

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.



FINANCIAL STATEMENTS

for the years ended July 31, 2017 and 2016

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Phoebe Putney Memorial Hospital, Inc.
Albany, Georgia

Report on the Financial Statements

We have audited the accompanying financial statements of Phoebe Putney Memorial Hospital, Inc. (Corporation), which comprise the balance sheets as of July 31, 2017 and 2016, and the related statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

Continued

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

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

Opinion

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

Draffin + Tucker, LLP

Albany, Georgia

December 6, 2017

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

BALANCE SHEETS, July 31, 2017 and 2016

	(Dollars in Thousands)	
	<u>2017</u>	<u>2016</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 91,916	\$ 49,285
Patient accounts receivable, net of allowance for doubtful accounts of \$23,000,000 in 2017 and \$34,000,000 in 2016	70,562	97,898
Supplies, at lower of cost (first-in, first-out) or market	12,391	10,587
Estimated third-party payor settlements	8,235	10,383
Other current assets	<u>11,288</u>	<u>11,084</u>
Total current assets	<u>194,392</u>	<u>179,237</u>
Assets limited as to use:		
Internally designated for capital improvements	<u>379</u>	<u>377</u>
Property and equipment, net	<u>288,656</u>	<u>292,454</u>
Other assets:		
Interest in net assets of Phoebe Foundation, Inc.	15,935	17,506
Deferred financing cost	1,170	1,245
Goodwill and other assets	<u>125,428</u>	<u>125,320</u>
Total other assets	<u>142,533</u>	<u>144,071</u>
Total assets	<u>\$ 625,960</u>	<u>\$ 616,139</u>

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

BALANCE SHEETS, July 31, 2017 and 2016

	(Dollars in Thousands)	
	<u>2017</u>	<u>2016</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	\$ 6,599	\$ 6,384
Accounts payable	18,332	12,767
Accrued expenses	<u>23,236</u>	<u>25,819</u>
Total current liabilities	48,167	44,970
Long-term debt, net of current portion	276,985	283,517
Accrued pension cost	99,471	129,646
Related party payables	69,270	52,065
Derivative financial instruments	<u>10,392</u>	<u>14,511</u>
Total liabilities	<u>504,285</u>	<u>524,709</u>
Net assets:		
Unrestricted	113,496	80,977
Temporarily restricted	6,155	8,429
Permanently restricted	<u>2,024</u>	<u>2,024</u>
Total net assets	<u>121,675</u>	<u>91,430</u>
Total liabilities and net assets	<u>\$ 625,960</u>	<u>\$ 616,139</u>

See accompanying notes to financial statements.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
for the years ended July 31, 2017 and 2016

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Unrestricted revenues, gains and other support:		
Patient service revenue (net of contractual allowances and discounts)	\$ 600,043	\$ 590,607
Provision for bad debts	<u>(100,078)</u>	<u>(91,706)</u>
Net patient service revenue	499,965	498,901
Other revenue	<u>18,603</u>	<u>17,661</u>
Total revenues, gains and other support	<u>518,568</u>	<u>516,562</u>
Expenses:		
Salaries and wages	145,086	148,217
Employee health and welfare	36,411	46,640
Medical supplies and other	207,856	200,116
Purchased services	84,288	85,023
Depreciation and amortization	36,380	39,368
Interest	<u>7,116</u>	<u>6,932</u>
Total expenses	<u>517,137</u>	<u>526,296</u>
Operating income (loss)	1,431	(9,734)
Nonoperating gain (loss):		
Investment and other nonoperating income (loss)	<u>4,504</u>	<u>(3,766)</u>
Excess revenues (expenses)	5,935	(13,500)

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS, Continued
for the years ended July 31, 2017 and 2016

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Change in interest in net assets of Phoebe Foundation, Inc.	\$ 703	\$ 380
Capital contributions	3,500	-
Net actuarial gain (loss)	19,599	(37,895)
Amortization of prior service cost	81	24
Amortization of net loss	<u>2,701</u>	<u>5,004</u>
Increase (decrease) in unrestricted net assets	<u>32,519</u>	<u>(45,987)</u>
Temporarily restricted net assets:		
Change in interest in net assets of Phoebe Foundation, Inc.	(<u>2,274</u>)	<u>1,227</u>
Permanently restricted net assets:		
Change in interest in net assets of Phoebe Foundation, Inc.	<u>-</u>	<u>5</u>
Increase (decrease) in net assets	30,245	(44,755)
Net assets, beginning of year	<u>91,430</u>	<u>136,185</u>
Net assets, end of year	\$ <u>121,675</u>	\$ <u>91,430</u>

See accompanying notes to financial statements.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

STATEMENTS OF CASH FLOWS
for the years ended July 31, 2017 and 2016

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in net assets	\$ 30,245	\$(44,755)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	36,380	39,368
Change in interest in net assets of Phoebe Foundation, Inc.	1,571	(1,612)
Change in derivative financial instruments	(4,119)	4,037
Changes in:		
Receivables	27,336	(741)
Supplies	(1,804)	803
Estimated third-party payor settlements	2,148	(2,344)
Other assets	(237)	(3,491)
Accounts payable and accrued expenses	2,982	(8,631)
Accrued pension cost	<u>(30,175)</u>	<u>29,955</u>
Net cash provided by operating activities	<u>64,327</u>	<u>12,589</u>
Cash flows from investing activities:		
Purchase of property and equipment	(32,515)	(19,698)
Purchases of assets limited as to use	<u>(2)</u>	<u>(2)</u>
Net cash used by investing activities	<u>(32,517)</u>	<u>(19,700)</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

STATEMENTS OF CASH FLOWS, Continued
for the years ended July 31, 2017 and 2016

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Cash flows from financing activities:		
Payments on long-term debt	\$(6,384)	\$(6,173)
Advances from related parties	<u>17,205</u>	<u>12,933</u>
Net cash provided by financing activities	<u>10,821</u>	<u>6,760</u>
Increase (decrease) in cash and cash equivalents	42,631	(351)
Cash and cash equivalents, beginning of year	<u>49,285</u>	<u>49,636</u>
Cash and cash equivalents, end of year	\$ <u>91,916</u>	\$ <u>49,285</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ <u>7,086</u>	\$ <u>6,720</u>

See accompanying notes to financial statements.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS

July 31, 2017 and 2016

1. Summary of Significant Accounting Policies

Organization

Phoebe Putney Memorial Hospital, Inc., (Corporation) located in Albany, Georgia, is a not-for-profit acute care hospital which operates satellite clinics in the surrounding counties. The Corporation provides inpatient, outpatient and emergency care services for residents of Southwest Georgia. Admitting physicians are primarily practitioners in the local area. The Corporation is a single operating entity and is a wholly-owned subsidiary of Phoebe Putney Health System, Inc. (System).

