



PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Financial Statements

June 30, 2018 and 2017

(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, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Piedmont Columbus Regional, Inc., a wholly owned subsidiary, which statements reflect total assets constituting approximately 13.6% of consolidated total assets at June 30, 2018, and total revenues constituting approximately 4.7% of consolidated total revenues for the year then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Piedmont Columbus Regional, Inc., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States 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, based on our audits and the report of the other auditors, 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, 2018 and 2017, 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
November 19, 2018

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

Assets	2018	2017
Current assets:		
Cash and cash equivalents	\$ 458,213	565,999
Patient accounts receivable, net of allowance for doubtful accounts of \$519,626 and \$307,597 in 2018 and 2017, respectively	445,628	316,339
Bond proceeds receivable	37,755	47,985
Current portion of self-insurance investments	14,293	12,097
Other current assets	151,211	95,354
Total current assets	1,107,100	1,037,774
Investments and assets limited as to use	1,090,048	710,899
Property and equipment, net	1,624,888	1,220,789
Self-insurance investments, net of current portion	34,990	37,032
Beneficial interest in perpetual trust	8,032	7,694
Other assets	192,067	124,940
Total assets	\$ 4,057,125	3,139,128
Liabilities and Net Assets		
Current liabilities:		
Current portion of bonds payable	\$ 20,795	24,290
Accounts payable and accrued expenses	386,651	273,331
Estimated third-party payor settlements	44,590	33,847
Current portion of self-insurance reserves	41,641	30,812
Total current liabilities	493,677	362,280
Bonds payable, net of current portion	865,750	787,783
Medical office building financing obligation	43,602	43,358
Note payable to a bank	337,119	32,234
Self-insurance reserves, net of current portion	67,743	55,504
Accrued pension cost and other benefits	83,832	77,768
Other long-term liabilities	127,964	108,195
Total liabilities	2,019,687	1,467,122
Net assets:		
Unrestricted	1,974,376	1,620,787
Temporarily restricted	38,091	27,537
Permanently restricted	24,971	23,682
Total net assets	2,037,438	1,672,006
Total liabilities and net assets	\$ 4,057,125	3,139,128

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Operations

Years ended June 30, 2018 and 2017

(In thousands)

	<u>2018</u>	<u>2017</u>
Unrestricted revenue, gains, and other support:		
Patient service revenue	\$ 3,237,765	2,585,540
Provision for bad debt	<u>(250,712)</u>	<u>(163,681)</u>
Net patient service revenue	2,987,053	2,421,859
Other revenue	<u>88,658</u>	<u>87,681</u>
Total revenue, gains, and other support	<u>3,075,711</u>	<u>2,509,540</u>
Expenses:		
Salaries and benefits	1,644,108	1,330,355
Supplies and other	1,134,192	892,923
Depreciation and amortization	109,145	106,004
Interest	<u>34,398</u>	<u>33,479</u>
Total expenses	<u>2,921,843</u>	<u>2,362,761</u>
Operating income before loss on extinguishment of debt, acquisition costs and unrestricted contribution received in acquisition	153,868	146,779
Loss on extinguishment of debt	(14,524)	(28,416)
Acquisition costs	(16,283)	(6,418)
Contribution received in acquisition	<u>117,262</u>	<u>173,832</u>
Operating income	<u>240,323</u>	<u>285,777</u>
Nonoperating income (expense):		
Investment income, net	78,446	77,406
Other components of pension expense	179	(688)
Gain from equity investments	3,638	—
Change in fair value of interest rate swaps	<u>7,010</u>	<u>8,855</u>
Total nonoperating income (expense)	<u>89,273</u>	<u>85,573</u>
Excess of revenue, gains, and other support over expenses	329,596	371,350
Net assets released from restrictions used for purchase of property and equipment	4,026	1,904
Pension adjustments	18,867	24,447
Other	<u>1,100</u>	<u>(1,433)</u>
Change in unrestricted net assets	<u>\$ 353,589</u>	<u>396,268</u>

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

	<u>2018</u>	<u>2017</u>
Unrestricted net assets:		
Excess of revenue, gains, and other support over expenses	\$ 329,596	371,350
Net assets released from restrictions used for purchase of property and equipment	4,026	1,904
Pension adjustments	18,867	24,447
Other	<u>1,100</u>	<u>(1,433)</u>
Change in unrestricted net assets	<u>353,589</u>	<u>396,268</u>
Temporarily restricted net assets:		
Contributions	15,443	12,983
Restricted contribution received in acquisition	7,457	2,067
Net assets released from restrictions used for purchase of property and equipment	(4,026)	(1,904)
Net assets released from restrictions used for operations	(6,507)	(3,647)
Other	<u>(1,813)</u>	<u>5</u>
Change in temporarily restricted net assets	<u>10,554</u>	<u>9,504</u>
Permanently restricted net assets:		
Contributions	55	54
Change in beneficial interest in perpetual trust	338	396
Restricted contribution received in acquisition	<u>896</u>	<u>—</u>
Change in permanently restricted net assets	<u>1,289</u>	<u>450</u>
Change in net assets	365,432	406,222
Net assets at beginning of year	<u>1,672,006</u>	<u>1,265,784</u>
Net assets at end of year	\$ <u><u>2,037,438</u></u>	\$ <u><u>1,672,006</u></u>

See accompanying notes to consolidated financial statements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

(In thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Change in net assets	\$ 365,432	406,222
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	109,145	106,004
Contribution received in acquisitions, net of cash acquired	(102,246)	(115,208)
Net unrealized gains on investments	(35,580)	(25,871)
Net realized gains on investments	(25,624)	(41,575)
Change in beneficial interest in perpetual trust	(338)	(396)
Amortization of bond (premium) discount	(6,079)	(5,761)
Loss on extinguishment of debt	14,524	28,416
Provision for bad debt	250,712	163,681
Pension adjustments	(18,867)	(24,447)
Change in fair value of interest rate swaps	(7,010)	(8,855)
Contributions restricted for long-term investment	(23,851)	(15,104)
(Increase) decrease in:		
Patient accounts receivable	(329,435)	(171,823)
Other current assets	(17,807)	(7,843)
Other assets	2,143	(9,773)
(Decrease) increase in:		
Accounts payable and accrued expenses	63,326	(57,640)
Estimated third-party payor settlements	6,437	(3,445)
Self-insurance reserves	14,019	12,297
Accrued pension cost	(8,013)	(7,782)
Other long-term liabilities	(7,767)	14,780
Net cash provided by operating activities	<u>243,121</u>	<u>235,877</u>
Cash flows from investing activities:		
Purchases of investments and assets limited as to use	(208,840)	(970,011)
Proceeds from sale of investments and assets limited as to use	113,450	906,560
Acquisitions, net of cash acquired	(119,000)	—
Capital expenditures	<u>(246,292)</u>	<u>(184,978)</u>
Net cash used in investing activities	<u>(460,682)</u>	<u>(248,429)</u>
Cash flows from financing activities:		
Contributions restricted for long-term investment	23,851	15,104
Repayments on note payable to a bank	(101,615)	(2,565)
Proceeds from issuance of notes payable	387,600	—
Repayments of indebtedness	(24,290)	(12,800)
Proceeds from issuance of bonds	—	469,532
Bond redemptions	<u>(175,771)</u>	<u>(402,851)</u>
Net cash provided by financing activities	<u>109,775</u>	<u>66,420</u>
Net (decrease) increase in cash and cash equivalents	(107,786)	53,868
Cash and cash equivalents at beginning of year	<u>565,999</u>	<u>512,131</u>
Cash and cash equivalents at end of year	\$ <u>458,213</u>	\$ <u>565,999</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 36,850	26,196
Income taxes (net of refunds)	—	(344)
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, 2018 and 2017

