
The Methodist Hospitals, Inc.

Consolidated Financial Report
December 31, 2017

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Independent Auditor's Report

To the Board of Directors
The Methodist Hospitals, Inc.

We have audited the accompanying consolidated financial statements of The Methodist Hospitals, Inc. (the "Hospital"), which comprise the consolidated balance sheet as of December 31, 2017 and 2016 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's 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 opinions.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Methodist Hospitals, Inc. as of December 31, 2017 and 2016 and the consolidated results of its operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Plante & Moran, PLLC".

April 12, 2018

Consolidated Balance Sheet

December 31, 2017 and 2016

| | 2017 | 2016 |
|--|-----------------------|-----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 612,061 | \$ 2,080,713 |
| Short-term investments (Note 6) | 576,070 | 3,003,724 |
| Accounts receivable - Net (Note 3) | 48,913,705 | 44,110,820 |
| Cost report settlements receivable (Note 4) | 22,724,126 | 35,279,556 |
| Other current assets (Note 8) | 16,189,252 | 15,342,574 |
| Total current assets | 89,015,214 | 99,817,387 |
| Assets Limited as to Use (Note 6) | 125,884,579 | 134,093,580 |
| Property and Equipment - Net (Note 9) | 145,870,116 | 141,237,536 |
| Other Assets | 4,833,351 | 5,674,302 |
| Total assets | \$ 365,603,260 | \$ 380,822,805 |
| Liabilities and Net Assets | | |
| Current Liabilities | | |
| Accounts payable | \$ 11,292,470 | \$ 21,460,327 |
| Current portion of long-term debt (Note 11) | 2,436,521 | 2,317,017 |
| Cost report settlements payable (Note 4) | 7,577,574 | 8,809,918 |
| Accrued liabilities and other (Note 10) | 17,483,748 | 16,846,060 |
| Total current liabilities | 38,790,313 | 49,433,322 |
| Long-term Debt - Net of current portion (Note 11) | 61,519,535 | 64,234,151 |
| Other Liabilities (Note 12) | 20,995,640 | 30,986,826 |
| Total liabilities | 121,305,488 | 144,654,299 |
| Net Assets | | |
| Unrestricted | 243,922,279 | 235,714,898 |
| Temporarily restricted | 350,493 | 428,608 |
| Permanently restricted | 25,000 | 25,000 |
| Total net assets | 244,297,772 | 236,168,506 |
| Total liabilities and net assets | \$ 365,603,260 | \$ 380,822,805 |

The Methodist Hospitals, Inc.

Consolidated Statement of Operations

Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|--|----------------------------|----------------------------|
| Unrestricted Revenue, Gains, and Other Support | | |
| Net patient service revenue | \$ 310,939,690 | \$ 312,052,331 |
| Provision for bad debts | <u>(20,384,296)</u> | <u>(16,098,325)</u> |
| Net patient service revenue less provision for bad debts | 290,555,394 | 295,954,006 |
| Excess of fair value of assets acquired over consideration paid in acquisition of Advanced Imaging Center, LLC | 1,947,592 | - |
| Investment income (Note 6) | 16,214,524 | 7,261,553 |
| Other operating revenue | 4,954,056 | 5,035,140 |
| Medicaid disproportionate share revenue | 52,277,548 | 51,899,484 |
| Net assets released from restrictions used for operations | <u>201,179</u> | <u>85,619</u> |
| Total unrestricted revenue, gains, and other support | 366,150,293 | 360,235,802 |
| Operating Expenses | | |
| Salaries and wages | 152,262,553 | 148,178,574 |
| Employee benefits and payroll taxes | 37,537,681 | 35,789,468 |
| Supplies | 61,364,096 | 61,365,200 |
| Outside services | 46,278,663 | 44,199,383 |
| Professional and other liability costs | 3,032,767 | 3,047,672 |
| Utilities | 6,989,957 | 6,776,840 |
| Repairs and maintenance | 10,019,352 | 8,359,122 |
| Medicaid assessment fee (Note 4) | 13,881,669 | 11,970,565 |
| Depreciation and amortization | 18,855,286 | 19,132,347 |
| Interest expense | 3,470,054 | 3,582,259 |
| Other | <u>4,336,987</u> | <u>6,886,884</u> |
| Total operating expenses (Note 17) | <u>358,029,065</u> | <u>349,288,314</u> |
| Operating Income | 8,121,228 | 10,947,488 |
| Nonoperating Income | <u>32,083</u> | <u>35,000</u> |
| Excess of Revenue Over Expenses | 8,153,311 | 10,982,488 |
| Pension-related Changes Other than Net Periodic Cost (Note 15) | <u>54,070</u> | <u>(6,666,451)</u> |
| Increase in Unrestricted Net Assets | <u><u>\$ 8,207,381</u></u> | <u><u>\$ 4,316,037</u></u> |

The Methodist Hospitals, Inc.

