HOUSTON HEALTHCARE SYSTEM, INC.

COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Warren Averett
CPAs AND ADVISORS

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Warren Averett
CPAs AND ADVISORS

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Houston Healthcare System, Inc.

We have audited the accompanying combined financial statements of Houston Healthcare System, Inc. (a Georgia corporation), which comprise the combined balance sheets as of December 31, 2018 and 2017 and the related combined statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements
Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

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

Warren Averett, LLC

Atlanta, Georgia
March 26, 2019

HOUSTON HEALTHCARE SYSTEM, INC.
COMBINED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

ASSETS

	2018	2017
CURRENT ASSETS		
Cash and cash equivalents	$ 10,725,000	$ 5,091,000
Assets limited as to use – current portion	610,000	602,000
Patient accounts receivable, net	26,616,000	29,739,000
Estimated third-party payor receivable	82,000	1,061,000
Insurance recoveries – current portion	1,651,000	1,710,000
Supplies, at lower of cost (first-in, first-out) or market and other assets	6,545,000	8,209,000
Total current assets	46,229,000	46,412,000
ASSETS LIMITED AS TO USE		
Internally designated for capital acquisition and other	207,634,000	235,357,000
Held by trustee under indenture agreement	2,295,000	2,256,000
	209,929,000	237,613,000
Less amounts required to meet current obligations	610,000	602,000
Total assets limited as to use	209,319,000	237,011,000
PROPERTY AND EQUIPMENT, NET	143,035,000	153,499,000
OTHER ASSETS		
Long-term investments and other	3,374,000	3,570,000
Insurance recoveries	5,411,000	5,711,000
Total other assets	8,785,000	9,281,000
TOTAL ASSETS	$ 407,368,000	$ 446,203,000

See notes to the combined financial statements.

HOUSTON HEALTHCARE SYSTEM, INC.
COMBINED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

LIABILITIES AND NET ASSETS

	2018	2017
CURRENT LIABILITIES		
Current maturities of long-term debt	$ 3,835,000	$ 3,655,000
Accounts payable and accrued expenses	6,668,000	3,898,000
Accrued compensation and benefits	16,837,000	17,049,000
Estimated third-party payor settlements	3,833,000	4,980,000
Other current liabilities	6,408,000	6,082,000
Total current liabilities	37,581,000	35,664,000
LONG-TERM DEBT, NET OF CURRENT INSTALLMENTS	69,547,000	74,164,000
SELF-INSURANCE RESERVES	13,385,000	13,142,000
ACCRUED PENSION LIABILITY	9,893,000	11,220,000
TOTAL LIABILITIES	130,406,000	134,190,000
NET ASSETS		
Without donor imposed restrictions	276,962,000	312,013,000
Total net assets	276,962,000	312,013,000
TOTAL LIABILITIES AND NET ASSETS	$ 407,368,000	$ 446,203,000

See notes to the combined financial statements.

HOUSTON HEALTHCARE SYSTEM, INC.
COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	(as adjusted) 2017
OPERATING REVENUES		
Net patient service revenue	$ 237,385,000	$ 231,580,000
Other revenue	2,174,000	3,684,000
Total operating revenues	239,559,000	235,264,000
OPERATING EXPENSES		
Salaries and benefits	141,397,000	140,243,000
Supplies and drugs	42,605,000	39,457,000
Other expenses	56,293,000	52,413,000
Depreciation and amortization	18,583,000	19,397,000
Interest expense	2,753,000	4,886,000
Total operating expenses	261,631,000	256,396,000
OPERATING LOSS	(22,072,000)	(21,132,000)
NONOPERATING (EXPENSES) REVENUES		
Investment income	4,682,000	4,431,000
Other components of net periodic pension costs	1,039,000	2,029,000
Net realized gains on sales of securities	12,740,000	10,826,000
Net unrealized (losses) gains on securities	(26,968,000)	11,533,000
Noncapital grants, contributions, and other	(124,000)	(91,000)
Total nonoperating (expenses) revenues	(8,631,000)	28,728,000
EXCESS OF REVENUES (UNDER) OVER EXPENSES	(30,703,000)	7,596,000
Changes in pension assets and benefit obligations not included in net periodic pension costs	(4,348,000)	(5,285,000)
(DECREASE) INCREASE IN NET ASSETS WITHOUT DONOR IMPOSED RESTRICTIONS	(35,051,000)	2,311,000
NET ASSETS AT BEGINNING OF YEAR	312,013,000	309,702,000
NET ASSETS AT END OF YEAR	$ 276,962,000	$ 312,013,000

See notes to the combined financial statements.

HOUSTON HEALTHCARE SYSTEM, INC.
COMBINED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	(as adjusted) 2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ (35,051,000)	$ 2,311,000
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	18,678,000	19,397,000
Bond premium / discount amortization	(900,000)	(602,000)
Loss on sale of assets	164,000	117,000
Net unrealized losses (gains) on securities	26,968,000	(11,533,000)
Net realized gains on sales of securities	(12,740,000)	(10,826,000)
Changes in:		
Patient accounts receivable, net	3,123,000	(172,000)
Supplies and other assets	1,664,000	(1,941,000)
Self-insurance reserves and insurance recoveries	602,000	489,000
Long-term investments and other	157,000	(442,000)
Accounts payable and accrued expenses	2,558,000	(3,645,000)
Estimated third-party payor settlements	(168,000)	(288,000)
Other current liabilities	326,000	(404,000)
Accrued pension obligations	(1,327,000)	(1,283,000)
Net cash provided by (used in) operating activities	4,054,000	(8,822,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of assets limited as to use	(137,053,000)	(134,143,000)
Proceeds from sale of assets limited as to use	133,548,000	131,033,000
Withdrawals from assets limited as to use	17,000,000	20,000,000
Sales of state and local government securities	-	66,956,000
Change in assets held by trustee under indenture agreement, net	-	1,266,000
Capital expenditures	(8,261,000)	(12,784,000)
Proceeds from sale of property and equipment	-	213,000
Net cash provided by investing activities	5,234,000	72,541,000

See notes to the combined financial statements.

