Consolidated Financial Statements and Supplementary Information

Beacon Health System, Inc. and Affiliated Corporations
Year Ended December 31, 2018 and 2017
(Unaudited)

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Consolidated Financial Statements
and Supplementary Information

Years Ended December 31, 2018 and 2017

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Beacon Health System, Inc. and Affiliated Corporations
Consolidated Balance Sheets
(Unaudited)
(In Thousands)

	Unaudited	
	December 31	
	2018	**2017**
Assets		
Current assets:		
Cash and cash equivalents	**$ 56,926**	$ 65,127
Short-term investments	**38,637**	3,388
Patient accounts receivable	**162,335**	151,791
Due from third-party payors	**46,739**	27,064
Other receivables	**8,256**	5,055
Inventories	**25,192**	23,942
Prepaid expenses	**14,357**	15,954
Total current assets	**352,442**	292,321
Assets limited as to use:		
Internally designated investments	**674,952**	705,511
Restricted Cash	**3,886**	2,758
Externally designated investments - insurance trust	**2,747**	2,710
Board-designated endowment	**25,002**	27,316
Endowment investment assets	**7,322**	7,930
	713,909	746,225
Property and equipment:		
Land	**53,342**	45,101
Buildings and improvements	**824,120**	795,115
Furniture and equipment	**500,329**	490,299
Construction in progress	**21,295**	16,037
	1,399,086	1,346,552
Less allowances for depreciation and amortization	**737,060**	687,048
	662,026	659,504
Deferred charges and other assets	**57,411**	38,911
Interest rate swap	**–**	625
Total assets	**$ 1,785,788**	$ 1,737,586

Beacon Health System, Inc. and Affiliated Corporations
Consolidated Balance Sheets
(Unaudited)
(In Thousands)

	Unaudited	
	December 31	
	2018	**2017**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 45,980**	$ 47,085
Accrued expenses	**51,780**	41,667
Due to third party payors	**5,942**	6,159
Current maturities of long-term debt	**10,724**	8,745
Total current liabilities	**114,426**	103,656
Noncurrent liabilities:		
Long-term debt, less current maturities	**307,012**	270,680
Pension and other long-term liabilities	**12,635**	27,111
Interest rate and basis swaps	**14,051**	16,305
	333,698	314,096
Total liabilities	**448,124**	417,752
Net assets:		
Net assets without donor restrictions	**1,325,251**	1,305,777
Net assets with donor restrictions	**12,413**	14,057
Total net assets	**1,337,664**	1,319,834
Total liabilities and net assets	**$ 1,785,788**	$ 1,737,586

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations
Consolidated Statements of Operations
and Changes in Net Assets
(Unaudited)
(In Thousands)

	Unaudited			
	For the Quarter Ended December 31		**For the Year Ended December 31**	
	2018	**2017**	**2018**	**2017**
Unrestricted revenue, gains, and other support				
Patient service revenue	**$ 271,898**	$ 243,328	**$ 975,114**	$ 901,101
Other revenue	**11,934**	10,275	**46,776**	40,439
Net assets released from restrictions used for operations	**588**	866	**1,054**	1,810
	284,420	254,469	**1,022,944**	943,350
Expenses				
Salaries and wages	**106,959**	101,250	**418,097**	394,191
Employee benefits	**27,000**	26,540	**111,591**	101,922
Supplies and other	**67,778**	65,371	**250,122**	232,358
Professional fees and purchased services	**31,109**	29,122	**117,650**	117,039
Depreciation and amortization	**14,970**	15,944	**58,951**	59,496
Interest	**2,073**	2,030	**7,905**	7,052
	249,889	240,257	**964,316**	912,058
Income from operations	**34,531**	14,212	**58,628**	31,292
Nonoperating				
Investment (losses) income, net	**(42,475)**	18,889	**(21,923)**	82,462
Unrealized gains (losses) on swap transactions, net	**(1,487)**	2,902	**1,628**	7,099
Pension settlement	**(118,087)**	–	**(118,087)**	–
Loss on bond refunding	**–**	–	**–**	(534)
Revenue and gains in excess of expenses	**(127,518)**	36,003	**(79,754)**	120,319

Beacon Health System, Inc. and Affiliated Corporations
Consolidated Statements of Operations
and Changes in Net Assets (continued)
(Unaudited)
(In Thousands)

	Unaudited			
	For the Quarter Ended December 31		For the Year Ended December 31	
	2018	**2017**	**2018**	**2017**
Net assets without donor restrictions				
Revenue and gains in excess of expenses	**$ (127,518)**	$ 36,003	**$ (79,754)**	$ 120,319
Net assets released from restriction used for capital purposes	**1,150**	2,296	**1,187**	2,473
Net assets released from restriction to others	**–**	–	**6**	–
Contribution of net assets of Community Hospital of Bremen	**(267)**	–	**–**	–
Post retirement benefit adjustments, other than periodic costs	**98,035**	9,005	**98,035**	9,005
Increase (decrease) in net assets without donor restrictions	**(28,600)**	47,304	**19,474**	131,797
Net assets with donor restrictions				
Purpose restricted contributions	**536**	836	**1,347**	2,156
Investment income	**(943)**	9	**(744)**	776
Net assets released from restriction used for operating and capital purposes	**(1,738)**	(3,162)	**(2,247)**	(4,283)
Increase (decrease) in net assets with donor restrictions	**(2,145)**	(2,317)	**(1,644)**	(1,351)
Increase (decrease) in net assets	**(30,745)**	44,987	**17,830**	130,446
Net assets at beginning of period	**1,368,409**	1,274,847	**1,319,834**	1,189,388
Net assets at end of period	**$ 1,337,664**	$ 1,319,834	**$ 1,337,664**	$ 1,319,834

See accompanying notes.

Beacon Health System, Inc. and Affiliated Corporations
Consolidated Statements of Cash Flows
(Unaudited)
(In Thousands)

	Unaudited			
	For the Quarter Ended December 31		For the Year Ended December 31	
	2018	**2017**	**2018**	**2017**
Operating activities				
Change in net assets	**$ (30,745)**	$ 44,987	**$ 17,830**	$ 130,446
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Depreciation and amortization	**14,970**	15,944	**58,951**	59,496
Unrealized losses (gains) on swap transactions, net	**1,487**	(2,902)	**(1,628)**	(7,099)
Loss on bond refunding	**–**	534	**–**	534
Postretirement benefit adjustments other than periodic costs	**(98,035)**	(9,005)	**(98,035)**	(9,005)
Unrealized gains on investments	**51,745**	(66,153)	**59,512**	(67,030)
Restricted contributions and investment income received	**407**	(845)	**(603)**	(2,932)
Changes in operating assets and liabilities:				
Patient accounts receivable	**(796)**	(976)	**(7,501)**	9,082
Other receivables, inventories, due from afiliated corporations, and prepaid expenses	**(4,568)**	– 576	**(2,695)**	5,315
Other assets	**(6,571)**	(8,388)	**(19,336)**	(20,876)
Restricted cash	**620**	2,020	**(1,128)**	1,768
Investments	**(33,082)**	46,818	**(61,317)**	(1,279)
Accounts payable, accrued expenses, and other current liabilities	**(2,362)**	2,656	**6,574**	1,024
Due to third-party payors	**(21,408)**	(15,351)	**(19,762)**	15,019
Other long-term liabilities	**81,192**	(339)	**83,408**	(56,189)
Net cash provided by operating activities	**(47,146)**	9,576	**14,270**	58,274
Investing activities				
Asset acquisition	**–**	–	**(309)**	–
Net additions to property and equipment	**(7,422)**	(14,322)	**(47,938)**	(49,757)
Net cash used in investing activities	**(7,422)**	**(14,322)**	**(48,247)**	**(49,757)**
Financing activities				
Principal payments on long-term debt and other debt obligations	**(279)**	(78,424)	**(9,669)**	(86,338)
Proceeds from long-term debt	**35,000**	77,450	**35,000**	77,450
Payment of bond issue costs	**(158)**	511	**(158)**	(235)
Restricted contributions and investment income received	**(407)**	845	**603**	2,932
Net cash (used in) provided by financing activities	**34,156**	382	**25,776**	(6,191)
(Decrease) increase in cash and cash equivalents	**(20,412)**	(4,364)	**(8,201)**	2,326
Cash and cash equivalents at beginning of period	**77,338**	69,491	**65,127**	62,801
Cash and cash equivalents at end of period	**$ 56,926**	$ 65,127	**$ 56,926**	$ 65,127

1. Organization and Basis of Consolidation

The accompanying consolidated financial statements represent the accounts of Beacon Health System, Inc. (the Corporation) and its various affiliated corporations under the control of the Corporation (collectively, BHS). The Corporation is an Indiana not-for-profit corporation exempt from federal income tax under Internal Revenue Code (the Code) Section 501(a) as an organization described in Section 501(c)(3) and a public charity as described in Section 509(a)(3). The Corporation is the sole corporate member of the following entities:

- Elkhart General Hospital, Inc. (EGH)
- Memorial Hospital of South Bend, Inc. (MHSB)
- Beacon Health Foundation, Inc. (BHF), formerly Memorial Health Foundation, Inc.
- Beacon Medical Group, Inc. (BMG), formerly Memorial Health System, Inc.
- Beacon Health Ventures, Inc. (BHV)
- Community Occupational Medicine, Inc. (COM)
- CHA ACO, LLC (CHA ACO)
- Beacon Health, LLC (BH)
- Community Hospital of Bremen, Inc. (CHB)
- BPL Acquisitions, LLC
- Beacon Specialty Surgery, LLC (BSS)

In June 2018, The Corporation became the sole corporate member of Community Hospital of Bremen, Inc (CHB).

1. Organization and Basis of Consolidation (continued)

EGH, MHSB, CHB, BMG, and BHF are also exempt from federal income tax under Section 501(a) of the Code as organizations described in Section 501(c)(3) and as public charities described in Sections 509(a)(1) and 509(a)(2). BHV and COM are Indiana for-profit corporations. EGH is a 365-licensed-bed (254 available) acute care community hospital located in Elkhart, Indiana. MHSB is a 657-licensed-bed (409 available) acute care trauma center located in South Bend, Indiana. CHB is a 24-bed critical access hospital located in Bremen, Indiana. EGH, MHSB and CHB (collectively, the Hospitals) provide inpatient, outpatient, and 24-hour emergency care services for residents of Elkhart, South Bend, and Bremen, Indiana, and the surrounding communities.

