

# Baptist Healthcare System, Inc. and Affiliates

Consolidated Financial Statements as of and for the  
Years Ended August 31, 2018 and 2017, and  
Independent Auditors' Report

# **BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES**

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## **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors,  
Audit Committee and Management  
Baptist Healthcare System, Inc. and Affiliates  
Louisville, Kentucky

We have audited the accompanying consolidated financial statements of Baptist Healthcare System, Inc. and Affiliates ("Baptist") which comprise the consolidated balance sheets as of August 31, 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 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 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 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 financial statements are free from material misstatement.

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

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

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Baptist as of August 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

December 10, 2018

# BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES

## CONSOLIDATED BALANCE SHEETS AS OF AUGUST 31, 2018 AND 2017 (Amounts in thousands)

	2018	2017
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 167,958	\$ 207,876
Investments	193,340	207,175
Assets limited as to use or restricted—required for current obligations	22,881	20,775
Patient accounts receivable—net of allowance for uncollectible accounts of \$72,943 and \$78,095 in 2018 and 2017, respectively.	401,864	380,643
Inventories	46,923	43,681
Estimated third-party settlement receivable <sup>1</sup>	5,512	10,572
Prepays and other	<u>69,995</u>	<u>69,215</u>
Total current assets	908,473	939,937
ASSETS LIMITED AS TO USE OR RESTRICTED	1,091,994	931,894
PROPERTY AND EQUIPMENT—Net	1,232,506	1,273,432
OTHER ASSETS	<u>92,004</u>	<u>57,504</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 3,324,977</u></b>	<b><u>\$ 3,202,767</u></b>
<b>LIABILITIES AND NET ASSETS</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 100,614	\$ 101,387
Accrued expenses	149,142	162,917
Accrued interest payable	2,742	2,748
Estimated third-party settlement payable	10,830	14,359
Current installments of long-term debt	9,625	21,795
Current portion for medical malpractice and workers' compensation	22,881	20,775
Other	<u>50,811</u>	<u>50,019</u>
Total current liabilities	346,645	374,000
LONG-TERM DEBT	960,198	965,943
OTHER LIABILITIES	<u>170,113</u>	<u>164,727</u>
Total liabilities	<u>1,476,956</u>	<u>1,504,670</u>
NET ASSETS:		
Unrestricted net assets attributable to Baptist	1,805,002	1,660,710
Unrestricted net assets attributable to noncontrolling interest	<u>5,452</u>	<u>875</u>
Total unrestricted net assets	1,810,454	1,661,585
Temporarily restricted	13,886	15,215
Permanently restricted	<u>23,681</u>	<u>21,297</u>
Total net assets	<u>1,848,021</u>	<u>1,698,097</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 3,324,977</u></b>	<b><u>\$ 3,202,767</u></b>

See notes to consolidated financial statements.

## BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES

### CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED AUGUST 31, 2018 AND 2017 (In thousands)

	2018	2017
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:		
Patient service revenue—net of contractual discounts and allowances	\$2,656,869	\$2,551,753
Less provision for uncollectible accounts	<u>81,357</u>	<u>93,948</u>
Net patient service revenue	2,575,512	2,457,805
Premium revenue	56,507	147,254
Other	91,345	80,053
Net assets released from restrictions used for operations	<u>1,780</u>	<u>2,894</u>
Total revenues, gains, and other support	<u>2,725,144</u>	<u>2,688,006</u>
EXPENSES:		
Salaries and benefits	1,480,953	1,502,587
Supplies	550,870	534,093
Purchased services	218,221	217,796
Utilities	34,374	34,155
Administration and other	165,803	248,600
Depreciation and amortization	133,111	154,343
Provider tax and assessment fees	41,567	39,346
Interest	<u>35,563</u>	<u>26,299</u>
Total expenses	<u>2,660,462</u>	<u>2,757,219</u>
OPERATING INCOME (LOSS)	<u>64,682</u>	<u>(69,213)</u>
OTHER INCOME (LOSS):		
Net investment income	79,543	70,919
Other loss	<u>(6,727)</u>	<u>(4,805)</u>
Total other income	<u>72,816</u>	<u>66,114</u>
EXCESS (DEFICIENCY) OF REVENUES, GAINS, AND OTHER SUPPORT OVER EXPENSES BEFORE PROVISION FROM INCOME TAX	137,498	(3,099)
PROVISION FOR INCOME TAX	<u>247</u>	<u>635</u>
EXCESS (DEFICIENCY) OF REVENUES, GAINS, AND OTHER SUPPORT OVER EXPENSES	137,251	(3,734)
EXCESS OF REVENUES OVER EXPENSES ATTRIBUTABLE TO NONCONTROLLING INTEREST	<u>(1,377)</u>	<u>(663)</u>
EXCESS (DEFICIENCY) OF REVENUES, GAINS AND OTHER SUPPORT OVER EXPENSES ATTRIBUTABLE TO BAPTIST—Net of noncontrolling interest	<u>\$ 135,874</u>	<u>\$ (4,397)</u>

See notes to consolidated financial statements.

## BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES

### CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS FOR THE YEARS ENDED AUGUST 31, 2018 AND 2017 (In thousands)

	2018	2017
UNRESTRICTED NET ASSETS ATTRIBUTABLE TO BAPTIST:		
Excess (deficiency) of revenues, gains, and other support over expenses attributable to Baptist—net of noncontrolling interest	\$ 135,874	\$ (4,397)
Net change in defined benefit pension related items	1,275	566
Net change in post-retirement benefit plan related items	2,888	1,408
Net assets released from restrictions used for capital	<u>4,255</u>	<u>1,983</u>
Increase (decrease) in unrestricted net assets attributable to Baptist	<u>144,292</u>	<u>(440)</u>
UNRESTRICTED NET ASSETS ATTRIBUTABLE TO NONCONTROLLING INTEREST:		
Excess of revenues over expenses	1,377	663
Contributions from noncontrolling interest	4,514	635
Distributions to noncontrolling interest	<u>(1,314)</u>	<u>(1,119)</u>
Increase in unrestricted net assets attributable to noncontrolling interest	<u>4,577</u>	<u>179</u>
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	<u>148,869</u>	<u>(261)</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions, interest income, and other	4,706	9,299
Net assets released from restrictions used for capital	(4,255)	(1,983)
Net assets released from restrictions used for operations	<u>(1,780)</u>	<u>(2,894)</u>
(Decrease) increase in temporarily restricted net assets	<u>(1,329)</u>	<u>4,422</u>
PERMANENTLY RESTRICTED NET ASSETS—Change in beneficial interest in perpetual trust		
	<u>2,384</u>	<u>1,678</u>
Increase in permanently restricted net assets	<u>2,384</u>	<u>1,678</u>
CHANGE IN NET ASSETS	149,924	5,839
NET ASSETS—Beginning of year	<u>1,698,097</u>	<u>1,692,258</u>
NET ASSETS—End of year	<u>\$ 1,848,021</u>	<u>\$ 1,698,097</u>

See notes to consolidated financial statements.

# BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED AUGUST 31, 2018 AND 2017

(In thousands)

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 149,924	\$ 5,839
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Provision for uncollectible accounts	81,357	93,948
Depreciation and amortization	133,111	154,343
Loss on extinguishment of debt	2,903	
Net realized and unrealized gains on investments and assets limited as to use or restricted	(70,952)	(62,439)
Restricted contributions	(4,706)	(9,299)
Distributions from joint ventures	3,130	6,943
Undistributed equity in the net earnings of joint ventures	(4,300)	(6,893)
Gain on sale of joint venture	(3,252)	
Loss on sale or disposition of property and equipment	3,271	2,607
Impairment of goodwill	83	1,974
Change in noncontrolling interest	(3,199)	484
Net change in defined benefit pension related items	(1,275)	(566)
Net change in post-retirement benefit plan related items	(2,888)	(1,408)
Change in beneficial interest in perpetual trust	(2,384)	(1,678)
Changes in:		
Patient accounts receivable—net	(102,210)	(87,621)
Inventories and prepaids and other	12,673	(11,071)
Other assets	(36,951)	(63)
Accounts payable, accrued expenses, and accrued interest payable	(13,774)	(3,683)
Estimated third-party payer settlements	1,532	(11,249)
Other current liabilities	14,775	(6,158)
Other liabilities	12,736	5,479
Net cash provided by operating activities	<u>169,604</u>	<u>69,489</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(4,278,944)	(5,380,615)
Proceeds from disposition of investments	4,186,127	5,395,665
Purchases of property and equipment	(97,560)	(127,853)
Proceeds from sale of property and equipment	597	296
Acquisition of Floyd Memorial Hospital & Health Services and other investments, net of cash acquired	(4,335)	(129,000)
Proceeds from sale of joint venture	4,306	
Net cash used in investing activities	<u>(189,809)</u>	<u>(241,507)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt and line of credit	194,225	532,345
Net costs of debt issuance	(2,023)	(3,230)
Principal payments on long-term debt	(211,360)	(264,203)
Capital lease and notes payable payments	(4,296)	(4,478)
Restricted contributions	4,706	9,299
Contributions from noncontrolling interest	349	635
Distributions to noncontrolling interest	(1,314)	(1,119)
Net cash (used in) provided by financing activities	<u>(19,713)</u>	<u>269,249</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(39,918)	97,231
CASH AND CASH EQUIVALENTS—Beginning of year	<u>207,876</u>	<u>110,645</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 167,958</u>	<u>\$ 207,876</u>
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid—net of capitalized amount of \$471 in 2018 and \$423 in 2017	<u>\$ 35,569</u>	<u>\$ 24,492</u>
Income taxes paid	<u>\$ 112</u>	<u>\$ 365</u>
Purchases of property and equipment in accounts payable	<u>\$ 5,639</u>	<u>\$ 7,415</u>

See notes to consolidated financial statements.