(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 Rockdale Hospital (Rockdale). Rockdale, located in Conyers, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Rockdale County.
- Piedmont Columbus Regional Midtown Hospital (Midtown). Midtown, located in Columbus, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Muscogee County.
- Piedmont Columbus Regional Northside Hospital (Northside). Northside, located in Columbus, Georgia, is a not-for-profit acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Muscogee County.
- Piedmont Walton Hospital (Walton). Walton, located in Monroe, Georgia, is an acute care hospital providing inpatient, outpatient, and emergency care services primarily for residents of Walton County.
- 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 HEALTHCARE, INC. AND AFFILIATES

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- 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.
- Columbus Regional Medical Group (CRMG). CRMG 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.
- 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.
- Columbus Regional Health Resources, Inc. (CRHR). CRHR is a for-profit corporation, which exists primarily to hold leases on or own and manage real estate utilized in connection with CRHS operations.
- 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.
- My Health Alliance, LLC (MHA). MHA is a collaborative effort between PCR and physicians pursuing clinical integration.
- My Health Network, LLC (MHN). MHN is a PHO made up of employed and other community physicians providing credentialing services and access to payer contracts.
- 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.
- Columbus Regional Medical Foundation, Inc. (CRMF). CRMF provides fund-raising services, soliciting tax-exempt contributions to support and enhance the operations of certain PHC entities.

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- Columbus Regional Health System (CRHS). CRHS is a nonprofit integrated healthcare delivery organization providing a wide range of healthcare services to areas of southwest Georgia and southeast Alabama through the operation of two acute care hospitals, physician practices, retail pharmacies, and joint ventures providing diagnostic imaging, a provider hospital organization (PHO), and a rehabilitation hospital.

(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, Rockdale, Midtown, Northside, Walton, PMCC, PHIP, ARPS, ARSS, RFC, CRMG, ARHS, CRHR, PHI, AMIC, The Clinic, MHA, MHN, PHF, ARF, CRMF, CRHS 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 actuarially determined liability related to PHC's defined-benefit pension plans.

(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

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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June 30, 2018 and 2017

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 plans 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 stated at the lower of average cost or net realizable value. Inventory consists primarily of pharmaceuticals and medical supplies and is recorded within other current assets in the accompanying consolidated balance sheets.

(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.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

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(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).

(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, 2018 and 2017 and no related impairment losses were recognized during the years then ended.

(j) Other Assets

Other assets include goodwill of \$108,243,000 and \$62,133,000 at June 30, 2018 and 2017, respectively. 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, 2018 or 2017.

(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, 2018 and 2017 aggregating \$8,032,000 and \$7,694,000, respectively. The beneficial interest at June 30, 2018 and 2017 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.

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(l) Vacation Policy

PHC accrues employee vacation pay as earned by the employee.

(m) Advertising Costs

Advertising costs are expensed as incurred and approximated \$13,842,000 and \$10,886,000 for the years ended June 30, 2018 and 2017, 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.

(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	
	2018	2017
Patient service charges	\$ 12,969,018	10,135,557
Less contractual adjustments and other deductions	9,731,253	7,550,017
Patient service revenue	3,237,765	2,585,540
Less provision for bad debt	250,712	163,681
Net patient service revenue	\$ 2,987,053	2,421,859

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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 patient service revenue due to different contractual agreements among payors. These changes in net patient service revenue are recognized in the period that the changes in payor become known.

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	
	2018	2017
Third-party payors, net of contractual allowances	\$ 3,019,791	2,245,460
Self-pay patients	<u>217,974</u>	<u>340,080</u>
Patient service revenue	<u>\$ 3,237,765</u>	<u>2,585,540</u>

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 54% and 49% of patient accounts receivable after contractual allowances as of June 30, 2018 and 2017, 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.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(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).

(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, which is expected to be completed in late 2020. As of June 30, 2018, PHC had not recognized any contribution revenue related to the grant. Through June 30, 2018, PHC has received approximately \$11,807,000 under the grant, which is included in accounts payable and accrued expenses in the accompanying 2018 consolidated balance sheet. No such amounts were received in the year ended June 30, 2017.

FASB ASC 958, *Not-for-Profit Entities*, provides guidance on the net asset classification of donor restricted endowment funds for a not-for-profit organization that are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and also requires disclosures about endowment funds, both donor-restricted endowment funds and board-designated endowment funds.

PHC has historically and to-date received a limited amount of donor-restricted endowment funds. The Board has interpreted Georgia's State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. Income from PHC's donor-restricted endowment funds is generally restricted to specific donor-directed purposes, and is therefore accounted for within temporarily restricted net assets until expended in accordance with the donor's stipulations. PHC oversees individual donor-restricted endowment funds to ensure that the fair value of the original gift is preserved.

PHC invests donor-restricted endowment funds within the framework of PHC's overall investment management program.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Cash receipts from the sale of donated financial assets are classified consistently with cash donations received in the combined statement of cash flows if those cash receipts were from the sale of donated financial assets that upon receipt were directed without the entity imposing any limitations for sale and were converted nearly immediately into cash.

(t) Interest Expense

PHC incurred interest expense totaling approximately \$34,398,000 and \$33,479,000 for the years ended June 30, 2018 and 2017, respectively. During 2018, \$6,305,000 of interest was capitalized and included in property and equipment on the accompanying 2018 balance sheet. There was no interest capitalized in 2017.

(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 \$213,000 and \$2,695,000 of Medicare incentive payments in other revenue in the accompanying consolidated statements of operations for the years ended June 30, 2018 and 2017, 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, Midtown, Northside, ARPS, ARSS, RFC, CRMG, ARHS, CRHR, MHA, MHN, PHI, PHF, ARF, CRMF and CRHS 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, PHIP and The Clinic 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, 2018 and 2017. HPS is a taxable, not-for-profit entity that operated in a net income position for financial reporting and tax purposes during the year ended June 30, 2018 and 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.

During the year ended June 30, 2018, PHC acquired Rockdale and Walton (note 3). Rockdale has submitted an application to the Internal Revenue Service (IRS) to be recognized as exempt from federal tax under IRC 501(a) as described in 501(c)(3). Walton is in the process of submitting its application. Management believes it is operating these entities consistent with the requirements to be recognized as tax exempt; however, there can be no guarantee of recognition as exempt from federal tax. Subsequent to June 30, 2018, Rockdale's application for exempt status was approved retroactive to August 7, 2017.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

At June 30, 2018 and 2017, Atlanta (as it relates to unrelated business income), PMCC, the Clinic, and PHIP had net operating loss (NOL) carryforwards totaling approximately \$884,223,000 and \$752,692,000, respectively, which expire at various dates between 2020 and 2035. PMCC, the Clinic, and PHIP had deferred income tax assets totaling approximately \$219,499,000 and \$287,820,000 at June 30, 2018 and 2017, 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.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the Tax Act) was signed into law. The legislation significantly revises the U.S. corporate income tax system by, among other things, lowering the corporate income tax rate from 35.0% to 21.0%, for tax years beginning after December 31, 2017. The Tax Act did not give rise to any material impact to PHC's consolidated balance sheet and consolidated statement of operations.

As a result of the Tax Act, there was a change related to NOLs. Previously, NOLs incurred before December 31, 2017 could be carried forward 20 years. Under the Tax Act, for tax years beginning after December 31, 2017, NOLs may offset 80% of taxable income incurred with an unlimited carryforward period.

PHC accounts for income taxes under the provisions of ASC 740, *Income Taxes* (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, 2018 or 2017.