BHF is organized primarily to promote and encourage philanthropic activities for the support of the Corporation and its affiliates.

BHV manages the taxable operations of the Corporation, including home care and other non-acute health care services.

COM primarily promotes population health management.

CHA ACO coordinates high-quality care for Medicare beneficiaries participating in the Medicare Shared Savings Programs.

BMG operates the physician enterprise of the Corporation.

BH improves and expands delivery and quality of health care services for the Corporation.

BPL Acquisitions, LLC, is a real estate holding company established to purchase land.

BSS, formerly Memorial Spine and Neuroscience Center, LLC, previously a joint venture that is now fully owned by BMG, is an outpatient surgery center specializing in neurologic, spine, and pain control procedures.

All significant intercompany accounts and transactions have been eliminated in consolidation.

(In Thousands)

1. Organization and Basis of Consolidation (continued)

The Corporation owns a less than majority ownership or controlling interest in the following:

- 50% interest in Community Health Alliance LLC, an Indiana physician hospital organization
- 42% interest in LaPorte Medical Group Surgery Center, LLP, an outpatient surgery center
- 50% interest in Valparaiso Medical Development, LLC, a professional medical building venture
- 25% interest in Magnetic Resonance Imaging, LLC, an imaging and radiology center
- 33% interest in Michiana Information Health Network, Inc., a health information exchange
- 40% interest in Elkhart Health, Fitness & Aquatics, Inc., a health fitness and aquatics center
- 10% interest in Alick's Home Medical Equipment, Inc., a home medical equipment provider
- 68% interest in South Bend Specialty Surgery Center, LLC, an outpatient surgery center

Aggregate financial information relating to these investments is as follows:

	2018	2017
Assets	**$ 83,627**	$ 51,377
Liabilities	**22,542**	17,016
Net income	**11,650**	8,199

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ from those estimates.

Cash Equivalents

All investments that are not limited as to use with a maturity of three months or less at the time of acquisition are reflected as cash equivalents. Cash equivalents include checking accounts, money market accounts, corporate credit card accounts, and petty cash. The carrying value of cash equivalents approximates fair value.

Short-Term Investments

Short-term investments include cash reinvested on a daily basis, accrued interest on investments, and money expected to be used in less than a year. Also included in short-term investments are restricted and unrestricted investment donations that are in the process of being liquidated.

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Directors (the Board) for future capital improvements and community health enhancement initiatives that the Board, at its discretion, may subsequently use for other purposes. In addition, assets limited as to use also include assets held by trustees under self-funded insurance agreements, investments externally designated under indenture or donor restriction and money expected to be used as part of BHS' community benefit.

2. Summary of Significant Accounting Policies (continued)

Investments

The Corporation classifies its investments as trading. Under a trading classification, all unrestricted realized and unrealized gains and losses are included in revenue and gains in excess of expenses.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Dividend and interest income, realized gains and losses, and changes to fair values of investments are reported as non-operating investment income in the consolidated statements of operations and changes in net assets.

Investments in alternative investments, primarily hedge fund of funds, that invest in marketable securities and derivative products are reported using the equity method. The estimated fair values are provided by the respective fund managers and are based on historical costs, appraisals, and other estimates that require varying degrees of judgment. Management has utilized the best available information for reported values, which in some instances are valuations as of an interim date not more than 90 days before year-end. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and may differ from the value that would have been used had a ready market for such investments existed. Resulting differences could be material. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in non-operating investment income. The Corporation's holding reflects net contributions to the hedge fund and an allocated share of realized and unrealized investment income and expense.

Inventories

Inventories are stated at the lower of cost (average cost method) or market.

Unamortized Bond Issuance Costs

Costs incurred in connection with the issuance of long-term debt are deferred and amortized over the term of the related financing, which approximates the effective interest method.

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

The Corporation's carrying amount for its financial instruments, which include cash and cash equivalents, investments and assets limited as to use, accounts receivable, debt and interest rate and basis swaps, at December 31, 2018 and 2017, approximates fair value. The estimated fair value amounts have been determined by the Corporation using available market information and appropriate valuation methodologies.

Property and Equipment

Property and equipment are carried at cost, except for donated assets, which are recorded at fair value at the date of donation. Allowances for depreciation and amortization are computed primarily utilizing the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years.

Asset Impairment

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine whether the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating expenses at the time the impairment is identified. There was $537 and $681 of impairment of long-lived assets in 2018 and 2017, respectively.

Deferred Charges and Other Assets

Included in deferred charges and other assets are intangible assets, goodwill, and investments in unconsolidated affiliates.

The acquisition of a business entity can result in the recording of intangible assets. Acquired definite-lived intangible assets (excluding goodwill) are amortized over the useful life of the assets. Goodwill is carried at acquisition value, less any impairment reductions.

2. Summary of Significant Accounting Policies (continued)

The carrying value of goodwill amounted to approximately $12,038 and $10,409 at December 31, 2018 and 2017, respectively, and is included in deferred charges and other assets in the consolidated balance sheets. Goodwill is assessed for impairment on an annual basis at the reporting unit level. If the fair value of the reporting unit is less than the carrying value, an impairment loss equal to the difference between the implied fair value of the reporting unit goodwill and the carrying value of the reporting unit goodwill is recognized. There was no impairment of goodwill in 2018 or 2017.The Corporation accounts for its investments in less than majority owned and controlled affiliates using either the equity method of accounting. Income from these investments is reflected in other revenue in the consolidated statements of operations and changes in net assets.

Endowment Investments

Income is received directly by BHF from BHF board-designated quasi-endowment investments and quasi endowments with restrictionand is included in investment income within both net assets with and without donor restrictions. EGH receives a portion of the income from investments in endowments directly as they are released from restriction. These endowment investments have perpetual existence.

Contributions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received to the extent estimated to be collectible by the Corporation.

Net Assets Without Donor Restrictions

Net assets without donor restrictions are available for use at the discretion of the Board of Directors (the Board) and/or management for general operating purposes.

Net Assets With Donor Restrictions

Net assets with donor restrictions consist of assets whose use is limited by donor imposed, time and/or purpose restrictions.

2. Summary of Significant Accounting Policies (continued)

The Corporation reports pledges, gifts of cash and other assets as revenue with donor restrictions if they are received with donor stipulation that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, the net assets are reclassified as net assets without donor restriction and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Assets released from restrictions that are used for the purchase of property and equipment or capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to net assets without restriction. Resources restricted by donors for specific operating purposes are reported in revenue without restriction, gains, and other support to the extent expended within the period.

Some net assets have been restricted by donors to be maintained by the Corporation in perpetuity. In accordance with the restriction, a majority of the investment income and investment gains or losses from these net assets are restricted by the donor for a specific purpose. A specified portion of income earned by the net assets is released from restriction and used for operations each year and, therefore, is included in the consolidated statements of operations and changes in net assets as other revenue.

Patient Service Revenue and Patient Accounts Receivable

Patient service revenue and patient accounts receivable are reported at the amount that reflects the consideration to which BHS expects to be entitled in exchange for providing patient care. BHS has agreements with various third-party payors that provide for payments to BHS at amounts different from its established rates. Third parties include Medicare, Medicaid, managed health care plans, and other commercial plans. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. These amounts include estimated adjustments under certain reimbursement agreements with third-party payors, which are subject to audit by the applicable administering agency. These adjustments are accrued on an estimated basis and are adjusted in future periods as final settlements are determined (see Note 4). The Hospitals provide care to all patients regardless of their ability to pay. Charity care provided is excluded from patient service revenue (see Note 5).

2. Summary of Significant Accounting Policies (continued)

Performance Indicator

The consolidated statements of operations and changes in net assets include a performance indicator, revenue and gains in excess of expenses. Changes in net assets without restrictions, which are excluded from revenue and gains in excess of expenses, consistent with industry practice, include contributions of long-lived assets, including assets acquired using contributions, which, by donor restrictions, were to be used for the purpose of acquiring such assets, and pension-related changes other than net periodic costs.

Allocation of Costs

The Corporation's ability to exercise control over consolidated entities could result in the entities having a financial position or operating results that are significantly different from those that would have been obtained if the entities were autonomous. The manner of allocating certain shared and centralized costs, such as accounts payable processing, information technology support, and other Corporation-managed administration costs, is determined by the Corporation utilizing Internal Revenue Service (IRS) transfer pricing guidance and is not audited. Alternate methods of accounting for these cost allocations may produce significantly different operating results for each of the consolidated entities.

Interest Rate and Basis Swaps

All interest rate and basis swaps are measured at fair value based on techniques consistent with the market approach. None of the swaps are designated as hedging instruments; therefore, the unrealized gains or losses on the fair value of the swaps are included in revenue and gains in excess of expenses in the consolidated statements of operations and changes in net assets.

2. Summary of Significant Accounting Policies (continued)

Asset Retirement Obligations

The Corporation accounts for the fair value of legal obligations associated with long-lived asset retirements by recognizing an expense and accreting a liability over the life of the asset to cover potential legal obligations at the end of the asset's useful life. The asset retirement obligation primarily relates to future asbestos remediation related to buildings on MHSB's campus, as well as ground/soil remediation associated with the removal of underground fuel tanks. The carrying value of the obligation amounted to approximately $4,741 and $4,590 at December 31, 2018 and 2017, respectively, and is reflected in pension and other liabilities on the consolidated balance sheets.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606),* and subsequently issued amendments ASU 2016-08, 2016-10 and 2016-12 further clarifying key guidance related to revenue recognition. The core principle of the new ASU is to require an entity to recognize as revenue the amount that reflects the consideration to which it expects to be entitled in exchange for goods or services as it transfers control to its customers. The new ASU converged and replaced most current revenue recognition guidance, including industry-specific guidance, and may be applied retrospectively to each period presented (full retrospective method) or retrospectively with the cumulative effect recognized in beginning retained earnings as of the date of adoption (modified retrospective method).