Reorganization

Effective September 1, 1991, the Hospital Authority of Albany-Dougherty County, Georgia (Authority) implemented a reorganization plan for the hospital whereby all the assets, management and governance of the hospital was transferred to Phoebe Putney Memorial Hospital, Inc., a not-for-profit corporation, qualified as an organization described in Section 501(c)(3) of the Internal Revenue Code, pursuant to a lease and transfer agreement. During 2009, the lease term was renewed for an additional forty years with a nominal annual lease payment.

Effective August 1, 2012, the lease and transfer agreement between the Corporation and the Authority was amended and restated. The amendment was made for the transfer and inclusion of the hospital formerly known as Palmyra Park Hospital, LLC (Palmyra) which was acquired by the Authority on December 15, 2011. The amendment included the extension of the lease for a term of forty years from the date of the current amendment.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in money market mutual funds.

Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Corporation analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Corporation analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Corporation records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Corporation's allowance for doubtful accounts for self-pay patients was approximately 99% of self-pay accounts receivable at July 31, 2017 and 2016. The Corporation updated its Financial Assistance Policy during 2017 as discussed in Note 2.

Supplies

Supplies, which consist primarily of drugs, food, and medical supplies, are valued at first-in, first-out cost, but not in excess of market.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Derivative Financial Instruments

The Corporation has entered into interest rate swap agreements as part of its interest rate risk management strategy. These arrangements are accounted for under the provisions of FASB ASC 815 *Derivatives and Hedging*. FASB ASC 815 establishes accounting and reporting standards requiring that derivative instruments be recorded at fair value as either an asset or liability.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of unrestricted net assets. The ineffective component, if any, is recorded in excess revenues (expenses) in the period in which the hedge transaction affects earnings. If the hedging relationship ceases to be highly effective or it becomes probable that an expected transaction will no longer occur, gains or losses on the derivative are recorded in excess revenues (expenses). For derivative instruments not designated as hedging instruments, the unrealized gain or loss is recognized in nonoperating gains (losses) during the period of change.

Assets Limited as to Use

Assets limited as to use include designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from excess revenues (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

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Property and Equipment, Continued

must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Beneficial Interest in Net Assets of Foundation

The Corporation accounts for the activities of Phoebe Foundation, Inc. in accordance with FASB ASC 958-20, *Not-For-Profit Entities, Financially Interrelated Entities*. FASB ASC 958-20 establishes reporting standards for transactions in which a donor makes a contribution to a not-for-profit organization which accepts the assets on behalf of or transfers these assets to a beneficiary which is specified by the donor. Phoebe Foundation, Inc. accepts assets on behalf of the Corporation.

Goodwill

Goodwill and intangible assets with indefinite lives are tested for impairment annually and more frequently in the event of an impairment indicator. Intangible assets with definite lives are amortized over their respective estimated useful lives, and reviewed whenever events or circumstances indicate impairment may exist.

In accordance with the accounting standard, the Corporation assesses goodwill for impairment on an annual basis. See Note 6 for goodwill disclosures. The Corporation assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Corporation determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is required. If the two-step impairment test is determined to be necessary, and in step two the carrying value of a reporting unit's goodwill exceeds its implied fair value, an impairment loss equal to the difference will be recorded.

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PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Deferred Financing Cost

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, over the life of the related debt. Debt issuance costs related to a recognized debt liability are presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability. Costs related to the issuance of derivative financial instruments were deferred and are being amortized. The unamortized amounts are included with other assets in the balance sheets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation in perpetuity.

Excess Revenues (Expenses)

The statement of operations and changes in net assets includes excess revenues (expenses). Changes in unrestricted net assets which are excluded from excess revenues (expenses), consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, 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).

Net Patient Service Revenue

The Corporation has agreements with third-party payors that provide for payments to the Corporation at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Net Patient Service Revenue, Continued

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care

The Corporation 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 Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenues.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Corporation 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 either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement 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 unrestricted contributions in the accompanying financial statements.

Estimated Malpractice and Other Self-Insurance Cost

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

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Income Taxes

The Corporation 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 accounting policies prescribe when to recognize and how to measure the 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 Corporation 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 balance sheet for unrecognized income tax positions. Further, no interest or penalties have been accrued or charged to expense as of July 31, 2017 and 2016 or for the years then ended. The Corporation's tax returns are subject to possible examination by the 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.

Impairment of Long-Lived Assets

The Corporation 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 Corporation has not recorded any impairment charges of long-lived assets in the accompanying statements of operations and changes in net assets for the years ended July 31, 2017 and 2016.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Fair Value Measurements

FASB ASC 820, *Fair Value Measurement and Disclosures* defines fair value as the amount that would be received for an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. FASB ASC 820 describes the following three levels of inputs that may be used:

- *Level 1:* Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- *Level 2:* Observable prices that are based on inputs not quoted on active markets but corroborated by market data.
- *Level 3:* Unobservable inputs when there is little or no market data available, thereby requiring an entity to develop its own assumptions. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Subsequent Event

In preparing these financial statements, the Corporation has evaluated events and transactions for potential recognition or disclosure through December 6, 2017, the date the financial statements were issued.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

1. Summary of Significant Accounting Policies, Continued

Recently Adopted Accounting Pronouncement

In 2017, the Corporation adopted the provisions of Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2015-03, *Interest-Imputation of Interest-Simplifying the Presentation of Debt Issuance Costs*. The ASU simplifies the presentation of debt issuance costs by requiring debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. All periods presented in these financial statements and notes to the financial statements reflect the new guidance. The reclassification of fiscal year 2016 amounts did not have a material effect on the financial statements.

Prior Year Reclassifications

Certain reclassifications have been made to the fiscal year 2016 financial statements to conform to the fiscal year 2017 presentation. These reclassifications had no impact on the change in net assets in the accompanying financial statements.

2. Net Patient Service Revenue

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

The Corporation 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 Corporation 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 Corporation's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Corporation records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

2. Net Patient Service Revenue, Continued

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

July 31, 2017				
Patient Service Revenue				
(Net of Contractual Allowances and Discounts)				
(Dollars in Thousands)				
<u>Medicare</u>	<u>Medicaid</u>	<u>Third-Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
\$ <u>201,976</u>	\$ <u>93,508</u>	\$ <u>258,191</u>	\$ <u>46,368</u>	\$ <u>600,043</u>

July 31, 2016				
Patient Service Revenue				
(Net of Contractual Allowances and Discounts)				
(Dollars in Thousands)				
<u>Medicare</u>	<u>Medicaid</u>	<u>Third-Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
\$ <u>183,179</u>	\$ <u>90,545</u>	\$ <u>255,212</u>	\$ <u>61,671</u>	\$ <u>590,607</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 40% and 19%, respectively, of the Corporation's net patient revenue for the year ended July 31, 2017 and 37% and 18%, respectively, of the Corporation's net patient revenue for the year ended July 31, 2016. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

2. Net Patient Service Revenue, Continued

The Corporation 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 and federal levels including the initiation of the Recovery Audit Contractor (RAC) program and the Medicaid Integrity Contractor (MIC) program. These programs were created to review Medicare and Medicaid claims for medical necessity and coding appropriateness. The RAC's have 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 and Medicaid programs.