Consolidated Statement of Changes in Net Assets

Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|--|-----------------------|-----------------------|
| Unrestricted | | |
| Excess of revenue over expenses | \$ 8,153,311 | \$ 10,982,488 |
| Pension-related changes other than net periodic cost | 54,070 | (6,666,451) |
| Increase in unrestricted | 8,207,381 | 4,316,037 |
| Temporarily Restricted | | |
| Restricted contributions | 123,064 | 128,048 |
| Net assets released from restriction | (201,179) | (85,619) |
| (Decrease) increase in temporarily restricted | (78,115) | 42,429 |
| Increase in Net Assets | 8,129,266 | 4,358,466 |
| Net Assets - Beginning of year | 236,168,506 | 231,810,040 |
| Net Assets - End of year | \$ 244,297,772 | \$ 236,168,506 |

Consolidated Statement of Cash Flows

Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|--|-------------------|---------------------|
| Cash Flows from Operating Activities | | |
| Increase in net assets | \$ 8,129,266 | \$ 4,358,466 |
| Adjustments to reconcile increase in net assets to net cash from operating activities: | | |
| Depreciation and amortization | 18,855,286 | 19,132,347 |
| Net change in unrealized net gains on investments | (2,620,238) | (2,019,893) |
| Realized gains on investments | (9,475,491) | (1,842,397) |
| Pension-related changes other than net periodic costs | (54,070) | 6,666,451 |
| Gain on disposal of property and equipment | (158,516) | (175,956) |
| Amortization of bond premium | (318,677) | (318,677) |
| Temporarily restricted contributions | (123,064) | (128,048) |
| Provision for bad debts | 20,384,296 | 16,098,325 |
| Inherent contribution on purchase of remaining equity method investment | (1,947,592) | - |
| Amortization of debt issuance costs | 40,583 | 40,583 |
| Changes in assets and liabilities that (used) provided cash: | | |
| Accounts receivable | (24,866,242) | (16,383,478) |
| Other current assets | (846,678) | (664,289) |
| Costs report settlements receivable | 12,555,430 | (26,200,788) |
| Other assets | 594,975 | (527,559) |
| Accounts payable | (10,256,379) | 10,258,546 |
| Accrued liabilities and other | 637,688 | 1,690,623 |
| Cost report settlements payable | (1,232,344) | 4,160,532 |
| Other liabilities | (9,937,116) | (7,689,201) |
| Net cash (used in) provided by operating activities | (638,883) | 6,455,587 |
| Cash Flows from Investing Activities | | |
| Purchase of property and equipment | (19,575,817) | (35,616,085) |
| Proceeds from sale of property and equipment | 191,667 | 175,956 |
| Purchase of investments and assets limited as to use | (100,258,987) | (60,518,528) |
| Proceeds from sale and maturities of investments and assets limited as to use | 122,991,371 | 76,225,069 |
| Business acquisition of equity method investment - Net of cash acquired | (1,516,674) | - |
| Net cash provided by (used in) investing activities | 1,831,560 | (19,733,588) |
| Cash Flows from Financing Activities | | |
| Early termination of capital lease obligation | - | (934,342) |
| Payments on capital lease obligations | (172,018) | (158,643) |
| Principal payments on long-term debt | (2,612,375) | (2,955,359) |
| Temporarily restricted contributions | 123,064 | 128,048 |
| Net cash used in financing activities | (2,661,329) | (3,920,296) |
| Net Decrease in Cash and Cash Equivalents | (1,468,652) | (17,198,297) |
| Cash and Cash Equivalents - Beginning of year | 2,080,713 | 19,279,010 |
| Cash and Cash Equivalents - End of year | \$ 612,061 | \$ 2,080,713 |
| Supplemental Cash Flow Information - Cash paid for interest | \$ 3,460,753 | \$ 3,541,676 |

Note 1 - Nature of Business

The Methodist Hospitals, Inc. (the "Hospital") is an Indiana nonprofit corporation operating a 269-bed general acute-care facility in Gary, Indiana (Northlake Campus) and a 313-bed general acute-care facility in Merrillville, Indiana (Southlake Campus). The Hospital also provides physician services to patients through the following wholly owned limited liability companies: Methodist Cardiographics, LLC, Methodist Anesthesia, LLC, Methodist Pathology, LLC, and Advanced Imaging Center, LLC.

The Hospital is the sole member of The Methodist Hospitals Foundation, Inc. (the "Foundation"), which was established to support and benefit the Hospital. The Foundation has been accounted for within the Hospital's consolidated financial statements.

Note 2 - Significant Accounting Policies

Basis of Consolidation

The consolidated financial statements include the accounts of The Methodist Hospitals, Inc., The Methodist Hospitals Foundation, Inc., Methodist Cardiographics, LLC, Methodist Anesthesia, LLC, Methodist Pathology, LLC, and Advanced Imaging Center, LLC; all intercompany accounts have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

The Hospital's cash balances are only insured up to the Federal Deposit Insurance Corporation limit. As of December 31, 2017 and 2016, there was approximately \$11.1 million and \$8.2 million of uninsured cash, respectively. The Hospital evaluates the financial institutions with which it deposits funds; however, it is not practical to insure all cash deposits. The Hospital has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on its cash and cash equivalents.

Accounts Receivable

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Investments

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

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheet.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Significant Accounting Policies (Continued)

Goodwill

The recorded amounts of goodwill from prior business combinations are based on management's best estimates of the fair values of assets acquired and liabilities assumed at the date of acquisition. The Hospital assesses goodwill annually for impairment. No impairment charge was recognized in the years ended December 31, 2017 and 2016. It is reasonably possible that management's estimates of the carrying amount of goodwill will change in the near term. Goodwill is recorded within other assets in the consolidated balance sheet.

Inventories

Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at cost or net realizable value determined on a first-in, first-out basis.

