after July 1, 2008 are not eligible to participate in the Plan. Then-current participants had the option under the "Choice" program to continue to accrue benefits in the Piedmont Healthcare Retirement Plan or to participate in the new Piedmont 401(k) plan, which began on January 1, 2009. Approximately 64% of active participants elected to continue to accrue benefits in the defined-benefit pension plan.

On September 20, 2012, the Plan was amended to reflect a freeze as of December 31, 2014. Therefore, no further benefit accruals will be provided after that date for additional credited service or earnings. In addition, all existing participants became fully vested as of December 31, 2014.

The following cumulative amounts have not yet been recognized in the net periodic cost, and are recognized as a reduction to unrestricted net assets (in thousands):

	June 30	
	2017	2016
Actuarial losses	\$ 115,539	139,986
Prior service cost	—	—
Total	<u>\$ 115,539</u>	<u>139,986</u>

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

Changes in the Plan's obligations and assets resulted in the following changes in unrestricted net assets (in thousands):

	Year ended June 30	
	2017	2016
Amortization of prior service cost	\$ —	—
Amortization of net actuarial loss	3,148	13,133
Net actuarial income (loss) during the year	21,299	(59,230)
Total	<u>\$ 24,447</u>	<u>(46,097)</u>

The unrecognized loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ended June 30, 2018 is approximately \$2,487,000.

The following table presents a reconciliation of the beginning and ending balances of the Plan's projected benefit obligation, the fair value of plan assets, the funded status of the Plan, and the accumulated benefit obligation (in thousands):

	June 30	
	2017	2016
Change in benefit obligation:		
Projected benefit obligation, beginning of year:	\$ 400,303	387,257
Service cost	3,530	2,000
Interest cost	15,594	17,995
Benefits paid	(11,608)	(10,560)
Settlements	—	(32,872)
Actuarial (gain) loss	(9,860)	39,181
Administrative expenses paid from pension trust	(3,186)	(2,698)
Projected benefit obligation, end of year	<u>\$ 394,773</u>	<u>400,303</u>
Accumulated benefit obligation	\$ 394,773	400,303

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

	June 30	
	2017	2016
Change in Plan assets:		
Fair value of Plan assets, beginning of year	\$ 290,306	329,096
Actual return on Plan assets	29,493	2,340
Employer contributions	12,000	5,000
Benefits paid	(11,608)	(10,560)
Settlements	—	(32,872)
Administrative expenses paid from pension trust	(3,186)	(2,698)
Fair value of Plan assets, end of year	<u>\$ 317,005</u>	<u>290,306</u>
Funded status of the Plan	\$ (77,768)	(109,997)

The unfunded status of the Plan of approximately \$77,768,000 and \$109,997,000 at June 30, 2017 and 2016, respectively, is recognized in the accompanying consolidated balance sheets as accrued pension cost. No Plan assets are expected to be returned to PHC during the fiscal year ending June 30, 2018.

During the year ended June 30, 2016, the Plan offered a bulk lump-sum payment window. Benefits paid from the Plan relating to this bulk lump-sum window totaled approximately \$32,872,000 and resulted in a curtailment charge of \$11,498,000, which is included in other components of pension expense with in nonoperating expense in the accompanying consolidated statement of operations for the year ended June 30, 2016.

The following table sets forth the components of net periodic benefit cost (in thousands):

	Year ended June 30	
	2017	2016
Components of net periodic benefit cost:		
Service cost	\$ 3,530	2,000
Interest cost	15,594	17,995
Expected return on Plan assets	(18,054)	(22,389)
Curtailment charge	—	11,498
Amortization of prior service cost	—	—
Amortization of net actuarial loss	3,148	1,635
Total net periodic benefit cost	<u>\$ 4,218</u>	<u>10,739</u>

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

The actuarial assumptions used in the accounting for the net periodic cost for the Plan were as follows:

	Year ended June 30	
	2017	2016
Discount rate	3.96 %	4.72 %
Rate of increase in future compensation levels	N/A	N/A
Expected long-term rate of return on Plan assets	6.40	6.95

The actuarial assumptions used to determine the year-end benefit obligations for the Plan were as follows:

	June 30	
	2017	2016
Discount rate	4.03 %	3.96 %
Rate of increase in future compensation levels	N/A	N/A

PHC uses fair value as the market-related value of assets in calculating the expected return on Plan assets component of net periodic pension expense for the years ended June 30, 2017 and 2016.