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

- Medicare

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

The Corporation is reimbursed for certain reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Corporation and audits thereof by the Medicare Administrative Contractor (MAC). The Corporation'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 Corporation. The Corporation's Medicare cost reports have been audited by the MAC through July 31, 2011.

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PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

2. Net Patient Service Revenue, Continued

- Medicaid

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

Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Corporation is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Corporation and audits thereof by the Medicaid fiscal intermediary. The Corporation's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through July 31, 2011.

The Corporation 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 Corporation participates in the Georgia Indigent Care Trust Fund (ICTF) Program. The Corporation receives ICTF payments for treating a disproportionate number of Medicaid and other indigent patients. ICTF payments are based on the Corporation's estimated uncompensated cost of services to Medicaid and uninsured patients. The amount of ICTF payments recognized in net patient service revenue was approximately \$4,960,000 and \$10,197,000 for the years ended July 31, 2017 and 2016, respectively.

The Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) provides for payment adjustments to certain facilities based on the Medicaid Upper Payment Limit (UPL). The UPL payment adjustments are based on a measure of the difference between Medicaid payments and the amount that could be paid based on Medicare payment principles. The net amount of UPL payment adjustments recognized in net patient service revenue was approximately \$4,173,000 and \$2,756,000 for the years ended July 31, 2017 and 2016, respectively.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

2. Net Patient Service Revenue, Continued

- Medicaid, Continued

During 2010, the state of Georgia enacted legislation known as the Provider Payment Agreement Act (Act) whereby hospitals in the state of Georgia are assessed a “provider payment” in the amount of 1.45% of their net patient 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 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 hospital payments on Medicaid services of approximately 11.88%. Approximately \$6,251,000 and \$6,871,000 relating to the Act is included in medical supplies and other in the accompanying statement of operations and changes in net assets for the years ended July 31, 2017 and 2016, respectively.

- Other Arrangements

The Corporation has also entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

- Uninsured Patients

The Corporation maintains its Financial Assistance Policy (FAP) in accordance with Internal Revenue Code Section 501(r). Based on the FAP, following a determination of financial assistance eligibility, patients who are eligible individuals will not be charged more for emergency or other medically necessary care than the Amounts Generally Billed (AGB) for individuals who have insurance coverage. The minimum percentage discount to be applied to FAP eligible individuals shall be calculated on an annual basis. AGB is determined by dividing the sum of claims paid the previous fiscal year by Medicare fee-for-service and all private health insurance, including payments received from beneficiaries and insured patients, by the sum of the associated gross charges for those claims.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

3. Uncompensated Services

The Corporation was compensated for services at amounts less than its established rates. Charges for uncompensated services for 2017 and 2016 were approximately \$1,060,000,000 and \$957,000,000, respectively.

Uncompensated care includes charity and indigent care services of approximately \$60,000,000 and \$59,000,000 in 2017 and 2016, respectively. The cost of charity and indigent care services provided during 2017 and 2016 was approximately \$20,000,000 and \$21,000,000, respectively computed by applying a total cost factor to the charges foregone.

The following is a summary of uncompensated services and a reconciliation of gross patient charges to net patient service revenue for 2017 and 2016.

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Gross patient charges	\$ <u>1,560,154</u>	\$ <u>1,455,599</u>
Uncompensated services:		
Charity and indigent care	59,553	58,823
Medicare	553,457	486,143
Medicaid	200,167	181,964
Other allowances	146,934	138,062
Bad debts	<u>100,078</u>	<u>91,706</u>
Total uncompensated care	<u>1,060,189</u>	<u>956,698</u>
Net patient service revenue	\$ <u>499,965</u>	\$ <u>498,901</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

4. Investments

Assets Limited as to Use

The composition of assets limited as to use at July 31, 2017 and 2016 is set forth in the following table. Assets limited as to use are classified as trading. See Note 18 for valuation methodologies.

	<u>Dollars in Thousands</u>	
	<u>2017</u>	<u>2016</u>
By board for capital improvements:		
Certificates of deposit	\$ <u>379</u>	\$ <u>377</u>

Interest income for cash and cash equivalents and assets limited as to use are recorded in investment and other nonoperating income (loss) on the statements of operations and changes in net assets.

5. Property and Equipment

A summary of property and equipment at July 31, 2017 and 2016 follows:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Land	\$ 12,068	\$ 12,128
Land improvements	3,625	3,583
Building	353,723	339,506
Equipment	<u>395,321</u>	<u>378,298</u>
	764,737	733,515
Less accumulated depreciation	<u>487,091</u>	<u>451,845</u>
	277,646	281,670
Construction in progress	<u>11,010</u>	<u>10,784</u>
Net property and equipment	\$ <u>288,656</u>	\$ <u>292,454</u>

Depreciation expense for the years ended July 31, 2017 and 2016 amounted to approximately \$36,313,000 and \$39,368,000, respectively.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

6. Goodwill and Other Assets

A summary of goodwill and other assets at July 31, 2017 and 2016 follows:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Goodwill	\$ 124,992	\$ 124,992
Other assets	<u>436</u>	<u>328</u>
Total goodwill and other assets	\$ <u>125,428</u>	\$ <u>125,320</u>

Goodwill is related to the Corporation's purchase of health care clinics and lease of Palmyra, formerly purchased by the Authority. The goodwill is evaluated annually for impairment.

The changes in the carrying amount of goodwill for the years ended July 31, 2017 and 2016, are as follows:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Balance at beginning of year:		
Goodwill	\$ 168,921	\$ 168,921
Accumulated impairment losses	<u>(43,929)</u>	<u>(43,929)</u>
	124,992	124,992
Goodwill acquired during the year	-	-
Impairment losses	<u>-</u>	<u>-</u>
Balance at end of year:		
Goodwill	168,921	168,921
Accumulated impairment losses	<u>(43,929)</u>	<u>(43,929)</u>
Total	\$ <u>124,992</u>	\$ <u>124,992</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

7. Long-Term Debt

Long-term debt for the years ended July 31, 2017 and 2016 follows:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
2012 Series Revenue Anticipation Certificates, payable in varying annual amounts from \$940,000 to \$16,285,000 in 2043; bearing interest at fixed rates from 2.00% to 5.00%. Net of unamortized issue costs of \$824,000 and \$857,000 at July 31, 2017 and 2016, respectively.	\$ 98,231	\$ 100,698
2008A Series Refunding Revenue Anticipation Certificates, payable in varying annual amounts from \$1,835,000 to \$3,795,000 in 2033; bearing interest at a variable rate based on a percentage of LIBOR plus a credit spread. Net of unamortized issue costs of \$175,000 and \$186,000 at July 31, 2017 and 2016, respectively.	41,600	43,369
2008B Series Refunding Revenue Anticipation Certificates, payable in varying annual amounts from \$1,835,000 to \$3,790,000 in 2033; bearing interest at a variable rate based on a percentage of LIBOR plus a credit spread. Net of unamortized issue costs of \$175,000 and \$186,000 at July 31, 2017 and 2016, respectively.	41,530	43,289