# BAPTIST HEALTHCARE SYSTEM, INC. AND AFFILIATES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED AUGUST 31, 2018 AND 2017 (In thousands)

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### 1. DESCRIPTION OF ORGANIZATION SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization**—Baptist Healthcare System, Inc. and Affiliates (Baptist) is a nonprofit, tax-exempt organization that owns and operates seven hospitals in the Commonwealth of Kentucky and one in the state of Indiana, along with the entities described below.

Baptist Community Health Services, Inc. (BCHS) is a nonprofit, tax-exempt affiliate. BCHS owns 55% of Baptist Physicians' Surgery Center, a for-profit limited liability corporation, 51% of Cumberland Valley Surgery Center, LLC, and 84% of Baptist Eastpoint Surgery Center, LLC. BCHS has an ownership interest in CHC Community Care LLC, a Delaware for-profit limited liability company that is the sole member of two non-profit corporations and one limited liability company, each of which operates an accredited long-term acute care hospital located within a Baptist Health hospital: ContinueCare Hospital at Baptist Health Corbin; ContinueCare Hospital at Baptist Health Paducah; and ContinueCare Hospital at Baptist Health Madisonville. Effective August 31, 2018, BCHS was dissolved and the ownership interests of the surgery centers and other joint ventures were transferred to Baptist Healthcare System, Inc.

Baptist Health Plan f/k/a Bluegrass Family Health (BHP) is a nonprofit, taxable affiliate health maintenance organization. On August 24, 2017, BHP's Board of Directors agreed to the voluntary dissolution of BHP. On March 13, 2018, BHP received an order from the Kentucky Department of Insurance approving the voluntary dissolution of BHP. As a result, all active enrollment ends on December 31, 2018. BHP will not engage in any new business activities except to the extent necessary to preserve the value of its assets, wind up its business affairs, and distribute its assets in accordance with the Voluntary Plan of Dissolution.

Baptist Health Medical Group, Inc. (BHMGM), was formed in 2006 to employ physicians and own and operate healthcare facilities such as physician offices, primary care centers, special health clinics, express care clinics, physical therapy, occupational medicine and urgent care centers in all Baptist Health markets and surrounding communities. Baptist is the sole member of BHMGM.

Baptist Healthcare Foundation, Inc., Baptist Health Foundation of Greater Louisville, Inc., Baptist Health Foundation Corbin, Baptist Health Foundation Lexington, Inc., Baptist Health Foundation Madisonville, Inc. and Baptist Health Foundation, Richmond, Inc. and Baptist Health Foundation Paducah, Inc. are nonprofit, tax-exempt affiliate corporations.

Baptist Ventures, Inc. (BVI) is a Kentucky for-profit corporation that manages, operates, maintains, leases, or enters into joint ventures with hospitals, medical facilities or other entities that provide health care services. Effective October 19, 2018, BVI was dissolved and the ownership interests of the joint ventures were transferred to Baptist Healthcare System, Inc.

Purchase Health Quality Collaborative, LLC is a Kentucky limited liability company that supports hospital/physician clinical integration in the western region of Kentucky.

Baptist Healthcare Partners, LLC is a Kentucky limited liability company formed in 2015 whose sole member is Baptist Healthcare System, Inc. BHCP was formed to participate in the Centers for Medicare and Medicaid ("CMS") Medicare Shared Savings Program ("MSSP") as an Accountable Care Organization, and was approved by CMS for a three-year initial participation cycle in the MSSP beginning January 1, 2016.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**—The accompanying consolidated financial statements represent the consolidated operations of Baptist, the affiliates in which it has sole ownership or membership, and the entities in which it has greater than 50% equity interest with commensurate control. All significant intercompany accounts and transactions are eliminated in consolidation.

**Mission and Vision Statement**—Baptist's mission is to demonstrate the love of Christ by providing and coordinating care and improving health in our communities. Baptist will lead in clinical excellence, compassionate care and growth to meet the needs of our patients. Baptist's faith-based values include Integrity, Respect, Excellence, Collaboration, Compassion and Joy.

**Cash Equivalents**—Baptist considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At August 31, 2018 and 2017, cash equivalents consisted primarily of money market accounts. Cash and cash equivalent balances may exceed limits insured by the FDIC from time to time.

**Noncontrolling Interest**—Noncontrolling interest represents the portion of the following entities: Baptist Physicians' Surgery Center, Baptist Eastpoint Surgery Center, LLC, Cumberland Valley Surgery Center, LLC, and Baptist Health Performance Training, LLC, that Baptist does not own. Losses attributable to the noncontrolling interest are allocated to the noncontrolling interest even if the carrying amount of the noncontrolling interest is reduced below zero.

**Investments and Investment Return**—Investments in equity securities with readily determinable fair values and all debt securities are carried at fair value in the consolidated balance sheets. Investments in an equity investee are reported on the equity method of accounting.

Investment income or loss (including realized gains and losses on investments, dividends, interest and unrealized gains and losses on investments carried at fair value) is included in the excess of revenues, gains and other support over expenses unless donor or law restricts the income or loss.

**Patient Accounts Receivable**—Baptist reports patient accounts receivable for services rendered at net realizable amounts from third-party payers and patients. In evaluating the ability to collect accounts receivable, Baptist analyzes its history and identifies trends for each of its major payer sources of revenue to estimate the appropriate provisions and allowances. Management regularly reviews data regarding these major payer sources of revenue in evaluating the sufficiency of the allowances.

**Inventories**—Inventories are stated at the lower of cost or market on a first-in, first-out basis. The cost of inventories is determined principally by the weighted average cost method.

**Assets Limited as to Use or Restricted**—Assets limited as to use or restricted are recorded at fair value and include: (1) assets set aside by the board for capital improvements over which the board retains control and may, at its discretion, subsequently use for other purposes, (2) assets set aside by the board for endowment over which the board retains control and may, at its discretion, subsequently use for other purposes, (3) assets held by trustee related to bond indenture, (4) assets held by trustee for donor restricted funds, (5) assets held by trustee for the medical malpractice and workers' compensation self-insurance funding arrangements and (6) assets held by trustee in perpetual trust. Amounts required to meet current liabilities are reported as current assets in the consolidated balance sheets.

Baptist invests in various securities including money market funds, U.S. Government securities, corporate debt instruments, corporate stocks, mutual funds, commingled funds and derivative instruments. The unrealized gains and losses of these securities are recognized as a component of net investment income in the consolidated statement of operations. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations.

**Property and Equipment**—Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each class of depreciable asset. Leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. Land improvements are depreciated over a range of 5 to 25 years. Buildings are depreciated over a range of 15 to 40 years. Equipment is depreciated over a range of 3 to 20 years. Internal use software is depreciated over a range of 3 to 10 years. Useful lives are determined through consultation of the American Hospital Association's *Life of Depreciable Hospital Assets* and consideration of how Baptist intends to use the asset or has used similar assets in the past. Buildings and equipment under capital lease are amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the asset. Such amortization is included with depreciation and amortization in the consolidated financial statements.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets, unless the donor restricts use of the assets. Monetary gifts that must be used to acquire property and equipment are reported as donor-restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Baptist capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing for the project, net of interest earned on investments acquired with the proceeds of the borrowing or based on the weighted-average rates paid for long-term borrowing.

**Long-Lived Asset Impairment**—Baptist evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate of future cash flows is expected to result from the use and eventual

disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended August 31, 2018 and 2017.

**Goodwill**—The following represents the amount of goodwill, including changes in carrying value for the years ending August 31, 2018 and 2017 included in other assets in the consolidated balance sheets:

	<b>2018</b>	<b>2017</b>
Balance—beginning of year	\$24,179	\$20,772
Acquisitions of businesses	8,029	5,381
Impairment	<u>(83)</u>	<u>(1,974)</u>
Balance—end of year	<u>\$32,125</u>	<u>\$24,179</u>

Goodwill is tested for impairment on an annual basis or when an event or change in circumstance indicates the value of a reporting unit may have changed. Testing is conducted at the reporting unit level. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Estimates of fair value are based on estimates of discounted future cash flows.

In connection with the decision to wind down the operations of BHP, Baptist evaluated the goodwill at the BHP reporting unit for impairment, which resulted in a fair value that was significantly below the carrying value. As a result, the Company recorded an impairment of \$1,974, which represented a full impairment of the goodwill balance within that reporting unit. The impairment charge was recorded in other loss in the 2017 consolidated statement of operations. Baptist evaluated the goodwill associated with a practice in the Madisonville market and recorded a partial impairment of \$83, which represents a partial impairment of the goodwill balance related to that reporting unit. The impairment charge was recorded in other loss in the 2018 consolidated statement of operations.

**Temporarily Restricted Net Assets**—Temporarily restricted net assets are those whose use by Baptist has been limited by donors to a specific time period or purpose. Investment income from restricted funds, which has been restricted by the donor, is included in temporarily restricted net assets when earned.

**Permanently Restricted Net Assets**—Permanently restricted net assets are those that have been restricted by donors to be maintained in perpetuity. Permanently restricted net assets represent Baptist’s beneficial interest in perpetual trusts. The change in value of the beneficial interest in perpetual trust is included in permanently restricted net assets as change in beneficial interest in perpetual trust.

**Charity Care**—Baptist provides care to patients who meet certain criteria under its charity care policy, without charge or at amounts less than its established rates. Baptist also provides discounts from established rates to all uninsured patients. Because Baptist does not pursue collection of charity or uninsured discounts, such amounts are not reported as revenue. The cost of charity care is estimated by applying the ratio of cost to gross charges to the uncompensated charges. Total unreimbursed costs of charity and discounts to the uninsured were approximately \$37,134 and \$36,519 for the years ended August 31, 2018 and 2017, respectively.