No contributions are expected to be paid to the Plan during fiscal year 2018.

Benefits expected to be paid in each of the next five fiscal years are as follows: fiscal year 2018, \$15,214,000; fiscal year 2019, \$15,397,000; fiscal year 2020, \$16,572,000; 2021, \$17,699,000; and fiscal year 2022, \$18,680,000. For fiscal years 2023–2027, the aggregate benefits expected to be paid is \$105,098,000.

The following table sets forth the asset allocation for the Plan:

	June 30	
	2017	2016
Growth/equity securities	44 %	43 %
Hedge funds/private equity	13	14
Fixed-income securities	43	43
	<u>100 %</u>	<u>100 %</u>

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

The target allocation for the Plan is as follows:

	June 30	
	2017	2016
Growth/equity securities	45 %	57 %
Hedge funds/private equity	15	13
Fixed-income securities	40	30
	<u>100 %</u>	<u>100 %</u>

To develop the expected long-term rate of return on assets assumption, PHC considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the Plan's portfolio.

The investment strategy of the Plan is to ensure, over the long-term life of the Plan, an adequate pool of assets, along with contributions by PHC to satisfy the benefit obligations to participants and beneficiaries. PHC desires to achieve market returns consistent with a prudent level of diversification. All investments are made solely in the interest of the Plan's participants and beneficiaries for the exclusive purposes of providing benefits to such participants and their beneficiaries and defraying the expenses related to administering the Plan. The target allocation of all assets is to reflect proper diversification in order to reduce the potential of a single security or single sector of securities having a disproportionate impact on the portfolio. In an effort to maintain the overall risk level of the portfolio within an acceptable range, the relative mix of asset classes will be rebalanced back toward the target allocations as opportunities permit, but in any event not less often than annually. The use of futures and options contracts will be limited to liquid instruments listed and actively traded on major exchanges (except for short-term funds) to over-the-counter options or forward-contract positions executed with major dealers. No derivatives strategy may be used if it would subject the portfolios to greater variance than would be the case with the physical portfolio under a worst case scenario. Short-term funds may use only exchange-traded futures contracts and options—specifically prohibited are any off-exchange instruments and any exotic or structured securities, as well as notes whose interest rate is tied to security with a maturity of more than one year. PHC utilizes an outside investment consultant to implement its investment strategy.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

The fair value of plan assets of the Plan measured at fair value on a recurring basis was determined using the following inputs (note 15) at June 30, 2017 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and short-term investments	\$ 27,424	—	—	27,424
Corporate obligations	13,512	58,381	—	71,893
Fixed-income securities	9,998	—	—	9,998
Municipal securities	—	5,201	—	5,201
Corporate stocks	6,873	—	—	6,873
Mutual funds	126,270	—	—	126,270
Total assets at fair value	\$ <u>184,077</u>	<u>63,582</u>	<u>—</u>	247,659
Investments measured at NAV as a practical expedient				<u>69,346</u>
				\$ <u><u>317,005</u></u>

The fair value of Plan assets measured at fair value on a recurring basis was determined using the following inputs (note 15) at June 30, 2016 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and short-term investments	\$ 1,849	—	—	1,849
Corporate obligations	422	7,920	—	8,342
Fixed-income securities	25,878	—	—	25,878
Corporate stocks	20,513	—	—	20,513
Mutual funds	132,065	—	—	132,065
Total assets at fair value	\$ <u>180,727</u>	<u>7,920</u>	<u>—</u>	188,647
Investments measured at NAV as a practical expedient				<u>101,659</u>
				\$ <u><u>290,306</u></u>