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

7. Long-Term Debt, Continued

	(Dollars in Thousands)	
	<u>2017</u>	<u>2016</u>
2010A-1 Revenue Anticipation		
Certificates, payable in varying annual amounts from \$52,000 to \$7,010,000 in 2040; bearing interest at a variable rate based on a percentage of LIBOR plus a credit spread. Net of unamortized issue costs of \$169,000 and \$177,000 at July 31, 2017 and 2016, respectively.	\$ 59,756	\$ 59,823
2010A-2 Revenue Anticipation		
Certificates, payable in varying annual amounts from \$33,000 to \$4,345,000 in 2040; bearing interest at a variable rate based on a percentage of LIBOR plus a credit spread. Net of unamortized issue costs of \$106,000 and \$110,000 at July 31, 2017 and 2016, respectively.	<u>37,039</u>	<u>37,080</u>
	278,156	284,259
Less current portion	<u>6,599</u>	<u>6,384</u>
	271,557	277,875
Add unamortized premium	<u>5,428</u>	<u>5,642</u>
	\$ <u>276,985</u>	\$ <u>283,517</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

7. Long-Term Debt, Continued

The Series 2008A and 2008B Refunding Revenue Certificates were issued on October 30, 2008 for the purposes of refunding certain revenue certificates which financed the costs of making certain additions, extensions, and capital improvements to the Corporation's health care system. The Series 2008A and 2008B Refunding Revenue Certificates were reissued on December 7, 2012 and the interest rates were converted from a daily variable rate with security provided by bank letters of credit to a variable rate based on a percentage of LIBOR plus a credit spread. The Series 2008A and 2008B Refunding Revenue Certificates were reissued again on February 2, 2015 and the interest rates were converted from a variable rate based on a percentage of LIBOR plus a credit spread to a new variable rate based on a percentage of LIBOR plus a credit spread. The Corporation may convert the interest rate upon compliance with terms and provisions of the related indenture.

The Series 2010A Revenue Certificates were issued on July 9, 2010 for the purpose of reimbursing the Corporation for prior additions, extensions and improvements to the Corporation's facilities. The Series 2010A Revenue Certificates were reissued on February 2, 2015 as Series 2010A-1 Revenue Certificates and Series 2010A-2 Revenue Certificates, respectively, and the interest rate was converted from a variable rate based on a percentage of LIBOR plus a credit spread to a new variable rate based on a percentage of LIBOR plus a credit spread. The Corporation may convert the interest rate upon compliance with terms and provisions of the related indenture.

The Series 2012 Revenue Certificates were issued on December 1, 2012 for the purposes of financing the costs of making certain additions, extensions, and capital improvements to its health care system. The Series 2012 Revenue Certificates bear interest at fixed rates from 2.00% to 5.00%.

Series 2008A, 2008B, 2010A-1, 2010A-2 and 2012 Revenue Certificates are secured by all receipts of, and revenue, income and money derived from the Corporation's operation of the Hospital premises.

The outstanding notes securing the Series 2008A, 2008B, 2010A-1, 2010A-2 and 2012 Revenue Certificates were issued pursuant to the Master Trust Indenture dated as of March 1, 2002, as amended, among the Corporation, the System and U.S. Bank National Association, as master trustee. Under the terms of the Master Trust Indenture, the Corporation is limited on the incurrence of additional borrowings and requires that the Corporation satisfy certain measures of financial performance as long as the notes are outstanding.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

7. Long-Term Debt, Continued

Scheduled principal repayments on long-term debt for the next five years are as follows:

(Dollars in Thousands)						
Year	2008A	2008B	2010A-1	2010A-2	2012	Total
2018	\$ 1,860	\$ 1,850	\$ 52	\$ 33	\$ 2,590	\$ 6,385
2019	1,835	1,835	136	84	2,755	6,645
2020	2,065	2,065	-	-	2,790	6,920
2021	2,285	2,285	-	-	2,600	7,170
2022	2,020	2,020	1,516	939	940	7,435
Thereafter	<u>31,710</u>	<u>31,650</u>	<u>58,221</u>	<u>36,089</u>	<u>87,380</u>	<u>245,050</u>
Total	<u>\$ 41,775</u>	<u>\$ 41,705</u>	<u>\$ 59,925</u>	<u>\$ 37,145</u>	<u>\$ 99,055</u>	<u>\$ 279,605</u>

8. Derivative Financial Instruments

The Corporation entered into fixed pay and constant maturity swaps to effectively swap variable interest rates to fixed interest rates thus reducing the impact of interest rate changes on future interest expense. The fair market value of the swaps are reported in noncurrent liabilities on the balance sheet. The critical terms of the swaps are as follows:

\$25MM Fixed Pay LIBOR Swap – Non-Hedge
(Dollars in Thousands)

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 21,627	\$ 21,874
Fair market value	\$(4,648)	\$(6,676)
Life remaining on swap	15 Years	16 Years

\$25MM Fixed Pay LIBOR Swap – Non-Hedge
(Dollars in Thousands)

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 21,627	\$ 21,874
Fair market value	\$(4,380)	\$(6,369)
Life remaining on swap	15 Years	16 Years

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

8. Derivative Financial Instruments, Continued

**\$21.145MM Fixed Pay LIBOR Swap – Non-Hedge
(Dollars in Thousands)**

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 18,292	\$ 18,501
Fair market value	\$(3,705)	\$(5,387)
Life remaining on swap	15 Years	16 Years

**Constant Maturity LIBOR Swap – Non-Hedge
(Dollars in Thousands)**

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 34,720	\$ 35,945
Fair market value	\$ 1,001	\$ 1,470
Life remaining on swap	15 Years	16 Years

**Constant Maturity LIBOR Swap – Non-Hedge
(Dollars in Thousands)**

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 34,720	\$ 35,945
Fair market value	\$ 931	\$ 1,509
Life remaining on swap	15 Years	16 Years

**Constant Maturity LIBOR Swap – Non-Hedge
(Dollars in Thousands)**

	<u>2017</u>	<u>2016</u>
Notional amount	\$ 69,440	\$ 71,890
Fair market value	\$ 408	\$ 942
Life remaining on swap	1 Year	2 Years

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

8. Derivative Financial Instruments, Continued

The swaps were issued at market terms so that they had no fair value at their inception. The carrying amount of the swaps has been adjusted to fair value at the end of the year which, because of changes in forecasted levels of the LIBOR, resulted in reporting a liability. The Corporation deemed the capacity to perform on the part of the derivative counterparty to be of little or no concern; and no adjustment was applied to standard market valuation practices.