BHS adopted the ASU effective January 1, 2018 using the full retrospective method. BHS's process for implementation began with a preliminary evaluation of the standard and considered subsequent interpretations by the FASB Transition Resource Group for Revenue Recognition and the American Institute of Certified Public Accountants. BHS performed an analysis of revenue streams and transactions under the ASU. In particular, for patient service revenue, BHS performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Additionally, BHS evaluated any variable consideration and potential constraints on the estimate of variable consideration, in particular as it related to third-party settlements.

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

The impact to operating revenues and income from operations upon adoption was not material. Upon adoption, the majority of what was previously classified as bad debt expense (and presented as a reduction to patient service revenue on the consolidated statements of operations and changes in net assets) is treated as an implicit price concession that reduces the transaction price (patient service revenue). The new ASU also requires enhanced disclosures related to the disaggregation of revenue and significant judgments made in measurement and recognition.

Adopting Acconting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, on January 1, 2018 using the full retrospective transition method had the following impact to the previously reported consolidated statements of operations and changes in net assets:

	For the Twelve Months Ended December 31, 2017		
	As Previously Reported	**Adjustment for ASC 606**	**Restated**
Patient service revenue	$ 960,770	$ (59,669)	$ 901,101
Provision for bad debts	(59,669)	59,669	–

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance and cash flows. The main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The ASU also enhances disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification. On January 1, 2018, this standard was adopted by BHS on a retrospective basis. The prior period financial statements presented were adjusted to reflect these changes. The adoption of the ASU resulted in no material impact to the consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flow (Topic 230), Classification of Certain Cash Receipts and Cash Payments*. The amendments in this update clarify the classification of eight types of transactions, including proceeds from the settlement of insurance claims and distributions received from equity method investees, in the statement of cash flows to reduce diversity in practices. BHS is required to adopt the new ASU for the year ended December 31, 2019 (and interim periods within the annual period beginning January 1, 2020), and does not expect the guidance to have a material impact to the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* The ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheets. The ASU will require disclosures to help the financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The ASU is effective for the Company beginning January 1, 2019 and will be applied using a modified retrospective approach. The Company is currently in the process of evaluating its lease contracts, as well as certain service contracts that may include embedded leases. Additionally, the Company is finalizing its analysis of certain key assumptions that will be utilized at the transition date, including the incremental borrowing rate. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases which will have a material impact on the balance sheet and significant incremental disclosures in the consolidated financial statement footnotes. The transition adjustment is not expected to have a material impact on the statement of operations.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958) – Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made.* This ASU provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. BHS is required to adopt the new ASU for the fiscal year beginning on January 1, 2019, including interim periods, and is currently evaluating the impact this ASU will have on its consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles – Goodwill and Other, Internal-Use software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.* This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. BHS is required to adopt the new ASU for the fiscal year beginning January 1, 2021 and is currently evaluating the impact this guidance will have on its consolidated financial statements.

Reclassifications

Certain reclassifications were made to the 2017 consolidated financial statements to conform with classifications made in 2018. The reclassifications had no effect on the changes in net assets or on net assets previously reported.

3. Acquisition

BHS accounts for business combinations in accordance with ASC 958-805, *Not-for-Profit Entities: Business Combinations*, under which the purchase of an acquired business is allocated to its identifiable assets and liabilities based on estimated fair values. The excess of the consideration paid over the amount allocated to the assets and liabilities, if any, is recorded to goodwill. For acquisitions in which no consideration is paid, the fair value of the net assets acquired is recorded as an inherent contribution to nonoperating income. BHS typically engages third-party valuation specialists to assist in the fair value determination of certain assets and liabilities.

Effective June 1, 2018, BHS entered into a combination agreement (Agreement) with CHB to become the sole corporate member of CHB. The purpose of the Agreement was to provide BHS with greater presence in the surrounding market while promoting greater access to patients in the market. Additionally, the Agreement provided CHB with the financial stability to maintain their presence in the local community as a critical access hospital and provide additional services through access to capital and BHS's expansive specialty medical services.

For accounting purposes, this transaction is considered an acquisition. No cash or other consideration was transferred, however, BHS became the co-borrower for CHB's outstanding debt obligations. Goodwill of $1,759 was recorded as a result of this transaction.

(In Thousands)

3. Acquisition (continued)

The acquisition-date fair value of identifiable assets and liabilities of CHB as of June 1, 2018 consisted of the following:

Cash and cash equivalents	$	(67)
Accounts receivable		3,042
Other current assets		316
Property and equipment		11,200
Current liabilities		(2,379)
Long-term debt		(13,871)
Goodwill	$	1,759

The valuation of assets and liabilities was completed in 2018. The fair value of accounts receivable, other current assets, and current liabilities are generally equal to the carrying value because of their short-term nature. The fair value of long-term debt approximates the carrying value based on the terms of the obligations. The fair value of property and equipment was determined by an independent third-party valuation utilizing market-based valuations methods which are generally Level 3 fair value measurements.

The following are the operating results and changes in net assets attributable to CHB since the date of acquisition included in the accompanying consolidated statement of operations and changes in net assets for the year ended December 31, 2018:

Unrestricted revenue, gains and other support	$	12,617
Loss from operations		(1,278)
Expenses in excess of revenue and gains		(1,251)
Change in net assets without donor restrictions		3,803

Operating expenses for the year ended December 31, 2018 included costs related to the integration of CHB into BHS, transition costs related to benefit plans, information technology costs and other shared service costs.

4. Revenue and Accounts Receivable

Patient Service Revenue

Patient service revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Corporation bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Corporation. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Corporation believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospitals receiving inpatient acute care services. The Corporation measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Corporation has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

BHS uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. Based on the historical collection trends and other analysis, BHS believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

4. Revenue and Accounts Receivable (continued)

The Corporation determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with the Corporation's policy and/or implicit price concessions based on the historical collection experience of patient accounts.

The Corporation determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. A summary of the payment arrangements with major third-party payors follows:

- **Medicare:** Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic and other factors. Certain services are paid based on cost-reimbursement methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.

- **Medicaid:** Reimbursements for Medicaid services are generally paid at prospectively determined rates per discharge, per occasion of service, or per covered member.

- **Other:** Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Disproportionate Share Hospital (DSH) payments by the state of Indiana, if eligible, are paid according to the fiscal year of the State, which ends on June 30 of each year, and are based on the cost of uncompensated care provided by the DSH providers during their respective fiscal year ended during the State fiscal year. In 2016, MHSB qualified for the State DSH program for State Fiscal Years (SFY) 2016 and 2017. In 2018, MHSB qualified for the State DSH program for SFY 2018 and 2019. MHSB recorded patient service revenue of $20,143 and $27,923 for the twelve months ended December 31, 2018 and 2017, respectively, related to SFY 2019, 2018, 2017 and 2016 DSH payments.

(In Thousands)

4. Revenue and Accounts Receivable (continued)

In April 2014, the Indiana Hospital Assessment Fee program (HAF) was approved by the Centers for Medicare & Medicaid Services (CMS) retroactively for the period July 1, 2013 to June 30, 2017. The state budget extended HAF 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 (included in patient service revenue) and an assessment (included in supplies and other expenses) against the Hospitals, which is paid to the state the same year. BHS recognized HAF revenues and assessments as follows:

	Year Recognized		
	2018	**2017**	**Total**
Year ended December 31, 2018 HAF: Revenue	**$ 58,073**	$ –	$ 58,073
Year ended December 31, 2018 HAF: Assessments	**(34,406)**	–	(34,406)
Year ended December 31, 2017 HAF: Revenue	**–**	46,507	46,507
Year ended December 31, 2017 HAF: Assessments	**(368)**	(29,435)	(29,803)
Year ended December 31, 2016 HAF: Assessments	**–**	(855)	(855)
	$ 23,299	$ 16,217	$ 39,516

HAF revenue is included in patient service revenue and HAF assessments are included in supplies and other expenses in the consolidated statements of operations and changes in net assets.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the

4. Revenue and Accounts Receivable (continued)

related programs. There can be no assurance that regulatory authorities will not challenge the Corporation's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Corporation. In addition, the contracts the Corporation has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Corporation's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Corporation also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Corporation estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change.

Estimates for DSH, settlements with third-party payors, and other contractual adjustments can differ from actual reimbursement based on the results of subsequent reviews, government regulatory changes, and cost report audits. For the years ended December 31, 2018 and 2017, patient service revenue has been increased by approximately $1,304 and $3,468, respectively, for changes in estimates of third-party payor settlements related to prior years. There were no other significant changes to the judgements used to determine the transaction price in prior periods.

(In Thousands)

4. Revenue and Accounts Receivable (continued)

Management has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors and service lines that renders services to patients. Patient service revenue recognized for the years ended December 31, 2018 and 2017 from major payor sources is as follows:

Payor	**2018**	**2017**
Anthem	**$ 216,471**	$ 184,112
Commercial	**307,489**	282,779
Medicare	**280,833**	266,851
Medicaid	**135,491**	141,146
Self-pay	**34,830**	26,213
Patient service revenue	**$ 975,114**	$ 901,101

(In Thousands)

4. Revenue and Accounts Receivable (continued)

The composition of patient care service revenue based on services lines the Corporation operates for the years ended December 31, 2018 and 2017 is as follows:

Service lines	2018	2017
Hospitals	**$ 835,250**	$ 757,810
Medical Group	**117,335**	110,979
Health Ventures	**13,390**	24,909
Other	**9,139**	7,403
Patient service revenue	**$ 975,114**	$ 901,101

Patient service revenues related to the Medicare program are approximately 29% and 30% of patient service revenue for the years ended December 31, 2018 and 2017, respectively. Patient service revenues related to the Medicaid program are approximately 14% and 16% of patient service revenue for the years ended December 31, 2018 and 2017, respectively. Amounts reported under the Anthem payor contract account for approximately 22% and 20% of patient service revenue for the years ended December 31, 2018 and 2017, respectively.

4. Revenue and Accounts Receivable (continued)

Credit is granted without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Major components of patient accounts receivable include approximately 26% from Medicare and approximately 25% from Anthem at December 31, 2018, and 26% from Medicare and approximately 21% from Anthem at December 31, 2017.

The Corporation has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Corporation's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that services will be one year or less. However, the Corporation does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

The Corporation has applied the practical expedient provided by FASB ASC 340-40-25-4 and all incremental customer contract acquisition costs are expensed as they are incurred as the amortization period of the asset that the Corporation, otherwise, would have recognized is one year or less in duration.