HOUSTON HEALTHCARE SYSTEM, INC.
COMBINED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	(as adjusted) 2017
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt	$ (3,654,000)	$ (70,563,000)
Net cash used in financing activities	(3,654,000)	(70,563,000)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,634,000	(6,844,000)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	5,091,000	11,935,000
AT END OF YEAR	$ 10,725,000	$ 5,091,000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 3,579,000	$ 5,880,000

See notes to the combined financial statements.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Houston Healthcare System, Inc. (the "System"), located in Warner Robins, Georgia, is a not-for-profit corporation that operates acute care hospitals and freestanding outpatient treatment facilities. The System provides a full range of inpatient, outpatient, and emergency services to the residents of Houston County and surrounding areas. The following entities comprise the System: Houston Hospitals, Inc. operates two acute care hospitals, Houston Medical Center and Perry Hospital, which provide inpatient, outpatient, and urgent care services; Houston Healthcare EMS, Inc. provides ambulance services to the residents of Houston County; Houston Healthcare Properties, Inc. owns and manages the non-hospital property of the System; Houston Health Ventures, Inc. is a for-profit corporation engaged in joint ventures that assist and promote the tax exempt purposes of the System; Houston Primary Care Physicians, LLC and Houston Physician Specialties, LLC operate free-standing primary care and specialty physician practices. All intercompany transactions have been eliminated.

Effective January 1, 2009, the Hospital Authority of Houston County, Georgia (the Authority) implemented a reorganization plan for Houston Hospitals, Inc. and related facilities whereby all the assets, liabilities, management and governance of the facilities were transferred to Houston Hospitals, Inc., pursuant to a lease and transfer agreement which provides for a nominal rate to the Authority by the System. The lease term expires December 31, 2048.

Adoption of New Accounting Standards

On January 1, 2018, the System adopted Accounting Standards Update (ASU) 2014-09, the new revenue recognition accounting standard issued by the Financial Accounting Standards Board (FASB) and codified in the FASB Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*. The revenue recognition standard in ASC 606 outlines a single comprehensive model for recognizing revenue as performance obligations, defined in a contract with a customer as goods or services transferred to the customer in exchange for consideration, are satisfied. The standard also requires expanded disclosures regarding the System's revenue recognition policies and significant judgments employed in the determination of revenue.

The System applied the retrospective approach to all contracts when adopting ASC 606. As a result, upon the System's adoption of ASC 606 the majority of what was previously classified as the provision for bad debts in the combined statements of operations and changes in net assets is now reflected as implicit price concessions (as defined in ASC 606) and therefore is included as a reduction to net operating revenues in 2018 and 2017. For changes in credit issues not assessed at the date of service, the System prospectively recognizes those amounts, if any, in operating expenses on the combined statements of operations and changes in net assets. For periods prior to the adoption of ASC 606, the provision for bad debts had been presented consistent with the previous revenue recognition standards that required such provision to be presented separately as a component of net operating revenues. Additionally, upon adoption of ASC 606 the allowance for doubtful accounts of approximately $30.6 million as of December 31, 2017, was reclassified as a component of patient accounts receivable, net. Other than these changes in presentation on the combined statements of operations and changes in net assets and combined balance sheets, the adoption of ASC 606 did not have a material impact on the financial position or change in net assets for the years ended December 31, 2018 and 2017, and the System does not expect it to have a material impact on its results of operations on a prospective basis.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

In January 2016, the FASB issued ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which amends the measurement, presentation and disclosure requirements for equity investments, other than those accounted for under the equity method or that require consolidation of the investee. The ASU eliminates the classification of equity investments as other than trading with any changes in fair value of such investments recognized in other changes in net assets, and requires entities to measure equity investments at fair value, with any changes in fair value recognized in income. This ASU is effective for fiscal years beginning after December 15, 2017. The System adopted this ASU on January 1, 2018, and the adoption of this ASU did not have a material impact on its financial position or change in net assets. For presentation purposes, the 2017 combined statement of operations and changes in net assets has been reclassified to conform to the 2018 presentation.

In August 2016, the FASB issued ASU 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, which made several improvements to current financial reporting for not-for-profits. The guidance was effective for the System's annual combined financial statements for the year ending December 31, 2018. The most significant provisions of this standard required two classes of net assets, rather than the previously required three classes and additional disclosures for functional allocation of expenses and liquidity. The changes in the ASU were applied on a retrospective basis, which means that all combined financial statements presented reflect the changes. The adoption of this ASU did not have a material impact on the combined financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which changes the presentation of the components of net periodic benefit cost for sponsors of defined benefit plans for pensions. Under the changes in this ASU, the service cost component of net periodic benefit cost is reported in the same income statement line as other employee compensation costs arising from services during the reporting period. The other components of net periodic benefit cost are presented separately in a line item outside of operating loss. This ASU is effective for fiscal years beginning after December 15, 2017. The System adopted this ASU on January 1, 2018, and the adoption of this ASU did not have a material impact on the System's financial position or change in net assets. The 2017 combined statement of operations and changes in nets assets has been adjusted to conform to the 2018 presentation.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Change in Accounting Policy

In connection with the adoption of ASU 2016-01, the System reassessed its previous treatment of investments in debt securities as other than trading securities which necessitated any unrealized gains and losses on those investments to be presented in the combined statements of operations and changes in net assets as other changes in net assets outside of the excess of revenues (under) over expenses. After the reassessment, the System determined that those investments are more appropriately classified as trading securities whereby the unrealized gains and losses are included in the excess of revenues (under) over expenses. This reassessment provides for consistent treatment of all unrealized gains and losses and better aligns the presentation of unrealized gains and losses on investments in debt securities with the System's investment strategy. For presentation purposes, the 2017 combined statement of operations and changes in net assets has been reclassified to conform to the 2018 presentation.

Use of Estimates

The preparation of combined financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) 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 combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

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

Investments and Investment Income

Investments in equity and debt securities are measured at fair value in the combined balance sheets. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in excess of revenues (under) over expenses unless the income or loss is restricted by donor or law.

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustee under indenture agreements and designated assets set aside by the Board of Trustees (the Board) for future capital improvements and other, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the System have been reclassified in the combined balance sheets at December 31, 2018 and 2017.

Property and Equipment

Property and equipment acquisitions are recorded at cost and generally defined as items with an acquisition cost of $2,500 per unit or greater, a useful life of three years or more, and qualify as tangible personal property. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the combined financial statements.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support, and are excluded from excess of revenues (under) over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations addressing how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of Long-Lived Assets
The System evaluates on an ongoing basis the recoverability of its assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is required to be recognized if the carrying value of the asset exceeds the undiscounted future net cash flows associated with that asset. The impairment loss to be recognized is the amount by which the carrying value of the long-lived asset exceeds the asset's fair value. In most instances, the fair value is determined by discounted estimated future cash flows using an appropriate interest rate. The System has not recorded any impairment charges in the accompanying combined statements of operations and changes in net assets for the years ended December 31, 2018 and 2017.