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

Alternative investments included in the Plan at June 30, 2017 and 2016 and related net unrealized gains and losses for the years then ended consist of the following (in thousands):

	Estimated fair value, year ended June 30		Net unrealized gains (losses), year ended June 30	
	2017	2016	2017	2016
Lighthouse Diversified Fund	\$ —	9,398	—	(424)
Archipelago Holdings Ltd Offshore Fund	—	6,248	—	(416)
Titan Masters International Fund	—	12,861	—	(1,438)
Clarion Lion Properties ING Fund	5,289	8,507	323	733
LSV Emerging Markets Equity Fund	—	11,579	—	(1,948)
Loomis Sayles Long Duration Fund	—	22,900	—	3,000
IFP Global Equity L.P.	11,335	—	921	—
Chatham Asset High Yield Offshore Fund, Ltd.	12,873	—	1,373	—
Canyon Balanced Fund	9,465	—	865	—
PHC Fund, Ltd.	25,899	—	355	—
LGIMA Long Duration Fund	—	22,049	—	2,747
Harvest MLP Income II Fund	4,485	8,117	431	(1,686)
	<u>\$ 69,346</u>	<u>101,659</u>	<u>4,268</u>	<u>568</u>

Redemption frequency and redemption notice periods for alternative investments held by the Plan at June 30, 2017 are as follows:

	Redemption frequency	Redemption notice period
Clarion Lion Properties ING Fund	Quarterly	90 Days
Harvest MLP Income II Fund	Monthly	30 Days
Canyon Balanced Fund	Quarterly	90 Days
Chatham Asset High Yield Offshore Fund, Ltd.	Quarterly	45 Days
IFP Global Equity, L.P.	Biweekly	3 Days
PHC Fund, Ltd.	Monthly	90 Days

All investments at June 30, 2017 and 2016 were in domestic investments.

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 financial assets for the corporate obligations were determined through evaluated bid prices provided by third-party pricing services where quoted market prices are not available. The fair value of Level 2 alternative investments was determined based on the use of net asset value per share as a practical expedient in accordance with ASC 820, *Fair Value Measurement*.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(b) Deferred Compensation Plans

PHC also offers two nonqualified deferred compensation plans, which are available to certain highly compensated PMCC and PHIP employees. These plans permit such employees to defer the receipt and taxation of all or a portion of their salary until future years. The deferred compensation is available for distribution to employees upon the election by the employee, provided the distribution election with respect to the deferred amounts has been made for a minimum of one year prior to the date of distribution.

All deferrals are held as part of PHC's general assets and are subject to the claims of PHC's general creditors. Employees' rights to the payment of benefits under these plans are equal to those of general and unsecured creditors of the PHC. PHC has no liability for losses under the deferred compensation plans.

The amounts recorded for the deferred compensation plans are approximately \$48,390,000 and \$38,360,000 at June 30, 2017 and 2016, respectively, and are recorded within other long-term liabilities in the accompanying consolidated balance sheets.

(c) 401(k) Plan

PHC offers, as the sponsor, a deferred tax annuity plan (the 401(k) Plan) pursuant to Section 401(k) of the IRC of 1986, covering substantially all employees of PHC. PHC contributes 100% of pretax contributions up to the first 3% of eligible pay and 50% of pretax contributions up to the next 2% into the 401(k) Plan and may make an additional discretionary contribution. PHC recognized as salaries and benefits expense approximately \$39,006,000 and \$34,158,000 for the years ended June 30, 2017 and 2016, respectively, related to the 401(k) Plan. No discretionary contributions were made during the year ended June 30, 2017 or 2016.

(12) Concentrations of Credit Risk

PHC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors was as follows:

	June 30	
	2017	2016
Medicare	30 %	26 %
Medicaid	14	13
Other third-party payors	43	43
Patients	13	18
	<u>100 %</u>	<u>100 %</u>

PHC recognizes that revenue and receivables from government agencies and third-party payors are significant to its operations. PHC does not believe that there are significant credit risks associated with these sources of revenue.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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June 30, 2017 and 2016

As of June 30, 2017 and 2016, PHC had approximately \$560,831,000 and \$514,737,000, respectively, in funds deposited with various financial institutions in excess of Federal Deposit Insurance Corporation limits.