**Net Patient Service Revenue**—Baptist has agreements with third-party payers that may provide for payments at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payers for services rendered and includes estimated retroactive adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods, as final settlements are determined.

**Premium Revenue**—Baptist, through BHP, enters into membership contracts with employer groups. The contracts contain varying terms subject to cancellation by the employer group or BHP upon 60 days' written notice. Premiums are due at the beginning of each month and are recognized as revenue during the period in which BHP is obligated to provide services to members.

Premiums billed and collected in advance are recorded as unearned premiums and are included in the consolidated balance sheets in other current liabilities.

Estimated medical claims incurred but not reported are included in the consolidated balance sheets in accrued expenses and claims expense of \$37,745 and \$153,196 for the years ended August 31, 2018 and 2017, respectively, is reported in administrative and other expense in the consolidated statements of operations.

**Provider Tax and Assessment Fees**—Since July 1993, Kentucky has imposed various taxes on health care providers to help fund the state of Kentucky's portion of the Medicaid program. The law imposes a tax of 2.5% on the gross receipts of hospitals and 2% on nursing facility services, intermediate care facility services, services for the mentally handicapped, home health care services and health maintenance organization. Hospital provider taxes were capped in 2008 by Kentucky statute at the level paid in state fiscal year 2005–2006. Baptist recognized an expense for such provider taxes of approximately \$24,902 and \$24,951 in 2018 and 2017, respectively. No assurance can be given that the Kentucky General Assembly will not remove the cap on hospital provider taxes.

During 2012, the state of Indiana enacted the Hospital Assessment Fee (HAF) program, which is designed to increase Medicaid payments to hospitals. The program was approved by the federal Centers for Medicare & Medicaid Services (CMS) through June 30, 2017 and subsequently extended through June 30, 2019. Under HAF, Indiana hospitals receive additional federal Medicaid funds for the state's health care system, administered by the Indiana Family and Social Services Administration. HAF includes both a payment to the hospitals from the state and an assessment against the hospitals, which is paid to the state in the same year. Baptist Health Floyd recognized payments totaling \$17,726 and \$11,496 and assessments of \$16,666 and \$14,395 during 2018 and 2017, respectively. HAF payments to Baptist Health Floyd are included in net patient service revenue in the consolidated statement of operations and HAF assessments from Baptist Health Floyd are included in provider taxes and assessment fees in the consolidated statement of operations.

**Contributions**—Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined by using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Donor-restricted stipulations that limit the use of contributions are initially reported as temporarily or permanently restricted net 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 changes in net assets as net assets released from restriction.

**Estimated Malpractice Costs**—An annual estimated provision is accrued for the self-insured portion of medical malpractice claims and is reported in the consolidated statements of operations as an administration and other expense. The liability for self-insured malpractice claims includes an estimate of the ultimate costs for both reported claims and claims incurred but not reported and are reported in the consolidated balance sheets in other liabilities and current portion for malpractice and workers’ compensation.

**Income Taxes**—Baptist nonprofit, tax exempt entities are recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (Code). However, these entities are subject to federal income tax on income earned through unrelated business activities. In addition, the Baptist taxable and for-profit entities are subject to federal and state income taxes. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are recognized for temporary differences between the basis of assets and liabilities for financial and income tax purposes. Deferred tax assets and liabilities represent the future tax return consequences of those differences, which will be either deductible or taxable when the assets and liabilities are recovered or settled.

On December 22, 2017, President Trump signed H.R.1 (the “Tax Cuts and Jobs Act”) that reduced the US corporate income tax rate to 21% for tax years after December 31, 2017. As a result of this decreased rate, the Company remeasured its deferred tax assets and liabilities as of December 22, 2017 in accordance with ASC 740. The provision for income taxes for the year ended August 31, 2018 included a decrease of \$8,430 (\$0 net impact after offset associated with deferred tax asset valuation allowance) related to the estimated impact of tax rate changes under the 2017 Tax Cuts and Jobs Act on our deferred tax assets and liabilities.

Total deferred tax assets and liabilities as of August 31, 2018 and 2017, are as follows:

	<b>2018</b>	<b>2017</b>
Deferred tax assets	\$ 17,648	\$ 25,079
Deferred tax liabilities	<u>(345)</u>	<u>(965)</u>
	17,303	24,114
Valuation allowance	<u>(17,303)</u>	<u>(24,114)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

Baptist’s federal net operating losses carry forward was \$13,181 and \$18,434 at August 31, 2018 and 2017, respectively. A valuation allowance was recorded related to certain assets that were not considered realizable in future periods. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable

income during the periods in which those temporary differences become deductible. Management considers the projected future taxable income and tax planning strategies in making this assessment.

Baptist evaluates its uncertain tax positions on an annual basis. A tax benefit from an uncertain position may be recognized when it is more likely than not that the position will be sustained upon examination, include resolution of any related appeals or litigation processes, based on the technical merit of the position. Baptist has determined that it has no uncertain tax positions that are required to be recorded as of August 31, 2018. Tax years that are open include the years from 2014 to 2017.

**Use of Estimates**—Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include net patient accounts receivable, malpractice, workers' compensation, litigation matters, post-retirement benefits and medical service claims incurred but not yet reported.

The preparation of 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Self-Insurance**—Baptist is self-insured for certain costs related to employee health, medical malpractice and workers' compensation programs. Costs resulting from noninsured losses are charged to income when incurred. Baptist purchases insurance that limits its exposure for individual claims. See Note 11 for additional information related to medical malpractice and workers' compensation programs. At August 31, 2018 and 2017, Baptist had \$13,240 and \$13,528 in self-insured employee health reserves recorded in the consolidated balance sheets in accrued expenses.

**Excess of Revenues, Gains and Other Support over Expenses**—The consolidated statements of operations includes excess of revenues, gains and other support over expenses before provision (benefit) from income tax. Changes in unrestricted net assets, which are excluded from excess of revenues, gains and other support over expenses, consistent with industry practice, include contributions of long-lived assets received or gifted (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), and net change in retirement plan-related items.

**Forthcoming Accounting Pronouncements**—In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." In August 2015, the FASB amended the guidance to defer the effective date of this standard by one year. ASU No. 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principle of the guidance in ASU No. 2014-09 is that an entity should 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. Baptist has substantially completed its evaluation of the requirements of the new standard which will be effective for Baptist beginning September 1, 2018. The modified retrospective method

will be used to adopt ASU No. 2014-09. For health care operations, Baptist will apply a portfolio approach to apply the new model to classes of payors with similar characteristics and will analyze cash collection trends over an appropriate collection look-back period, depending on the payor. Adoption of ASU No. 2014-09 will result in changes to the presentation disclosure of revenue related to uninsured or self-pay patients as under ASU No. 2014-09, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to unrestricted revenue and, correspondingly, result in a material reduction in the amounts presented separately as provision for bad debts. While the adoption of ASU No. 2014-09 will have a material effect on the presentation of unrestricted revenue in the consolidated statements of operations and will impact certain disclosures, it will not materially impact the financial position, results of operations or cash flows of Baptist.

In February 2016, the FASB issued ASU No. 2016-02, "Leases." This guidance introduces a lessee model that brings substantially all leases onto the consolidated balance sheet. The main difference between the guidance in ASU No. 2016-02 and current GAAP is the recognition of leased assets and liabilities by lessees for those leases classified as operating leases under current GAAP. Recognition of these leased assets and liabilities will have a material impact on Baptist's consolidated balance sheet upon adoption. This guidance is effective for Baptist beginning September 1, 2019. Baptist is still evaluating the impact this guidance will have on its 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 amends the requirements related to the presentation of the components of net periodic benefit cost in the statement of operations for an entity's sponsored defined benefit pension and other postretirement plans. This guidance is effective for Baptist beginning September 1, 2019. Baptist does not expect this guidance to have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, "Premium Amortization on Purchased Callable Debt Securities," which shortens the amortization period for certain callable debt securities held at a premium to be amortized to the earliest call date. Under current GAAP, the premium is generally amortized to the maturity date. This guidance is effective for Baptist beginning September 1, 2020. Baptist is still evaluating the impact this guidance may have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, "Presentation of Financial Statements of Not-For-Profit Entities." This guidance simplifies and improves how not-for-profit entities classify net assets as well as the information presented in financial statements and notes about liquidity, financial performance and cash flows. Specifically, this guidance reduces the three classifications of net assets on the balance sheet to two classifications. This guidance is effective for Baptist for the annual reporting period ending August 31, 2019 and for interim reporting periods beginning September 1, 2019. While the adoption of ASU No. 2016-14 will have a material effect on the amounts presented as categories in net assets in the consolidated statements of operations and changes in net assets and will add disclosures, it will not materially impact Baptist's financial position, results of operations or cash flows.

In November 2016, the FASB issued ASU No. 2016-18 "Restricted Cash," which adds and clarifies guidance in the presentation of changes in restricted cash on the statement of cash flows and requires restricted cash to be included with cash and cash equivalents in the statement of cash flows. This guidance does not provide a definition of restricted cash.

This guidance is effective for Baptist beginning September 1, 2019. Baptist is still evaluating the impact this guidance may have on the consolidated statements of cash flows.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments." This guidance adds and clarifies guidance on the classification of certain cash receipts and payments in the consolidated statement of cash flows. This guidance is effective for Baptist beginning September 1, 2019. Baptist is still evaluating the impact this guidance may have on its consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedging Activities." This guidance changes the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities; this guidance also simplifies the application of the hedge accounting guidance. This guidance is effective for Baptist beginning September 1, 2019. Baptist does not expect this guidance to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, which amends ASC 715 to add, remove, and clarify disclosure requirements related to defined benefit pension and other postretirement plans. Early adoption is permitted; however, all provisions of ASU 2018-14 must be adopted if early adoption is elected. A retrospective transition method is required. This guidance is effective for Baptist beginning September 1, 2021. Baptist is still evaluating whether this guidance will have a material impact on its consolidated financial statements.