(w) Prior-Year Reclassifications

Certain reclassifications have been made to the fiscal year 2017 consolidated financial statements to conform to the fiscal year 2018 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 Plans

PHC accounts for its defined-benefit pension plans 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 plans (the Plans). The Plans' 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 Plans an amount sufficient to meet the minimum funding standards of Employee Retirement Income Security Act (ERISA) or an amount sufficient to maintain the Plans 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. See note 2(z) regarding presentation of pension cost.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(y) Subsequent Events

PHC evaluated events and transactions occurring subsequent to June 30, 2018 through November 19, 2018, 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.

(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.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

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.

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.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. ASU 2018-08 requires an entity to evaluate whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958 or as exchange (reciprocal) transactions subject to other guidance. Additionally, an entity must determine whether a contribution is conditional and the related impact on revenue recognition. The new standard is effective for annual reporting periods beginning after June 15, 2018 using a modified prospective basis, retrospective application is permitted. PHC has not yet determined the impact ASU 2018-08 will have on the consolidated financial statements.

Additionally, in July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. ASU 2018-11 allows companies to adopt ASC 842 without revising comparative period reporting or disclosures and provides an optional practical expedient to lessors to not separate lease and nonlease components of a contract if certain criteria are met. This ASU is effective for PHC at the same time as it adopts ASU 2016-02 (July 1, 2019).

(3) Acquisitions

(a) Walton

Effective April 1, 2018, PHC entered into an asset purchase agreement with Monroe HMA, LLC; Monroe HMA Physician Management, LLC; and Quorum Health Corporation whereby PHC paid \$39,000,000 to acquire certain assets and liabilities related to an acute care hospital f/k/a Clearview Regional Medical Center together with certain related businesses including physician clinic operations and ancillary services (collectively, the Walton Entities). The total cost of the purchase 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* (ASC 958-805).

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Based on the purchase price allocation as of June 30, 2018, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in goodwill of approximately \$18,312,000 being recorded on the accompanying 2018 consolidated balance sheet.

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

Assets:	
Other current assets	\$ 1,940
Property and equipment	19,889
Goodwill	18,312
Liabilities:	
Current liabilities	<u>(1,141)</u>
Total purchase price	\$ <u>39,000</u>

The revenue, gains and other support; operating income; and change in unrestricted net assets attributable to PHC related to the acquired Walton Entities for the period April 1, 2018 through June 30, 2018 were approximately \$12,549,000, \$189,000 and \$189,000, respectively.

(b) The Columbus Entities

Effective March 1, 2018, PHC entered into an affiliation agreement with Columbus Regional Healthcare System, Inc.; The Medical Center, Inc.; Hughston Hospital, Inc.; Columbus Healthcare Resources, Inc.; Columbus Regional Medical Foundation, Inc.; Columbus Ambulatory Healthcare, Services, Inc. and Columbus Regional Senior Living, Inc. whereby it became the sole corporate member of these entities (collectively, the Columbus Entities). Although no consideration was transferred, PHC assumed all the assets and liabilities of the Columbus Entities as of the affiliation date. As part of the affiliation, PHC assumed Midtown and Northside's lease with The Medical Center Hospital Authority (the TMC Authority). The lease covers all the assets and liabilities of Midtown and Northside at the inception of the lease. At the termination of the lease, the assets and liabilities revert back to the TMC 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 affiliation with the Columbus Entities 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, 2018, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in approximately \$125,615,000 being recorded as a contribution received in affiliation on the accompanying 2018 consolidated statements of operations and changes in net assets.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

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

Assets:	
Cash	\$ 23,369
Net patient accounts receivable	50,566
Other current assets	21,918
Assets limited as to use	214,116
Property and equipment	196,128
Other assets	24,113
Liabilities:	
Current liabilities	(47,678)
Long-term debt	(304,689)
Other liabilities	(60,581)
	<hr/>
Unrestricted contribution received in affiliation	117,262
Restricted contribution received in affiliation	8,353
	<hr/>
Total contribution received in affiliation	\$ <u>125,615</u>

The revenue, gains and other support; operating income; and change in unrestricted net assets attributable to PHC related to the acquired Columbus Entities for the period March 1, 2018 through June 30, 2018 were \$149,007,000, \$5,733,000, and \$44,261,000, respectively.

(c) Rockdale

Effective October 1, 2017, PHC entered into an asset purchase agreement with Rockdale Hospital, LLC; Rockdale Clinically Integrated Managed Care Organization, LLC, Rockdale Physician Practices, LLC, and LifePoint Holdings 2, LLC, whereby PHC paid \$80,000,000 for certain assets and liabilities related to an acute care hospital f/k/a Rockdale Medical Center together with certain ancillary businesses and facilities (collectively, the Rockdale Entities). The total cost of the purchase 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, 2018, PHC recorded the fair value of all assets acquired and liabilities assumed, resulting in goodwill of approximately \$27,153,000 being recorded on the accompanying 2018 consolidated balance sheet.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

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

Assets:		
Other current assets	\$	3,962
Property and equipment		50,621
Goodwill		27,153
Liabilities:		
Current liabilities		<u>(1,736)</u>
Total purchase price	\$	<u><u>80,000</u></u>

The revenue, gains and other support; operating income; and change in unrestricted net assets attributable to PHC related to the acquired Rockdale Entities for the period October 1, 2017 through June 30, 2018 were \$90,719,000, (\$9,480,000), and (\$9,480,000), respectively.

(d) The Athens Entities

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.

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 approximately \$175,899,000 being recorded as a contribution received in affiliation on the accompanying 2017 consolidated statements of operations and changes in net assets.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

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>

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 \$198,762,000, respectively. The revenue, gains and other support; operating loss; and change in unrestricted net assets attributable to PHC related to the acquired Athens Entities for the period July 1, 2017 through June 30, 2018 were approximately \$534,462,000, \$34,297,000, and \$34,297,000, respectively.

The operating results of the Walton Entities, the Columbus Entities, the Rockdale Entities, and the Athens Entities have been included in the accompanying consolidated statements of operations since their respective acquisition dates. The unaudited pro forma combined summary of operations, which gives effect to including the acquired operating results of the Walton Entities, the Columbus Entities, the Rockdale Entities, and the Athens Entities as if the acquisitions had occurred as of July 1, 2016, is as follows (in thousands):

		<u>Year ended June 30</u>	
		<u>2018</u>	<u>2017</u>
Revenue, gains, and other support	\$	3,437,055	3,413,462
Operating income		132,220	127,690
Change in unrestricted net assets		270,985	399,984

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

Pro forma adjustments to operating income and change in unrestricted net assets include adjustments to record the Walton Entities', the Columbus Entities', the Rockdale Entities', and the Athens Entities' 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 acquisition costs, loss on extinguishment of debt relating to acquired debt and contributions received in acquisition. 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, 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 35% and 5%, respectively, of PHC's net patient service revenue for the year ended June 30, 2018. 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. 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 \$44,590,000 and \$33,847,000 at June 30, 2018 and 2017, 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 \$8,723,000 and \$7,590,000 for the years ended June 30, 2018 and 2017, respectively. The amounts due to Medicare and Medicaid represent management's best estimates of final settlements.

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(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.

(c) Self-Pay

PHC incurred bad debt expense, valued at established charges, of \$250,712,000 and \$163,681,000 for the years ended June 30, 2018 and 2017, respectively. In an effort to improve amounts collected from uninsured patients that do not apply and/or qualify for charity assistance, PHC offers discounted prices to the uninsured under its charity care policy, as described in note 5. In addition to charity care and bad debt write-offs, PHC provided discounts to the uninsured of \$248,719,000 and \$268,060,000 (recorded as deductions from net patient service revenue) for the years ended June 30, 2018 and 2017, respectively.