The swap results are included in excess revenues (expenses). For the years ending July 31, 2017 and 2016, this earning impact totaled approximately \$4,119,000 and \$(4,037,000), respectively.

9. Temporarily and Permanently Restricted Net Assets

A summary of the restricted net assets at July 31, 2017 and 2016 follows:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
<u>Temporarily Restricted Net Assets</u>		
Donor restricted investments	\$ <u>6,155</u>	\$ <u>8,429</u>
<u>Permanently Restricted Net Assets</u>		
Restricted investments to be held in perpetuity by Phoebe Foundation, Inc.	\$ <u>2,024</u>	\$ <u>2,024</u>

10. Pension Plan

The Corporation has a defined benefit pension plan covering all full time regular employees working 1,000 hours or more in a twelve-month period with an employment date before December 31, 2006. The plan provides benefits that are based upon earnings and years of service. The Corporation'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.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

The measurement dates were July 31, 2017 and 2016. The Corporation issues a publicly available financial report that includes financial statements and required supplementary information for the Retirement Plan for Employees of Phoebe Putney Health System, Inc. That report may be obtained by contacting the management of the Corporation.

Effective December 31, 2014, the Corporation amended the pension plan to freeze all benefit accruals except for participants whose combined age and credited service equaled or exceeded 70 by the effective date. On July 28, 2016, the Corporation executed an amendment to permit vested terminated participants with an accrued benefit of \$150,000 or less to make an election during the period September 2, 2016 through November 1, 2016 to receive a lump sum distribution. This amendment was effective December 1, 2016 and eligibility was based on the benefit accruals as of December 1, 2016. Such distributions were made during the period December 1, 2016 through December 31, 2016. Effective December 31, 2016, the Corporation amended the pension plan to freeze all benefit accruals for all remaining participants.

The following table sets forth the defined benefit pension plan funded status and amounts recognized in the financial statements at July 31, 2017 and 2016:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Plan assets at fair value at July 31	\$ 200,338	\$ 191,320
Projected benefit obligation at July 31	<u>299,809</u>	<u>320,966</u>
Funded status	\$(<u>99,471</u>)	\$(<u>129,646</u>)
Amounts recognized in the consolidated balance sheet consist of:		
Noncurrent liabilities	\$(<u>99,471</u>)	\$(<u>129,646</u>)

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Amounts recognized in unrestricted net assets:		
Net actuarial loss	\$(102,919)	\$(125,219)
Prior service cost not yet recognized in net periodic pension cost	<u>-</u>	<u>(81)</u>
Deferred pension cost	<u>\$(102,919)</u>	<u>\$(125,300)</u>
Weighted-average assumptions used to determine pension benefit obligations:		
Discount rate	4.05%	3.87%
Rate of compensation increase	2.50%	2.50%
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	3.87%	4.60%
Expected long-term return on plan assets	7.00%	7.75%
Rate of compensation increase	2.50%	4.00%

Mortality table assumptions used to determine pension benefit obligations were RP-2006 Employee and Healthy Annuitant Mortality Tables with Fully Generational Projections using MP2016 and MP2015 for 2017 and 2016, respectively.

The Corporation'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.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

The following table sets forth the components of net periodic cost and other amounts recognized in unrestricted net assets for the years ended July 31, 2017 and 2016:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Service cost	\$ 1,032	\$ 3,259
Interest cost	9,714	11,454
Expected return on plan assets	(12,947)	(15,200)
Amortization of prior service cost	6	24
Amortization of recognized net actuarial loss	2,701	5,004
Gain due to curtailment	<u>75</u>	<u>-</u>
Net periodic benefit cost	<u>581</u>	<u>4,541</u>
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Net actuarial (gain) loss	(19,599)	37,895
Amortization of prior service cost	(81)	(24)
Amortization of net actuarial loss	<u>(2,701)</u>	<u>(5,004)</u>
Total recognized in unrestricted net assets	<u>(22,381)</u>	<u>32,867</u>
Total recognized in net periodic benefit cost and unrestricted net assets	<u>\$ (21,800)</u>	<u>\$ 37,408</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Projected benefit obligation, beginning of year	\$ 320,966	\$ 296,814
Service cost	1,032	3,259
Interest cost	9,714	11,454
Actuarial (gain) loss	(9,183)	18,010
Benefits paid	(19,992)	(8,571)
Gain due to curtailment	(2,728)	<u>-</u>
 Projected benefit obligation, end of year	 \$ <u>299,809</u>	 \$ <u>320,966</u>
 Accumulated benefit obligation	 \$ <u>299,809</u>	 \$ <u>317,897</u>

The change in fair value of plan assets for the years ended July 31, 2017 and 2016 included the following components:

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Plan assets at fair value, beginning of year	\$ 191,320	\$ 197,124
Actual return on assets	20,635	(4,686)
Employer contributions	8,375	7,453
Benefits paid	(19,992)	(8,571)
 Plan assets at fair value, end of year	 \$ <u>200,338</u>	 \$ <u>191,320</u>

The Corporation anticipates making a contribution during fiscal year 2018 of \$7,668,000.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

Estimated Future Benefit Payments

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

(Dollars in Thousands)

<u>Year Ending July 31</u>	<u>Pension Benefits</u>
2018	\$ 11,536
2019	\$ 12,331
2020	\$ 12,961
2021	\$ 13,496
2022	\$ 14,188
2023 – 2027	\$ 79,413

The expected benefits to be paid are based on the same assumptions used to measure the Corporation's benefit obligation at July 31, 2017.

The actuarial loss and prior service cost to be recognized during the next 12 months beginning August 1, 2017 is as follows:

	<u>(Dollars in Thousands)</u>
Amortization of net actuarial loss	\$ 2,816
Amortization of prior year service costs	<u>-</u>
Total	\$ <u>2,816</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

Estimated Future Benefit Payments, Continued

The composition of plan assets at July 31, 2017 and 2016 is as follows:

Asset category:	Target	Plan Assets	
	<u>Allocation</u>	<u>2017</u>	<u>2016</u>
U.S. equities	30%	23%	22%
Non U.S. equities	20%	18%	16%
Emerging markets	5%	7%	6%
Hedge funds	15%	19%	15%
Real assets	5%	9%	10%
Opportunistic funds	5%	7%	9%
Fixed income	20%	14%	18%
Cash and cash equivalents	<u>0%</u>	<u>3%</u>	<u>4%</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Corporation'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.

Pension assets are invested in various classes as summarized in the table below for 2017 and 2016. The allocation between different investment vehicles is determined by the Corporation, 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 Corporation 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.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

The Corporation attempts to mitigate investment risk by rebalancing between investment classes as the Corporation'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.