(13) Commitments and Contingencies

(a) General and Professional Liability Insurance

PHC has a self-insurance program for general and professional liability coverage through AMIC. AMIC insures PHC with professional liability and commercial general liability risks of PHC affiliates, namely Atlanta, Mountainside, Fayette, Newnan, Henry, Newton, Athens, PHIP, PMCC, ARPS, ARSS, and RFC on a claims-made basis for the hospital professional liability and on an-occurrence basis for the commercial general liability. The insurance policies between PHC and AMIC are \$5,000,000 per occurrence and \$20,000,000 aggregate annual limit for coverage effective May 1, 2003 through April 30, 2005, and \$5,000,000 per occurrence and \$19,000,000 aggregate annual limit for coverage effective May 1, 2005 through April 30, 2014 returning to \$5,000,000 per occurrence and \$20,000,000 aggregate annual limit for coverage effective May 1, 2014 through April 30, 2016 and \$5,000,000 per occurrence and \$21,000,000 annual aggregate as of May 1, 2016 and changing to \$5,000,000 per occurrence and \$25,000,000 annual aggregate as of May 1, 2017. The per occurrence general liability limit provided by AMIC was reduced from \$5,000,000 to \$2,000,000 on May 1, 2011 and remains at that level. AMIC is consolidated by PHC. PHC records the reported and estimated incurred-but-not-reported liability based on an actuarial study at June 30, 2017 and 2016, which totaled approximately \$66,603,000 and \$49,863,000, respectively, and is recorded as self-insurance reserves in the accompanying consolidated balance sheets. Commercial insurance has been obtained on a claims-made (professional liability) and on an-occurrence (general liability) basis to provide for excess coverage.

The general and professional self-insurance reserves included in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2017 and 2016, applicable to the general and professional liability self-insurance plans for PHC. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice and general losses have been discounted at 2% at June 30, 2017 and 2016.

(b) Other Self-Insurance Programs

PHC self-insures a portion of its workers' compensation liability exposure up to \$450,000 per claim at June 30, 2017 and 2016. Reserves for the self-insurance program are established to provide for estimated claims losses and applicable legal expenses for any claims incurred, both reported and unreported, through June 30, 2017 and 2016, and are recorded in the accompanying consolidated financial statements. PHC recorded the reported and estimated incurred-but-not-reported liability for its claims at June 30, 2017 and 2016, which totaled approximately \$5,800,000 and \$4,621,000, respectively. Commercial insurance has been obtained on an-occurrence basis to provide for excess coverage.

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June 30, 2017 and 2016

The workers' compensation self-insurance reserves included in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2017 and 2016. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued workers' compensation losses have been discounted at 2% at June 30, 2017 and 2016.

PHC is self-insured for employee health benefits for its subsidiaries with reinsurance for high dollar claims. Effective January 1, 2016, QualCare, Inc., a Cigna company, became the plan administrator for PHC's health benefits. Prior to that, beginning January 1, 2014, Piedmont WellStar HealthPlans, Inc. (PWHP), a 50% owned subsidiary of PHC (note 16), administered the plan for PHC's health benefits. At June 30, 2017 and 2016, PHC recorded \$13,409,000 and \$10,927,000, respectively, as an estimated liability for health benefit claims within the current portion of self-insurance reserves line item in the accompanying consolidated balance sheets.

The employee health benefits self-insurance reserves in the accompanying consolidated balance sheets include estimates of the ultimate costs for claims incurred but not reported through June 30, 2017 and 2016, applicable to the employee health benefits self-insurance plans. PHC has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued employee health benefits losses have not been discounted due to the short-term nature of the payout of these liabilities.

In the opinion of management, adequate provision has been made for losses that may occur from the asserted and unasserted claims for all self-insurance programs.