### **3. BAPTIST ACQUISITIONS**

Effective October 1, 2016, Baptist acquired Floyd Memorial Hospital and Health Services, now called Baptist Health Floyd. The acquisition agreement includes capital investment commitments by Baptist in Baptist Health Floyd of \$140,000,000 over approximately eight years to expand services, invest in improved technologies and transition to Epic.

This business combination was accounted for using the purchase method of accounting in accordance with ASC 958-805, Acquisition by a Not-for-Profit Entity. The following table shows the purchase price for Baptist Health Floyd:

Cash paid	\$ 91,387
Loan from Floyd County	<u>61,000</u>
Total purchase price	<u>\$152,387</u>

The following table shows the allocation of the purchase price for Baptist Health Floyd to the acquired identifiable assets and liabilities:

Cash and cash equivalents	\$ 23,387
Current assets	51,316
Investments	20,977
Property and equipment	163,030
Other assets	7,697
Goodwill	<u>5,381</u>
 Assets acquired	 271,788
 Current liabilities	 (29,356)
Long-term debt	<u>(90,045)</u>
 Total purchase price	 <u>\$152,387</u>

On an unaudited pro forma basis, if Baptist had owned Baptist Health Floyd at the beginning of the year ended August 31, 2017 (September 1, 2016), Baptist Health Floyd would have contributed approximately \$347,943 of operating revenue and approximately \$4,142 of excess of revenue over expenses to fiscal 2017. Certain adjustments to the pro forma amounts of the excess of revenues over expenses for fiscal 2017 were recorded for the effect of removing the loss on extinguishment of debt and pension curtailment for \$11,990 and \$15,883, respectively, associated with the completion of the transaction. However, unaudited pro forma information is not necessarily indicative of the historical results that would have been obtained had the transaction actually occurred on those dates, or of future results.

The financial position of Baptist Health Floyd is included in the consolidated financial statements as of August 31, 2017, and the results of operations and cash flows are included for the period from October 1, 2016 to August 31, 2017. For the period October 1, 2016 through August 31, 2017, the operations of Baptist Health Floyd contributed \$270,405 in operating revenue and \$18,973 of excess of revenue over expenses to the consolidated results of operations.

No transaction expenses were recognized by Baptist in the accompanying consolidated financial statements.

Effective September 1, 2017, Baptist acquired Cumberland Valley Surgery Center, LLC. Baptist acquired 51% of the membership interests. This business combination was accounted for using the purchase method of accounting in accordance with ASC 958-805, Acquisition by a Not-for-Profit Entity. The purchase price for Cumberland Valley Surgery Center, LLC was \$4,335.

The following table shows the allocation of the purchase price for Cumberland Valley Surgery Center, LLC to the acquired identifiable assets and liabilities:

Current assets	\$ 373
Property and equipment	368
Goodwill	<u>8,029</u>
Assets acquired	8,770
Current liabilities	(270)
Non-controlling interest	<u>(4,165)</u>
Total purchase price	<u>\$ 4,335</u>

On an unaudited pro forma basis, if Baptist had owned Cumberland Valley Surgery Center at the beginning of the year ended August 31, 2017 (September 1, 2016), Cumberland Valley Surgery Center would have contributed approximately \$5,032 of operating revenue and approximately \$339 of excess of revenue over expenses to fiscal 2017. However, unaudited pro forma information is not necessarily indicative of the historical results that would have been obtained had the transaction actually occurred on those dates, or of future results.

The financial position of Cumberland Valley Surgery Center, LLC is included in the consolidated financial statements as of August 31, 2018, and the results of operations and cash flows are included for the period from September 1, 2017 to August 31, 2018. For the period September 1, 2017 through August 31, 2018, the operations of Cumberland Valley Surgery Center, LLC contributed \$5,805 in operating revenue and \$505 of excess of revenue over expenses to the consolidated results of operations.

No transaction expenses were recognized by Baptist in the accompanying consolidated financial statements.

#### 4. PATIENT SERVICE REVENUE

Patient service revenues are derived from services provided to patients who are directly responsible for payment or are covered by various insurance programs including the Medicare and Medicaid programs. Baptist has agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to Baptist under these agreements includes prospectively determined rates per discharge and/or per day, discounts from established charges, fee schedules and other methods.

Baptist recognizes patient service revenue associated with services provided to patients who have third-party payer coverage based on contractual rates for the services rendered. These payment arrangements include:

**Medicare**—Substantially all inpatient and outpatient services are paid at prospectively determined rates. These rates vary according to the patient classification system that is based on clinical, diagnostic, acuity and other factors. Baptist is also reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by Baptist and audits thereof by the Medicare administrative contractor.

**Medicaid**—Medicaid members are enrolled through a Managed Care Organization (MCO) or are covered by “traditional” Medicaid. Inpatient services are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for other services.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

**Other Third-Party Payers**—Baptist has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to Baptist under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

**Patient Liability**—Baptist recognizes patient deductible and co-payment revenue for patients who have third-party insurance. A provision for uncollectible accounts is recorded in the period of service based on its past experience, which indicates that some patients are unwilling or unable to pay the portion of their bill for which they are financially responsible.

Baptist recognizes patient service revenue associated with services provided to patients who do not have third-party payer coverage as follows:

**Uninsured Patients**—Baptist provides a significant discount from standard charges to all uninsured patients who receive medically necessary care. An uninsured discount provision is recorded in the period of service. The amount for which the patient is responsible is recognized as patient service revenue. A provision for uncollectible accounts is recorded in the period of service based on past experience for patients who are unwilling to pay the portion of their bill for which they are financially responsible.

**Charity Care**—Baptist offers financial assistance programs to patients who are unable to pay the portion of their bill for which they are financially responsible and records a provision for charity in the period of service based on a patient’s ability to pay. Baptist provides medically necessary services to all patients regardless of ability to pay. In accordance with Baptist’s policy, a patient is classified as a charity patient based on income eligibility criteria as established by the Federal Poverty Guidelines. Revenue for services to patients who meet the Baptist’s guidelines for charity care are not reflected in the accompanying consolidated financial statements.

The following table indicates patient service revenue by payer, net of contractual allowances, uninsured discounts and charity (but before the provision from uncollectible accounts) for the year ended August 31:

	<b>2018</b>	<b>2017</b>
Patient service revenue:		
Medicare	\$ 1,054,777	\$ 946,700
Medicaid	387,903	336,831
Other third-party payers	<u>1,076,032</u>	<u>1,135,531</u>
Total third-party payers	2,518,712	2,419,062
Patient liability <sup>(a)</sup>	<u>138,157</u>	<u>132,691</u>
Patient service revenue	<u>\$ 2,656,869</u>	<u>\$ 2,551,753</u>

(a) Patient liability represents revenue due from both insured patients for co-payments, patient deductibles and other services for which the patient's insurance has deemed the responsibility of the patient and from uninsured patients after the uninsured discount and applicable financial assistance. Revenue from patient liability is reported in this table prior to the provision for uncollectible accounts.

## 5. FUNCTIONAL EXPENSES

Baptist provides general health care services to residents within its geographic locations. Approximately 87% and 85% of Baptist's expenses relate to health care services for the years ended August 31, 2018 and 2017, respectively, and 13% and 15% of Baptist's expenses relate to general and administrative expenses for the years ended August 31, 2018 and 2017, respectively. Functional expenses consist of the following for the years ended August 31, 2018 and 2017:

	<b>2018</b>	<b>2017</b>
Health care services	\$ 2,305,200	\$ 2,343,934
General and administrative	<u>355,262</u>	<u>413,285</u>
Total expenses	<u>\$ 2,660,462</u>	<u>\$ 2,757,219</u>

## 6. CONCENTRATION OF CREDIT RISK

**Accounts Receivable**—The portion of accounts receivable due from patients (patient liability portion) is reduced by various allowances.

For receivables associated with uninsured patients who are receiving medically necessary care, Baptist provides a significant discount from standard charges and records a provision and allowance for uninsured discounts.

For receivables associated with patients who qualify for a government or Baptist sponsored financial assistance charity program, which includes both the portion of accounts due from uninsured patients after the Baptist uninsured discount and the portion due from insured patients which the patients third-party insurance did not cover (deductible and co-payment balances), Baptist records a provision and allowance for charity care.

For receivables associated with patients who do not qualify for a government or Baptist sponsored financial assistance charity program, Baptist records a provision and allowance for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients are unwilling to pay the portion of their bill for which they are financially responsible. The difference between the total amount due from the patient and the amount actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

Baptist's total allowances for uninsured discounts, charity and uncollectible accounts was 48% and 55% of the total patient liability portion of accounts receivable at August 31, 2018 and 2017, respectively.

The percentages of receivables from patients and third-party payers at August 31 were as follows:

	<b>2018</b>	<b>2017</b>
Net patient accounts receivable:		
Medicare	22.6 %	26.6 %
Medicaid	12.2	12.0
Other third-party payers	<u>43.2</u>	<u>45.1</u>
Total third-party payers	78.0	83.7
Patient liability <sup>(a)</sup>	<u>22.0</u>	<u>16.3</u>
Patient accounts receivable—net of allowance for uncollectible accounts	<u>100.0 %</u>	<u>100.0 %</u>

<sup>(a)</sup> Patient liability represents revenue due from both insured patients for co-payments, patient deductibles and other services for which the patient's insurance has deemed the responsibility of the patient, less an allowance for uncollectible amounts, and from uninsured patients after the uninsured discount and applicable financial assistance.