The fair values of the Corporation's pension plan assets at July 31, 2017 and 2016, by asset category are as follows:

(Dollars in Thousands)				
Fair Value Measurements at July 31, 2017				
<u>Asset Category</u>	<u>Total</u>	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 5,761	\$ 15	\$ 5,746	\$ -
Equity securities	5,045	5,015	30	-
Real estate investment trusts	<u>6,265</u>	<u>6,265</u>	<u>-</u>	<u>-</u>
Total assets in fair value hierarchy	17,071	\$ <u>11,295</u>	\$ <u>5,776</u>	\$ <u>-</u>
Investments measured at net asset value	<u>183,267</u>			
Total assets at fair value	\$ <u>200,338</u>			

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

(Dollars in Thousands)

Fair Value Measurements at July 31, 2016

<u>Asset Category</u>	<u>Total</u>	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 8,392	\$ -	\$ 8,392	\$ -
Equity securities	5,727	5,688	39	-
Real estate investment trusts	<u>6,197</u>	<u>6,197</u>	<u>-</u>	<u>-</u>
Total assets in fair value hierarchy	20,316	\$ <u>11,885</u>	\$ <u>8,431</u>	\$ <u>-</u>
Investments measured at net asset value	<u>171,004</u>			
Total assets at fair value	\$ <u>191,320</u>			

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

The following table sets forth additional information for assets valued at NAV as a practical expedient:

	as of July 31, 2017			
	(Dollars in Thousands)			
	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Restrictions on Redemption Frequency</u>	<u>Redemption Notice Period</u>
Mutual funds – fixed income funds	\$ 5,829	None	Monthly	10 Business Days
Mutual funds – index funds	\$ 33,795	None	Daily	15 Days
Mutual funds – growth and other funds	\$ 6,948	None	Daily	None
Alternative investments:				
Hedge fund – credit opportunities	\$ 5,178	None	Annually	90 Days
Hedge fund – multi-strategy	\$ 14,736	None	Quarterly – Annually	45 – 95 Days
Hedge fund – long/short equity	\$ 16,199	None	Quarterly – Annually	30 – 180 Days
Hedge fund – other	\$ 9,260	None	Monthly	3 Business Days
Common collective trusts invested in equity securities	\$ 55,065	None	Monthly	10 Business Days – 30 Days
Limited partnerships invested in equity securities	\$ 36,257	\$ 297	Semi-Monthly – Quarterly	7 – 60 Days
	as of July 31, 2016			
	(Dollars in Thousands)			
	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Restrictions on Redemption Frequency</u>	<u>Redemption Notice Period</u>
Mutual funds – fixed income funds	\$ 14,466	None	Monthly	10 Business Days – 30 Days
Mutual funds – index funds	\$ 33,003	None	None	15 Days
Mutual funds – growth and other funds	\$ 6,046	None	None	None
Alternative investments:				
Hedge fund – credit opportunities	\$ 4,626	None	Annually	90 Days
Hedge fund – multi-strategy	\$ 13,179	None	Quarterly – Annually	45 – 95 Days
Hedge fund – long/short equity	\$ 15,718	None	Monthly – Annually	30 – 180 Days
Hedge fund – other	\$ 6,031	None	Monthly – Quarterly	3 Business Days – 33 Days
Common collective trusts invested in equity securities	\$ 46,589	None	Monthly	10 Business Days – 30 Days
Limited partnerships invested in equity securities	\$ 31,346	\$ 639	Semi-Monthly – Quarterly	7 – 60 Days

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

10. Pension Plan, Continued

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. Financial assets using Level 3 inputs were primarily valued using management's assumptions about the assumptions market participants would utilize in pricing the asset or liability. Valuation techniques utilized to determine fair value are consistently applied. See Note 18 for valuation methodologies.

Defined Contribution Pension Plan

The Corporation maintains defined contribution pension plans covering substantially all eligible employees. Employees may deposit a portion of their earnings for each pay period on a pre-tax basis and the Corporation matches 50% of each participant's voluntary contributions up to a maximum of 4% of the employee's annual salary. Effective January 1, 2017, the Corporation increased its match to 50% of each participant's voluntary contributions up to a maximum of 6% of the employee's annual salary. At its discretion, the Corporation may make additional contributions to the Plan. Matching and discretionary contribution expenses for the years ended July 31, 2017 and 2016 totaled approximately \$1,009,000 and \$3,648,000, respectively.

11. Employee Health Insurance

The Corporation has a self-insurance program under which a third-party administrator processes and pays claims. The Corporation reimburses the third-party administrator for claims incurred and paid. In addition, the Corporation participates in a shared group financing layer agreement with other Georgia hospitals through a program offered by Georgia ADS, LLC. The program is designed to provide for the financing and payment of covered claims. For fiscal year 2016 through December 31, 2015, the claims included in the financing program were covered claims between \$150,000 and \$500,000. Effective January 1, 2016, the parameters of the program changed to include covered claims between \$225,000 and \$650,000. Each participant in the program is responsible for a portion of the shared claims based on their percentage of the total claims for the group. Additional insurance has been obtained to provide coverage for claims exceeding \$650,000. Total expenses related to this plan were approximately \$17,394,000 and \$22,500,000 for 2017 and 2016, respectively.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

12. Malpractice Insurance

Effective August 1, 2006, Phoebe Putney Indemnity, LLC (PPI), located in South Carolina, issued a claims-made policy covering professional and general liabilities, personal injury, advertising injury liability, and contractual liability of the Corporation with a retroactive date of January 1, 1990. Under the policy, the limit of liability is \$5,000,000 per occurrence, with an annual aggregate of \$27,000,000 at July 31, 2017 and 2016.

Effective August 1, 2015, PPI purchased excess of loss reinsurance coverage in order to limit its financial exposure to large claims relating to employed physicians and surgeons. Under the per risk coverage, the reinsurer shall pay up to \$750,000 per loss, per insured, in excess of \$250,000 per loss, per insured. Under the clash coverage, the reinsurer shall pay up to \$750,000 per loss occurrence, in excess of \$250,000 per loss occurrence. The maximum amount recoverable for both of these coverage's combined shall not exceed 40% of the subject premium or \$6,000,000, whichever is greater. Under the excess of limits coverage, the reinsurer shall pay up to \$4,000,000 per loss, per insured, in excess of \$1,000,000, per loss, per insured. The maximum amount recoverable for this coverage shall not exceed \$8,000,000. The reinsurance treaty provides for adjustable premiums based on ceded losses up to a stated maximum.

The System has also purchased excess liability coverage which includes coverage of the Corporation. The limits of the policy are \$50,000,000 per occurrence and in aggregate in excess of the PPI coverage of \$5,000,000. All of the risk related to this coverage has been ceded to unrelated reinsurers via a contract of reinsurance.