(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, 2018 and 2017 is approximately \$31,048,000 and \$23,852,000, 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 \$122,060,000 and \$81,564,000 for years ended June 30, 2018 and 2017, 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, 2018 and 2017

(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	
	2018	2017
Investments internally designated for capital acquisition:		
Cash and short-term investments	\$ 22,194	13,318
Corporate obligations	15,500	49
Fixed-income securities	208,399	152,504
Corporate stocks	152,133	16,789
Mutual funds	432,326	324,400
Alternative investments	223,770	176,444
	1,054,322	683,504
Assets limited as to use:		
Cash and short-term investments	1,438	1,399
Corporate obligations	586	2
Fixed-income securities	7,069	5,912
Corporate stocks	4,567	590
Mutual funds	15,091	13,126
Alternative investments	6,975	6,366
	35,726	27,395
Totals	\$ 1,090,048	710,899

PIEDMONT HEALTHCARE, INC. AND AFFILIATES

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(b) Alternative Investments

Alternative investments included in investments and assets limited as to use at June 30, 2018 and 2017 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	
	2018	2017	2018	2017
Clarion Lion Properties ING Fund	\$ 19,251	17,726	998	(988)
Harvest MLP Income II Fund	364	15,386	(3,218)	74
Golub Capital Investment Corporation	4,485	1,556	—	—
IFP Global Equity, L.P.	40,467	20,029	961	1,629
Chatham Asset High Yield Offshore Fund, Ltd.	33,107	24,627	3,480	1,214
Canyon Balanced Fund	24,523	18,537	(1,166)	1,537
PHC Fund, Ltd.	108,548	84,949	7,600	343
	<u>\$ 230,745</u>	<u>182,810</u>	<u>8,655</u>	<u>3,809</u>

Redemption frequency and redemption notice periods for alternative investments held at June 30, 2018 and 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.	Semi-Monthly	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, 2018 and 2017, PHC had an unfunded commitment with Golub Capital Investment Corporation of \$12,750,000 and \$15,470,000, respectively.

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(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	
	2018	2017
Interest income	\$ 15,870	11,112
Net realized and unrealized gains (losses) on investments	61,204	67,446
Other	1,372	(1,152)
Investment income (loss), net	<u>\$ 78,446</u>	<u>77,406</u>

(7) Property and Equipment

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

	June 30	
	2018	2017
Land and land improvements	\$ 132,115	101,417
Buildings and fixtures	1,472,363	1,281,943
Equipment	1,042,624	901,870
	2,647,102	2,285,230
Less accumulated depreciation	1,248,226	1,140,488
	1,398,876	1,144,742
Construction in progress	226,012	76,047
Property and equipment, net	<u>\$ 1,624,888</u>	<u>1,220,789</u>

Construction in progress at June 30, 2018 and 2017 relates primarily to ongoing construction at Atlanta expected to be completed during the fiscal year ended June 30, 2021.

Depreciation and amortization expense for the years ended June 30, 2018 and 2017 totaled approximately \$110,417,000 and \$106,004,000, respectively. Amortization of capitalized software costs of approximately \$15,701,000 and \$13,284,000 are included in depreciation and amortization expense in the accompanying consolidated statements of operations for the years ended June 30, 2018 and 2017, respectively.

During the year ended June 30, 2018, PHC reviewed the estimated useful lives of certain buildings and equipment. This review indicated that the actual lives of certain assets were no longer the estimated useful lives used for depreciation purposes in PHC's consolidated financial statements. As a result, effective July 1, 2017, PHC changed its estimated useful lives on certain assets to better reflect the estimated

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periods during which these assets will remain in service. The effect of this change was a decrease in depreciation expense of \$16,332,000 for the year ended June 30, 2018.

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

	<u>June 30</u>	
	<u>2018</u>	<u>2017</u>
Capitalized software and software development costs	\$ 123,694	109,658
Less accumulated amortization	<u>62,445</u>	<u>46,744</u>
Capitalized software and software development costs, net	<u>\$ 61,249</u>	<u>62,914</u>

Based on the amortizable capitalized software and software development costs that have been placed into service at June 30, 2018, the estimated amortization expense for the succeeding five fiscal years and thereafter is as follows (in thousands):

Year ending June 30:	
2019	\$ 14,337
2020	12,742
2021	10,660
2022	8,651
2023	6,178
Thereafter	<u>8,681</u>
	<u>\$ 61,249</u>

At June 30, 2018 and 2017, PHC's remaining commitment for software and construction contracts approximated \$328,150,000 and \$351,901,000, respectively, primarily relating to ongoing construction at Atlanta expected to be completed during the fiscal year ended June 30, 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, 2018 and 2017. 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, 2018 and 2017, the net book value of the Fayette MOB included in buildings

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and fixtures totaled approximately \$13,317,000 and \$12,384,000, respectively, and the related Medical Office Building financing obligation approximated \$13,855,000 and \$13,708,000, respectively.

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, 2018 and 2017, the net book value of the Piedmont MOB included in buildings and fixtures totaled approximately \$15,110,000 and \$14,277,000, respectively, and the related Medical Office Building financing obligation approximated \$29,747,000 and \$29,650,000, respectively.

(8) Long-Term Debt

(a) Bonds Payable

Bonds payable consists of the following (in thousands):

	June 30	
	2018	2017
Series 2006, fixed interest rate of 4.50%, interest payments due semiannually, payable through 2024	\$ 3,835	4,380
Series 2007, fixed interest rate of 2.47%, interest payments due semiannually, payable through 2024	8,672	9,929
Series 2009A, fixed interest rates ranging from 4.375% to 5.25%, interest payments due semiannually, payable through 2024	35,895	35,895
Series 2009C, variable interest rates (1.77% and 1.15% at June 30, 2018 and 2017, respectively), interest payments due monthly, payable through 2019	9,020	17,465
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	86,625	86,885
Series 2014B, variable interest rates (2.40% and 1.35% at June 30, 2018 and 2017, respectively) interest payments due monthly, payable through 2034	84,330	89,590
Series 2016A, fixed interest rates ranging from 3.00% to 5.00%, interest payments due semiannually, payable through 2046	414,805	423,360

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	June 30	
	<u>2018</u>	<u>2017</u>
Series 2017, fixed interest rate of 4.88%, interest payments due semiannually, payable through 2022	\$ 104,280	—
Unamortized original issue premium, net	47,106	51,982
Unamortized debt issuance costs	<u>(8,023)</u>	<u>(7,413)</u>
	886,545	812,073
Less current maturities	<u>(20,795)</u>	<u>(24,290)</u>
	<u>\$ 865,750</u>	<u>787,783</u>

In connection with the acquisition of the Columbus Entities effective March 1, 2018, PHC assumed responsibility for payment of the Medical Center Authority's outstanding revenue certificates through the lease agreement described in note 3.

In February 2017, the Authority issued The Medical Center Hospital Authority Revenue Anticipation Certificates Series 2017 (the 2017 Bonds), in the amount of \$104,280,000. The 2017 Bonds are secured by the net revenues of the Columbus Obligated Group (comprised of The Medical Center, Doctors Hospital, Northside Hospital, Columbus Regional Medical Group, Columbus Healthcare Resources, CRHS Long Term and Home Care, CRSL and Columbus Regional Healthcare System) as well as certain security interests in portions of real and personal property owned or leased by such members of the Columbus Obligated Group. The proceeds of the 2017 Bonds were loaned to the Columbus Obligated Group under a loan agreement and were used to refund all outstanding principal with respect to certain revenue notes that were previously issued by the Authority and then loaned to the Columbus Obligated Group for the purpose of advance refunding of the 2008 Bonds and to pay all or a portion of the costs of issuance of the 2017 Bonds. The 2017 Bonds consist of term certificates maturing August 1, 2022 bearing interest at 4.88% paid semi-annually on August 1 and February 1.