(c) Operating Leases

PHC leases various equipment and facilities under operating leases expiring at various dates through fiscal year 2099. Total rent expense in fiscal years 2017 and 2016 for all operating leases was approximately \$44,915,000 and \$41,708,000, respectively, and is included in supplies and other expenses on the accompanying consolidated statements of operations.

The following is a schedule by year of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year (in thousands):

Year ending June 30:	
2018	\$ 36,785
2019	35,049
2020	33,538
2021	31,144
2022	27,884
Thereafter	<u>103,792</u>
	<u>\$ 268,192</u>

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(d) *Litigation and Other Commitment and Contingencies*

PHC is involved in litigation arising in the ordinary course of business. Liabilities for loss contingencies arising in the ordinary course of business are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred. After consultation with legal counsel, management estimates that these matters will be resolved without a material adverse effect on PHC's future financial position or results of operations.

On December 15, 2016, the United States Attorney's Office for the Northern District of Georgia issued a Civil Investigative Demand in connection with an investigation of PHC under the civil False Claims Act. PHC is cooperating fully with the United States Attorney's Office in connection with this investigation. PHC is currently unable to predict the likely outcome of this matter and unable to estimate the amount or range of potential loss that could result in the event of an unfavorable outcome.

(14) *Functional Expenses*

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

(15) *Fair Value of Financial Instruments*

PHC applies ASC 820, *Fair Value Measurements*, which defines fair value as 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 three-level 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 PHC's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market investments, 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 – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that PHC has the ability to access.

Level 2 – Financial assets and liabilities whose values are based on pricing inputs that are either directly observable or that can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets or liabilities in nonactive markets or pricing models whose inputs are observable for substantially the full term of the asset or liability.

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both significant to the fair value of the financial asset or financial liability and are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

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A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at June 30, 2017 (in thousands):

Assets	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 565,999	—	—	565,999
Investments and assets limited as to use:				
Cash and short-term investments	14,717	—	—	14,717
Corporate obligations	—	51	—	51
Fixed-income securities	158,416	—	—	158,416
Corporate stocks	17,379	—	—	17,379
Mutual funds	337,526	—	—	337,526
Total investments and assets limited as to use at fair value	528,038	51	—	528,089
Self-insurance investments:				
Corporate obligations	241	5,384	—	5,625
Treasury inflation protection securities	—	5,554	—	5,554
Fixed-income securities	11,900	—	—	11,900
Mortgage-backed securities	—	4,875	—	4,875
Mutual funds	21,175	—	—	21,175
Total self-insurance investments	33,316	15,813	—	49,129
Beneficial interest in perpetual trust	—	—	7,694	7,694
Total assets at fair value	\$ 1,127,353	15,864	7,694	1,150,911
Investments and assets limited as to use measured at NAV as a practical expedient				182,810
				\$ 1,333,721
Liabilities				
Interest rate swaps	\$ —	24,743	—	24,743

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The fair value of financial assets and financial liabilities measured at fair value on a recurring basis was determined using the following inputs at June 30, 2016 (in thousands):

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 512,131	—	—	512,131
Investments and assets limited as to use:				
Cash and short-term investments	8,633	—	—	8,633
Corporate obligations	1,142	18,398	—	19,540
Fixed-income securities	98,574	—	—	98,574
Corporate stocks	58,012	—	—	58,012
Mutual funds	229,572	—	—	229,572
Total investments and assets limited as to use at fair value	395,933	18,398	—	414,331
Self-insurance investments:				
Corporate obligations	526	4,954	—	5,480
Treasury inflation protection securities	—	5,088	—	5,088
Fixed-income securities	8,436	—	—	8,436
Mortgage-backed securities	—	6,068	—	6,068
Mutual funds	16,934	—	—	16,934
Total self-insurance investments	25,896	16,110	—	42,006
Beneficial interest in perpetual trust	—	—	7,298	7,298
Total assets at fair value	\$ 933,960	34,508	7,298	975,766
Investments and assets limited as to use measured at NAV as a practical expedient				159,393
				\$ 1,135,159
Liabilities				
Interest rate swaps	\$ —	33,537	—	33,537

Investments and assets limited as to use at June 30, 2017 and 2016 were in domestic investments.