Assets Limited as to Use

Assets limited as to use include assets designated by the governing board for future capital improvement, over which the board retains control and may, at its discretion, subsequently use for other purposes. Included in these investments are assets held by trustees under bond indenture agreements and assets held in self-insurance trust arrangements. Restricted foundation investments consist of assets whose use by the Hospital has been restricted by the donor.

Property and Equipment

Property and equipment amounts are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Repairs and maintenance costs are charged to expense as incurred.

Unamortized Financing Costs

Unamortized financing costs are amortized over the term of the related financing.

Classification of Net Assets

Net assets of the Hospital are classified as permanently restricted, temporarily restricted, or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the Hospital's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Permanently restricted net assets result from donor-imposed restrictions that limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

Excess of Revenue Over Expenses

The consolidated statement of changes in net assets includes excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets and pension-related changes other than periodic benefit costs.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Significant Accounting Policies (Continued)

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources is as follows:

| | Third-party Payors | Self-pay | Total All Payors |
|---|-----------------------|---------------|------------------|
| Patient service revenue (net of contractual allowances and discounts) - December 31, 2017 | \$ 285,597,425 | \$ 25,342,265 | \$ 310,939,690 |
| Patient service revenue (net of contractual allowances and discounts) - December 31, 2016 | 283,982,693 | 28,069,638 | 312,052,331 |

Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Contributions

The Hospital reports gifts of cash and other assets as 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 to unrestricted net assets and reported in the consolidated statement of changes in net assets as net assets released from restriction.

The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. 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, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Professional and Other Liability Insurance

The Hospital accrues an estimate of the ultimate expense, including litigation and settlement expense, for incidents of potential improper professional service and other liability claims occurring during the year as well as for those claims that have not been reported at year end. Amounts receivable from insurance related to stop-loss provisions are recorded as a receivable and included in other assets.

Note 2 - Significant Accounting Policies (Continued)

Accounting for Conditional Asset Retirement Obligation

Management has considered its legal obligation to report asset retirement activities, such as asbestos removal, on its existing properties. Over the past 20 years, management has systematically renovated, replaced, or constructed the majority of the physical plant facilities, resulting in a relatively small portion of the facility with any remaining hazardous material. Management has calculated the present value of the retirement obligation and the amount has been recognized as a liability on the consolidated balance sheet within other liabilities.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions, and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients.

Federal Income Tax

The Internal Revenue Service (IRS) has ruled that the Hospital and its subsidiaries are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and, accordingly, no tax provision is reflected in the consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Restatement

In 2017, it was determined that certain investments within the pension plan that were previously categorized as debt securities should have been categorized as common collective trust - equity funds. Accordingly, the 2016 disclosure has been updated.

Upcoming Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of 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. The ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The new guidance will be effective for the Hospital's year ending December 31, 2018. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. The Hospital has not yet determined which application method it will use. Management does not expect that this standard will have a significant impact to the timing and recognition pattern of the Hospital's main revenue streams.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 2 - Significant Accounting Policies (Continued)

The FASB issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Hospital's year ending December 31, 2019 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The expected impact on the consolidated balance sheet is a significant increase in long-term assets and lease liabilities. The effects on the results of operations are not expected to be significant as recognition and measurement of expenses and cash flows for leases will be substantially the same under the new standard.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 requires significant changes to the financial reporting model of organizations that follow the FASB not-for-profit rules, including changing from three classes of net assets to two classes: net assets with donor restrictions and net assets without donor restrictions. The ASU will also require changes in the way certain information is aggregated and reported by the Organization, including required disclosures about the liquidity and availability of resources. The new standard is effective for the Hospital's year ending December 31, 2018 and thereafter and must be applied on a retrospective basis. The standard is expected to have an impact on the presentation of net assets and to result in enhanced disclosures related to liquidity and availability.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard requires the presentation of the service cost component of net benefit cost to be in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. All other components of net benefit cost should be presented separately from the service cost component and outside of income from operations. The standard is effective for fiscal years beginning after December 15, 2018 and must be adopted retrospectively. Adoption of the new standard is not expected to have a material impact on the Hospital's financial statements.

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including April 12, 2018, which is the date the consolidated financial statements were issued.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

| | 2017 | 2016 |
|---------------------------------------|----------------------|----------------------|
| Patient accounts receivable | \$ 142,797,671 | \$ 136,242,089 |
| Less: | | |
| Allowance for uncollectible accounts | 24,489,599 | 20,969,134 |
| Allowance for contractual adjustments | 69,394,367 | 71,162,135 |
| Net patient accounts receivable | <u>\$ 48,913,705</u> | <u>\$ 44,110,820</u> |

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 3 - Patient Accounts Receivable (Continued)

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows as of December 31:

| | Percentage | |
|-----------------------------|------------|-------|
| | 2017 | 2016 |
| Medicare | 49 % | 50 % |
| Medicaid | 17 | 18 |
| Commercial and managed care | 26 | 26 |
| Self-pay | 8 | 6 |
| Total | 100 % | 100 % |

Note 4 - Cost Report Settlements

A significant portion of the Hospital's net patient service revenue is received from the Medicare and Medicaid programs. A summary of the basis of reimbursement with these third-party payors is as follows:

Medicare

Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.

Medicaid and Hospital Assessment Fee

Inpatient and outpatient services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge or per procedure.