Cost of Borrowing
Interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no capitalized interest cost for the years ended December 31, 2018 and 2017.

Long-Term Investments and Other
Long-term investments and other consist of notes receivable and investments in unconsolidated companies. Notes receivable are from loans secured by promissory contracts. Investments in unconsolidated companies represent the System's participation in joint ventures and partnerships, which are accounted for on the cost and equity methods and are not material to the System's combined financial statements.

Deferred Financing Costs
Deferred financing costs related to the issuance of long-term debt were deferred and are being amortized using the straight-line method, which approximates the effective interest method. Unamortized deferred financing costs are presented in the accompanying combined balance sheets as an adjustment to the carrying value of the related debt.

Excess of Revenues (Under) Over Expenses
The combined statements of operations and changes in net assets include excess of revenues (under) over expenses. Changes in unrestricted net assets which are excluded from excess of revenues (under) over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, changes in pension assets and benefit obligations not included in net periodic pension costs, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Net Patient Service Revenue

Upon the adoption of ASC 606, net patient service revenues are recorded at the transaction price estimated by the System to reflect the total consideration due from patients and third-party payors in exchange for providing goods and services for patient care. These services are considered to be a single performance obligation and have a duration of less than one year. Revenues are recorded as these goods and services are provided. The transaction price, which involves significant estimates, is determined based on the System's standard charges for the goods and services provided, with a reduction recorded for price concessions related to third-party contractual arrangements as well as patient discounts and other patient price concessions. During the years ended December 31, 2018 and 2017, the impact of changes to the inputs used to determine the transaction price was considered immaterial to the current periods.

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as support without donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as unrestricted net assets and reported in the combined statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying combined financial statements.

Risk Management

The System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The System is partially self-insured for employee health and professional liability as disclosed in Notes 12 and 13. The System is also partially self-insured for workers' compensation.

Estimated Malpractice Costs and Other Self-Insurance Costs

The provision for estimated medical malpractice claims and other self-insurance plans includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Income Taxes

The System is a not-for-profit corporation that has been recognized as tax-exempt pursuant to Section 501(c)3 of the Internal Revenue Code.

The System applies accounting policies that prescribe when to recognize and how to measure the combined financial statement effects of income tax positions taken or expected to be taken on its income tax returns. These rules require management to evaluate the likelihood that, upon examination by the relevant taxing jurisdictions, those income tax positions would be sustained. Based on that evaluation, the System only recognizes the maximum benefit of each income tax position that is more than 50% likely of being sustained. To the extent that all or a portion of the benefits of an income tax position are not recognized, a liability would be recognized for the unrecognized benefits, along with any interest and penalties that would result from disallowance of the position. Should any such penalties and interest be incurred, they would be recognized as operating expenses.

Based on the results of management's evaluation, no liability is recognized in the accompanying combined balance sheets for unrecognized income tax positions. Further, no interest or penalties have been accrued or charged to expense as of December 31, 2018 and 2017 or for the years then ended. The System's tax returns are subject to possible examination by taxing authorities. For federal income tax purposes, the tax returns essentially remain open for possible examination for a period of three years after the respective filing deadlines of those returns.

Houston Health Ventures, Inc. is a for-profit corporation and wholly-owned subsidiary of the System. The System has not recorded a current or deferred tax provision, as this would not have a material effect on the combined financial statements.

Fair Value Measurements

The standards for fair value measurement of financial assets and liabilities define fair value, establish a framework for measuring fair value, and expand disclosures about fair value measurement. The guidance also emphasizes that fair value is based on a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Fair value measurements are disclosed by level within the hierarchy.

Under the guidance for fair value measurement of nonfinancial assets and liabilities, measurements occur on a nonrecurring basis, and recognition at fair value occurs when nonfinancial assets and liabilities are deemed to be other-than-temporarily impaired. The System does not have any nonfinancial assets or nonfinancial liabilities at December 31, 2018 and 2017 that require disclosure by levels within the hierarchy.

Prior Year Reclassifications

Certain reclassifications have been made to the 2017 combined financial statements to conform to the 2018 presentation. These reclassifications had no significant impact on net assets, changes in net assets, or cash flows in the accompanying combined financial statements.

Subsequent Events

The System has evaluated the impact of subsequent events through March 26, 2019, representing the date on which the combined financial statements were issued.

1. DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Subtopic 842).* The purpose of this ASU is to increase transparency and comparability among organizations by recognizing leased assets and leased liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this ASU require that lessees recognize the rights and obligations resulting from leases as assets and liabilities on their balance sheets, initially measured at the present value of the lease payments over the term of the lease, including payments to be made in optional periods to extend the lease and payments to purchase the underlying assets if the lessee is reasonably certain of exercising those options. The main difference between previous GAAP and Topic 842 is the recognition of leased assets and leased liabilities by lessees for those leases classified as operating leases under previous GAAP.

At transition, entities are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, among other matters. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-to-use asset and a leased liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP.

The effective date of this ASU for a public business entity (including a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, like the System) is for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The System is currently assessing the impact this ASU will have on its combined financial statements.

2. PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. The System does not believe there are any significant credit risks associated with receivables due from third-party payors.

2. PATIENT SERVICE REVENUE – CONTINUED

A summary of the payment arrangements with major third-party payors follows:

Medicare
Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

The System is reimbursed for certain reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare Administrative Contractor (MAC). The System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the System. The System's Medicare cost reports have been audited by the MAC through 2014.

Revenue from the Medicare program accounted for approximately 42% and 36% of the System's net patient service revenue for 2018 and 2017, respectively. Laws and regulations governing the Medicare program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined. The 2018 net patient service revenue decreased approximately $181,000 (increased $429,000 for 2017) primarily due to changes in previously estimated settlements.

The System believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. However, there has been an increase in regulatory initiatives at the federal level including the initiation of the Recovery Audit Contractor (RAC) program. The RAC program was created to review Medicare claims for medical necessity and coding appropriateness. The RACs have the authority to pursue improper payments with a three year look back from the date the claim was paid. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare program.

Medicaid
Inpatient acute care services rendered to Medicaid program beneficiaries are paid at a prospectively determined rate per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services rendered to the Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology.

The System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary. The System's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through 2015.