Other Revenue

Other revenues consist of revenues associated with retail services, such as pharmacy and cafeteria, ancillary services and strategic initiatives with entities with less than majority ownership or non-controlling interests (Joint Ventures) by the Corporation, health and fitness membership and leased space rental agreements with third parties. Revenues associated with pharmacy services are estimated as prescriptions are filled and collected by patients. Retail sales are recorded at the time of service. Revenues associated with Joint Ventures are recognized on the equity method. Health and fitness revenue is recognized over the membership period and leased space rental revenue is recognized over the term of the lease.

(In Thousands)

4. Revenue and Accounts Receivable (continued)

The composition of other revenue for the year ended December 31 is as follows:

Service lines	2018	2017
Retail service revenue	**$ 12,194**	$ 12,052
Joint Venture revenue	**4,417**	1,723
Grant revenue	**4,852**	4,155
Health and fitness revenue	**4,446**	3,929
Rental revenue	**3,111**	2,961
Other revenue	**17,756**	15,619
	$ 46,776	$ 40,439

5. Charity Care

Patients who meet the Corporation's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Charity care represents unreimbursed costs for services rendered at a reduced fee, or no fee, due to the inability of the patient to pay for services. The amount of the charity care provided was approximately $6,652 and $5,203 for the years ended December 31, 2018 and 2017, respectively, at estimated cost. The Corporation utilized a cost to charge ratio methodology for the cost analysis. The only reimbursement for financial assistance care received by the Corporation is determined through a settlement process in the Hospitals' annual Medicare cost report filing. Financial assistance care reimbursement was approximately $1,017 and $815 for the years ended December 31, 2018 and 2017, respectively.

6. Retirement Plans

The Corporation maintains a defined-contribution employee retirement and savings plan for all employees who have attained 21 years of age and have completed 12 months of continuous service. The Corporation's contributions are based on 100% of the employee's contributions, up to 4% of the employee's salary. Both employee and corporation contributions are subject to certain limitations. Included in employee benefits on the consolidated statements of operations and changes in net assets are contributions of approximately $11,993 and $11,911 for the years ended December 31, 2018 and December 31, 2017, respectively. Effective December 31, 2018 the CHB defined-contribution employee retirement and savings plan was merged into The Corporation's plan.

The Corporation also has a noncontributory, defined-benefit pension plan (the MEM Plan), which includes MHSB, BMG, BHF, and BHV with a final average pay plan and a cash balance plan. The cash balance plan was frozen for new participants and accrual of benefits as of December 31, 2007, and the much smaller grandfathered final average pay plan, with fewer participants is also frozen.. The assets in the cash balance plan continued to earn interest, but service credits were frozen.

The Corporation also has a noncontributory, defined-benefit pension plan (the EGH Plan) for EGH. As of December 31, 2007, the EGH Plan was frozen for all participants who had not attained the age of 50 and accumulated 15 years of vesting service as of December 31, 2007. No new participants were allowed into the plan as of December 31, 2007. Participants who were at least 50 years old and had accumulated 15 years of service at December 31, 2007, continued to accrue benefits under the terms of the EGH Plan until it was frozen effective January 1, 2013. Additionally, a lump-sum payout option was effective for all participants on July 1, 2012.

In October 2017, the Board of Directors of the Corporation approved the termination of the MEM Plan and the EGH Plan (the Plans) effective December 31, 2017. An Application for Determination was filed with the Internal Revenue Service (IRS) in February 2018 with respect to the Plans termination. A Form 500 Standard Termination Notice was filed with the Pension Benefit Guaranty Corporation (PBGC) in February 2018. The 60-day PBGC waiting period lapsed without objection by the PBGC. The Corporation has received a favorable determination from the IRS regarding the termination of the Plans. In October 2018, all pension assets were converted to cash. All participants who selected a lump-sum cash payout were paid in full and annuity contracts were purchased from American General Life Insurance, Inc. for all remaining participants. The Corporation has recorded a receivable from the Plans of approximately $3,667 for assets that were not convertible to cash at the time of the lump sum payout and annuity

(In Thousands)

6. Retirement Plans (continued)

purchase. The plan benefits and benefit administration became the responsibility of the annuity provider. The Corporation no longer has a pension liability.

The measurement date of December 31 is utilized for both plans. The summary of the changes in the benefit obligation and plan assets and the resulting funded status of the plans are as follows:

	December 31, 2018		
	EGH	**MEM**	**Total**
Accumulated benefit obligation	**$ –**	**$ –**	**$ –**
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	**$ 156,308**	**$ 139,120**	**$ 295,428**
Service cost	**375**	**375**	**750**
Interest cost	**4,058**	**3,603**	**7,661**
Actuarial loss	**(804)**	**5,021**	**4,217**
Benefits and administrative expenses paid	**(83,599)**	**(70,126)**	**(153,725)**
Lump-sum benefits paid	**(76,338)**	**(77,993)**	**(154,331)**
Projected benefit obligation at end of year	**$ –**	**$ –**	**$ –**
Change in plan assets:			
Fair value of plan assets at beginning of year	**$ 145,334**	**$ 135,765**	**$ 281,099**
Actual return on plan assets	**(5,870)**	**(4,125)**	**(9,995)**
Employer contributions	**21,677**	**18,942**	**40,619**
Benefits and administrative fees paid	**(83,599)**	**(70,126)**	**(153,725)**
Lump-sum benefits paid	**(76,338)**	**(77,993)**	**(154,331)**
Due to BHS	**(1,204)**	**(2,463)**	**(3,667)**
Fair value of plan assets at end of year	**$ –**	**$ –**	**$ –**
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheets	**$ –**	**$ –**	**$ –**

(In Thousands)

6. Retirement Plans (continued)

	December 31, 2017		
	EGH	**MEM**	**Total**
Accumulated benefit obligation	$ 156,308	$ 139,120	$ 295,428
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$ 151,129	$ 138,800	$ 289,929
Service cost	285	901	1,186
Interest cost	5,451	5,035	10,486
Actuarial loss	9,125	4,870	13,995
Benefits and administrative expenses paid	(6,044)	(4,801)	(10,845)
Lump-sum benefits paid	(3,638)	(3,570)	(7,208)
Effect of settlement/curtailment	–	(2,115)	(2,115)
Projected benefit obligation at end of year	$ 156,308	$ 139,120	$ 295,428
Change in plan assets:			
Fair value of plan assets at beginning of year	$ 109,142	$ 101,267	$ 210,409
Actual return on plan assets	14,874	11,869	26,743
Employer contributions	31,000	31,000	62,000
Benefits and administrative fees paid	(6,044)	(4,801)	(10,845)
Lump-sum benefits paid	(3,638)	(3,570)	(7,208)
Fair value of plan assets at end of year	$ 145,334	$ 135,765	$ 281,099
Funded status:			
Funded status of the plan and amounts recognized as pension and other liabilities in the consolidated balance sheets	$ (10,974)	$ (3,355)	$ (14,329)

(In Thousands)

6. Retirement Plans (continued)

Included in unrestricted net assets are the following amounts that have been recognized in net periodic pension cost:

	At December 31, 2018		
	EGH	**MEM**	**Total**
Funded Status at December 31, 2017	**$ (10,974)**	**$ (3,355)**	**$ (14,329)**
Actuarial net loss not recognized in periodic pension cost at December 31, 2017	**57,896**	**40,139**	**98,035**
Employer contributions	**21,677**	**18,942**	**40,619**
Net periodic benefit costs	**(2,162)**	**(409)**	**(2,571)**
Effect of settlement	**(65,233)**	**(52,854)**	**(118,087)**
Due to BHS	**(1,204)**	**(2,463)**	**(3,667)**
	$ –	$ –	$ –

The components of net periodic benefit cost for the defined-benefit pension plans were as follows:

	Year Ended December 31, 2018		
	EGH	**MEM**	**Total**
Service cost	**$ 375**	**$ 375**	**$ 750**
Interest cost	**4,058**	**3,603**	**7,661**
Expected return on plan assets	**(6,057)**	**(5,689)**	**(11,746)**
Prior service credit recognized	**–**	**–**	**–**
Amortization of recognized losses	**3,786**	**2,120**	**5,906**
Benefit cost	**$ 2,162**	**$ 409**	**$ 2,571**

(In Thousands)

6. Retirement Plans (continued)

	Year Ended December 31, 2017		
	EGH	**MEM**	**Total**
Service cost	$ 285	$ 901	$ 1,186
Interest cost	5,451	5,035	10,486
Expected return on plan assets	(7,447)	(6,982)	(14,429)
Prior service credit recognized	–	2	2
Amortization of recognized losses	5,284	3,281	8,565
Benefit cost	$ 3,573	$ 2,237	$ 5,810

Assumptions used to determine benefit obligations at the measurement date are as follows:

	December 31, 2017	
	EGH	**MEM**
Discount rates	3.35%	3.35%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	N/A

In 2017, mortality assumptions for the plans utilizing the RP-2014 mortality tables were updated with the 2017 projection scale.

Assumptions used to determine net pension expense for the fiscal year are as follows:

	December 31, 2017	
	EGH	**MEM**
Discount rates	3.75%	3.75%
Expected return on plan assets	7.00	7.00
Rate of compensation increase	N/A	3.00

(In Thousands)

6. Retirement Plans (continued)

At December 31, 2017, the Corporation liquidated and transferred existing investments to bond funds with the intent to maintain the current asset value for the termination of the plans. Assets were held in highly liquid bond funds. The following is a summary of the pension plan asset actual allocations:

Asset Category	EGH/MEM Target	2017 EGH	2017 MEM
Equity securities	38%	1%	1%
Debt securities	33	74	74
Other	29	25	25
Total	100%	100%	100%

The following table sets forth by level, within the fair value hierarchy (see Note 13), the combined MEM and EGH plan assets carried at fair value as of December 31, 2017:

	Level 1	Level 2	Level 3	Fair Value
Cash and cash equivalents	$ 15,931	$ –	$ –	$ 15,931
Short-term investment funds[a]	26,710	–	–	26,710
Fixed income funds[b]	–	206,511	–	206,511
Total assets measured on a recurring basis at fair value	$ 42,641	$ 206,511	$ –	249,152
Investments recorded at fair value based on NAV				31,947
Total assets measured at fair value				$ 281,099

[a] Pricing for common stocks, mutual funds, and short-term investments is based on the open market and is valued on a daily basis.