The Indiana Hospital Association (IHA) and the Office of Medicaid Policy and Planning (OMPP) worked together to develop and implement a hospital assessment fee program as enacted by the 2011 Session of the Indiana General Assembly. In 2012, the Centers for Medicare and Medicaid Services (CMS) approved the state plan amendment necessary to implement these changes with a retroactive effective date of July 1, 2011. The program expired on June 30, 2013. In March 2014, the program was again approved by CMS, with an effective date of July 1, 2013, and continued through June 30, 2017. Effective July 1, 2017, the program was extended through June 30, 2019. Under this program, OMPP will collect an assessment fee from eligible hospitals. The fee will be used in part to increase reimbursement to eligible hospitals for services provided in both fee-for-service and managed care programs, and as the state share of Disproportionate Share Hospital (DSH) payments. Starting in 2016, the Hospital will be assessed a Hospital Assessment Fee on the Indiana HIP (Healthy Indiana Plan) 2.0 program based on the Medicaid DSH eligibility surveys. Due to the shift in Medicaid population from FFS to managed care, since 2017, the collection of the existing assessment fee is being made through a combination of offsets from claims payment and check payments. During 2017 and 2016, the Hospital incurred \$13,881,669 and \$11,970,565, respectively, in Medicaid assessment fees under this program, which is reflected in total operating expenses in the accompanying consolidated statement of operations. At December 31, 2017 and 2016, there is \$3,590,501 and \$5,046,268, respectively, included in cost report settlement payable in the consolidated balance sheet related to the hospital assessment fee program.

Final reimbursement under the Medicare and Medicaid programs is subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements. The effect of prior year settlements received in 2017 and 2016 resulted in an increase in net revenue of approximately \$748,000 and \$1,592,000, respectively.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 4 - Cost Report Settlements (Continued)

The Hospital qualifies as a Medicaid Disproportionate Share (DSH) provider under Indiana law and, as such, is eligible to receive DSH payments linked to the State of Indiana's fiscal year end, which is June 30. The Hospital records DSH program revenue and receivables when the related amounts are determinable and when collectibility is reasonably assured.

At December 31, 2017 and 2016, the Hospital recorded approximately \$22,700,000 and \$35,300,000, respectively, in amounts due from the State of Indiana under the DSH program. These amounts are reflected in cost report settlements receivable in the accompanying consolidated balance sheet. The amounts recorded represent estimated reimbursement due to the Hospital for services provided through December 31, 2017. During the years ended December 31, 2017 and 2016, approximately \$23,755,000 and \$27,982,000, respectively, was received in cash related to the DSH program.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare and Medicaid programs that are subject to audit by fiscal intermediaries. 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.

The Indiana Family and Social Services Administration (FSSA) has initiated a Medicaid Advisory Committee (MAC) initiative, whereby claims will be reviewed by contractors for validity, accuracy, and proper documentation. The Hospital is unable to determine the extent of liability for overpayments, if any. The potential exists for significant overpayment of claims liability for the Hospital at a future date.

Other Third-party Payors

The Hospital has also entered into agreements with certain commercial carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement to the Hospital under these agreements is discounts from established charges, prospectively determined rates per discharge, and prospectively determined daily rates.

Note 5 - Charity Care

In support of its mission, the Hospital's policy is to treat patients in need of medical services without regard to their ability to pay for such services. Charity care covers services provided to persons who cannot afford to pay. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses divided by gross patient service revenue. The Hospital estimates that it provided approximately \$10.0 million and \$9.5 million of services to indigent patients during 2017 and 2016, respectively.

In addition, the Hospital performs many activities of community benefit, including programs provided to persons with inadequate healthcare resources or for other groups within the community that need special services and support. Examples include programs related to the poor, the elderly, those suffering from substance abuse, victims of child abuse, and others with specific particular healthcare needs. They also include broader populations who benefit from health community initiatives such as health promotion, education, and health screening.

The Hospital also participates in the Medicare and Medicaid programs. At present, the reimbursement rates for both programs do not fully cover the cost of providing care to these patients. This represents the estimated "shortfall" created when a facility receives payments below the costs of treating Medicare and Medicaid beneficiaries. These uncompensated costs are not included above.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 6 - Assets Limited as to Use

The detail of assets limited as to use is summarized in the following schedule at December 31:

| | <u>2017</u> | <u>2016</u> |
|--|-----------------------|-----------------------|
| Funds held by trustees under bond indenture | \$ 4,426,379 | \$ 4,383,762 |
| Funds held in trust for payment of professional and other liability claims | 4,989,086 | 5,184,950 |
| Funds held by board for future capital improvements | 116,444,114 | 124,499,868 |
| Fund held by donors for specific purposes | <u>25,000</u> | <u>25,000</u> |
| Total assets limited as to use | <u>\$ 125,884,579</u> | <u>\$ 134,093,580</u> |

Investments, including short-term investments, consist of the following at December 31:

| | <u>2017</u> | <u>2016</u> |
|--------------------------|-----------------------|-----------------------|
| Money market investments | \$ 9,998,092 | \$ 8,980,721 |
| Government securities | 4,800,683 | 4,428,599 |
| Mutual funds | 83,475,216 | 95,980,001 |
| Corporate bonds | 24,769,977 | 24,756,278 |
| Pooled funds | <u>3,416,681</u> | <u>2,951,705</u> |
| Total | <u>\$ 126,460,649</u> | <u>\$ 137,097,304</u> |
| Classified as: | | |
| Short-term investments | 576,070 | 3,003,724 |
| Assets limited as to use | <u>125,884,579</u> | <u>134,093,580</u> |
| Total | <u>\$ 126,460,649</u> | <u>\$ 137,097,304</u> |

Funds held by the trustee under a bond indenture are held for the purpose of making future bond principal and interest payments. Investment income accrues to the funds as earned.