2. PATIENT SERVICE REVENUE – CONTINUED

Revenue from the Medicaid program accounted for approximately 10% of the System's net patient service revenue for both 2018 and 2017. Laws and regulations governing the Medicaid program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined.

The System also contracts with certain managed care organizations to receive reimbursement for providing services to selected enrolled Medicaid beneficiaries. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges, or prospectively determined per diems.

The System believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. However, there has been an increase in regulatory initiatives at the state level including the initiation of the Medicaid Integrity Contractor (MIC) program. This program was created to review Medicaid claims for medical necessity and coding appropriateness. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicaid program.

During 2010, the State of Georgia enacted legislation known as the Provider Payment Agreement Act (the Act) whereby hospitals in the State of Georgia are assessed a "provider payment" in the amount of 1.45% of their net patient service revenue. The Act became effective July 1, 2010, the beginning of state fiscal year 2011. The provider payments are due on a quarterly basis to the State of Georgia's Department of Community Health. The payments are to be used for the sole purpose of obtaining federal financial participation for medical assistance payments to providers on behalf of Medicaid recipients. The provider payment results in an increase in payments for Medicaid services to hospitals of approximately 11.88%. Approximately $3,149,000 and $3,048,000 of provider payments relating to the Act are included in other expense in the accompanying combined statements of operations and changes in net assets for years 2018 and 2017, respectively.

Other Agreements

The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these agreements include prospectively determined rates per discharge, prospectively determined daily rates, fixed rate fee schedules, and discounts from established charges.

The System recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided. Therefore, the System records an implicit price concession equal to the estimated uncollectible portion of the charges related to uninsured patients in the period the services are provided.

2. PATIENT SERVICE REVENUE – CONTINUED

The System's net patient revenues during the years ended December 31, 2018 and 2017 have been presented in the following table based on an allocation of the estimated transaction price with the patient between the primary patient classification and insurance coverage:

	2018	2017
Medicare	$ 100,544,000	$ 93,244,000
Medicaid	23,979,000	25,340,000
Other third-party payors	109,507,000	105,037,000
Self-pay	3,355,000	7,959,000
Total	$ 237,385,000	$ 231,580,000

Patient Accounts Receivable

Patient accounts receivable are recorded at net realizable value based on certain assumptions determined by each payor. For third-party payors including Medicare, Medicaid, and other third-party payors, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay accounts receivable, which includes patients who are uninsured and the patient responsibility portion for patients with insurance, the net realizable value is determined using estimates of historical collection experience. These estimates are adjusted for estimated conversions of patient responsibility portions, expected recoveries and any anticipated changes in trends. Patient accounts receivable can be impacted by the effectiveness of the System's collection efforts. Additionally, significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental healthcare coverage could affect the net realizable value of accounts receivable. The System also continually reviews the net realizable value of accounts receivable by monitoring historical cash collections as a percentage of trailing net patient revenues, as well as by analyzing current period net revenue and admissions by payor classification, aged accounts receivable by payor, days revenue outstanding, and the composition of self-pay receivables between pure self-pay patients and the patient responsibility portion of third-party insured receivables.

2. PATIENT SERVICE REVENUE – CONTINUED

Charity Care

In the ordinary course of business, the System renders services to patients who are financially unable to pay for hospital care. The System's policy is to not pursue collections for such amounts; therefore, the related charges for those patients who are financially unable to pay and that otherwise do not qualify for reimbursement from a governmental program are not reported in net operating revenues, and are; therefore, classified as charity care. The System determines amounts that qualify for charity care primarily based on the patient's household income relative to the federal poverty level guidelines, as established by the federal government. These charity care services are estimated to be $47,375,000 and $49,909,000 for the years ended December 31, 2018 and 2017, respectively, representing the value (at the System's standard charges) of these charity care services that are excluded from net operating revenues. The estimated cost incurred by the System to provide these charity care services to patients who are unable to pay was approximately $14,690,000 and $16,330,000 for the years ended December 31, 2018 and 2017, respectively. The estimated cost of these charity care services was determined using a ratio of cost to gross charges and applying that ratio to the gross charges associated with providing care to charity patients for the period.

3. UNCOMPENSATED SERVICES

The System was compensated for services at amounts less than its established rates. The following is a summary of uncompensated services and a reconciliation of gross patient charges to net patient service revenue for 2018 and 2017:

	2018	2017
Gross patient charges	$ 792,474,000	$ 777,414,000
Uncompensated services:		
Charity and indigent care	47,375,000	49,909,000
Medicare	255,594,000	226,988,000
Medicaid	82,503,000	74,300,000
Other allowances	169,617,000	194,637,000
Total uncompensated care	555,089,000	545,834,000
Net patient service revenue (net of provision for bad debts)	$ 237,385,000	$ 231,580,000

4. INVESTMENTS

Assets Limited as to Use

The composition of assets limited as to use at December 31, 2018 and 2017 is set forth in the following table. Investments are stated at fair value.

	2018	2017
Internally designated for capital acquisition and other:		
Cash and cash equivalents	$ 2,613,000	$ 4,094,000
Mutual funds – fixed income	35,587,000	35,545,000
Mutual funds – equities	28,744,000	40,883,000
Government agency obligations	37,399,000	33,633,000
U.S. corporate bonds	26,192,000	29,534,000
U.S. equities	48,771,000	57,664,000
International assets – corporate obligations	4,306,000	4,270,000
International assets – equities	24,022,000	29,734,000
	207,634,000	235,357,000
Held by trustee under indenture agreement:		
Cash and cash equivalents	2,295,000	2,256,000
	2,295,000	2,256,000
	$ 209,929,000	$ 237,613,000

The System's investments are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the amounts reported in the accompanying combined financial statements.

5. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2018 and 2017 is as follows:

	2018	2017
Medicare	29%	26%
Medicaid	8%	8%
Blue Cross	14%	14%
Other third-party payors	19%	21%
Patients	30%	31%
	100%	100%

At December 31, 2018, the System had deposits at major financial institutions which exceeded the Federal Deposit Insurance Corporation limits. Management believes the credit risks related to these deposits are minimal.

6. PROPERTY AND EQUIPMENT

A summary of property and equipment at December 31, 2018 and 2017 is as follows:

	2018	2017
Land	$ 14,910,000	$ 14,910,000
Land improvements	3,841,000	3,841,000
Buildings and improvements	218,844,000	211,799,000
Equipment	144,441,000	140,876,000
	382,036,000	371,426,000
Less accumulated depreciation	242,433,000	224,664,000
	139,603,000	146,762,000
Construction in progress	3,432,000	6,737,000
Property and equipment, net	$ 143,035,000	$ 153,499,000

Depreciation expense for the years ended December 31, 2018 and 2017 amounted to approximately $18,600,000 and $18,870,000, respectively.