[b] Pricing is based on the fair value of the underlying securities and is valued on a daily basis.

(In Thousands)

7. Lease Obligations

The Corporation leases certain office space and equipment under noncancelable operating leases. At December 31, 2018, the minimum future rental payments under these leases are as follows:

2019	$ 2,056
2020	1,647
2021	1,422
2022	1,331
2023	1,326
Thereafter	6,217
	$ 13,999

Rental expense for the years ended December 31, 2018 and 2017 was approximately $7,409 and $7,489, respectively, which is included in supplies and other expenses.

8. Long-Term Debt

Long-term debt consists of the following at December 31, 2018 and December 31, 2017:

	2018	2017
Tax-exempt bonds issued on behalf of BHS by the Indiana Finance Authority:		
BHS Revenue Bonds, Series 2018, bearing interest at a variable rate of 3.05% at December 31, 2018 due in varying annual installments on December 15 of each year through 2043, with a mandatory tender date of December 15, 2028	**$ 35,000**	$ –
BHS Revenue Refunding Bonds, Series 2017A, bearing interest at variable rates with a floating fixed interest rate swap of 1.93% at December 31, 2018, due in varying annual installments on August 15 of each year through 2033, with a mandatory tender date of September 8, 2022	**37,015**	37,240
BHS Revenue Refunding Bonds, Series 2017B, bearing interest at a variable rate of 2.06% at December 31, 2018 due annually on May 1 of each year through 2033	**39,190**	40,210
BHS Revenue Bonds, Series 2013A, bearing interest at fixed rates between 3.50% and 5.00% due in varying annual installments on August 15 of each year through 2034	**84,935**	90,525
BHS Revenue Note, Series 2013B, bearing interest at a fixed rate of 1.17%, at December 31, 2018 due in monthly installments through 2020	**1,475**	2,566

(In Thousands)

8. Long-Term Debt (continued)

	2018	2017
Tax-exempt bonds issued on behalf of BHS by the Hospital Authority of St. Joseph County:		
BHS Revenue Bonds, Series 2016, bearing interest at fixed rate of 1.39% due in varying annual installments through 2046	**$ 49,640**	$ 49,800
BHS Revenue Bonds, Series 2013C, bearing interest at fixed rates between 3.75% and 5.00% due in varying annual installments on August 15 of each year through 2044	**46,130**	46,130
Loans and Line of Credit issued on behalf of Community Hospital of Bremen by Lake City Bank:		
Loan payable to Lake City Bank dated August 4, 2004, semi-annual payments of principal and interest at variable rate (3.75% as of December 31, 2018), due January 1, 2025, secured by real property.	**2,616**	–
Loan on behalf of Community Hospital of Bremen by United States Department of Agriculture:		
Loan payable to United States Department of Agriculture dated April 25, 2005, semi-annual payments of principal and interest, interest at fixed rate of 4.25% due April 15, 2045, secured by real property.	**10,108**	–
Mortgage – bearing interest at variable rates of 3.96% and 2.99% at December 31, 2018 and 2017, respectively, London Interbank Offered Rate (LIBOR) plus 1.50% due to varying annual installments on the last day of every month through 2020	**296**	484
Capital leases	**541**	790
	306,946	267,745
Bond issuance costs	**(1,888)**	(1,833)
Unamortized premium	**12,678**	13,513
	317,736	279,425
Less current portion	**10,724**	8,745
	$ 307,012	$ 270,680

In December 2018, The Indiana Finance Authority, on behalf of BHS, issued revenue bonds Series 2018 (2018 Bonds) in the principal amount of $35,000,000. The 2018 Bonds are private placement bonds, bearing interest at a variable monthly interest rate. Proceeds from the bonds were utilized to fund existing and future capital projects.

8. Long-Term Debt (continued)

In September 2017, the Indiana Finance Authority, on behalf of BHS, issued revenue refunding bonds Series 2017A (2017A) in the principal amount of $37,240. The 2017A Bonds are private placement bonds, bearing interest at a variable monthly interest rate. The proceeds from 2017A were utilized to refund the MHSB Revenue Bonds, Series 2008A.

In September 2017, the Indiana Finance Authority, on behalf of BHS, issued revenue refunding bonds Series 2017B (2017B) in the principal amount of $40,210. The 2017B Bonds are private placement bonds, bearing interest at a variable monthly interest rate. The proceeds from 2017B were utilized to refund the EGH Revenue Bonds, Series 2008.

In August 2016, the Hospital Authority of St. Joseph County issued Hospital Revenue Bonds, Series 2016 (Series 2016 Bonds), on behalf of the Obligated Group. The Series 2016 Bonds are $50,000 private placement bonds bearing interest at a fixed rate of 1.39%, due in varying annual installments through 2046. Proceeds from the bonds were utilized to fund existing and future capital projects.

In May 2013, the Indiana Finance Authority, on behalf of BHS, issued revenue refunding bonds Series 2013A (2013A) in the principal amount of $116,705. The interest rate for 2013A is a fixed rate varying between 2.00% and 5.00%. The proceeds from 2013A were utilized to refund the MHSB Revenue Bonds, Series 2008B; MHSB Revenue Bonds, Series 1998A; and the EGH Revenue Bonds, Series 1998.

In May 2013, the Indiana Finance Authority, on behalf of BHS, issued a revenue note Series 2013B (2013B) in the principal amount of $7,492. The interest rate for 2013B is a fixed rate of 1.17%. Proceeds from the bond were utilized for the purchase of a helicopter.

In May 2013, the Hospital Authority of St. Joseph County, on behalf of BHS, issued revenue bonds Series 2013C (2013C) in the principal amount of $46,130. The interest rate for 2013C is a fixed rate varying between 3.75% and 5.00%. The proceeds from 2013C were utilized to refund the MHSB Revenue Bonds, Series 2007. The remaining proceeds are set aside in externally designated investments for future projects.

(In Thousands)

8. Long-Term Debt (continued)

The Corporation is the Obligated Group Agent for the Obligated Group under the Master Trust Indentures. The Obligated Group includes the Corporation, MHSB, EGH, and BMG. MHF and BHV constitute designated affiliates under the terms of the Master Trust Indentures. The bonds are secured by pledged revenues of the Obligated Group and contain various covenants, including achievement of specified financial ratios and limitations on additional debt.

The loan agreements require maintenance of certain debt service coverage ratios, limit additional borrowings, and require compliance with various other restrictive covenants. The Corporation was in compliance with all covenants during 2018 and 2017.

In June 2018, BHS became the sole corporate member of Community Hospital of Bremen (CHB). CHB's long-term debt instruments at December 31, 2018 included a loan from Lake City Bank and a loan from the United States Department of Agriculture.

CHB's loan with Lake City Bank, dated August 4, 2004, bears interest at a variable rate equal to the prime rate, minus .50%, adjusted annually with a floor of 3.50% and a ceiling of 8.50%. CHB's outstanding loan with Lake City Bank is secured by virtually all assets of CHB.

CHB obtained a direct construction loan, dated April 25, 2005, from the USDA in the amount of $12,000. The loan bears interest at a fixed of 4.25% to be repaid over 40 years. The loan is secured by the real property.

Interest capitalized for the year ended December 31, 2018 and 2017 was approximately $512 and $897, respectively.

Maturities of long-term debt and capital lease obligations for each of the next five years are as follows:

2019	$ 10,724
2020	9,902
2021	10,759
2022	11,154
2023	11,320

9. Line of Credit

The Corporation has a $2,000 revolving line of credit with 1st Source Bank. The line of credit was renewed and extended through May 31, 2020. Of the $2,000 revolving line of credit, $50 for the year ended December 31, 2018 and the year ended December 31, 2017 was segregated for the beneficiary of a self-insurance trust. Conversely, $1,950 was available to be drawn upon at December 31, 2018 and December 31, 2017. No draws were taken by MHSB in either 2018 or 2017. The interest rate on the line of credit is the prime rate minus 0.5%. No amounts were outstanding on the line of credit as of December 31, 2018 or December 31, 2017.

10. Interest Rate and Basis Swaps

MHSB has various derivative instruments related to long-term debt obligations to manage the exposure on interest rates and MHSB’s interest expense. Through the use of derivative financial instruments, MHSB is exposed to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of the derivative contract is positive, the counterparty owes MHSB, which creates credit risk to MHSB. When the fair value of the derivative contract is negative, MHSB owes the counterparty, and there is no credit risk to MHSB at that point in time. MHSB minimizes the credit risk in derivative instruments by entering into transactions that require the counterparty to post collateral for the benefit of the fair value of the derivative contract. Market risk is the adverse effect on the value of the financial instrument that results from a change in interest rates. The management of market risk associated with interest rate changes is defined in MHSB’s Swap Management Policy (the Policy). The Policy includes continuous monitoring of market conditions, emergent opportunities, and risks. Swap management is meant to be long term in nature, and any modifications to the program are reviewed for the long-term costs and benefits.

Management also mitigates risk through periodic reviews of its derivative position in the context of its total blended cost of capital.

(In Thousands)

10. Interest Rate and Basis Swaps (continued)

The derivative instruments require adherence to collateral posting thresholds. For the months ended December 31, 2018 and 2017, the mark-to-market valuation on the swap portfolio was below the required collateral posting threshold of $30,000 with PNC Bank, $25,000 with Morgan Stanley, $25,000 with Wells Fargo, and $25,000 with Deutsche Bank.