Investment income and gains and losses are comprised of the following for the years ended December 31:

| | <u>2017</u> | <u>2016</u> |
|--------------------------------|----------------------|---------------------|
| Interest and dividends | \$ 4,118,795 | \$ 3,399,263 |
| Change in net unrealized gains | 2,620,238 | 2,019,893 |
| Realized gains - Net | <u>9,475,491</u> | <u>1,842,397</u> |
| Total | <u>\$ 16,214,524</u> | <u>\$ 7,261,553</u> |

Note 7 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the consolidated financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Hospital's assets measured at fair value on a recurring basis at December 31, 2017 and 2016 and the valuation techniques used by the Hospital to determine those fair values.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Hospital has the ability to access.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 7 - Fair Value Measurements (Continued)

Fair values determined by Level 2 inputs use other inputs that are observable either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

| | Assets Measured at Fair Value on a Recurring Basis at December 31, 2017 | | | |
|---------------------------------|---|---|--|------------------------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2017 |
| Short-term Investments - | | | | |
| Money market investments | \$ 343,404 | \$ - | \$ - | \$ 343,404 |
| Assets Limited as to Use | | | | |
| Money market investments | 9,415,465 | - | - | 9,415,465 |
| Mutual funds: | | | | |
| U.S. companies | 22,533,175 | - | - | 22,533,175 |
| International companies | 27,106,546 | - | - | 27,106,546 |
| Fixed income | 24,606,589 | - | - | 24,606,589 |
| Balanced funds | 9,228,906 | - | - | 9,228,906 |
| Fixed income: | | | | |
| U.S. Treasuries | - | 4,544,276 | - | 4,544,276 |
| Governmental agency bonds | - | 256,407 | - | 256,407 |
| Pooled funds | - | 3,416,681 | - | 3,416,681 |
| Asset-backed securities | - | 10,759,638 | - | 10,759,638 |
| Mortgage-backed securities | - | 6,449,583 | - | 6,449,583 |
| Corporate - Domestic | - | 5,047,339 | - | 5,047,339 |
| Corporate - International | - | 2,513,417 | - | 2,513,417 |
| Total assets limited as to use | 92,890,681 | 32,987,341 | - | 125,878,022 |
| Total | \$ 93,234,085 | \$ 32,987,341 | \$ - | \$ 126,221,426 |

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2017 included money market investments of \$239,223, which are not measured at fair value on a recurring basis and, therefore, are not in the table above.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 7 - Fair Value Measurements (Continued)

| | Assets Measured at Fair Value on a Recurring Basis at December 31, 2016 | | | |
|---------------------------------|---|---|--|------------------------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2016 |
| Short-term Investments - | | | | |
| Money market investments | \$ 1,831,498 | \$ - | \$ - | \$ 1,831,498 |
| Assets Limited as to Use | | | | |
| Money market investments | 6,907,407 | - | - | 6,907,407 |
| Mutual funds: | | | | |
| U.S. companies | 24,947,825 | - | - | 24,947,825 |
| International companies | 30,044,803 | - | - | 30,044,803 |
| Fixed income | 31,994,548 | - | - | 31,994,548 |
| Balanced funds | 8,992,825 | - | - | 8,992,825 |
| Fixed income: | | | | |
| U.S. Treasuries | - | 3,708,534 | - | 3,708,534 |
| Governmental agency bonds | - | 720,065 | - | 720,065 |
| Pooled funds | - | 2,951,705 | - | 2,951,705 |
| Asset-backed securities | - | 9,555,651 | - | 9,555,651 |
| Mortgage-backed securities | - | 7,413,174 | - | 7,413,174 |
| Corporate - Domestic | - | 3,817,373 | - | 3,817,373 |
| Corporate - International | - | 3,970,080 | - | 3,970,080 |
| Total assets limited as to use | <u>102,887,408</u> | <u>32,136,582</u> | <u>-</u> | <u>135,023,990</u> |
| Total | <u>\$ 104,718,906</u> | <u>\$ 32,136,582</u> | <u>\$ -</u> | <u>\$ 136,855,488</u> |

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2016 include money market investments of \$241,816, which are not measured at fair value on a recurring basis and, therefore, are not in the table above.

The fair value of fixed-income securities at December 31, 2017 and 2016 was determined primarily based on Level 2 inputs. The Methodist Hospitals, Inc. estimates the fair value of these investments using the fair market values as determined by the investment custodians.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2017 and 2016, there were no significant transfers between levels.