## 7. INVESTMENTS, ASSETS LIMITED AS TO USE OR RESTRICTED AND INVESTMENT INCOME

Investments and assets limited as to use or restricted consists of the following as of August 31, 2018 and 2017:

### *Investments*

	<b>2018</b>	<b>2017</b>
Mutual funds	\$ 9,187	\$ 17,129
US treasury and agency obligations	2,095	11,080
US and foreign common and preferred stocks	4,389	3,647
US and foreign corporate bonds	<u>177,669</u>	<u>175,319</u>
Total investments	<u>\$193,340</u>	<u>\$207,175</u>

### *Assets Limited as to Use or Restricted*

	<b>2018</b>	<b>2017</b>
Designated by board for capital improvements	<u>\$ 981,764</u>	<u>\$819,340</u>
Designated by board for endowment <sup>(a)</sup>	<u>3,166</u>	<u>2,897</u>
Held by trustee or restricted:		
Under bond indenture agreements—certificate of deposit and other cash equivalents	751	16,482
Donor restricted	5,530	4,600
Under medical malpractice self-insurance funding arrangement—mutual funds	78,910	67,053
Under workers' compensation self-insurance funding arrangement <sup>(b)</sup>	21,080	20,560
In perpetual trust	<u>23,674</u>	<u>21,737</u>
Total held by trustee	<u>129,945</u>	<u>130,432</u>
Total assets limited as to use or restricted	1,114,875	952,669
Less amount required for current obligations	<u>(22,881)</u>	<u>(20,775)</u>
Assets limited as to use or restricted	<u>\$1,091,994</u>	<u>\$931,894</u>

<sup>(a)</sup> Assets designated by board for endowment are invested in securities in the same proportion as assets designated by board for capital improvements.

- (b) Assets under workers' compensation self-insurance funding arrangement are invested in securities in the same proportion as assets designated by board for capital improvements.

**Investment Income**—Total investment income for assets whose use is limited and investments are reflected in the consolidated statements of operations and are comprised of the following for the years ended August 31, 2018 and 2017:

	<b>2018</b>	<b>2017</b>
Other operating revenue:		
Interest and dividend income of BHP	\$ 700	\$ 1,186
Realized gains on sale of securities of BHP	<u>3,588</u>	<u>1,577</u>
Net investment income reported in other revenue	<u>4,288</u>	<u>2,763</u>
Other income:		
Interest and dividend income	19,050	15,518
Realized gains on sale of securities	24,957	43,717
Change in net unrealized gains	<u>35,536</u>	<u>11,684</u>
Net investment income reported in other income	<u>79,543</u>	<u>70,919</u>
Total investment income	<u><u>\$83,831</u></u>	<u><u>\$73,682</u></u>

Interest, dividend income and realized gains on sale of securities related to BHP operations are reported as other operating revenue based on the nature of their business as a health maintenance organization. Interest, dividend income and realized gains for the remainder of Baptist along with all unrealized gains are reported in other income (loss) in the accompanying consolidated statements of operations.

Certain investments in debt and marketable equity securities are reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at August 31, 2018 and 2017, was \$319,757 and \$239,923, which is approximately 24% and 21%, of the investment portfolio, respectively.

In the normal course of operations and within Baptist investment guidelines, Baptist's investment managers may enter into various exchange-traded and over-the-counter derivative contracts for trading purposes, including futures, options, forward contracts and swaps. Gains or losses, and changes in the fair value of these investments, which were immaterial for the years ended August 31, 2018 and 2017, respectively, are included in total investment income within the consolidated statements of operations.

These instruments are used primarily to adjust the portfolio duration, restructure term structure exposure, change sector exposure, and arbitrage market inefficiencies. See the Fair Value of Assets and Liabilities note for a discussion of how fair value for derivatives is determined.

Collateral posted for derivative investments consists of cash and cash equivalents. Collateral as of August 31, 2018 and 2017 was \$938 and \$1,849, respectively, and is reported in assets whose use is limited.

Baptist offsets the fair value of certain derivative investment instruments when executed with the same counterparty under a master netting arrangement. Baptist invests in a variety of derivative investment instruments through an investment manager that has executed a master netting arrangement with the counterparties of each of its contracts whereby the financial instruments held by the same counterparty are legally offset as the instruments are settled.

At August 31, 2018 and 2017, the gross notional amount of derivative investments in an asset position was 1,886,107,304 and 598,386,132, respectively and the gross notional amount of derivative investments in a liability position was 2,087,022,547 and 369,029,830, respectively primarily composed of offsetting foreign currency forwards related to the Mexican PESO, Canadian dollar, Australian dollar, Japanese YEN and Euros. Futures and interest rate swaps are cash settled on a daily basis and, accordingly, have a \$0 value for asset and liability positions for the periods presented. The net notional and related fair value of positions offset within the consolidated balance sheets at August 31, 2018 and 2017 include the following:

<b>2018</b>	<b>Notional</b>	<b>Asset</b>	<b>Liability</b>
Foreign currency forwards	(939,815,244)	\$24,126	\$(23,962)
Interest rate swaps	47,000,000		
Futures	667,100,000		
Mortgage forwards	8,200,000	8,145	(8,137)
Options	<u>16,600,000</u>	<u>26</u>	<u>(28)</u>
Total	<u>(200,915,244)</u>	<u>\$32,297</u>	<u>\$(32,127)</u>
<b>2017</b>	<b>Notional</b>	<b>Asset</b>	<b>Liability</b>
Foreign currency forwards	(27,843,698)	\$23,399	\$(23,162)
Credit swaps	2,100,000		(2)
Interest rate swaps	95,900,000		
Futures	151,000,000		
Mortgage forwards	<u>8,200,000</u>	<u>16,924</u>	<u>(16,892)</u>
Total	<u>229,356,302</u>	<u>\$40,323</u>	<u>\$(40,056)</u>

Baptist also has certain futures contracts that are not subject to a master netting agreement and therefore are not presented net within the consolidated balance sheets. At August 31, 2018 and 2017, the gross notional amount of these futures in an asset position was 584,923,232 and 111,062,561 and the gross notional amount of these futures in a liability position was 54,900,000 and 78,600,000. The fair value of these positions was \$1,368 and \$1,750 as of August 31, 2018 and 2017, respectively. The majority of the positions cash-settle on a daily basis.

At August 31, 2018 and 2017, Baptist had pending trade receivables of \$299 and \$912 reported in other current assets and pending trade payables of \$17,316 and \$28,225, respectively, reported in other current liabilities.

## 8. BENEFICIAL INTEREST IN PERPETUAL TRUSTS

Baptist is an income beneficiary of several perpetual trusts controlled by unrelated third-party trustees. The beneficial interests in the assets of these trusts are included in Baptist's consolidated financial statements as permanently restricted net assets. Trust income is distributed in accordance with the individual trust documents and is included in investment income. The fair value of asset of \$23,674 and \$21,737 is based on the fair value of the underlying perpetual trust assets at August 31, 2018 and 2017, respectively. Trust income distributed to Baptist for the year ended August 31, 2018 and 2017, was \$925 and \$781, respectively.

## 9. FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs.

There is a hierarchy of three levels of inputs that may be used to measure fair value:

**Level 1**—Quoted prices in active markets for identical assets or liabilities.

**Level 2**—Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3**—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

There were no significant transfers between Levels 1 and 2 during the years ended August 31, 2018 and 2017.

**Recurring Measurements**—The following table presents the fair value measurements of assets and liabilities recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at August 31, 2018 and 2017.

### **Investments**

<b>2018</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Mutual funds—equity	\$ 9,187	\$ -	\$ -	\$ 9,187
U.S. treasury and agency obligations		2,095		2,095
U.S. and foreign common and preferred stock	4,389			4,389
U.S. and foreign corporate bonds		177,669		177,669
Investments	<u>\$13,576</u>	<u>\$179,764</u>	<u>\$ -</u>	<u>\$193,340</u>

<b>2017</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Mutual funds—equity	\$17,129	\$ -	\$ -	\$ 17,129
U.S. treasury and agency obligations		11,080		11,080
U.S. and foreign common and preferred stock	3,647			3,647
U.S. and foreign corporate bonds		<u>175,319</u>		<u>175,319</u>
Investments	<u>\$20,776</u>	<u>\$186,399</u>	<u>\$ -</u>	<u>\$207,175</u>

***Assets Limited as to Use or Restricted***

<b>2018</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Cash equivalents	\$ 123,746	\$ -	\$ -	\$ 123,746
Exchange traded/mutual funds:				
Balanced	34,859			34,859
Equity	60,431			60,431
Fixed income	10,304			10,304
U.S. Treasury and agency obligations		128,653		128,653
U.S. common and preferred stocks	180,725			180,725
Foreign common and preferred stock	7,770			7,770
U.S. corporate bonds		292,516		292,516
Foreign corporate bonds		80,422		80,422
Derivative investments—net		1,538		1,538
Perpetual trust		<u>23,674</u>		<u>23,674</u>
Assets limited as to use or restricted at fair value	<u>\$417,835</u>	<u>\$526,803</u>	<u>\$ -</u>	944,638
Commingled fund at net asset value				<u>170,237</u>
Assets limited as to use or restricted				<u>\$1,114,875</u>

<b>2017</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Cash equivalents	\$ 43,598	\$ -	\$ -	\$ 43,598
Exchange traded/mutual funds:				
Balanced	34,394			34,394
Equity	70,407			70,407
Fixed income	12,636			12,636
U.S. Treasury and agency obligations		157,901		157,901
U.S. common and preferred stocks	151,917			151,917
Foreign common and preferred stock	8,178			8,178
U.S. corporate bonds		238,759		238,759
Foreign corporate bonds		68,804		68,804
Derivative investments—net		2,017		2,017
Perpetual trust		<u>21,737</u>		<u>21,737</u>
Assets limited as to use or restricted at fair value	<u>\$321,130</u>	<u>\$489,218</u>	<u>\$ -</u>	810,348
Commingled fund at net asset value				<u>142,321</u>
Assets limited as to use or restricted				<u>\$ 952,669</u>

Following is a description of the inputs and valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the years ended August 31, 2018 and 2017.