In August 2010, the Authority issued The Medical Center Hospital Authority Tax-Exempt Revenue Anticipation Certificates Series 2010 (the Columbus 2010 Bonds), in the amount of \$170,680,000. The Columbus 2010 Bonds are secured by the revenues and certain real property of the Columbus Obligated Group. The payment of principal and interest is also secured through a financial guarantee insurance policy.

The proceeds of the Columbus 2010 Bonds were loaned to the Columbus Obligated Group under a loan agreement and were used to refund all remaining outstanding principal amounts with respect to a promissory note that was previously issued to finance the acquisition of Hughston Hospital, to refund all remaining outstanding principal amounts related to a previous bond issuance, to finance certain improvements to the System's facilities and to pay all or a portion of the costs of issuance of the Columbus 2010 Bonds.

The Columbus 2010 Bonds were refinanced as part of The 2018 Bridge Loan described in note 8(b).

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In connection with the acquisition of The Athens Entities 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 during 2017 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 PHC Obligated Group (Piedmont Healthcare, Inc. and all of its affiliates exclusive of AMIC, ARPS, ARSS, RHC, ARHS, ARF, HPS and the Columbus Entities), 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, 2018 and 2017 consolidated balance sheets is \$30,994,000 and \$30,927,000, respectively, 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, 2018 and 2017 consolidated balance sheets is \$6,761,000 and \$6,758,000, 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 PHC 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 PHC 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, 2017 and 2018 consolidated balance sheets. The Series 2006 Bonds were recorded at their fair value upon acquisition. At June 30, 2018 and 2017, the stated value and carrying value of the Series 2006 Bonds approximated \$3,835,000 and \$4,380,000, 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, 2018 and 2017 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, 2018 and 2017, the stated value of the Series 2007 Bonds approximated \$8,465,000 and \$9,690,000, respectively, and the carrying value approximated \$8,672,000 and \$9,929,000, respectively.

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Scheduled principal repayments on the Series 2017, Series 2016, Series 2014, Series 2010, Series 2009, Series 2007, and Series 2006 Bonds are as follows (in thousands):

Year ending June 30:		
2019	\$	20,795
2020		22,705
2021		25,065
2022		26,210
2023		125,705
Thereafter		<u>626,982</u>
	\$	<u>847,462</u>

(b) Notes Payable to Banks

Effective June 27, 2018, PHC entered into two note payable agreements with two banks totaling \$307,600,000 (collectively, the 2018 Bridge Loan). The proceeds of the 2018 Bridge Loan were used to fully repay the Columbus 2010 Bonds, to fully repay a loan payable obtained through the affiliation with Columbus (note 3), to fully repay a bridge loan obtained for the purchase of Rockdale (note 3) and finance the purchase of Walton (note 3). Each note is for \$153,800,000, bears an interest rate of LIBOR plus 0.20% payable monthly and is due and payable July 1, 2020.

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, 2018 and 2017 totaled \$29,519,000 and \$32,234,000, 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% (2.744% and 1.876% as of June 30, 2018 and 2017, respectively) and the payment terms are as follows: \$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) Lines 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, 2018 or 2017.

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In August 2015, CRHS obtained a line of credit from a financial institution. The line was executed on August 1, 2015 for a maximum borrowing capacity of \$10,000,000 with a maturity date of August 26, 2016. The line was subsequently amended to extend maturity to August 31, 2018 and has not subsequently been extended. The line bears interest at LIBOR plus 2.50%. Interest is calculated daily and interest payments are due monthly. The outstanding balance and accrued and unpaid interest on this note are due and payable in full on the maturity date. The line is secured by a 2015-A Master note constituting obligations, which are on parity with the obligations issued under the Columbus Master Trust Indenture and are secured by the Columbus Master Trust Indenture and are obligations of the Columbus Obligated Group. There were no outstanding borrowings on the lines of credit at June 30, 2018.

(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, 2018 and 2017, the total notional amount of PHC's interest rate swaps was approximately \$117,920,000 and \$121,820,000, respectively.

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):

	<u>June 30</u>	
	<u>2018</u>	<u>2017</u>
Other long-term liabilities	\$ 17,759	24,743

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

	<u>Year ended June 30</u>	
	<u>2018</u>	<u>2017</u>
Income recognized in nonoperating income	\$ 7,010	8,855
Loss recognized in supplies and other expenses	(3,115)	(3,866)
	<u>\$ 3,895</u>	<u>4,989</u>

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(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 \$5,896,000, interest expense of approximately \$4,772,000, and supplies and other expenses of approximately \$2,503,000 for the year ended June 30, 2018 and 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.

(10) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets available primarily for capital purchases, education, and geriatric services were approximately \$38,091,000 and \$27,537,000 at June 30, 2018 and 2017, respectively.

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	
	2018	2017
Support of education	\$ 1,065	1,064
Beneficial interest in perpetual trust	8,032	7,694
Support of specific services	15,874	14,924
	<u>\$ 24,971</u>	<u>23,682</u>

(11) Employee Benefits

(a) Piedmont Healthcare, Inc. Retirement Plan

PHC has a trustee, noncontributory defined-benefit pension plan (the PHC Plan) covering certain PHC employees. The PHC 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 PHC 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. PHC Plan assets consist primarily of common stocks, alternative investments and cash equivalents.

In fiscal year 2008, PHC's Board of Directors approved the freezing of the PHC Plan for participation purposes, so that employees hired or rehired on and after July 1, 2008 are not eligible to participate in the PHC Plan. Then-current participants had the option under the "Choice" program to continue to accrue benefits in the PHC 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 PHC 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.

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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	
	2018	2017
Actuarial losses	\$ 97,559	115,539
Prior service cost	—	—
Total	<u>\$ 97,559</u>	<u>115,539</u>

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

	Year ended June 30	
	2018	2017
Amortization of prior service cost	\$ —	—
Amortization of net actuarial loss	2,487	3,148
Net actuarial income (loss) during the year	<u>15,493</u>	<u>21,299</u>
Total	<u>\$ 17,980</u>	<u>24,447</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, 2019 is approximately \$2,015,000.

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

	June 30	
	2018	2017
Change in benefit obligation:		
Projected benefit obligation, beginning of year	\$ 394,773	400,303
Service cost	3,410	3,530
Interest cost	13,656	15,594
Benefits paid	(12,448)	(11,608)
Actuarial gain	(14,364)	(9,860)
Administrative expenses paid from pension trust	<u>(3,668)</u>	<u>(3,186)</u>
Projected benefit obligation, end of year	<u>\$ 381,359</u>	<u>394,773</u>
Accumulated benefit obligation	\$ 381,359	394,773

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	June 30	
	2018	2017
Change in Plan assets:		
Fair value of Plan assets, beginning of year	\$ 317,005	290,306
Actual return on Plan assets	20,214	29,493
Employer contributions	12,000	12,000
Benefits paid	(12,448)	(11,608)
Administrative expenses paid from pension trust	(3,668)	(3,186)
	<u>333,103</u>	<u>317,005</u>
Fair value of Plan assets, end of year	\$ 333,103	317,005
Funded status of the Plan	\$ (48,256)	(77,768)

The unfunded status of the PHC Plan of approximately \$48,256,000 and \$77,768,000 at June 30, 2018 and 2017, respectively, is recognized in the accompanying consolidated balance sheets as accrued pension cost. No PHC Plan assets are expected to be returned to PHC during the fiscal year ending June 30, 2019.