Contracts of approximately $3,711,000 exist for the purchase of various equipment and renovations to facilities. At December 31, 2018, the remaining commitment on these contracts approximated $1,980,000.

7. LONG-TERM DEBT

A summary of long-term debt at December 31, 2018 and 2017 is as follows:

	2018	2017
Revenue certificates – Series 2016A, payable in annual installments ranging from $1,360,000 on October 1, 2017 to $1,420,000 on October 1, 2031, with an interest rate of 5% paid semi-annually secured by gross revenues	$ 14,000,000	$ 14,755,000
Revenue certificates – Series 2016B, payable in annual installments ranging from $2,900,000 on October 1, 2018 to $5,465,000 on October 1, 2031, with an interest rate of 5% paid semi-annually secured by gross revenues	53,920,000	56,820,000
Total revenue certificates	67,920,000	71,575,000
Less current maturities	3,835,000	3,655,000
Plus net premiums, discounts, and deferred issue costs	5,462,000	6,244,000
Total long-term debt	$ 69,547,000	$ 74,164,000

Discounts and premiums on long-term debt are amortized using the straight-line method over the life of the related bonds, which approximates the effective interest method.

With the reorganization plan implemented by the Authority on January 1, 2009, Houston Hospitals, Inc. (Hospitals), along with the Authority, entered into a master trust indenture (MTI) with a commercial bank as the trustee in which Hospitals pledged its gross revenues to the payment of all obligations issued from time-to-time under the terms of the MTI. Such obligations take the form of tax-exempt issuances of the Authority, the proceeds of which are loaned to Hospitals as conduit obligations under related loan agreements. Such conduit obligations issued under the MTI are secured by a lien on the gross revenues of the members of the Obligated Group, which have joint and severable liability for such obligations. The Obligated Group is currently composed of the Authority, Houston Healthcare System, Inc., Houston Hospitals, Inc., Houston Healthcare Properties, Inc., Houston Healthcare EMS, Inc., Houston Primary Care Physicians, LLC, and Houston Physician Specialists, LLC. The MTI provides the terms for the addition and removal of members of the Obligated Group.

On November 1, 2016, the Authority issued $16,115,000 of Series 2016A Revenue Anticipation Certificates (the Series 2016A Certificates). In connection with the issuance of the Series 2016A Certificates, the Authority loaned the proceeds of the Series 2016A Certificates to the System to refund the previously issued Series 2013 Revenue Anticipation Certificates and to pay costs of issuance of the Series 2016A Certificates. The Series 2016A Certificates have outstanding sinking fund redemptions and maturities ranging from $1,360,000 to $1,420,000 through fiscal year 2031.

7. LONG-TERM DEBT – CONTINUED

On November 1, 2016, the Authority issued $56,820,000 of Series 2016B Revenue Anticipation Certificates (the "Series 2016B Certificates"). In connection with the issuance of the Series 2016B Certificates, the Authority loaned the proceeds of the Series 2016B Certificates to the System for the purpose of (1) redeeming the Authority's Revenue Anticipation Certificates Series 2007 maturing in years 2018 through and including 2042 on October 1, 2017, (2) paying interest on the Series 2016B Certificates up to October 1, 2017, and (3) paying the costs of issuance of the Series 2016B Certificates. The Series 2016B Certificates have outstanding sinking fund redemptions and maturities ranging from $2,900,000 to $5,465,000 through fiscal year 2031.

Under the terms of the MTI and related loan agreements, the System is required (1) to maintain certain deposits with a trustee and (2) meet certain financial and nonfinancial covenants as long as the certificates are outstanding. The System is in compliance with these requirements for 2018 and 2017.

Scheduled principal repayments on long-term debt are as follows:

For the Years Ending December 31,	Amount
2019	$ 3,835,000
2020	4,025,000
2021	4,225,000
2022	4,440,000
2023	4,660,000
Thereafter	46,735,000
	$ 67,920,000

8. NET ASSETS

At December 31, 2018 and 2017, net assets without donor imposed restrictions were as follows:

	2018	2017
Without donor imposed restrictions:		
Internally designated for capital acquisition and other	$ 207,634,000	$ 235,357,000
Held by trustee under indenture agreement	2,295,000	2,256,000
Undesignated	67,033,000	74,400,000
Total net assets without donor imposed restrictions	$ 276,962,000	$ 312,013,000

9. LIQUIDITY

The following reflects the System's financial assets at December 31, 2018 and 2017, reduced by amounts not available for general use within one year of the combined balance sheet dates because of contractual or internal designations. Amounts not available include amounts set aside by the Board of Trustees for future capital acquisition and other reserves that could be drawn upon if the Board approves the action.

	2018	2017
Cash and cash equivalents	$ 10,725,000	$ 5,091,000
Patients accounts receivable, net	26,616,000	29,739,000
Estimated third-party payor receivable	82,000	1,061,000
Insurance recoveries – current portion	1,651,000	1,710,000
	$ 39,074,000	$ 37,601,000

As part of the System's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

10. PENSION PLAN

Plan Description

The System contributes to a defined benefit pension plan (the Plan) managed by a trustee. All full-time and part-time employees who regularly worked 32 or more hours per week that were hired prior to May 1, 2009, age 21 or older and with at least one year of service, are eligible to participate in the Plan. Plan participants under the age of 45 as of January 1, 2011 no longer accumulate benefits. System employees who are vested are entitled to an annual benefit payable monthly for life, in an amount equal to 1% of final average earnings up to covered compensation, plus 1.55% of final average earnings in excess of covered compensation, times credited service up to 30 years. Participants are 100% vested after five years of employment. Participants are fully vested at age 65. The System's funding policy is to make the minimum annual contribution required by applicable regulations. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The measurement date was December 31, 2018 and 2017.