**Cash Equivalents**—The carrying amount is fair value.

**Commingled Fund**—The commingled fund is developed for investment by institutional investors only and therefore does not require registration with the Securities and Exchange Commission. The commingled fund is valued at net asset value of the underlying investments. The net asset value, as provided by the trustee, is used as a practical expedient to estimate fair value. There are no participant restrictions for these investments, and redemptions can be processed daily from the fund. There are no unfunded commitments.

**Exchange Traded/Mutual Funds**—Exchange traded funds are valued at the closing price reported on the applicable exchange on which the fund is traded, or estimated using quoted market prices for similar securities. Mutual funds are valued using the net asset value based on the value of the underlying assets owned by the fund, minus liabilities, divided by the number of shares outstanding, and multiplied by the number of shares owned. Accordingly, exchange traded funds and mutual funds are classified as Level 1 investments.

**Equity Securities**—Equity securities are valued at the closing price reported on the applicable exchange on which the security is traded. Accordingly, equity securities are classified as Level 1 investments.

**Debt Securities**—Debt securities are valued using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. As these models are primarily industry-standard models that consider various assumptions, including time value and yield curve as well as other relevant economic measures. Accordingly, debt securities are classified as Level 2 investments.

**Derivative Investments**—Derivative investments include derivative assets and derivative liabilities, whose fair value is primarily determined using techniques consistent with the market approach. Significant observable inputs to valuation models include interest rates, Treasury yields, volatilities, credit spreads, maturity, and recovery rates. Accordingly, derivative investments are classified as Level 2 investments.

**Perpetual Trust**—For beneficial interest in perpetual trust, fair value is based on the fair value of the underlying assets of the trust. Due to the nature of the valuation inputs the interest is classified within Level 2 of the hierarchy.

Where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the valuation hierarchy. Baptist does not hold Level 3 securities.

**Fair Value of Other Financial Instruments**—The following table presents estimated fair values of Baptist’s financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at August 31, 2018 and 2017:

	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>2018</b>				
Long-term debt	\$959,910	\$ -	\$ 990,326	\$ -
<b>2017</b>				
Long-term debt	\$977,045	\$ -	\$ 1,025,730	\$ -

**Long-Term Debt**—Fair value is estimated based on the borrowing rates currently available to Baptist for bank loans with similar terms and maturities

Carrying value approximates fair value for accounts receivable and accounts payable and all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**—Assets and liabilities recognized or disclosed at fair value on a nonrecurring basis include items such as property, plant and equipment and goodwill. These assets are measured at fair value if determined to be impaired. Impairment of goodwill is included at Note 2, Summary of Significant Accounting Policies. Goodwill has been determined to be a Level 3 fair value measurement.

## 10. PROPERTY AND EQUIPMENT—NET

	2018	2017
Land and land improvements	\$ 158,223	\$ 161,718
Buildings and leasehold improvements	1,345,066	1,363,548
Equipment	1,082,193	1,204,416
Construction in progress	42,859	50,104
Total	2,628,341	2,779,786
Less accumulated depreciation	1,395,835	1,506,354
Property and equipment—net	<u>\$ 1,232,506</u>	<u>\$ 1,273,432</u>

Internal use software is included in equipment in the table above. Original cost and accumulated depreciation were \$182,670 and \$80,063 as of August 31, 2018 and \$226,337 and \$107,683 as of August 31, 2017.

As of August 31, 2018, Baptist entered into non-cancellable contractual agreements for the purchase of equipment and the construction of hospital facilities for approximately \$27,533.

## **11. COMMITMENTS AND CONTINGENCIES**

Baptist is party to various legal matters arising in the ordinary course of business including patient-care related claims and litigation. Some of these allegations are in areas not covered by Baptist's self-insurance program or by commercial insurance. Based on the advice and assistance from professional and legal counsel, Baptist assesses the probable outcome of unresolved litigation and records an estimate of the ultimate expected loss. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term. Baptist believes that the resolution of such matters will not result in liability materially in excess of accounting accruals established with respect to such matters.

Baptist is self-insured with respect to medical malpractice risks and has established an irrevocable trust fund for the payment of medical malpractice claim settlements. Professional insurance consultants have been retained to assist Baptist in determining liability amounts to be recognized, as well as amounts to be deposited into the trust fund.

Baptist's self-insured limits are \$4,000 per occurrence and not to exceed \$16,000 in the aggregate for all Baptist hospitals. Baptist is self-insured for the first \$1,000 up to \$3,000 in the aggregate for the majority of its physician practices. Baptist participates in the American Excess Insurance Exchange (AEIX), Risk Retention Group, a Vermont-chartered "captive" insurance company organized as a reciprocal for coverage above the self-insurance limits. Baptist currently has an 8.22% ownership in AEIX, the value of which is reported using the equity method of accounting and which is not material to the accompanying consolidated financial statements.

As of October 1, 2016, Baptist Health Floyd merged into the trust and became insured for tail occurrence based claims and all new claims-made based claims. Prior to October 1, 2016, Baptist Health Floyd was self-insured for the first \$250 per occurrence and \$750 in the aggregate through the Risk Retention Group under a claims-made policy. The Risk Retention Group policy was cancelled effective September 30, 2016.

Related to the Baptist Health Floyd operations, the Indiana Malpractice Act (Act) limits professional liability for claims prior to July 1, 1999, to a maximum recovery of \$750 per occurrence (\$3,000 annual aggregate), \$100 of which would be paid through malpractice insurance coverage and the balance would be paid by the State of Indiana Patient Compensation Fund (Fund). For claims on or after July 1, 1999 through June 30, 2017, the maximum recovery is \$1,250 per occurrence (\$7,500 annual aggregate), \$250 of which would be paid through self-insurance coverage and the remainder by the Fund. From June 1, 2017 forward, the maximum recovery \$1,650 per occurrence (\$7,500 annual aggregate), \$400 of which would be paid through self-insurance coverage and the remainder by the Fund.

The total current liability for medical malpractice claims reported and claims incurred but not reported was approximately \$17,000 and \$14,900 at August 31, 2018 and 2017, respectively. The total long-term liability for medical malpractice claims reported and claims incurred but not reported was approximately \$119,570 and \$106,922 at August 31, 2018 and 2017, respectively, and is included in other long-term liabilities in the consolidated balance sheets. Net malpractice expense recognized was approximately \$34,969 and \$19,290 for the years ended August 31, 2018 and 2017, respectively.

Earnings on investments of the malpractice self-insurance trust funds amounted to approximately \$3,418 and \$1,795 for the years ended August 31, 2018 and 2017, respectively.

Baptist is self-insured with respect to workers' compensation risks and has established an irrevocable trust fund for the payment of workers' compensation claim settlements. Professional insurance consultants have been retained to assist Baptist in determining liability amounts to be recognized, as well as amounts to be deposited into the trust fund.

The total current liability for incurred and incurred but not reported workers' compensation claims and related costs of settlement was approximately \$5,881 and \$5,875 at August 31, 2018 and 2017, respectively. The total long-term liability for incurred and incurred but not reported workers' compensation claims and related costs of settlement was approximately \$13,710 and \$13,060 at August 31, 2018 and 2017, respectively, and is included in other long-term liabilities in the consolidated financial statements. Net workers' compensation expense recognized was approximately \$6,395 and \$4,909 for the years ended August 31, 2018 and 2017, respectively.

## 12. LONG-TERM DEBT

The bonds are collateralized by a pledge of revenues of the obligated group. Prior to September 1, 2016, the obligated group consists of Baptist Healthcare System, Inc., which encompasses five hospitals (Baptist Health Corbin, Baptist Health LaGrange, Baptist Health Lexington, Baptist Health Louisville, and Baptist Health Paducah) and corporate system services. On September 1, 2016 the obligated group was expanded to include the addition of BHMG, Baptist Health Richmond, Inc. and Baptist Health Madisonville, Inc. On October 1, 2016, the obligated group was expanded to include Baptist Health Floyd. The agreements also contain several covenants, the most significant of which places limitations on additional indebtedness.

	<b>2018</b>	<b>2017</b>
Revenue Bonds, Series 2009A <sup>(A)</sup>	\$ -	\$ 136,570
Revenue Bonds Series 2009B <sup>(B)</sup>	284,435	284,435
Revenue Bonds, Series 2011 <sup>(C)</sup>	140,000	140,000
Revenue Bonds, Series 2015A <sup>(D)</sup>	14,050	16,380
Revenue Bonds, Series 2016A <sup>(E)</sup>	41,330	42,445
Floyd County Note, 2016 <sup>(F)</sup>	48,800	54,900
Revenue Bonds, Series 2017A <sup>(G)</sup>	84,410	84,410
Revenue Bonds, Series 2017B <sup>(H)</sup>	217,905	217,905
Revenue Bonds, Series 2018A <sup>(I)</sup>	<u>128,980</u>	<u>          </u>
Total debt	959,910	977,045
Less current installments of long-term debt	(9,625)	(21,795)
Plus unamortized premium (less discount)	18,169	18,115
Less unamortized debt issuance costs	<u>(8,256)</u>	<u>(7,422)</u>
Total long-term debt	<u>\$ 960,198</u>	<u>\$ 965,943</u>

<sup>(A)</sup> The Series 2009A Revenue Bonds were issued on February 19, 2009, to redeem the Series 1999A Bonds and to deposit \$99,287 into the project fund used to reimburse Baptist for the costs of acquiring and constructing hospital facilities and equipment. Interest on the bonds is fixed and is payable semi-annually on each February 15 and August 15, commencing August 15, 2009. Interest rates range from 3.00% to 5.625%.