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

	Year ended June 30	
	2018	2017
Components of net periodic benefit cost:		
Service cost	\$ 3,410	3,530
Interest cost	13,656	15,594
Expected return on Plan assets	(19,086)	(18,054)
Amortization of prior service cost	—	—
Amortization of net actuarial loss	2,487	3,148
	<u>467</u>	<u>4,218</u>
Total net periodic benefit cost	\$ 467	4,218

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

	Year ended June 30	
	2018	2017
Discount rate	4.03 %	3.96 %
Rate of increase in future compensation levels	N/A	N/A
Expected long-term rate of return on Plan assets	6.20 %	6.40 %

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

	June 30	
	2018	2017
Discount rate	4.35 %	4.03 %
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 PHC Plan assets component of net periodic pension expense for the years ended June 30, 2018 and 2017.

No contributions are expected to be paid to the PHC Plan during fiscal year 2019.

Benefits expected to be paid in each of the next five fiscal years are as follows: fiscal year 2019, \$14,833,000; fiscal year 2020, \$16,403,000; 2021, \$17,947,000; 2022, \$19,134,000; and fiscal year 2023, \$20,019,000. For fiscal years 2024–2028, the aggregate benefits expected to be paid is \$110,789,000.

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

	June 30	
	2018	2017
Growth/equity securities	46 %	44 %
Hedge funds/private equity	8	13
Fixed-income securities	39	43
Asset-backed securities	3	—
Cash	4	—
	100 %	100 %

The target allocation for the PHC Plan is as follows:

	June 30	
	2018	2017
Growth/equity securities	45 %	45 %
Hedge funds/private equity	10	15
Fixed-income securities	40	40
Asset-backed securities	5	—
	100 %	100 %

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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 PHC Plan's portfolio.

The investment strategy of the PHC Plan is to ensure, over the long-term life of the PHC 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 PHC 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 PHC 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.

The fair value of plan assets of the PHC Plan measured at fair value on a recurring basis was determined using the following inputs (note 16) at June 30, 2018 (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and short-term investments	\$ 19,979	—	—	19,979
Corporate obligations	11,994	67,806	—	79,800
Fixed-income securities	4,096	—	—	4,096
Municipal securities	—	4,897	—	4,897
Corporate stocks	7,486	—	—	7,486
Mutual funds	144,534	—	—	144,534
	<u>188,089</u>	<u>72,703</u>	<u>—</u>	<u>260,792</u>
Total assets at fair value	\$ <u>188,089</u>	<u>72,703</u>	<u>—</u>	<u>260,792</u>
Investments measured at NAV as a practical expedient				<u>72,311</u>
			\$	<u><u>333,103</u></u>

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The fair value of PHC Plan assets measured at fair value on a recurring basis was determined using the following inputs (note 16) 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>317,005</u>

Alternative investments included in the PHC Plan at June 30, 2018 and 2017 and related net unrealized gains and losses for the years then ended consist of the following (in thousands):

	<u>Estimated fair value, year ended June 30</u>		<u>Net unrealized gains (losses), year ended June 30</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Clarion Lion Properties ING Fund	\$ 5,744	5,289	414	323
IFP Global Equity L.P.	14,012	11,335	2,689	921
Chatham Asset High Yield Offshore Fund, Ltd.	14,418	12,873	1,545	1,373
Canyon Balanced Fund	10,243	9,465	778	865
PHC Fund, Ltd.	27,788	25,899	1,889	355
Harvest MLP Income II Fund	106	4,485	(4,431)	431
	\$ <u>72,311</u>	<u>69,346</u>	<u>2,884</u>	<u>4,268</u>

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Redemption frequency and redemption notice periods for alternative investments held by the PHC Plan at June 30, 2018 are as follows:

	<u>Redemption frequency</u>	<u>Redemption notice period</u>
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.	Semi-annually	3 Days
PHC Fund, Ltd.	Monthly	90 Days

All investments at June 30, 2018 and 2017 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*.

(b) Columbus Regional Healthcare System, Inc. Pension Plan

July 1, 1986, CRHS established the Columbus Regional Healthcare System, Inc. Pension Plan (the CRHS Pension Plan), a noncontributory defined benefit pension plan covering certain employees of CRHS and its affiliated companies that were employed prior to July 1, 2003. The plan provides benefits to the retired, terminated and active employees and their beneficiaries based on earnings and years of credited service. The funding policy is to contribute annually such amounts as are necessary to provide assets sufficient to meet the benefits to be paid to the plan's members and to keep the plan actuarially sound.

Effective June 30, 2013, the plan was amended to freeze future service benefits.

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The following table presents a reconciliation of the beginning and ending balances of the CRHS Pension Plan's benefit obligation, the fair value of plan assets and the funded status of the plan as of June 30, 2018 and for the period March 1, 2018 through June 30, 2018 (in thousands):

Change in benefit obligations:	
Benefit obligations, beginning of period	\$ 174,956
Interest cost	2,199
Benefits paid	(2,137)
Actuarial loss	<u>(4,493)</u>
Benefit obligations, end of period	\$ <u>170,525</u>
Change in plan assets:	
Fair value of plan assets, beginning of period	146,629
Actual return on plan assets	(1,031)
Contributions of plan sponsor	810
Benefits paid	<u>(2,137)</u>
Fair value of plan assets, end of period	\$ <u>144,271</u>
Funded status of the plan, end of period	\$ (26,254)

PHC recognizes the funded status of the CRHS Pension Plan as a liability and the gains or losses and prior service costs or credits not yet recognized as pension expense as changes in unrestricted net assets. Amounts reported in the accompanying consolidated balance sheets related to the CRHS Pension Plan consist of the following as of June 30, 2018 (in thousands):

Noncurrent liabilities	\$ (26,254)
Unrecognized net actuarial loss in unrestricted net assets	(688)

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The net periodic pension cost of the CRHS Pension Plan and other amounts recognized in unrestricted net assets consist of the following as of June 30, 2018 (in thousands):

Net periodic pension cost:		
Interest cost on benefit obligation	\$	2,199
Expected return on plan assets		(2,773)
Amortization of net actuarial loss		<u>—</u>
Net periodic pension (benefit)	\$	<u>(574)</u>
Other changes in unrestricted net assets:		
Current net actuarial loss	\$	(688)
Amortization of net actuarial loss		<u>—</u>
Other changes in unrestricted net assets	\$	<u>(688)</u>

There is no estimated net loss that will be amortized from unrestricted net assets into net periodic pension cost over the next fiscal year.

The actuarial assumptions used for the CRHS Pension Plan are as follows as of June 30, 2018:

Net periodic pension cost discount rate	3.84 %
Benefit obligation discount rate	4.34
Expected long-term rate of return on plan assets	5.75

The determination of the expected long-term rate of return on plan assets is based on assumptions that are developed by the CRHS Pension Plan investment consultant for each investment category as to the rate of return, risk, yield and correlation with other categories that serve as components of the long-term strategy. The expected long-term rate of return reflects assumptions as to continued execution of the current strategic asset allocation and the plan's investment policy.

The investment strategy of the CRHS Pension Plan is to achieve a mix of approximately 95% of investments for long-term growth and 5% for near-term benefit payments. The target allocation for plan assets is 70% equity securities, 25% corporate bonds and government agencies and 5% for all other

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types of investments. The fair value of plan assets of the CRHS Pension Plan at June 30, 2018 is as follows (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 4,572	—	—	4,572
Corporate bonds	—	57,768	—	57,768
Government agencies	—	27,750	—	27,750
Exchange traded funds	3,760	—	—	3,760
Mutual funds	13,006	—	—	13,006
Equity securities:				
Domestic	25,539	—	—	25,539
International	11,876	—	—	11,876
	<u>\$ 58,753</u>	<u>85,518</u>	<u>—</u>	<u>144,271</u>

PHC expects to contribute approximately \$1,620,000 to the CRHS Pension Plan during fiscal year 2019.