The following is a summary of the outstanding fixed payor rate swaps as of December 31, 2018:

Origination Date	Notional Amounts	MHSB Receives	MHSB Pays	Maturity Date
March 2006	$ 37,015	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	7,350	65% of 30-day LIBOR plus 0.45%	3.8100	August 2034

The following is a summary of the outstanding fixed payor rate swaps as of December 31, 2017:

Origination Date	Notional Amounts	MHSB Receives	MHSB Pays	Maturity Date
March 2006	$ 37,240	61.9% of 30-day LIBOR plus 0.31%	3.5150%	August 2033
March 2003	7,600	65% of 30-day LIBOR plus 0.45%	3.8100	August 2034

(In Thousands)

10. Interest Rate and Basis Swaps (continued)

The following is a summary of the outstanding basis rate swaps as of December 31, 2018:

Origination Date	Notional Amounts	MHSB Receives	MHSB Pays	Maturity Date
January 2007	$ 42,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.0715%	January 2041
March 2001	140,000	75.125% of 3M LIBOR	SIFMA tax-exempt index	March 2031
July 2009	63,000	74.6% of 1M LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	81,000	61.7% of 1M LIBOR + 0.76%	SIFMA tax-exempt index + 0.17%	August 2041

Net interest paid or received under the above swap agreements is included in interest expense. The net differential for MHSB as a result of the swap agreements amounted to payments of approximately $208 and $759 for the twelve months ended December 31, 2018 and the twelve months ended December 31, 2017, respectively, and is reflected as an increase to interest expense. The swap agreements do not qualify for hedge accounting; therefore, the change in the fair value of the swap agreements is recorded as an unrealized non-operating gain (loss) of approximately $1,628 and $7,099 for the twelve months ended December 31, 2018 and the twelve months ended December 31, 2017, respectively.

The fair value of derivative instruments at December 31, 2018 and December 31, 2017 is as follows:

	Balance Sheet Location	2018	2017
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate and basis swap receivable	**$ –**	$ 625
	Interest rate and basis swaps payable	**(14,051)**	(16,305)
		$ (14,051)	$ (15,680)

(In Thousands)

11. Liquidity and Availability of Resources

As of December 31, 2018, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, scheduled principal payments on debt, and capital expenditures not financed with debt, were as follows:

	2018
Cash and cash equivalents	**$ 56,926**
Short-term investments	**38,637**
Internally designated investments	**674,952**
Restricted cash	**3,886**
Externally designated investments – insurance trust	**2,747**
Board designated endowment	**25,002**
Endowment investments	**7,322**
Total financial assets	**$ 809,472**
Less: amounts unavailable for general expenditure due to:	
Restricted bond funds	**(38,845)**
Restricted by donors with purpose restrictions	**(11,938)**
Restricted by donors in perpetuity	**(475)**
Restricted for insurance trust	**(2,747)**
Board designated	**(25,002)**
Add: liquidity resources:	
Unused line of credit	**1,950**
Total financial assets available for general expenditure within one year	**$ 732,415**

(In Thousands)

11. Liquidity and Availability of Resources (continued)

BHS has various investments to maintain and strengthen the financial well being and liquidity of of BHS. The management of investments is defined by the Investment Policy and is under the direction of an investment committee consisting of external advisors and BHS employees with the knowledge and understanding to undertake the monitoring of market conditions, emergent opportunities and risks to help maximize the financial strength of the investments while considering the liquidity needs of BHS.

12. Investments

Total investment return for the years ended December 31 is summarized as follows:

	2018	**2017**
Investment return:		
Net unrealized (losses) gains on investments	**$ (54,687)**	$ 60,391
Net realized gains on investments	**36,847**	16,208
Net equity (losses)earnings on alternative investments	**(4,826)**	6,639
	$ (22,666)	$ 83,238
Reported as:		
Investment income, net (non-operating)	**$ (21,922)**	$ 82,462
Investment (loss) income (net assets with donor restrictions)	**(744)**	776
	$ (22,666)	$ 83,238

The Corporation’s investments are exposed to various kinds and levels of risk. Equity mutual funds expose the Corporation to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is the risk associated with a company’s operating performance. Fixed-income securities expose the Corporation to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Liquidity risk tends to be higher for equities related to small capitalization companies. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value, resulting in additional gains and losses in the near term.

13. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

The fair value of the Corporation's long-term debt, excluding capital leases and the mortgage, is approximately $314,921 and $279,277 at December 31, 2018 and 2017, respectively. The valuation for the estimated fair value of long-term debt is completed by a third-party service and takes into account a number of factors, including, but not limited to, any one or more of the following: (i) general interest rate and market conditions; (ii) macroeconomic and/or deal-specific credit fundamentals; (iii) valuations of other financial instruments that may be comparable in terms of rating, structure, maturity, and/or covenant protection; (iv) investor opinions about the respective deal parties; (v) size of the transaction; (vi) cash flow projections, which, in turn, are based on assumptions about certain parameters that include, but are not limited to, default, recovery, prepayment, and reinvestment rates; (vii) administrator reports, asset manager estimates, broker quotations, and/or trustee reports; and (viii) comparable trades, where observable. Based on the inputs in determining the estimated fair value of debt, this fair value measurement would be considered Level 2.

ASC 820-10-50-2, *Fair Value Measurements and Disclosures*, establishes a three-level valuation hierarchy. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in an active market and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.

- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

(In Thousands)

13. Fair Value of Financial Instruments (continued)

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried as of December 31, 2018 and 2017, by caption, on the consolidated balance sheets by the valuation hierarchy defined above for those instruments carried at fair value, as well as the alternative investments that are reported on the equity method of accounting. Deferred compensation investments are included in other assets on the consolidated balance sheets.

	December 31, 2018					
	Level 1	**Level 2**	**Level 3**	**Fair Value**	**Equity Method**	**Carrying Value**
Assets						
Short-term investments[(a)]	**$ 38,637**	**$ –**	**$ –**	**$ 38,637**	**$ –**	**$ 38,637**
Internally designated investments:						
Blended fund	**322,130**	**–**	**–**	**322,130**	**–**	**322,130**
Total mutual funds	**322,130**	**–**	**–**	**322,130**	**–**	**322,130**
Common stock[(a)]	**5,151**	**–**	**–**	**5,151**	**–**	**5,151**
Alternatives:						
Fund of hedge funds	**–**	**–**	**–**	**–**	**–**	**–**
International equity	**–**	**–**	**–**	**–**	**1,018**	**1,018**
MLP	**–**	**–**	**–**	**–**	**39,096**	**39,096**
Private equity	**–**	**–**	**–**	**–**	**49,261**	**49,261**
REIT	**–**	**–**	**–**	**–**	**33,716**	**33,716**
International	**–**	**–**	**–**	**–**	**14,494**	**14,494**
Commingled funds	**–**	**–**	**–**	**–**	**148,370**	**148,370**
Other	**–**	**–**	**–**	**–**	**19,714**	**19,714**
Long/short hedge	**–**	**–**	**–**	**–**	**14,787**	**14,787**
Global	**–**	**–**	**–**	**–**	**4,480**	**4,480**
Multi-strategy	**–**	**–**	**–**	**–**	**22,735**	**22,735**
Total alternatives	**–**	**–**	**–**	**–**	**347,671**	**347,671**
Total internally designated investments	**327,281**	**–**	**–**	**327,281**	**347,671**	**674,952**

(In Thousands)

13. Fair Value of Financial Instruments (continued)

	December 31, 2018					
	Level 1	**Level 2**	**Level 3**	**Fair Value**	**Equity Method**	**Carrying Value**
Assets (continued)						
Restricted cash[a]	**$ 3,866**	**$ –**	**$ –**	**$ 3,866**	**$ –**	**$ 3,866**
Ext. designated investment – insurance trust:						
Fixed income[a]	**2,747**	**–**	**–**	**2,747**	**–**	**2,747**
Board-designated endowment:						
Mutual funds:[a]						
Equities	**1,151**	**–**	**–**	**1,151**	**–**	**1,151**
Blended fund	**13,528**	**–**	**–**	**13,528**	**–**	**13,528**
Fixed income[a], [b]	**396**	**–**	**–**	**396**	**–**	**396**
Equities[a]	**1,525**	**–**	**–**	**1,525**	**–**	**1,525**
Alternatives	**–**	**–**	**–**	**–**	**8,402**	**8,402**
Total board-designated endowment	**16,600**	**–**	**–**	**16,600**	**8,402**	**25,002**
Endowment:						
Mutual funds:[a]						
Fixed income	**–**	**–**	**–**	**–**	**–**	**–**
Blended fund	**4,210**	**–**	**–**	**4,210**	**–**	**4,210**
Money market[a]	**1**	**–**	**–**	**1**	**–**	**1**
Equities[a]	**474**	**–**	**–**	**474**	**–**	**474**
Alternatives	**–**	**–**	**–**	**–**	**2,637**	**2,637**
Total endowment	**4,685**	**–**	**–**	**4,685**	**2,637**	**7,322**
Swap[c]	**–**	**–**	**–**	**–**	**–**	**–**
Total	**$ 393,816**	**$ –**	**$ –**	**$ 393,816**	**$ 358,710**	**$ 752,526**
Liabilities						
Swaps[c]	**$ –**	**$ –**	**$ (14,051)**	**$ (14,051)**	**$ –**	**$ (14,051)**
Total	**$ –**	**$ –**	**$ (14,051)**	**$ (14,051)**	**$ –**	**$ (14,051)**

(In Thousands)

13. Fair Value of Financial Instruments (continued)

	December 31, 2017					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets						
Short-term investments[(a)]	$ 3,388	$ –	$ –	$ 3,388	$ –	$ 3,388
Internally designated investments:						
Blended fund	421,268	–	–	421,268	–	421,268
Total mutual funds	421,268	–	–	421,268	–	421,268
Common stock[(a)]	5,961	–	–	5,961	–	5,961
Alternatives:						
Fund of hedge funds	–	–	–	–	2,884	2,884
International equity	–	–	–	–	2,772	2,772
MLP	–	–	–	–	38,208	38,208
Private equity	–	–	–	–	33,006	33,006
REIT	–	–	–	–	31,050	31,050
International	–	–	–	–	14,969	14,969
Commingled funds	–	–	–	–	94,174	94,174
Other	–	–	–	–	16,656	16,656
Long/short hedge	–	–	–	–	14,144	14,144
Global	–	–	–	–	4,946	4,946
Multi-strategy	–	–	–	–	25,473	25,473
Total alternatives	–	–	–	–	278,282	278,282
Total internally designated investments	427,229	–	–	427,229	278,282	705,511

(In Thousands)