Various claims and assertions have been made against the Corporation 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.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

13. Concentrations of Credit Risk

The Corporation is located in Albany, Georgia. The Corporation grants credit without collateral to its patients, most of whom are residents of Southwest Georgia and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at July 31, 2017 and 2016 was as follows:

	<u>2017</u>	<u>2016</u>
Medicare	33%	38%
Medicaid	19%	18%
Blue Cross	13%	10%
Commercial	22%	21%
Patients	<u>13%</u>	<u>13%</u>
Total	<u>100%</u>	<u>100%</u>

At July 31, 2017, the Corporation had deposits at major financial institutions which exceeded the \$250,000 Federal Deposit Insurance Corporation limits. Management believes the credit risks related to these deposits is minimal.

14. Related Party Payables

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Due to Phoebe Putney Health System, Inc.	\$(69,366)	\$(52,124)
Due from other related parties	<u>96</u>	<u>59</u>
Net related party payables	\$(<u>69,270</u>)	\$(<u>52,065</u>)

The related party transactions that affect the above receivables and payables arise from the sharing of services and costs.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

15. Related Organization

Phoebe Foundation, Inc. (Foundation) was established to raise funds to support the operation of the Corporation. The Foundation's bylaws provide that all funds raised, except for funds required for the operation of the Foundation, be distributed to or be held for the benefit of the Corporation. The Foundation's general funds, which represent the Foundation's unrestricted resources, are distributed to the Corporation in amounts and in periods determined by the Foundation's Board of Directors, who may also restrict the use of general funds for hospital plant replacement or expansion or other specific purposes. Plant replacement and expansion funds, specific-purpose funds, and assets obtained from endowment income of the Foundation are distributed to the Corporation as required to comply with the purposes specified by donors. The Corporation's interest in the net assets of the Foundation is reported as an other asset in the balance sheets.

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Assets:		
Cash and cash equivalents	\$ 3,435	\$ 5,555
Investments	12,098	11,371
Other assets	836	589
Due from related parties	<u>-</u>	<u>10</u>
Total assets	\$ <u>16,369</u>	\$ <u>17,525</u>
Liabilities and net assets:		
Accounts payable	\$ 433	\$ 19
Due to related parties	<u>1</u>	<u>-</u>
Total liabilities	434	19
Net assets	<u>15,935</u>	<u>17,506</u>
Total liabilities and net assets	\$ <u>16,369</u>	\$ <u>17,525</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

15. Related Organization, Continued

	<u>(Dollars in Thousands)</u>	
	<u>2017</u>	<u>2016</u>
Revenue and support	\$ 5,480	\$ 839
Expenses	<u>4,750</u>	<u>970</u>
Excess of revenue and support (expenses)	730	(131)
Restricted contributions	1,727	1,682
Net assets released from restriction and other changes in net assets	(4,028)	61
Net assets, beginning of year	<u>17,506</u>	<u>15,894</u>
Net assets, end of year	\$ <u>15,935</u>	\$ <u>17,506</u>

16. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	<u>(Dollars in Thousands)</u>	
	<u>July 31,</u>	
	<u>2017</u>	<u>2016</u>
Patient care services	\$ 404,376	\$ 411,313
General and administrative	<u>112,761</u>	<u>114,983</u>
Total	\$ <u>517,137</u>	\$ <u>526,296</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

17. Fair Values of Financial Instruments

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

- *Cash and cash equivalents:* The carrying amount reported in the balance sheet for cash and cash equivalents approximates its fair value.
- *Assets limited as to use:* Amounts reported in the balance sheet approximate fair value. See Note 18 for fair value measurement disclosures.
- *Accounts payable and accrued expenses:* The carrying amount reported in the balance sheet for accounts payable and accrued expenses approximates its fair value.
- *Estimated third-party payor settlements:* The carrying amount reported in the balance sheet for estimated third-party payor settlements approximates its fair value.
- *Derivative financial instruments:* The carrying amount reported in the balance sheet for derivative financial instruments approximates its fair value. See Note 18 for fair value measurement disclosures.
- *Long-term debt:* Fair values of the Corporation's revenue notes are based on current traded value. The carrying amount reported in the balance sheet for debt totals approximately \$285,033,000 and \$291,416,000 at July 31, 2017 and 2016, respectively, with a fair value of approximately \$287,455,000 and \$297,581,000, respectively. Based on inputs used in determining the estimated fair value, the Corporation's long-term debt would be classified as Level 2 in the fair value hierarchy.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

18. Fair Value Measurement

Following is a description of the valuation methodologies used for assets and liabilities at fair value. There have been no changes in the methodologies used at July 31, 2017 and 2016.

- *Money market funds and certificates of deposit:* Valued at amortized cost, which approximates fair value.
- *Equity securities:* Certain equity securities are valued at the closing price reported on the active market on which the individual securities are traded. Other equity securities are valued based on quoted prices for similar investments in active or inactive markets or valued using observable market data.
- *Mutual funds and alternative investments in hedge funds:* Certain mutual funds are valued at closing price reported on the active market on which the individual securities are traded. Other mutual funds are valued at the net asset value (NAV) of shares held at year end. Certain investments invest in a variety of growth and value assets. Management of the funds has the ability to shift investments as they feel necessary to meet established goals.
- *Real estate investment trusts:* These exchange traded investments are valued on the basis of a discounted cash flow approach, which includes the future rental receipts, expenses, and residual values as the highest and best use of the real estate from a market participant view as rental property.
- *Common collective trusts:* Valued using net asset value (NAV). The NAV's are based on fair value, determined based on prices quoted and published by the investment manager of the accounts. Quoted prices are determined based on fair value of the underlying assets.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

18. Fair Value Measurement, Continued

- *Limited partnerships invested in equity securities:* Valued at net asset value (NAV) which is determined by the underlying assets held by the limited partnerships. The limited partnerships invest in a variety of equity securities, some of which do not have readily available market prices. In the absence of readily available market prices, the fair values are estimated by the investment managers of those equity securities. Estimated values may differ from the values that would have been used if readily available market prices existed or if the equity securities were liquidated at the valuation date.
- *Derivatives:* Valued using forward LIBOR curves. Values are then verified against counterparty mark-to-market valuations.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair values of liabilities measured on a recurring basis at July 31, 2017 and 2016 are as follows:

	<u>Fair Value</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets For Identical Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>July 31, 2017</u>				
Liabilities:				
Derivatives	\$ <u>10,392</u>	\$ <u>-</u>	\$ <u>10,392</u>	\$ <u>-</u>
<u>July 31, 2016</u>				
Liabilities:				
Derivatives	\$ <u>14,511</u>	\$ <u>-</u>	\$ <u>14,511</u>	\$ <u>-</u>

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

18. Fair Value Measurement, Continued

Following is a description of the valuation methodologies used and investment strategies for assets measured using NAV as a practical expedient.