Estimated future benefit payments are expected to be paid by the CRHS Pension Plan as follows for years ending June 30 (in thousands):

2019	\$ 6,920
2020	7,306
2021	7,708
2022	8,356
2023	8,784
2024–2028	50,857

(c) The Medical Center Hospital Authority Pension Plan

The TMC Authority sponsors The Medical Center Hospital Authority Pension Plan (the TMC Authority Pension Plan), a frozen noncontributory defined benefit pension plan covering substantially all former employees of the TMC Authority. As a result of the corporate reorganization, PHC is obligated to pay pension benefits to eligible participants in the frozen plan.

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The following table presents a reconciliation of the beginning and ending balances of the TMC Authority Pension Plan's benefit obligation and the fair value of plan assets and the funded status of the plan as of June 30, 2018 and for the period March 1, 2018 through June 30, 2018 (in thousands):

Change in benefit obligations:	
Benefit obligations, beginning of period	\$ 27,664
Interest cost	327
Benefits paid	(613)
Actuarial loss	(471)
	<hr/>
Benefit obligations, end of period	\$ 26,907
Change in plan assets:	
Fair value of plan assets, beginning of period	23,047
Actual return on plan assets	126
Contributions of plan sponsor	500
Benefits paid	(613)
	<hr/>
Fair value of plan assets, end of period	\$ 23,060
Funded status of the plan, end of period	\$ (3,847)

PHC recognizes the funded status of the TMC Authority Pension Plan as an asset or liability and the gains or losses and prior service costs or credits not yet recognized as pension expense as a change in unrestricted net assets. Amounts reported in the accompanying consolidated balance sheets related to the TMC Authority Pension Plan consist of the following as of June 30, 2018 (in thousands):

Noncurrent liabilities	\$ (3,847)
Unrecognized net actuarial loss in unrestricted net assets	(199)

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Net periodic pension cost of the TMC Authority Pension Plan and other amounts recognized in unrestricted net assets consist of the following as of June 30, 2018 (in thousands):

Net periodic pension benefit:		
Interest cost on benefit obligation	\$	327
Expected return on plan assets		(398)
Amortization of net actuarial loss		—
		<hr/>
Net periodic pension benefit		(71)
Other changes in unrestricted net assets:		
Current net actuarial loss		(199)
Amortization of net actuarial loss		—
		<hr/>
Other changes in unrestricted net assets		(199)
		<hr/>
Total net periodic pension cost and change in unrestricted net assets	\$	<u>(270)</u>

There is no estimated net loss that will be amortized from unrestricted net assets into net periodic pension cost over the next fiscal year.

The actuarial assumptions used for the TMC Authority Pension Plan are as follows as of June 30, 2018:

Net periodic pension cost discount rate	3.99 %
Benefit obligation discount rate	4.21
Expected long-term rate of return on plan assets	5.25
Rates of compensation increase	2.50

The determination of the expected long-term rate of return on plan assets is based on assumptions that are developed by the TMC Authority Pension Plan investment consultant for each investment category as to the rate of return, risk, yield and correlation with other categories that serve as components of the long-term strategy. The expected long-term rate of return reflects assumptions as to continued execution of the current strategic asset allocation and the plan's investment policy.

The investment strategy of the TMC Authority Pension Plan is to achieve a mix of approximately 95% of investments for long-term growth and 5% for near-term benefit payments. The target allocation for plan assets is 60% equity securities, 35% corporate bonds and government agencies and 5% for all other types of investments.

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The fair value of plan assets at June 30, 2018, is as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 2,251	—	—	2,251
Exchange traded funds	9,009	—	—	9,009
Equity mutual funds	4,666	—	—	4,666
Equity securities:				
Domestic	5,077	—	—	5,077
International	2,057	—	—	2,057
	\$ 23,060	—	—	23,060

PHC expects to contribute approximately \$1,000,000 to the TMC Authority Pension Plan during fiscal year 2019.

Estimated future benefit payments are expected to be paid by the TMC Authority Pension Plan as follows for the years ending June 30 (in thousands):

2019	\$ 1,992
2020	2,003
2021	1,988
2022	2,011
2023	2,031
2024–2028	9,854

(d) 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 \$57,183,000 and \$48,390,000 at June 30, 2018 and 2017, respectively, and are recorded within other long-term liabilities in the accompanying consolidated balance sheets.

CRHS implemented a 457(b) plan for certain highly compensated senior employees and physicians. The plan is funded solely by employee contributions. The assets of the plan are the legal assets of

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CRHS until they are distributed to participants and therefore, the plan assets and corresponding liability are reported in the accompanying balance sheets. Plan assets, at fair value, at June 30, 2018 totaled approximately \$5,476,000 and are reflected in other long term assets with an offsetting liability in other long term liabilities on the accompanying consolidated balance sheets.

(e) 401(k) Plans

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, except employees of the Columbus Entities. 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 \$48,104,000 and \$39,006,000 for the years ended June 30, 2018 and 2017, respectively, related to the 401(k) Plan. No discretionary contributions were made during the years ended June 30, 2018 or 2017.

CRHS sponsors a defined contribution plan for substantially all full-time CRHS employees. Prior to July 1, 2014, CRHS made a matching contribution to the plan equal to 25% of the amount contributed to the plan through employee deferrals, limited to 6% of compensation. CRHS made an additional tiered contribution based on years of service and compensation levels ranging from 1.5% to 5.0% of compensation. Effective July 1, 2014, the plan was amended to a discretionary contribution. Contribution expenses under the terms of this plan totaled approximately \$2,156,000 for the period March 1, 2018 through June 30, 2018.

(12) Continuing Care Retirement Community

On August 4, 2004, CRHS entered into a series of agreements with respect to the TMC Authority's construction and funding of a continuing care retirement community (CCRC). These agreements include a ground lease, a completion and support funding agreement, an indemnity agreement, an environmental compliance and indemnification agreement and a supplemental subordination agreement.

Under the terms of the ground lease, CRHS leases certain real estate to the TMC Authority through 2044. The TMC Authority issued tax-exempt bonds totaling \$74,660,000 to construct a CCRC on the leased land. Upon termination of the lease agreement, the land and all improvements thereon will revert, or transfer, to CRHS.

CRHS issued an environmental compliance and indemnification agreement, which indemnifies certain third parties with respect to any environmental-related losses, which may be associated with the land. CRHS has assigned all of its rights in the leased property to specified third parties with respect to the TMC Authority's bond issue.

During the CCRC's construction phase, CRHS provided funds to the TMC Authority for the CCRC's construction amounting to approximately \$3,100,000. This funding was initially recorded as a debt, subordinate to the Series 2004 Bonds. On April 1, 2007, the TMC Authority entered into an amended and restated loan agreement in conjunction with the issuance of the Series 2007 Bonds, which includes a provision whereby the TMC Authority will be released from its liability under the loan agreement upon termination of the ground lease. As such, at that time the funding was recognized as a capital contribution to the TMC Authority.

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The TMC Authority entered into a management agreement with Columbus Regional Senior Living, a controlled affiliate of CRHS, which subsequently entered into a submanagement agreement with a third-party to manage the operations of the CCRC and to perform the duties and obligations thereof pursuant to the management agreement. The CCRC management activity is immaterial to PHC as a whole.