13. Fair Value of Financial Instruments (continued)

	December 31, 2017					
	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets (continued)						
Restricted cash[a]	$ 2,758	$ –	$ –	$ 2,758	$ –	$ 2,758
Ext. designated investment – insurance trust:						
Fixed income[a]	2,710	–	–	2,710	–	2,710
Designated cash[a]	20,315	–	–	20,315	–	20,315
Board-designated endowment:						
Mutual funds:[a]						
Equities	1,378	–	–	1,378	–	1,378
Blended fund	16,812	–	–	16,812	–	16,812
Fixed income[a], [b]	197	146	–	343	–	343
Equities[a]	1,576	–	–	1,576	–	1,576
Alternatives	–	–	–	–	7,207	7,207
Total board-designated endowment	19,963	146	–	20,109	7,207	27,316
Endowment:						
Mutual funds:[a]						
Fixed income	1	–	–	1	–	1
Blended fund	4,914	–	–	4,914	–	4,914
Money market[a]	3	–	–	3	–	3
Equities[a]	460	–	–	460	–	460
Alternatives	–	–	–	–	2,552	2,552
Total endowment	5,378	–	–	5,378	2,552	7,930
Swap[c]	–	–	625	625	–	625
Total	$ 481,741	$ 146	$ 625	$ 482,512	$ 288,041	$ 770,553
Liabilities						
Swaps[c]	$ –	$ –	$ (16,305)	$ (16,305)	$ –	$ (16,305)
Total	$ –	$ –	$ (16,305)	$ (16,305)	$ –	$ (16,305)

(In Thousands)

13. Fair Value of Financial Instruments (continued)

(a) Pricing for mutual funds, short-term investments, equities, and government obligations is based on the open market and is valued on a daily basis.

(b) Pricing is based on the fair value of the securities and is valued on a monthly basis. Information used to value this account is provided by International Data Corp. (IDC). In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue from the IDC data to appropriately value the holding.

(c) Pricing is based on discounted cash flows to reflect a credit spread adjustment to the LIBOR discount curve in order to reflect “nonperformance” risk. The credit spread adjustment is derived from how other comparable entities’ bonds price and trade in the market. As the credit spread adjustment is a significant component of the swap valuation and is an unobservable input, the swaps have been classified as Level 3.

(d) Pricing is based on the market value of the securities and is valued on a monthly basis.

The table below sets forth a summary of changes in the fair value of the Corporation’s Level 3 swaps for the years ended December 31:

	2018	**2017**
Balance, beginning of the year	**$ (15,679)**	$ (22,779)
Unrealized gains, net	**1,628**	7,099
Realized gains, net	–	–
Sales of swaps	–	–
Balance, end of the year	**$ (14,051)**	$ (15,680)

For the year ended December 31, 2018, the Corporation recorded approximately $1,628 in non-operating gains, which relates to gains of $1,958 due to the change in the swaps’ value and loss of $330 to reflect the fair value of the uncollateralized portion of the swap balance. For the year ended December 31, 2017, the Corporation recorded approximately $7,099 in non-operating gains, which relates to gains of $7,775 due to the change in the swaps’ value and loss of $676 to reflect the fair value of the uncollateralized portion of the swap balance.

14. Professional Liability Insurance

The Corporation is involved in lawsuits and various governmental investigations, audits, reviews, and administrative proceedings arising in the ordinary course of business. Additionally, the Corporation may be subject to additional claims alleging professional liability for medical malpractice. The Corporation has a claims made policy that covers all entities and has a $25,000 deductible per claim. Historically, MHSB and EGH have obtained separate professional liability insurance coverage under claims-made policies. The claims made policy covers all years other than years that were self-funded. MHSB was self-funded of its professional and general liability coverage for the period of December 1, 2003 to November 30, 2009. EGH was self-funded for its professional and general liability coverage for the period of March 1, 2010 to April 1, 2012. The Indiana Medical Malpractice Act has provided recovery up to $1,250, per occurrence, with the first $250 covered by the respective entity, for claims prior to July 1, 2017. Effective July 1, 2017, the coverage limit was increased to $1,650, per occurrence, with the first $400 covered by the respective entity. MHSB maintains a trust fund for its self-insurance program, which it will continue to maintain until all claims have been settled. The fair value of the trust fund at December 31, 2018 and 2017 was approximately $2,747 and $2,710, respectively. The amount of malpractice and general liability claims, including a component for incurred but not reported claims, was approximately $5,097 and $5,227, gross of an insurance recoverable at December 31, 2018 and 2017, respectively, which is included in pension and other liabilities. The interest rate used to discount these claims was 3% at December 31, 2018. In addition, at December 31, 2018 and 2017, the Corporation recognized a recoverable insurance asset of approximately $4,287, which is included in deferred charges and other assets.

15. Income Taxes

The Corporation and its related affiliates, except for BHV, have been determined to qualify as exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) of the Code.

Most of the income received by the Corporation and its related affiliates, except for BHV, is exempt from taxation, as the income is related to the mission of the organization. Accordingly, there is no material provision for income tax for these entities. However, some of the income received by exempt entities is subject to taxation as unrelated business income. The Corporation and its subsidiaries file federal and various state income tax returns in the United States.

(In Thousands)

15. Income Taxes (continued)

ASC 740, *Income Taxes*, requires that realization of an uncertain income tax position is more likely than not (i.e., greater than 50% likelihood of receiving a benefit) before it is recognized in the financial statements as the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. This interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. No amount was recorded for the years ended December 31, 2018 or 2017.

16. Net Assets Without Donor Restrictions

Net assets without donor restrictions are comprised of the following at December 31:

	2018	2017
Undesignated	**$ 1,300,249**	$ 1,278,461
Board Designated Endowment	**25,002**	27,316
	$ 1,325,251	$ 1,305,777

Board Designated Endowment – The Board has designated a portion of net assets without donor restrictions as a board designated endowment for the purpose of funding the Foundation's operational expenses.

17. Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following purposes at December 31:

	2018	2017
Net assets currently available for:		
Children's Services	**$ 2,431**	$ 3,251
Education	**1,965**	1,997
Patient Care	**6,693**	7,726
System Priorities	**505**	418
Community Impact	**344**	190
Quasi Endowments	**475**	475
	$ 12,413	$ 14,057

17. Net Assets With Donor Restrictions (continued)

The various purposes of the above donor restricted amounts are as follows:

Children's Services – Programs and services for pediatric patients throughout the Corporation

Education – Formal and continuing education

Patient Care – Specific patient care services lines (i.e., cancer, cardiac and trauma)

System Priorities – Specific system intiatives as determined throughout the Corporation requiring formal approval and funding

Community Impact – Initiatives that focus on preventative care and education throughout our community

Quasi Endowments – Designated to be held in perpetuity, income generated to be used for indignant care and/or area of greatest need

18. Subsequent Events

The Corporation evaluated events and transactions occurring subsequent to December 31, 2018 through March 1, 2019, the date of issuance of the accompanying consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

Supplementary Information

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet

(Unaudited)

December 31, 2018

(In Thousands)

	Consolidated	Eliminations	Beacon Health System, Inc.	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Beacon Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Community Hospital of Bremen
Assets									
Current assets:									
Cash and cash equivalents	$ 56,926	$ –	$ 35,377	$ (3,694)	$ 6,167	$ 100	$ 4,602	$ 13,337	$ 1,037
Short-term investments	38,637	–	37,575	12	–	1,050	–	–	–
Patient accounts receivable	162,335	(5,340)	989	97,057	17,310	–	1,834	47,948	2,537
Due from third-party payors	46,739	–	–	44,999	1,133	–	–	607	–
Other receivables	8,256	–	891	3,577	1,410	811	262	1,302	3
Inventories	25,192	–	–	17,814	90	–	163	6,970	155
Prepaid expenses	14,357	–	10,219	1,774	755	–	113	1,348	148
Due from affiliates	-	(6,943)	6,929	4	9	–	–	1	–
Total current assets	352,442	(12,283)	91,980	161,543	26,874	1,961	6,974	71,513	3,880
Assets limited as to use:									
Internally designated investments	674,952	–	674,952	–	–	–	–	–	–
Restricted Cash	3,886	–	–	–	–	2,632	–	–	1,254
Externally designated investments - insurance trust	2,747	–	–	2,718	19	–	10	–	–
Board designated endowment	25,002	–	–	–	–	25,002	–	–	–
Endowment invesment assets	7,322	–	–	–	–	742	–	6,580	–
	713,909	–	674,952	2,718	19	28,376	10	6,580	1,254
Property and equipment:									
Land	53,342	–	23,248	21,501	3,968	–	–	3,846	779
Building and improvements	824,120	–	4,598	504,886	50,077	19	1,437	254,069	9,034
Furniture and equipment	500,329	–	48,063	294,503	35,753	162	2,687	117,263	1,898
Construction in progress	21,295	–	15,147	3,936	648	75	–	1,468	21
	1,399,086	–	91,056	824,826	90,446	256	4,124	376,646	11,732
Less allowances for depreciation and amortization	737,060	–	34,623	460,418	43,089	156	3,149	195,121	504
	662,026	–	56,433	364,408	47,357	100	975	181,525	11,228
Deferred charges and other assets	57,411	(12,367)	32,129	4,530	18,904	521	7,027	4,896	1,771
Interest in net assets of recipient organization	-	(5,758)	–	5,758					
	$ 1,785,788	$ (30,408)	$ 855,494	$ 538,957	$ 93,154	$ 30,958	$ 14,986	$ 264,514	$ 18,133

* Days Cash on Hand (including investments) is 306.67 as of December 31, 2018
* MADS (Maxium Annual Debt Service) is $21.5M as of December 31, 2018

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet (continued)
(Unaudited)
December 31, 2018
(In Thousands)