- Principal payments began August 2011 with a maturity date of August 2027. On December 28, 2017, Baptist used the proceeds from the Series 2017C Bonds to extinguish \$62,165 of the Series 2009A Bonds. Baptist recorded a loss on debt extinguishment of \$2,244.
- (B) The Series 2009B Variable Rate Demand Hospital Revenue Bonds were issued on February 19, 2009. Principal payments begin August 2027 through August 2038.
- (C) Effective July 1, 2015, Baptist entered into bond purchase agreements with U.S. Bank (Series 2009 B-1 Bonds for \$66,065), Bank of America Merrill Lynch (BAML) (2009 Series B-2 Bonds for \$65,660) and BB&T (2009 Series B-3 and Series B-4 for \$76,555 and \$76,155, respectively) in order to replace its existing bank facilities with longer tenor facilities to reduce refinancing risk, lower spreads and remove daily/weekly put risk. The Series 2009 Bonds were converted from variable rate demand bonds to a variable rate Bank Mode (direct bank purchase). The initial term for each bank is 10 years and matures effective June 30, 2025. Interest cost for the Series 2009 B Bonds is based on a percentage of the London Interbank Offered Rate (LIBOR) and a fee expressed in basis points payable to each bank. Interest rates for the 2009B Bonds ranged from 1.41% to 2.12% at August 31, 2018 and from 0.83% to 2.12% during 2018.
- (C) The Series 2011 Fixed Rate Hospital Revenue Bonds were issued on December 15, 2011, in the amount of \$140,000 to pay or reimburse Baptist for the costs of certain hospital projects, including a portion of the costs of constructing and equipping a new seven-story, approximately 400,000 square foot medical structure connected to the existing hospital building at Baptist Health Lexington. Principal payments for the 2042 term bond in the amount of \$63,060 will begin August 15, 2039, with a maturity date of August 15, 2042. The 2042 term bonds bear an interest rate of 5.00%. Principal payments for 2046 term bond in the amount of \$76,940 will begin August 15, 2043, with a maturity date of August 15, 2046. The 2046 bonds bear an interest rate of 5.25%. Interest on the bonds is fixed and is payable semi-annually on each February 15 and August 15.
- (D) The Series 2015A Bonds were directly purchased by U.S. Bank on December 15, 2015, in the amount of \$18,683 to refinance the Series 2010 Variable Rate Demand Hospital Revenue Bonds issued by Baptist Health Madisonville, with a maturity date of August 15, 2024. Interest cost for the Series 2015A Bonds is based on a percentage of the London Interbank Offered Rate (LIBOR) and a fee expressed in basis points payable to U.S. Bank. The interest rate for the 2015A Bonds was 1.31% on August 31, 2018 and from 0.83% to 1.40% during 2018.
- (E) The Series 2016A Bonds were issued on September 30, 2016 in the amount of \$43,365 primarily used for the reissuance and redesignation of the 2012 bonds (originally issued by Floyd Memorial). The 2016A bonds are subject to retirement in varying principal amounts through 2036. Interest cost for the Series 2016A Bonds is based on a percentage of LIBOR plus 1.39%. The interest rates for the 2016A Bonds ranged from 1.40% to 2.42% at August 31, 2018.
- (F) The Floyd County Note was issued September 30, 2016 with a maturity date of January 1, 2026. Principal of \$6,100 is due annually on January 1. Interest is set annually based on the 10 year US Treasury rate plus 50 basis points. Interest is paid annually each January. Interest rates for the Floyd County Note was 2.10% at August 31, 2018 and ranged from 2.10% to 2.45% during 2018. On or after January 1, 2019, Floyd County has the right to put the Floyd County Note at a price equal to the unpaid principal amount together with all accrued and unpaid interest and all other sums due under the Floyd County Note at any time after at least one year prior written notice to Baptist. The entire amount of the unpaid principal amount together with all accrued and unpaid interest and all other sums due under the Floyd County Note that remain unpaid shall be due on the later of the date specified in the notice or the date that is one year following the date the notice is received by Baptist.
- (G) The Series 2017A Bonds were issued on May 31, 2017 in the amount of \$84,410 primarily for the purpose of refinancing a portion of the original bridge loan of \$146,600 used as part of the financing of the Baptist Health Floyd acquisition and to pay all or a portion of the costs of issuance. The bonds were issued with an original issue premium of \$5,408 which is being amortized over the term of the related obligations. Interest on the bonds is fixed and is payable semi-annually on each February 15 and August 15, commencing August 15, 2017. Interest is fixed at 5%. Principal payments begin August 2047 with a maturity date of August 2051.
- (H) The Series 2017B Bonds were issued on May 31, 2017 in the amount of \$217,905 primarily for the purpose of paying and reimbursing the costs of construction, acquisition, installation, renovation and equipping health care and health related properties and facilities and to pay all or a portion of the costs of issuance. The bonds were issued with a net original issue premium of \$17,022 which is being amortized over the term of the related obligations. Interest on the bonds is fixed and is payable semi annually on each February 15 and August 15, commencing August 15, 2017. Interest rates range from 3.75% to 5.00%. Principal payments begin August 2027 with a maturity date of August 2046.
- (I) The Series 2017C Bonds were issued on December 28, 2017 in the aggregate principal amount of \$65,245 for the benefit of Baptist. Baptist used the proceeds of the Series 2017C Bonds to extinguish a portion of the Series 2009A Bonds and to pay the costs of issuance associated with the Series 2017C Bonds. The Series 2017C Bonds were initially issued in an Index Rate mode and placed with Bank of America, N.A for an

Initial Period ending June 28, 2018, at a rate equal to 1.75%. Baptist recorded a loss on the debt extinguishment of \$2,244. The Series 2017C Bonds were refinanced in conjunction with the issuance of the Series 2018A Bonds. See note (J) below.

- <sup>(1)</sup> The Series 2018A Bonds were issued on August 17, 2018 in the aggregate principal amount of \$128,980. Baptist used the proceeds of the Series 2018A Bonds to extinguish both the remaining portion of the Series 2009 Bonds outstanding as well as the Series 2017C Bonds. Baptist recorded a loss on the refinancing of \$659. Interest on the bonds is fixed at 5.079% and is payable semi-annually on each February and August 15, commencing February 15, 2019. The Series 2018A Bonds have a lump-sum payment of principal due on August 15, 2048.

The aggregate amount at August 31, 2018, of required funding for principal payments of long-term debt is as follows:

	<b>Amount</b>
2019	\$ 9,625
2020	9,675
2021	9,785
2022	9,785
2023	10,180
Thereafter	<u>910,860</u>
 Total	 <u>\$959,910</u>

### **13. LEASES AND INSTALLMENT PAYABLE**

Baptist has certain equipment that is leased under non-cancellable operating leases with terms greater than one year. Rental expense under operating leases was \$24,791 and \$26,369 for the year ended August 31, 2018 and 2017 respectively.

As of August 31, 2018, future minimum rental payments under non-cancellable operating leases are as follows:

	<b>Amount</b>
2019	\$13,210
2020	7,660
2021	5,297
2022	3,630
2023	2,498
Thereafter	<u>7,535</u>
 Total	 <u>\$39,830</u>

Baptist leases certain facilities and equipment under capital leases. Minimum payments under capital leases for the next five years are as follows: \$791 in each of the years from 2019-2023 and \$1,846 thereafter. The capital lease obligation is included in other long-term liabilities (less current portion) in the consolidated balance sheets.

Baptist purchased its electronic health record system through an installment payable. Minimum payments under the installment payable are \$2,925 in 2019. The installment payable is included in other current liabilities in the consolidated balance sheets.

#### **14. EMPLOYEE BENEFIT AND RETIREMENT PLANS**

Baptist employees who meet eligibility requirements are covered by a Retirement Accumulation Plan (RAP), which includes a defined contribution plan funded entirely by Baptist and a 401(k) plan to which the employees of BHP are the only participants permitted to make 401(k) deferrals. The finance committee of the board of directors of Baptist controls and manages the operation of the RAP. Participants are immediately fully vested in participant contributions and related earnings and are fully vested in Baptist contributions after five years of service, or after reaching age 65, whichever occurs first. Contributions by Baptist to the RAP were approximately \$140 and \$270 for the years ended August 31, 2018 and 2017, respectively.

Baptist offers a Thrift 403(b) Plan to which employees may defer up to 10% of their earnings on a pre-tax basis. Baptist matches fifty cents on each dollar for the first 6% of the employees' contributions. Employees are immediately vested in their contributions and related earnings. Employee vesting in employer contributions is graduated with full vesting after five years.

Baptist Health Richmond has a noncontributory defined benefit pension plan covering substantially all of its employees employed prior to 2005 (the "Pension"). Baptist Health Richmond's funding policy is to make the minimum annual contribution that is required by applicable regulations. Effective December 31, 2004, the defined benefit pension plan was frozen and does not allow any new participants. Effective December 31, 2007, Baptist Health Richmond resolved to freeze the accrued benefits of the defined benefit plan as part of its plan to restructure employee benefits of its employees. Baptist expects to contribute approximately \$802 to the Pension in 2019.