10. PENSION PLAN – CONTINUED

The following table sets forth the Plan's funded status and amounts recognized in the combined financial statements at December 31, 2018 and 2017:

	2018	2017
Plan assets at fair value at December 31	$ 105,620,000	$ 109,864,000
Projected benefit obligation at December 31	115,513,000	121,084,000
Funded status	$ (9,893,000)	$ (11,220,000)
Amounts recognized in the combined balance sheets consist of:		
Noncurrent liabilities	$ (9,893,000)	$ (11,220,000)
Amounts recognized in net assets without donor imposed restrictions:		
Net actuarial loss	$ 23,907,000	$ 19,559,000

The following table sets forth the components of net periodic pension cost and other amounts recognized in net assets without donor imposed restrictions for the years ended December 31, 2018 and 2017:

	2018	2017
Service cost	$ 1,364,000	$ 1,461,000
Interest cost	4,256,000	4,070,000
Expected return on Plan assets	(7,016,000)	(6,796,000)
Amortization of net actuarial loss	1,721,000	697,000
Net periodic cost	325,000	(568,000)
Other changes in Plan assets and benefit obligations recognized in net assets without donor imposed restrictions:		
Net actuarial loss	6,069,000	5,982,000
Amortization of net actuarial loss	(1,721,000)	(697,000)
Total recognized in net assets without donor imposed restrictions	4,348,000	5,285,000
Total recognized in net periodic benefit cost and net assets without donor imposed restrictions	$ 4,673,000	$ 4,717,000

The components of net periodic cost above other than service cost are included in nonoperating (expenses) revenues in the combined statements of operations and changes in net assets.

10. PENSION PLAN – CONTINUED

The System's expected rate of return on Plan assets is determined by the Plan assets' historical long-term investment performance, current asset allocation, and estimates of future long-term returns by asset class.

	2018	2017
Weighted-average assumptions used to determine pension benefit obligations:		
Discount rate	4.45%	3.78%
Rate of increase in future compensation levels	2.00%	2.00%
Weighted-average assumptions used to determine net period benefit cost:		
Discount rate	3.77%	4.40%
Expected long-term return on Plan assets	6.50%	7.00%
Rate of increase in future compensation levels	2.00%	2.00%

The change in projected benefit obligation for the Plan for the years ended December 31, 2018 and 2017 included the following components:

	2018	2017
Projected benefit obligation, end of year	$ 121,084,000	$ 108,178,000
Service cost	1,364,000	1,461,000
Interest cost	4,256,000	4,070,000
Actuarial (gain) loss	(7,728,000)	10,422,000
Benefits paid	(3,463,000)	(3,047,000)
Projected benefit obligation, end of year	$ 115,513,000	$ 121,084,000
Accumulated benefit obligation	$ 113,248,000	$ 118,529,000

The change in fair value of Plan assets for the years ended December 31, 2018 and 2017 is included the following components:

	2018	2017
Plan assets at fair value, beginning of year	$ 109,864,000	$ 95,675,000
Actual return on assets	(6,781,000)	11,236,000
Employer contributions	6,000,000	6,000,000
Benefits paid	(3,463,000)	(3,047,000)
Plan assets at fair value, end of year	$ 105,620,000	$ 109,864,000

10. PENSION PLAN – CONTINUED

Plan Assets

The composition of Plan assets at December 31, 2018 and 2017 is as follows:

	2018	%	2017	%
Cash and cash equivalents	$ 3,314,000	3%	$ 2,130,000	2%
Mutual funds – fixed income	13,915,000	13%	13,913,000	13%
Mutual funds – equities	31,259,000	30%	32,801,000	30%
Government agency obligations	10,744,000	10%	10,422,000	9%
U.S. Corporate bonds	11,194,000	11%	11,378,000	10%
U.S. Equities	24,148,000	23%	27,206,000	25%
International assets – government agency obligations	162,000	0%	129,000	0%
International assets – corporate obligations	1,783,000	2%	1,597,000	1%
International assets – equities	9,101,000	9%	10,288,000	9%
	$ 105,620,000	100%	$ 109,864,000	100%

The System's investment strategy is to manage the portfolio to preserve principal and liquidity while maximizing the return on the investment portfolio through the full investment of available funds. The portfolio is diversified by investing in multiple types of investment-grade securities. The investment policy requires assets of the Plan to be primarily invested in securities with at least an investment grade rating to minimize interest rate and credit risk. The Plan assets are long-term in nature and are intended to generate returns while preserving capital. The target allocation for the investment is 45% U.S. equity, 10% international equity, 35% fixed income, and 10% other securities.

Pension assets are invested in equities, fixed income securities, and cash and cash equivalents. The allocation between different investment vehicles is determined by the System's investment committee, based on current market conditions, short-term and long-term market outlooks, and cash needs for distributions and Plan expenses. Assumptions for expected returns on Plan assets are based on historical performance, long-term market outlook, and a diversified investment approach designed to provide steady, consistent returns that minimize market fluctuations. The System utilizes the services of a professional investment advisor in the selection of individual fund managers. The investment advisor tracks the performance of each fund manager and makes recommendations for redistributions, as needed, to comply with targeted allocations or to replace underperforming funds.

The System attempts to mitigate investment risk by rebalancing between investment classes as the System's contributions and monthly benefit payments are made. Although changes in interest rates may affect the fair value of a portion of the investment portfolio and cause unrealized gains and losses, such gains or losses would not be realized unless the investments are sold.

10. PENSION PLAN – CONTINUED

The fair values of the System's Plan assets at December 31, 2018 and 2017, by asset category (see Note 15) are as follows:

		Fair Value Measurements		
December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Cash and cash equivalents	$ 3,314,000	$ 3,314,000	$ -	$ -
Mutual funds – fixed income	13,915,000	13,915,000	-	-
Mutual funds – equities	31,259,000	31,259,000	-	-
Government agency obligations	10,744,000	-	10,744,000	-
U.S. corporate bonds	11,194,000	-	11,194,000	-
U.S. equities	24,148,000	24,148,000	-	-
International assets – Government agency obligations	162,000	-	162,000	-
International assets – corporate obligations	1,783,000	-	1,783,000	-
International assets – equities	9,101,000	9,101,000	-	-
Total	$ 105,620,000	$ 81,737,000	$ 23,883,000	$ -

		Fair Value Measurements		
December 31, 2017	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Cash and cash equivalents	$ 2,130,000	$ 2,130,000	$ -	$ -
Mutual funds – fixed income	13,913,000	13,913,000	-	-
Mutual funds – equities	32,801,000	32,801,000	-	-
Government agency obligations	10,422,000	-	10,422,000	-
U.S. corporate bonds	11,378,000	-	11,378,000	-
U.S. equities	27,206,000	27,096,000	110,000	-
International assets – Government agency obligations	129,000	-	129,000	-
International assets – corporate obligations	1,597,000	-	1,597,000	-
International assets – equities	10,288,000	10,140,000	148,000	-
Total	$ 109,864,000	$ 86,080,000	$ 23,784,000	$ -

See Note 15 for the methods and assumptions used by the System in estimating the fair value of the above Plan assets.