Note 8 - Other Current Assets

The details of other assets at December 31, 2017 and 2016 are as follows:

| | 2017 | 2016 |
|------------------|----------------------|----------------------|
| Prepaid expenses | \$ 3,629,167 | \$ 3,434,204 |
| Inventory | 11,414,094 | 11,126,424 |
| Other | 1,145,991 | 781,946 |
| Total | <u>\$ 16,189,252</u> | <u>\$ 15,342,574</u> |

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 9 - Property and Equipment

The cost of property, plant, and equipment and depreciable lives are summarized as follows:

| | 2017 | 2016 | Depreciable Life - Years |
|----------------------------|-----------------------|-----------------------|-----------------------------|
| Land | \$ 5,373,674 | \$ 4,445,499 | - |
| Buildings | 282,354,735 | 268,921,805 | 2-40 |
| Equipment | 200,151,060 | 192,359,037 | 3-5 |
| Construction in progress | 5,894,855 | 11,938,146 | - |
| Total cost | 493,774,324 | 477,664,487 | |
| Accumulated depreciation | 347,904,208 | 336,426,951 | |
| Net property and equipment | <u>\$ 145,870,116</u> | <u>\$ 141,237,536</u> | |

Depreciation and amortization expense, including assets under capital lease, totaled \$18,855,286 and \$19,132,347 in 2017 and 2016, respectively.

The Hospital holds buildings under capital leases with an original cost of approximately \$20,500,000 at December 31, 2017 and 2016. Accumulated amortization for buildings under capital lease obligations was approximately \$6,150,000 and \$5,638,000 at December 31, 2017 and 2016, respectively.

Construction in progress consists primarily of costs incurred for the emergency department and intensive care unit renovation, new building renovations, and installation of various clinical equipment. Remaining costs to complete the project are approximately \$3,091,000 as of December 31, 2017.

Note 10 - Accrued Liabilities and Other

The details of accrued liabilities at December 31 are as follows:

| | 2017 | 2016 |
|---------------------------|----------------------|----------------------|
| Payroll and related items | \$ 7,125,233 | \$ 6,552,304 |
| Compensated absences | 9,621,085 | 9,524,417 |
| Interest | 598,281 | 629,563 |
| Other | 139,149 | 139,776 |
| Total accrued liabilities | <u>\$ 17,483,748</u> | <u>\$ 16,846,060</u> |

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 11 - Long-term Debt

The following is a summary of long-term debt and capital lease obligations at December 31, 2017 and 2016:

| | <u>2017</u> | <u>2016</u> |
|--|----------------------|----------------------|
| Indiana Finance Authority Hospital Revenue Refunding Bonds, Series 2014A, interest ranging from 4.00 percent to 5.00 percent, due in installments through 2031 | \$ 41,025,000 | \$ 43,170,000 |
| Medical office building capital lease obligations, expires December 31, 2045, collateralized by leased medical office buildings | 19,125,222 | 19,297,239 |
| Original issue premium | <u>4,355,250</u> | <u>4,673,927</u> |
| Total | 64,505,472 | 67,141,166 |
| Less current portion | 2,436,521 | 2,317,017 |
| Less unamortized debt issuance costs | <u>549,416</u> | <u>589,998</u> |
| Long-term portion | <u>\$ 61,519,535</u> | <u>\$ 64,234,151</u> |

The Indiana Health Facility Financing Authority (the "IHFFA") has issued bonds on behalf of The Methodist Hospitals, Inc. Obligated Group (the "Obligated Group") and has loaned the proceeds to the Obligated Group under the terms of the master indenture. The sole member of the Obligated Group is The Methodist Hospitals, Inc.

Hospital Obligated Group Bonds Payable, Series 2014A consist of hospital revenue bonds issued by the Indiana Finance Authority (previously the IHFFA). The bonds consist of serial bonds payable in annual installments for 2015 through 2031, ranging from \$1,875,000 to \$3,465,000 at interest rates ranging from 4 percent to 5 percent and term bonds payable in annual installments beginning in 2030 through 2031, ranging from \$3,375,000 to \$3,555,000 at 5 percent interest.

The Series 2014A Bonds have been issued under a master trust indenture and are secured by the gross revenue of the Hospital. In connection with the bond indenture and loan agreements, the Obligated Group is subject to certain financial covenants related to, among others, transfer of assets, restrictions on additional indebtedness, and maintenance of certain financial covenants, including a minimum debt service coverage ratio and minimum debt service reserve funds.

The Hospital has entered into a series of capital lease arrangements for a medical office building on the Merrillville hospital campus. The Hospital is leasing the underlying land to the developer under terms of a ground lease. The medical office building houses physician offices, laboratory and diagnostic facilities, and an ambulatory surgery center. The lease agreements have terms from 5 to 27 years.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 11 - Long-term Debt (Continued)

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows as of December 31:

| Years Ending December 31 | Long-term Debt | Capital Lease Obligations |
|--|----------------|---------------------------|
| 2018 | \$ 2,250,000 | \$ 1,732,968 |
| 2019 | 2,350,000 | 1,732,968 |
| 2020 | 2,455,000 | 1,732,968 |
| 2021 | 2,570,000 | 1,732,968 |
| 2022 | 2,690,000 | 1,732,968 |
| Thereafter | 28,710,000 | 20,523,360 |
| Total | 41,025,000 | 29,188,200 |
| Less amount representing interest under capital lease obligations | - | (10,062,978) |
| Total debt and present value of minimum lease payments | \$ 41,025,000 | \$ 19,125,222 |

Note 12 - Other Liabilities

The detail of other liabilities is shown below:

| | 2017 | 2016 |
|---|---------------|---------------|
| Accrued pension cost (Note 15) | \$ 12,461,605 | \$ 21,156,071 |
| Accrued professional and other liability claims (Note 16) | 7,864,669 | 8,229,952 |
| Other | 669,366 | 1,600,803 |
| Total other liabilities | \$ 20,995,640 | \$ 30,986,826 |

Note 13 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately \$2,670,000 and \$2,728,000 for the years ended December 31, 2017 and 2016, respectively.