Baptist has a post-retirement benefit plan covering all employees who meet the eligibility requirements (the "Post Retirement" plan). The Post Retirement plan provides for a continuation of medical benefits until the retiree reaches the age of 65 and for death benefits that vary with retirement date and position.

The Post Retirement medical benefits plan is contributory, with retiree contributions adjusted annually. Funding by Baptist is on a cash basis as benefits are paid. Baptist contributed approximately \$2,741 and \$2,627 for the years ended August 31, 2018 and 2017, respectively. Baptist expects to contribute approximately \$2,231 to the plan in 2019.

Baptist Health uses an August 31 measurement date for the Plans. Information about the Plans' funded status follows:

### Change in Accumulated Benefit Obligation

	<u>Pension</u>		<u>Post Retirement</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Accumulated benefit obligation—beginning of year	\$ 22,449	\$ 22,839	\$ 30,060	\$ 30,876
Service cost			628	660
Interest cost	815	791	1,181	1,138
Amortization of loss			1,315	1,421
Net periodic benefit cost	815	791	3,124	3,219
Employer contributions			(2,741)	(2,627)
Net plan expense	815	791	383	592
Amortization of loss			(1,315)	(1,421)
Net loss arising during the period			(1,573)	13
Change in unrestricted net assets	-	-	(2,888)	(1,408)
Actuarial (gain)	(1,111)	(358)		
Benefits paid	(886)	(823)		
Accumulated benefit obligation—end of year	\$ 21,267	\$ 22,449	\$ 27,555	\$ 30,060

### Changes in Plan Assets

	<u>Pension</u>		<u>Post Retirement</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Fair value—beginning of year	\$ 15,009	\$ 14,461	\$ -	\$ -
Actual return on plan assets	865	880		
Employer contributions	621	491	2,741	2,627
Benefits paid	(886)	(823)	(2,741)	(2,627)
Fair value—end of year	\$ 15,609	\$ 15,009	\$ -	\$ -

### Plan Obligations and Funded Status

	<u>Pension</u>		<u>Post Retirement</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Benefit obligation	\$ (21,267)	\$ (22,449)	\$ (27,555)	\$ (30,060)
Fair value of plan assets	15,609	15,009		
Funded status	\$ (5,658)	\$ (7,440)	\$ (27,555)	\$ (30,060)

### Liabilities Recognized in the Consolidated Balance Sheets

	<u>Pension</u>		<u>Post Retirement</u>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Accrued expenses—current	\$ -	\$ -	\$ 2,421	\$ 2,564
Other liabilities—noncurrent	<u>5,658</u>	<u>7,440</u>	<u>25,134</u>	<u>27,496</u>
Total liabilities	<u>\$5,658</u>	<u>\$7,440</u>	<u>\$27,555</u>	<u>\$30,060</u>

### Amounts Recognized in Unrestricted Net Assets

	<u>Pension</u>		<u>Post Retirement</u>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Net gain (loss)	\$ 701	\$ (574)	\$ -	\$ -
Accumulated contributions in excess of net periodic benefit cost	<u>(6,359)</u>	<u>(6,866)</u>	<u>(12,759)</u>	<u>(15,647)</u>
Net amount recognized in unrestricted net assets	<u>\$(5,658)</u>	<u>\$(7,440)</u>	<u>\$(12,759)</u>	<u>\$(15,647)</u>

### Amounts Recognized as Components of Net Periodic Benefit Cost Consist of

	<u>Pension</u>		<u>Post Retirement</u>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Service cost	\$ -	\$ -	\$ 628	\$ 660
Interest cost	815	791	1,181	1,138
Amortization of loss			1,315	1,421
Expected return on plan assets	<u>(701)</u>	<u>(673)</u>		
Net periodic benefit cost	<u>\$ 114</u>	<u>\$ 118</u>	<u>\$3,124</u>	<u>\$3,219</u>

There are no estimated net losses, prior service cost and transition obligation for the defined benefit pension plan to be amortized to net periodic benefit cost over the next fiscal year.

### Significant Assumptions Include

	<u>Pension</u>		<u>Post Retirement</u>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Weighted-average assumptions to determine benefit obligation—discount rate	4.22 %	3.73 %	4.22 %	3.82 %
Assumptions to determine net cost:				
Discount rate	3.73 %	3.55 %	3.73 %	3.63 %
Expected return on plan assets	4.75	4.75		

For measurement purposes, a 6.06% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended August 31, 2018. The rate was assumed to decrease gradually to 4.50% by the year 2037 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the post-retirement plan costs and benefit obligation. A one-percentage-point increase in assumed health care cost trend rates would have the following effects:

	<b>Post Retirement</b>	
	<b>2018</b>	<b>2017</b>
Effect on total of service cost and interest cost	\$ 45	\$ 35
Effect on post-retirement benefit obligation	881	776

Assumed health care cost trend rates have a significant effect on the amounts reported for the post-retirement plan costs and benefit obligation. A one-percentage-point decrease in assumed health care cost trend rates would have the following effects:

	<b>Post Retirement</b>	
	<b>2018</b>	<b>2017</b>
Effect on total of service cost and interest cost	\$ (40)	\$ (33)
Effect on post-retirement benefit obligation	(780)	(736)

**Pension Plan Assets**—Valuation technologies maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for pension plan assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of pension plan assets pursuant to the valuation hierarchy. There have been no changes in the methodologies used at August 31, 2018 and 2017.

**Mutual Funds**—Valued at the daily closing price as reported by the fund. Mutual funds held by the Plan are open-ended mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the pension plan are deemed to be actively traded.

**Insurance Immediate Participation Contract**—The immediate participation guarantee contract is stated at contract value. Contract value represents contributions made under the contract, plus interest at the contract rate, less funds used to purchase annuities and pay administrative expenses. New York Life matches similar groups of its contractual liabilities with assets to support those liabilities through segmentation of its general account, which is comprised of a variety of investments. Investment income earned by those segmented assets is then allocated directly to that segment. The immediate participation guarantee contract is comprised of two funds, the fixed dollar fund and the pension fund. The pension fund is subject to a minimum balance provision based upon the aggregate estimated present values of all pension benefits to which pensioners are entitled under the contract. Any amounts needed to maintain the minimum balance are transferred from the mutual fund portion of Plan assets. Interest is credited at the rate used to calculate the minimum balance as of the preceding December 31. Such rate is determined based on the rate of investment income earned by New York Life since the preceding December 31.

**Transfers Between Levels**—The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, transfers are reported at the beginning of the reporting period.

We evaluate the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total net assets available for benefits. There were no transfers between levels for the years ended August 31, 2018 and 2017.

The following tables set forth by level, within the fair value hierarchy, the pension plan's assets at fair value as of August 31, 2018 and 2017:

2018 Asset Class	Fair Value Measurements Using			
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mutual funds (A)	\$ 2,460	<u>\$2,460</u>	<u>\$ -</u>	<u>\$ -</u>
Immediate participation guarantee contract at contract value	<u>13,149</u>			
Total assets	<u>\$15,609</u>			

88% invested in common stock and 12% invested in fixed income.

2017 Asset Class	Fair Value Measurements Using			
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mutual funds (A)	\$ 2,834	<u>\$2,834</u>	<u>\$ -</u>	<u>\$ -</u>
Immediate participation guarantee contract at contract value	<u>12,175</u>			
Total assets	<u>\$15,009</u>			

87% invested in common stock and 13% invested in fixed income.

The primary investment objective of the Plan is to maximize long-term investment returns recognizing the need to preserve capital, and provide retirement income to plan participants and beneficiaries. Assets are allocated within asset classes and across investment categories to enhance investment return and reduce risk. A long-term time horizon is used for evaluating investment performance.

The following benefit payments are expected to be paid as of August 31:

	<b>Pension</b>	<b>Post Retirement</b>
2019	\$1,190	\$2,421
2020	1,231	2,280
2021	1,250	2,144
2022	1,270	2,070
2023	1,309	1,897
2024–2028	6,833	6,648

**15. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS**

**Temporarily Restricted**

	<b>2018</b>	<b>2017</b>
Health care services:		
Capital purchases	\$ 4,726	\$ 4,220
Indigent care	1,094	840
Health research and education	1,152	1,073
Other	<u>6,914</u>	<u>9,082</u>
Total	<u>\$13,886</u>	<u>\$15,215</u>

Permanently restricted net assets represent Baptist’s interest in perpetual trusts.

**16. SUBSEQUENT EVENTS**

On May 23, 2018, Baptist and Hardin County, Kentucky d/b/a Hardin Memorial Hospital (“HMH”) entered into an Asset Purchase Agreement (the “APA”) for Baptist to acquire substantially all of the assets from HMH. Terms of the APA provide that at closing, Baptist will pay Hardin County \$60,000. In addition, Baptist will pay \$50,000 over 25 years (plus interest at a 2.5% fixed rate). Baptist committed to invest \$150,000 in the first five years and \$85,000 in the subsequent five years to invest in capital projects as defined in the APA. On July 2, 2018, a resident of Hardin County filed a lawsuit against Hardin County and Baptist alleging that the manner in which the Hardin County Fiscal Court approved the sale and personal property of HMH to Baptist violated Kentucky statutes governing the sale of county-owned property. The lawsuit asked that the sale of HMH be declared void and set aside and that a permanent injunction be granted directing Hardin County to comply with the Kentucky statutes identified in the complaint. Baptist was dismissed from the lawsuit on August 7, 2018. On October 4, 2018 the Hardin County Circuit Court upheld the process used by the County to approve the sale. The plaintiff appealed the case to the Kentucky Court of Appeals.

Subsequent events have been evaluated through December 10, 2018, the date the consolidated financial statements were available to be issued.

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