10. PENSION PLAN – CONTINUED

Estimated Contributions

The System plans to contribute approximately $6,000,000 to the Plan in 2019. No Plan assets are expected to be returned to the System during 2019.

Estimated Future Benefit Payments

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

For the Years Ending December 31,	Pension Benefits
2019	$ 4,638,000
2020	5,044,000
2021	5,544,000
2022	5,955,000
2023	6,302,000
2024 - 2028	36,188,000

The expected benefits to be paid are based on the same assumptions used to measure the System's benefit obligation at December 31, 2018.

The System will recognize approximately $2,087,000 of actuarial loss during the next 12 months beginning January 1, 2019.

11. DEFINED CONTRIBUTION PLAN

The System has a defined contribution retirement plan (the Retirement Plan) covering substantially all employees. The Retirement Plan is a tax-deferred annuity plan under Section 403(b) of the Internal Revenue Code which allows employee contributions upon employment and at least 1,000 hours of work, and allows employer contributions upon attainment of the age of 21 and at least one year of service. Participants may contribute up to 20% of their annual compensation up to a maximum dollar limitation. Employer contributions are made at a matching level of 50% of the participants' annual contribution to the Retirement Plan, up to a maximum of 4% of the employee's annual compensation. The System made contributions to the Retirement Plan of approximately $2,400,000 and $2,034,000 for the years ended December 31, 2018 and 2017, respectively.

12. EMPLOYEE HEALTH PLAN

The System has a self-insurance program under which a third-party administrator processes and pays claims. The System reimburses the third-party administrator for claims incurred and paid and has purchased stop-loss insurance coverage for claims in excess of $650,000 for each individual employee. Under this self-insurance program, approximately $17,371,000 and $21,063,000 were paid or accrued during the years ended December 31, 2018 and 2017, respectively.

13. PROFESSIONAL LIABILITY CLAIMS

The System is covered by a claims-made general and professional liability insurance policy with excess coverage not to exceed $35 million. Self-insured retention related to this policy in 2018 and 2017 was $1 million per occurrence and $5 million in aggregate. The System uses a third-party administrator to review and analyze incidents that may result in a claim against the System. In conjunction with the third-party administrator, incidents are assigned reserve amounts for the ultimate liability that may result from an asserted claim. The System also uses independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Long-term accrued professional claims are included in self-insurance reserves and the current portion is included in other current liabilities in the combined balance sheets, and in management's opinion, provide an adequate reserve for loss contingencies.

Various claims and assertions have been made against the System in its normal course of providing services. In addition, other claims may be asserted arising from services provided to patients in the past. In the opinion of management, adequate provision has been made for losses which may occur from such asserted and unasserted claims that are not covered by liability insurance.

Obligations covered by reinsurance contracts are included in the reserves for professional liability risks, as the System remains liable to the extent the reinsurers do not meet their obligations under the reinsurance contracts. The current amount receivable under the reinsurance contracts include $1,644,000 and $1,699,000 at December 31, 2018 and 2017, respectively, recorded in insurance recoveries – current portion and the long-term portion of $5,056,000 and $5,226,000, respectively, is recorded in insurance recoveries.

14. FUNCTIONAL EXPENSES

The System provides general health care services to residents within its geographic location. The following tables present expenses by both their nature and function for the years ended December 31:

	Health Care Services	General and Administrative	2018 Total	Health Care Services	General and Administrative	2017 Total
Salaries and benefits	$ 126,150,000	$ 15,247,000	$ 141,397,000	$ 121,491,000	$ 18,752,000	$ 140,243,000
Supplies and drugs	42,229,000	376,000	42,605,000	39,162,000	295,000	39,457,000
Other expenses	39,068,000	17,225,000	56,293,000	34,222,000	18,191,000	52,413,000
Depreciation and amortization	13,394,000	5,189,000	18,583,000	14,068,000	5,329,000	19,397,000
Interest expense	1,984,000	769,000	2,753,000	3,543,000	1,343,000	4,886,000
Total operating expenses	$ 222,825,000	$ 38,806,000	$ 261,631,000	$ 212,486,000	$ 43,910,000	$ 256,396,000

The financial statements report certain categories of expenses that are attributable to health care services as well as general and administrative functions. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include utilities, depreciation and amortization, and interest, all of which are allocated based on a square footage basis, as well as certain employee benefits, which are allocated based on salaries.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

The System's assets and liabilities recorded at fair value or for which fair value is required to be disclosed have been categorized based upon a fair value hierarchy in accordance with accounting standards which require that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

- Level 1 - Observable quoted market prices in active markets for identical assets or liabilities.
- Level 2 - Observable inputs other than Level 1, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3 - Unobservable inputs for the asset or liability that are significant to the fair value of the assets or liabilities.

The following methods and assumptions were used by the System in estimating the fair value of its financial instruments:

- *Cash and cash equivalents*, *accounts payable, accrued expenses, and estimated third-party payor settlements*: The carrying amount reported in the combined balance sheets approximates its fair value, due to the short-term nature of these instruments.
- *Assets limited as to use*: Fair values, which are the amounts reported in the combined balance sheets, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS-CONTINUED

- *Long-term debt*: The fair value of the System's fixed rate long-term debt is estimated based on quoted market value, if available, for the debt instruments or the net present values of scheduled principal and interest payments discounted using current borrowing rates if quoted market values are not available. The System's fixed rate long-term debt for which quoted market prices are available would be classified as Level 1 in the fair value hierarchy. Based on inputs used in determining the estimated fair value, the System's remaining fixed rate debt would be classified as Level 2 in the fair value hierarchy.

Financial assets valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets valued using Level 2 inputs are based primarily on quoted prices for similar investments in active or inactive markets. Valuation techniques utilized to determine fair value are consistently applied. All assets have been valued using a market approach.

- *Government agency obligations:* Level 2 assets are valued using pricing models maximizing the use of observable inputs for similar securities.
- *U.S. Corporate bonds:* Level 2 assets are valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing values on yields currently available on comparable securities of issuers with similar credit ratings. The corporate bonds contain credit ratings of A3 to AAA.