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

| Years Ending December 31 | Amount |
|-----------------------------|--------------|
| 2018 | \$ 2,213,909 |
| 2019 | 1,838,195 |
| 2020 | 1,421,516 |
| 2021 | 684,835 |
| 2022 | 546,617 |
| Thereafter | 1,692,214 |
| Total | \$ 8,397,286 |

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 14 - Defined Contribution Plan

The Hospital established a defined contribution retirement plan effective January 1, 2006, which allows for employee contributions and requires a matching employer contribution of 50 percent of the first 6 percent of employees' earnings. Expense for the years ended December 31, 2017 and 2016 was approximately \$1,977,000 and \$2,132,000, respectively.

Note 15 - Pension Plan

The Methodist Hospitals, Inc. sponsors a defined benefit pension plan covering certain employees.

The board of directors of the Hospital elected to freeze the employees' participation in the future accrual of benefits under the existing defined benefit plan effective December 31, 2005.

Effective June 1, 2007, the plan was amended to provide early retirement window benefits to participants who had attained age 50 and completed 10 or more years of service on or before June 30, 2007. Under the terms of the amendment, eligible participants who elected to participate received three years of additional benefits accrual based on 2006 compensation, and the early retirement reduction was calculated assuming a participant was 50 years or older. Participants were allowed to take their full benefit as a lump sum. A significant portion of participants eligible for the early retirement program elected to participate in the program.

Obligations and Funded Status

| | Pension Benefits | |
|--|------------------|-----------------|
| | 2017 | 2016 |
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$ 131,237,041 | \$ 125,156,701 |
| Service cost | 43,000 | 15,000 |
| Interest cost | 5,244,300 | 5,434,241 |
| Actuarial loss | 5,249,582 | 4,876,400 |
| Benefits paid | (4,095,028) | (4,245,301) |
| Benefit obligation at end of year | 137,678,895 | 131,237,041 |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | 110,080,970 | 102,679,561 |
| Actual return on plan assets | 12,831,348 | 5,246,710 |
| Employer contributions | 6,400,000 | 6,400,000 |
| Benefits paid | (4,095,028) | (4,245,301) |
| Fair value of plan assets at end of year | 125,217,290 | 110,080,970 |
| Funded status at end of year | \$ (12,461,605) | \$ (21,156,071) |

The components of net periodic benefit cost and other amounts recognized are as follows:

| | Pension Benefits | |
|----------------------------------|------------------|-------------|
| | 2017 | 2016 |
| Net Periodic Benefit Cost | | |
| Service cost | \$ 43,000 | \$ 15,000 |
| Interest cost | 5,244,300 | 5,434,241 |
| Expected return on plan assets | (7,527,696) | (7,035,302) |
| Amortization of net loss | 2,740,048 | 2,439,475 |
| Total cost | \$ 499,652 | \$ 853,414 |

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 15 - Pension Plan (Continued)

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic pension cost:

| | Pension Benefits | |
|-----------------|------------------|--------------|
| | 2017 | 2016 |
| Net (gain) loss | \$ (54,070) | \$ 6,666,451 |

Weighted-average assumptions used to determine benefit obligations at December 31 are as follows:

| | Pension Benefits | |
|---------------|------------------|--------|
| | 2017 | 2016 |
| Discount rate | 3.70 % | 4.10 % |

Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31 are as follows:

| | Pension Benefits | |
|--|------------------|--------|
| | 2017 | 2016 |
| Discount rate | 4.10 % | 4.40 % |
| Expected long-term return on plan assets | 6.75 | 6.75 |

In selecting the expected long-term rate of return on assets, the Hospital considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of this plan. This included considering the allocation of trust assets and the expected returns likely to be earned over the life of the plan.

Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the Hospital, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and assures timely payment of retirement benefits. Pension funds are invested in growth-oriented securities up to 41 percent in equities, including international equities.

The target allocation range of percentages for plan assets is 41 percent equity securities and 59 percent debt securities and 48 percent equity securities and 52 percent debt securities as of December 31, 2017 and 2016, respectively.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 15 - Pension Plan (Continued)

The fair values of the Hospital's pension plan assets at December 31, 2017 and 2016 by major asset categories are as follows:

| Asset Category | Fair Value Measurements at December 31, 2017 | | | Total |
|---------------------------------------|--|---|---|-----------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Equity securities: | | | | |
| U.S. companies | \$ 25,156,725 | \$ - | \$ - | \$ 25,156,725 |
| International companies | 26,729,624 | - | - | 26,729,624 |
| Debt securities | - | 33,433,654 | - | 33,433,654 |
| Fixed income - Pooled funds | - | 1,716,478 | - | 1,716,478 |
| Common collective trust - Equity fund | - | 38,033,416 | - | 38,033,416 |
| Total | \$ 51,886,349 | \$ 73,183,548 | \$ - | \$ 125,069,897 |

| Asset Category | Fair Value Measurements at December 31, 2016 | | | Total |
|---------------------------------------|--|---|---|-----------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Equity securities: | | | | |
| U.S. companies | \$ 23,379,202 | \$ - | \$ - | \$ 23,379,202 |
| International companies | 26,287,380 | - | - | 26,287,380 |
| Debt securities | - | 23,537,807 | - | 23,537,807 |
| Fixed income - Pooled funds | - | 1,487,652 | - | 1,487,652 |
| Common collective trust - Equity fund | - | 34,998,307 | - | 34,998,307 |
| Total | \$ 49,666,582 | \$ 60,023,766 | \$ - | \$ 109,690,348 |