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The fair values of the securities included in Level 1 were determined through unadjusted quoted market prices. The fair value of Level 2 and Level 3 financial assets and liabilities were determined as follows:

Corporate obligations, treasury inflated protection securities, and mortgage-backed securities – These Level 2 investments were determined through evaluated bid prices provided by third-party pricing services where quoted market values are not available. There is no significant subjectivity in the fair value estimate due to changes in the unobservable inputs.

Beneficial interest in perpetual trust – The fair values of these related financial assets were determined from the fair value of the underlying assets contributed to the trusts. Based on the nature of the underlying assets, there is no significant subjectivity in the fair value estimate due to changes in the unobservable inputs.

Interest rate swaps – The fair values of these financial liabilities interest rate swaps were determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The analysis reflects contractual terms of the interest rate swaps and uses observable market-based inputs, such as discount rates interpolated based on relevant swap curves. In addition, credit valuation adjustments are included to reflect nonperformance risk. PHC pays fixed rates ranging from 3.17% to 4.84% and receives cash flows based on 67.00% of one month LIBOR.

The following is the reconciliation of the beginning and ending balances of Level 3 financial assets measured at fair value on a recurring basis (in thousands):

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 7,298	7,918
Change in beneficial interest in perpetual trust	<u>396</u>	<u>(620)</u>
Ending balance	\$ <u><u>7,694</u></u>	<u><u>7,298</u></u>

Change in beneficial interest in perpetual trust is included within permanently restricted net assets in the accompanying consolidated statements of changes in net assets.

The carrying values of patient accounts receivable, pledges receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments. The fair value of PHC's fixed-rate bonds is derived using Level 2 market-observable inputs, such as risk-free rates, yield curves, and credit spreads for debt that is actively traded and has similar maturities and credit ratings.

(16) Related-Party Transactions

PWHP is a health insurance company owned 50% by PHC and 50% by WellStar Health System. Included in loss from equity investment within nonoperating income (expense) in the accompanying consolidated statement of operations for the year ended June 30, 2016 is a loss of \$3,100,000, relating to a capital contribution.

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From January 1, 2014 to January 1, 2016, PWHP was the plan administrator for PHC's health benefits. During the years ended June 30, 2017 and 2016, PHC paid \$3,184,000 and \$5,116,000, respectively, to PWHP for fees relating to administration of its health benefits and wellness programs

(17) Graduate Medical Education

Athens continues in its development of Accreditation Council for Graduate Medical Education (ACGME) residency programs, and has successfully recruited and employed program directors for the Internal Medicine and Transitional Year residency programs. The Internal Medicine residency program received ACGME accreditation approval on March 19, 2015 for a three-year training program. Athens has been approved to fill 45 internal medicine residency positions, or 15 per training year. The Internal Medicine program currently has 30 medicine residents and will complete interviews of over 150 residency candidates to fill its 15 positions for the 2018 match.

(18) Subsequent Events

On August 30, 2017, PHC (through its newly formed subsidiary, Piedmont Acquisition Subsidiary, Inc.), Rockdale Hospital, LLC, Rockdale Clinically Integrated Managed Care Organization, LLC, and Rockdale Physician Practices, LLC (collectively, Rockdale) entered into an Asset Purchase Agreement (the Purchase Agreement), under which PHC agreed to pay \$80,000,000 for certain assets and liabilities of Rockdale. Under the terms of the Purchase Agreement, PHC becomes the sole member of Rockdale. The related transaction was consummated on September 29, 2017.

In connection with the above acquisition, effective September 28, 2017, PHC entered into a note payable with a bank. The \$80,000,000 proceeds of the note were used to purchase Rockdale on September 29, 2017. The note bears interest at the one-month LI BOR plus 0.35% and is payable on October 1, 2019.