	Consolidated	Eliminations	Beacon Health System, Inc.	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Beacon Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Community Hospital of Bremen
Liabilities and net assets									
Current liabilities:									
Accounts payable	$ 45,980	$ –	$ 5,427	$ 19,435	$ 8,088	$ 26	$ 1,860	$ 10,987	$ 157
Accrued expenses	51,780	(5,340)	8,896	24,341	9,252	–	745	12,439	1,447
Due to third-party payors	5,942	–	–	5,469	–	–	–	473	–
Due to affiliates	–	(6,943)	–	–	–	2	6,941	–	–
Current maturities of long-term debt	10,724	–	2,090	5,179	50	–	–	2,844	561
Total current liabilities	114,426	(12,283)	16,413	54,424	17,390	28	9,546	26,743	2,165
Noncurrent liabilities:									
Long-term debt, less current maturities	307,012	–	82,131	144,265	240	–	–	68,211	12,165
Pension and other liabilities	12,635	–	2,703	8,085	23	–	12	1,812	–
Interest rate and basis swaps	14,051	–	–	14,051	–	–	–	–	–
	333,698	–	84,834	166,401	263	–	12	70,023	12,165
Total liabilities	448,124	(12,283)	101,247	220,825	17,653	28	9,558	96,766	14,330
Net assets:									
Net assets without donor restrictions	1,325,251	(12,367)	754,247	312,374	75,501	25,097	5,428	161,168	3,803
Net assets with donor restrictions	12,413	(5,758)	–	5,758	–	5,833	–	6,580	–
Total net assets	1,337,664	(18,125)	754,247	318,132	75,501	30,930	5,428	167,748	3,803
Total liabilities and net assets	$ 1,785,788	$ (30,408)	$ 855,494	$ 538,957	$ 93,154	$ 30,958	$ 14,986	$ 264,514	$ 18,133

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Statement of Operations and Changes in Net Assets
(Unaudited)
Year Ended December 31, 2018
(In Thousands)

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Beacon Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.	Community Hospital of Bremen
Unrestricted revenue, gains, and other support									
Patient service revenue	$ 975,114	$ –	$ 543,838	$ 117,335	$ –	$ 13,390	$ 280,131	$ 9,139	$ 11,281
Other revenue	46,776	(7,571)	21,555	7,208	1,121	3,291	9,392	10,444	1,336
Net assets released from restrictions used for operations	1,054	–	589	32	77	–	15	341	–
	1,022,944	(7,571)	565,982	124,575	1,198	16,681	289,538	19,924	12,617
Expenses									
Salaries and wages	418,097	–	151,191	136,045	–	10,723	82,149	32,835	5,154
Employee benefits	111,591	–	42,259	25,513	–	2,783	25,156	13,052	2,828
Supplies and other	250,122	(7,571)	137,248	21,567	326	3,762	79,083	12,998	2,709
Management fees	–	–	35,014	11,474	153	1,239	23,031	(71,578)	667
Professional fees and purchased services	117,650	–	46,196	5,257	1,095	717	28,970	33,703	1,712
Depreciation and amortization	58,951	–	30,115	5,470	6	434	17,810	4,620	496
Interest	7,905	–	5,604	2	–	–	1,908	62	329
	964,316	(7,571)	447,627	205,328	1,580	19,658	258,107	25,692	13,895
Income (loss) from operations	58,628	–	118,355	(80,753)	(382)	(2,977)	31,431	(5,768)	(1,278)
Investment income, net	(21,923)	–	122	61	(2,301)	5	22	(19,859)	27
Unrealized losses on swap transactions, net	1,628	–	1,628	–	–	–	–	–	–
Pension Settlement	(118,087)	–	–	(52,854)	–	–	(65,233)	–	–
Revenue and gains (less than) in excess of expenses	(79,754)	–	120,105	(133,546)	(2,683)	(2,972)	(33,780)	(25,627)	(1,251)

Beacon Health System, Inc. and Affiliated Corporations

Details of Consolidated Statement of Operations and Changes in Net Assets (continued)
(Unaudited)
Year Ended December 31, 2018
(In Thousands)

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Beacon Medical Group, Inc.	Beacon Health Foundation, Inc.	Beacon Health Ventures, Inc.	Elkhart General Hospital, Inc.	Beacon Health System, Inc.	Community Hospital of Bremen
Net assets without donor restrictions									
Revenue and gains (less than) in excess of expenses	$ (79,754)	$ –	$ 120,105	$ (133,546)	$ (2,683)	$ (2,972)	$ (33,780)	$ (25,627)	$ (1,251)
Net assets released from restrictions used for capital purposes	1,187	–	1,155	–	–	–	27	5	–
Net assets released from restrictions used for RMFR operating	6	–	–	–	6	–	–	–	–
Transfer (to) from affiliates	–	–	(99,873)	96,123	904	–	(21,377)	19,169	5,054
Post retirement benefit adjustments, other than periodic costs	98,035	–	–	40,139	–	–	57,896	–	–
Increase (decrease) in net assets without donor restrictions	19,474	–	21,387	2,716	(1,773)	(2,972)	2,766	(6,453)	3,803
Net assets with donor restrictions									
Purpose-restricted contributions	1,347	–	–	–	1,347	–	–	–	–
Investment loss	(744)	–	–	–	(156)	–	(588)	–	–
Net assets released from restriction used for operating and capital purposes	(2,247)	–	–	–	(2,247)	–	–	–	–
Change in interest in recipient organization	–	1,056	(1,056)	–	–	–	–	–	–
(Decrease) increase in net assets with donor restrictions	(1,644)	1,056	(1,056)	–	(1,056)	–	(588)	–	–
Increase (decrease) in net assets	17,830	1,056	20,331	2,716	(2,829)	(2,972)	2,178	(6,453)	3,803
Net assets at beginning of year	1,319,834	(19,181)	297,801	72,785	33,759	8,400	165,570	760,700	–
Net assets at end of year	$ 1,337,664	$ (18,125)	$ 318,132	$ 75,501	$ 30,930	$ 5,428	$ 167,748	$ 754,247	$ 3,803

Management Discussion
Year ended December 31, 2018 Compared to Year Ended December 31, 2017

Revenue, Expenses and Net Income

Net Patient Service Revenue. The Corporation's net patient service revenue (NPSR) for the Year ended December 31, 2018 (2018) compared to December 31, 2017 (2017) increased by 8.2%, while gross patient revenues increased by 9.0%. NPSR in 2018 and 2017 includes approximately $20,143,000 and $27,960,000 recorded by Memorial Hospital of South Bend for the Indiana Medicaid Disproportionate Share (DSH) program. Hospital inpatient (IP) days increased 3.7%, while IP admissions increased 1.3% through of 2018. Outpatient (OP) procedures decreased by 0.5% while OP days decreased by 1.2%.

The Corporation has adopted Topic 606, Revenue from contracts with Customers, including a full retrospective method for comparative periods. The Corporation includes Medicaid related assessments in other expenses. Medicaid assessments included in NPSR were $34,774,000 in 2018 and $30,290,000 in 2017. Upon adoption what was previously classified as bad debt expense as a reduction in NPSR is now treated as an implicit price concession that reduces the transaction price and is included in NPSR. There were no other material impacts from implementation of the standard.

Operating Expenses. The Corporation's operating expenses in 2018 compared to 2017 increased 5.7% or $52,260,000. Salaries and wages increased $23,906,000 or 6.1% related to volume increases as well as overall cost of living adjustments. Supplies costs increased $17,765,000 or 7.7% related to volume.

Operating Margin. The Corporation's operating income of $58,625,000 represents a $27,334,000 increase compared to 2017. Management attributes the increase to significant volume increases as gross revenue increased by approximately 9.0% but operating expenses as a percentage of gross revenue decreased by approximately 1.1%, mainly driven by salaries and wages and supplies costs not increasing as significantly as patient volumes.

Nonoperating Activity. Investment income performance decreased in 2018 compared to 2017. Investments reflected losses of $21,923,000 in 2018 compared to gains of $82,462,000 in 2017. Unrealized gains on swaps were $1,628,000 in 2018 compared to $7,099,000 in 2017. Pension Settlement losses of $118,087,000 were recorded in 2018 for the final termination of the pension obligation.

Balance Sheet

Current Assets: Current assets increased by approximately $60,121,000 since December 31, 2017, due to approximately $33,000,000 from 2018 bond proceeds in short term investments for use in future capital projects and an increase in amounts due from third party payors related to outstanding DSH receivables. Net patient service accounts receivable has increased by approximately $10,544,000. Net days in accounts receivable were 57 days at December 31, 2018 and 2017.

Current Liabilities: Current liabilities have decreased by approximately $11,618,000 since December 31, 2017. This is primarily driven by timing differences in accounts payable, payroll and other related accruals.

Other Liabilities and Long Term Debt: In October 2018, The Corporation made additional contributions of approximately $36,179,000 to the defined-benefit pension plans. The Corporation purchased annuity contracts from American General Life Insurance, Inc. and paid lump-sum cash payouts to all remaining participants to fully relieve the Corporation of the outstanding pension obligations as of December 31, 2018. In December 2018, The Corporation issued $35,000,000 of 2018 Series bonds Proceeds from the bonds are being utilized to construct, furnish and equip a new 32,800 square foot hospital and 50,000 square foot office building located on Beacon Parkway in Mishawaka, Indiana.

Beacon Health System
Summary of Key Statistics
For the Years Ended December 31, 2018 and 2017

	Years Ended			
	2018			2017
	Actual	Budget	Var	Prior Year
Elkhart General Hospital				
Adult & Pediatric IP Admissions	10,448	10,317	131	10,340
Total IP Patient Days	42,916	40,817	2,099	41,109
I/P Surgical Procedures (incl Open Heart)	2,436	2,526	(90)	2,593
O/P Surgical Procedures	3,918	3,709	209	3,728
Births	1,304	1,403	(99)	1,366
ER Visits	56,478	61,263	(4,785)	60,249
Memorial Hospital				
Adult & Pediatric IP Admissions	18,698	18,725	(27)	18,422
Total IP Patient Days	90,533	88,600	1,933	87,619
I/P Surgical Procedures (incl Open Heart)	4,379	3,890	489	3,964
O/P Surgical Procedures	8,191	8,675	(484)	8,444
Births	2,419	2,660	(241)	2,453
ER Visits	57,739	54,585	3,154	54,623
Physician Practices:				
Total Visits- BMG	874,294	933,462	(59,168)	859,193

Payor Mix based on Gross Revenues:	YTD	YTD 2017
Elkhart		
Medicare	50.8%	50.0%
Medicaid	13.8%	14.9%
Self Pay	5.3%	4.6%
Commercial	30.1%	30.5%
Memorial		
Medicare	44.6%	43.3%
Medicaid	18.8%	19.8%
Self Pay	3.8%	3.3%
Commercial	32.8%	33.6%