The pension plan assets shown above included cash and cash equivalents of \$147,393 and \$390,622 at December 31, 2017 and 2016, respectively. Cash and cash equivalents are not measured at fair value on a recurring basis and, therefore, are not included in the tables above.

The tables above present information about the pension plan assets measured at fair value at December 31, 2017 and 2016 and the valuation techniques used by the Hospital to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Plan has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 15 - Pension Plan (Continued)

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each plan asset.

The fair value of debt securities, fixed-income securities, and common collective trust at December 31, 2017 and 2016 was determined based on Level 2 inputs. The Methodist Hospitals, Inc. estimates the fair value of these investments using the fair market values as determined by the investment custodians.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2017 and 2016, there were no significant transfers between levels.

Cash Flow

Contributions

The Hospital expects to contribute \$3.2 million to the pension plan in 2018.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| <u>Year</u> | <u>Pension Benefits</u> |
|-------------|-------------------------|
| 2018 | \$ 4,930,759 |
| 2019 | 5,245,026 |
| 2020 | 5,558,179 |
| 2021 | 5,937,568 |
| 2022 | 6,314,651 |
| 2023-2027 | 36,333,142 |

Note 16 - Professional Liability Self-insurance

On April 2, 1983, the Hospital became qualified under the Indiana Medical Malpractice Act (the "Act"). The Act limits the amount of individual claims to \$1,250,000 (\$7,500,000 annual aggregate), of which \$1,000,000 would be paid by the State of Indiana Patient Compensation Fund and \$250,000 by the Hospital. The Hospital carries commercial insurance coverage for incidents that would exceed coverages specified by the self-insurance program. Prior to April 2, 1983, the Hospital carried commercial insurance for professional liability risks on an occurrence basis. The Hospital's liability for medical malpractice self-insurance is actuarially determined based upon the Hospital's estimated claims reserves and various assumptions, and includes an estimate for claims incurred but not yet reported.

In connection with the self-insurance program, the Hospital established a trust. Under the trust agreement, the trust assets can only be used for payment of professional liability losses, related expenses, and the costs of administering the trust. The assets of the trust are included in unrestricted funds and income from the trust assets and administrative costs are included in the consolidated statement of operations.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 17 - Functional Expenses

The Hospital provides general healthcare services to residents within its geographical location.

Expenses related to providing these services are as follows:

| | <u>2017</u> | <u>2016</u> |
|----------------------------|-----------------------|-----------------------|
| Healthcare services | \$ 317,809,915 | \$ 309,594,386 |
| General and administrative | 40,219,150 | 39,693,928 |
| Total | <u>\$ 358,029,065</u> | <u>\$ 349,288,314</u> |

Note 18 - Related Party Transactions

For the year ended December 31, 2017, the Hospital purchased construction project services from an affiliate, totaling approximately \$3,300,000.

Note 19 - Business Combinations

On September 29, 2017, the Hospital acquired the remaining 60 percent of the outstanding membership interest in Advanced Imaging Center, LLC, which the Hospital previously held as an equity method investment at December 31, 2016. The purchase was funded through operating cash. The primary reason for the acquisition was to improve the quality of and reduce the cost of providing healthcare services in the areas served by the Hospital and the related subsidiaries.

The following table summarizes the fair value of the consideration transferred as part of the acquisition of Advanced Imaging Center, LLC:

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

| | |
|--|-------------------------|
| Consideration paid | \$ 1,519,575 |
| Assets acquired: | |
| Cash | 2,901 |
| Patient accounts receivable | 320,939 |
| Property and equipment | <u>3,945,200</u> |
| Total assets acquired | 4,269,040 |
| Liabilities assumed/incurred: | |
| Patient accounts receivable collections | (88,522) |
| Loan | <u>(467,375)</u> |
| Total liabilities assumed | <u>(555,897)</u> |
| Net identifiable assets acquired and liabilities assumed | <u>3,713,143</u> |
| Consideration paid less net identifiable assets acquired and liabilities assumed | (2,193,568) |
| Adjustment for interest held with equity interest in investment held before business combination | <u>245,975</u> |
| Inherent contribution recognized | <u><u>1,947,593</u></u> |

The amounts of Advanced Imaging Center, LLC's revenue and earnings included in the accompanying consolidated statement of operations for the year ended December 31, 2017 totaled \$204,194 and \$(327,812), respectively, from the date of acquisition.

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Note 19 - Business Combinations (Continued)

Supplemental pro forma financial information of Advanced Imaging Center, LLC beginning January 1, 2016 and for the period from January 1, 2016 through December 31, 2017 is not practical as the financial statements of Advanced Imaging Center, LLC before the acquisition were maintained on a comprehensive basis of accounting different than those required by generally accepted accounting principles.