PHC has agreed to indemnify the TMC Authority and specified third parties with respect to certain losses of the TMC Authority, including ad valorem real estate property taxes. As discussed in note 14, the TMC Authority is involved in a property tax dispute related to the CCRC, which exposes PHC to risk of loss.

(13) 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	
	2018	2017
Medicare	30 %	30 %
Medicaid	15	14
Other third-party payors	39	43
Patients	16	13
	<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.

As of June 30, 2018 and 2017, PHC had approximately \$491,331,000 and \$560,831,000, respectively, in funds deposited with various financial institutions in excess of Federal Deposit Insurance Corporation limits.

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(14) 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 risks of PHC affiliates, namely Atlanta, Mountainside, Fayette, Newnan, Henry, Newton, Athens, Rockdale, Walton, Midtown, Northside and Piedmont Medical Care Corporation on a claims-made basis for the hospital professional. 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. As of May 1, 2018, the per occurrence limit remains at \$5,000,000 with the annual aggregate at \$31,000,000. AMIC provides commercial general liability coverage on an occurrence basis to Piedmont Heart Institute Physicians, Athens Regional Physician Services, Athens Regional Specialty Services, Regional First Care, Columbus Ambulatory Healthcare Services and Columbus Regional Medical Group in addition to the affiliates named above. 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, 2018 and 2017, which totaled approximately \$88,463,000 and \$66,603,000, 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, 2018 and 2017, 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, 2018 and 2017.

(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, 2018 and 2017. 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, 2018 and 2017, 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, 2018 and 2017, which totaled approximately \$8,644,000 and \$5,800,000, respectively. Commercial insurance has been obtained on an-occurrence basis to provide for excess coverage.

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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, 2018 and 2017. 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, 2018 and 2017.

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 17), administered the plan for PHC's health benefits. At June 30, 2018 and 2017, PHC recorded \$15,398,000 and \$13,409,000, 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, 2018 and 2017, 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 2018 and 2017 for all operating leases was approximately \$53,859,000 and \$44,915,000, 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:	
2019	\$ 55,301
2020	52,950
2021	49,387
2022	44,238
2023	37,758
Thereafter	<u>145,262</u>
	<u>\$ 384,896</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 believes it has meritorious defenses against the allegations and estimates that any loss exposure in excess of amounts currently accrued would not have a material adverse effect on PHC's financial position or results of operations.

In May 2013, CRHS, certain affiliates and certain personnel, were named in an unsealed "qui tam" lawsuit filed under the federal and state False Claims Acts alleging improper coding and billing practices and violations of the federal Stark and Anti-Kickback Acts that resulted in overbilling of governmental insurers. The United States declined to intervene in the lawsuit. In December 2014, the "qui tam" lawsuit was re-filed and the United States and the State of Georgia intervened for the purposes of settlement. The United States and the State of Georgia contend that the System, certain affiliates and certain personnel named in the lawsuit submitted or caused to be submitted claims for payment to the Medicare and Medicaid Programs at higher levels than supported by the documentation in patients' medical records, during the period from May 2006 through May 2013. The lawsuit also contends that payment by the System of improper salary and medical directorship payments to a certain physician violated the Stark statute. A settlement agreement was reached during September 2015, which included a fixed total of \$26,000,000 as well as a contingent amount, which is capped at \$9,000,000. Management has estimated remaining settlement loss of \$11,352,000, of which \$3,143,000 is considered current at June 30, 2018.

Contemporaneously with the settlement agreement, CRHS entered into a Corporate Integrity Agreement (CIA) with the Office of Inspector General to promote compliance with the statutes, regulations and written directives of Medicare, Medicaid and all other Federal health care programs. The CIA will last five years commencing in September 2015 and requires CRHS to provide certain information and maintain certain requirements at CRHS each year.

The TMC Authority is involved in a property tax dispute over certain real estate it owns and leases. The Columbus Consolidated Government holds that the property in question is subject to ad valorem real estate property tax and is pursuing collection of billed property taxes totaling approximately \$11,778,000 for the years 2005 through 2018 related to the CCRC discussed in note 12. PHC has indemnified the TMC Authority for such property taxes; therefore, PHC has exposure to loss related to the dispute. During 2017, the Supreme Court of Georgia granted the City of Columbus's Petition of Certiorari, which was seeking a review and reversal of the decision of the Georgia Court of Appeals, which had affirmed the Superior Court's entry of Summary Judgment for the TMC Authority. In October 2017, the Supreme Court of Georgia reversed the decision of the Georgia Court of Appeals. As such, the litigation had been remanded to the Superior Court of Muscogee County for further

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proceedings. In April 2018, the court of appeals vacated its previous opinion, adopting the decision of the Supreme Court as their own, vacated the superior court's judgment that the TMC Authority is entitled to a public property exemption, and remanded the case for proceedings consistent with the opinion of the Supreme Court. Counsel for the TMC Authority intend to pursue the remanded case and seek to obtain judgment of the Superior Court that the TMC Authority's interest is exempt from property tax as a public property. However, the ultimate outcome of this matter is unknown at this time.

(15) 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.

(16) Fair Value of Financial Instruments

PHC applies ASC 820, *Fair Value Measurement*, 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.

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

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liabilities measured at fair value on a recurring basis was determined using the following inputs at June 30, 2018 (in thousands):

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 458,213	—	—	458,213
Investments and assets limited as to use:				
Cash and short-term investments	23,632	—	—	23,632
Corporate obligations	—	16,086	—	16,086
Asset-backed securities	—	8,590	—	8,590
Fixed-income securities	215,468	—	—	215,468
Government agencies	—	25,571	—	25,571
Corporate stocks	148,110	—	—	148,110
Mutual funds	421,846	—	—	421,846
Total investments and assets limited as to use at fair value	<u>809,056</u>	<u>50,247</u>	<u>—</u>	<u>859,303</u>
Self-insurance investments:				
Corporate obligations	403	5,879	—	6,282
Fixed-income securities	18,236	—	—	18,236
Mortgage-backed securities	—	5,626	—	5,626
Equity securities	19,139	—	—	19,139
Total self-insurance investments	37,778	11,505	—	49,283
Beneficial interest in perpetual trust	—	—	8,032	8,032
Total assets at fair value	<u>\$ 1,305,047</u>	<u>61,752</u>	<u>8,032</u>	<u>1,374,831</u>
Investments and assets limited as to use measured at NAV as a practical expedient				<u>230,745</u>
				<u>\$ 1,605,576</u>
Liabilities				
Interest rate swaps	\$ —	17,759	—	17,759

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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, 2017 (in thousands):

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
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	<u>528,038</u>	<u>51</u>	<u>—</u>	<u>528,089</u>
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	<u>\$ 1,127,353</u>	<u>15,864</u>	<u>7,694</u>	1,150,911
Investments and assets limited as to use measured at NAV as a practical expedient				<u>182,810</u>
				<u>\$ 1,333,721</u>
Liabilities				
Interest rate swaps	\$ —	24,743	—	24,743

Investments and assets limited as to use at June 30, 2018 and 2017 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):

	2018	2017
Beginning balance	\$ 7,694	7,298
Change in beneficial interest in perpetual trust	338	396
Ending balance	\$ 8,032	7,694

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.

(17) Related-Party Transactions

PWHP is a health insurance company owned 50% by PHC and 50% by WellStar Health System. Included in gain from equity investment within nonoperating income in the accompanying consolidated statement of operations for the year ended June 30, 2018 is \$1,650,000 relating to a true up of previous expenses.

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

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(18) 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. For the years ended June 30, 2018 and 2017, Athens received \$1,725,000 and \$638,000 for the Internal Medicine and Transitional Years residency programs.