The carrying amount and estimated fair values of the System's long-term debt at December 31, 2018 and 2017 are as follows:

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt	$ 73,382,000	$ 74,222,000	$ 77,819,000	$ 80,535,000

The estimated fair values of the System's investments at December 31, 2018 and 2017 and the level within the fair value hierarchy are as follows:

		Fair Value Measurements		
December 31, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Cash and cash equivalents	$ 4,908,000	$ 4,908,000	$ -	$ -
Mutual funds – fixed income	35,587,000	35,587,000	-	-
Mutual funds – equities	28,744,000	28,744,000	-	-
Government agency obligations	37,399,000	-	37,399,000	-
U.S. corporate bonds	26,192,000	-	26,192,000	-
U.S. equities	48,771,000	48,771,000		-
International assets – corporate obligations	4,306,000	-	4,306,000	-
International assets – equities	24,022,000	24,022,000	-	-
Total	$ 209,929,000	$ 142,032,000	$ 67,897,000	$ -

15. FAIR VALUE OF FINANCIAL INSTRUMENTS-CONTINUED

		Fair Value Measurements		
December 31, 2017	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Cash and cash equivalents	$ 6,350,000	$ 6,350,000	$ -	$ -
Mutual funds – fixed income	35,545,000	35,545,000	-	-
Mutual funds – equities	40,883,000	40,883,000	-	-
Government agency obligations	33,633,000	-	33,633,000	-
U.S. corporate bonds	29,534,000	-	29,534,000	-
U.S. equities	57,664,000	57,482,000	182,000	-
International assets – corporate obligations	4,270,000	-	4,270,000	-
International assets – equities	29,734,000	29,310,000	424,000	-
Total	$ 237,613,000	$ 169,570,000	$ 68,043,000	$ -

16. MEDICAID UPPER PAYMENT LIMIT

The Medicare, Medicaid, and State Children's Health Insurance Program (SCHIP) Benefits Improvement and Protection Act of 2000 (BIPA) provides for enhanced payments to Medicaid providers under the Upper Payment Limit (UPL) methodology. Subsequent to the implementation of the UPL methodology, federal budget concerns have led to reconsideration of the BIPA legislation with possible elimination or reduction of enhanced Medicaid payments. Legislation has been enacted to reduce the level of UPL payments. These reductions are anticipated to remain in effect in future periods. Net patient service revenue includes enhanced payments for December 31, 2018 and 2017 of approximately $2,011,000 and $1,488,000, respectively.

17. INDIGENT CARE TRUST FUND

The System participates in the Georgia Indigent Care Trust Fund (ICTF) Program. The System receives ICTF payments for treating a disproportionate number of Medicaid and other indigent patients. ICTF payments are based on the System's estimated uncompensated cost of services to Medicaid and uninsured patients. The amount of ICTF payments recognized in net patient revenue was approximately $3,222,000 and $3,044,000 for the years ended December 31, 2018 and 2017, respectively.

18. COMMITMENTS AND CONTINGENCIES

Operating Leases

The System leases various equipment and facilities under operating leases expiring at various dates. Total rental expense in 2018 and 2017 for all operating leases was approximately $913,000 and $872,000, respectively.

The following is a schedule by year of future minimum lease payments under operating leases as of December 31, 2018 that have initial or remaining lease terms in excess of one year.

For the Years Ending December 31,	Amount
2019	$ 561,000
2020	486,000
2021	486,000
2022	486,000
2023	446,000
	$ 2,465,000

Compliance Plan

The healthcare industry has recently been subjected to increased scrutiny from governmental agencies at both the national and state level with respect to compliance with regulations. Areas of noncompliance identified at the national level include Medicare and Medicaid, Internal Revenue Service (IRS), and other regulations governing the healthcare industry. The System has implemented a compliance plan focusing on such issues. There can be no assurance that the System will not be subjected to future investigations with accompanying monetary damages.

Health Care Reform

In recent years, there has been increasing pressure on Congress and some state legislatures to control and reduce the cost of healthcare on the national or at the state level. In 2010, legislation was enacted which included cost controls on hospitals, insurance market reforms, delivery system reforms and various individual and business mandates among other provisions. The costs of certain provisions will be funded in part by reductions in payments by government programs, including Medicare and Medicaid. There can be no assurance that these changes will not adversely affect the System.

Litigation

The System is involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the System’s future financial position or results from operations.

19. ELECTRONIC HEALTH RECORD MEANINGFUL USE INCENTIVES

The Health Information Technology for Economic and Clinical Health Act (the HITECH Act) was enacted into law on February 17, 2009, as part of the American Recovery and Reinvestment Act of 2009 (ARRA). The HITECH Act includes provisions designed to increase the use of Electronic Health Records (EHR) by both physicians and hospitals. Beginning with federal fiscal year 2011 and extending through federal fiscal year 2016, eligible hospitals participating in the Medicare and Medicaid programs are eligible for reimbursement incentives based on successfully demonstrating meaningful use of its certified EHR technology. Conversely, those hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to reductions to Medicare reimbursements beginning in fiscal year 2015. On July 13, 2010, the Department of Health and Human Services (DHHS) released final meaningful use regulations. Meaningful use criteria are divided into three distinct stages: I, II and III. The final rules specify the initial criteria for physicians and eligible hospitals necessary to qualify for incentive payments; calculation of the incentive payment amounts; payment adjustments under Medicare for covered professional services and inpatient hospital services; eligible hospitals failing to demonstrate meaningful use of certified EHR technology; and other program participation requirements.

The final rule set the earliest interim payment date for the incentive payment at May 2011. The first year of the Medicare portion of the program is defined as the federal fiscal year October 1, 2010 to September 30, 2011.

The System recognizes income related to Medicare and Medicaid incentive payments using a gain contingency model. Under this model, the income from incentive payments is recorded entirely in the period in which the last remaining contingency is resolved.

The System attested that it met all requirements to receive Medicaid Year 1 in 2012, Medicare Year 1 and Medicaid Year 2 in 2013, Medicare Year 2 in 2014, Medicaid Year 3 in 2015 and Medicare Year 3 in 2016. The System applied for and received approval from Medicare and Medicaid notifying the System qualified for approximately $1,008,000 in 2017 from the programs. During 2018 and 2017, the System recorded no recoupments of estimated payments from previous years. The net amounts received are included in other revenue on the 2017 combined statement of operations and changes in net assets. Also, if the System satisfies specified meaningful use criteria in future periods, they may become entitled to additional Medicare and Medicaid incentive payments; however, as they have not met these specific requirements as of December 31, 2018, no such additional amounts are accrued.