- *Mutual funds – fixed income funds:* The fixed income mutual funds seek to provide a high level of current income while preserving principal by primarily investing in a portfolio of domestic and international debt securities with an investment grade or better and with a dollar weighted average maturity between three and ten years.
- *Mutual funds – index funds:* The index mutual funds are invested in a variety of large cap domestic companies that are members of the indices. Members of the indices are determined each year during annual reconstruction and enhanced quarterly with the addition of initial public offerings.
- *Mutual funds – growth and other funds:* The growth and other mutual funds seek to provide a high level of return through the allocation of investments among both small cap investments and mortgage-backed securities.
- *Alternative investments in hedge funds:* The objective of the hedge funds is to use leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns while maintaining minimal risk.
- *Common collective trusts invested in equity securities (CCTs):* The CCTs seek to provide high returns by investing in small and large cap securities, distressed securities, as well as the acquisition of controlling interests with equity.
- *Limited partnerships invested in equity securities:* The limited partnerships invested in equity securities seek to provide risk-adjusted returns by investing in a mixture of domestic and international highly liquid equities, equities in global real estate markets, and equities in consumer markets.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

19. Commitments and Contingencies

Compliance Plan

The healthcare industry has been subjected to increased scrutiny from governmental agencies at both the federal and state level with respect to compliance with regulations. Areas of noncompliance identified at the national level include Medicare and Medicaid, Internal Revenue Service, and other regulations governing the healthcare industry. In addition, the Reform Legislation includes provisions aimed at reducing fraud, waste, and abuse in the healthcare industry. These provisions allocate significant additional resources to federal enforcement agencies and expand the use of private contractors to recover potentially inappropriate Medicare and Medicaid payments. The Corporation has implemented a compliance plan focusing on such issues. There can be no assurance that the Corporation will not be subjected to future investigations with accompanying monetary damages.

Health Care Reform

There has been increasing pressure on Congress and state legislatures to control and reduce the cost of healthcare on the national or at the state level. Legislation has been passed that includes cost controls on healthcare providers, insurance market reforms, delivery system reforms, and various individual and business mandates among other provisions. The costs of these provisions are and 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 Corporation.

Litigation

The Corporation is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results from operations. See malpractice insurance disclosures in Note 12.

Other

On May 18, 2017, a group submitted to the Georgia Department of Community Health, a certificate of need application for a new hospital to be located within the Corporation's services area. On November 15, 2017, the Georgia Department of Community Health approved the group's certificate of need. No consideration has been given in the financial statements to the approved certificate of need.

Continued

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

NOTES TO FINANCIAL STATEMENTS, Continued
July 31, 2017 and 2016

20. Electronic Health Record Incentive Payments

The Health Information Technology for Economic and Clinical Health Act (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 in Medicare reimbursements beginning in FY 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 government fiscal year October 1, 2010 to September 30, 2011.

The Corporation recognizes income related to the Medicare and Medicaid incentive payments using a grant model based upon when it has determined that it is reasonably assured that the Hospital will be meaningfully using EHR technology for the applicable period and the cost report information is reasonably estimable.

The Corporation successfully demonstrated meeting meaningful use of its certified EHR technology for fiscal year 2017 and 2016. The Corporation applied for and received approval from Medicare and Medicaid notifying the Corporation qualified for approximately \$-0- and \$600,000, respectively, which has been recorded in other revenue. Approximately \$-0- and \$600,000 of the payments are accrued in other current assets at July 31, 2017 and 2016, respectively.

INDEPENDENT AUDITOR'S REPORT ON
SUPPLEMENTAL INFORMATION

Board of Directors
Phoebe Putney Memorial Hospital, Inc.
Albany, Georgia

We have audited the financial statements of Phoebe Putney Memorial Hospital, Inc. as of and for the years ended July 31, 2017 and 2016 and our report thereon dated December 6, 2017, which expressed an unmodified opinion on those financial statements, appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The information included in this report on pages 52 to 59, inclusive, which is the responsibility of management, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Draffin & Tucker, LLP
Albany, Georgia
December 6, 2017

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY

July 31, 2017

Phoebe Putney Memorial Hospital, Inc. (Corporation) is a not-for-profit health care organization that exists to serve the community. The Corporation opened in 1911 to serve the community by caring for the sick regardless of ability to pay. As a tax-exempt hospital, the Corporation has no stockholders or owners. All revenue after expenses is reinvested in the mission to care for the citizens of the community – into clinical care, health programs, state-of-the-art technology and facilities, research, and teaching and training of medical professionals now and for the future.

The Corporation operates as a charitable organization consistent with the requirements of Internal Revenue Code Section 501(c)(3) and the “community benefit standard” of IRS Revenue Ruling 69-545. The Corporation takes seriously its responsibility as the community’s safety net hospital and has a strong record of meeting and exceeding the charitable care and the organizational and operational standards required for federal tax-exempt status. The Corporation demonstrates a continued and expanding commitment to meeting its mission and serving the citizens by providing community benefits. A community benefit is a planned, managed, organized, and measured approach to meeting identified community health needs, requiring a partnership between the healthcare organization and the community to benefit residents through programs and services that improve health status and quality of life.

The Corporation improves the health and well-being of Southwest Georgia through clinical services, education, research and partnerships that build health capacity in the community. The Corporation provides community benefits for every citizen in its service area as well as for the medically underserved. The Corporation conducts community needs assessments and pays close attention to the needs of low income and other vulnerable persons and the community at large. The Corporation often works with community groups to identify needs, strengthen existing community programs and plan newly needed services. It provides a wide-ranging array of community benefit services designed to improve community health and the health of individuals and to increase access to health care, in addition to providing free and discounted services to people who are uninsured and underinsured. The Corporation’s excellence in community benefit programs was recognized by the prestigious Foster McGaw Prize awarded to the Corporation in 2003 for its broad-based outreach in building collaboratives that make measurable improvements in health status, expand access to care and build community capacity, so that patients receive care closest to their own neighborhoods. Drawing on a dynamic and flexible structure, the community benefit programs are designed to respond to assessed needs and are focused on upstream prevention.

As Southwest Georgia’s leading provider of cost-effective, patient-centered health care, the Corporation is also the region’s largest employer with more than 3,600 members of the Corporation Family caring for patients. The Corporation participates in the Medicare and Medicaid programs and is one of the leading providers of Medicaid services in Georgia.

See independent auditor’s report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued

July 31, 2017

The following table summarizes the amounts of charges foregone (i.e., contractual adjustments) and estimates the losses incurred by the Corporation due to inadequate payments by these programs and for indigent/charity. This table does not include discounts offered by the Corporation under managed care and other agreements:

	<u>Charges Foregone</u>	<u>Estimated Unreimbursed Cost</u>
Medicare	\$ 553,000,000	\$ 183,000,000
Medicaid	200,000,000	66,000,000
Indigent/charity	<u>60,000,000</u>	<u>20,000,000</u>
	<u>\$ 813,000,000</u>	<u>\$ 269,000,000</u>

Indigent/Charity Care by County

The Corporation provided care to a total of 9,002 Indigent/Charity patients during 2017. These patients came from numerous counties throughout Georgia and surrounding states. The following table summarizes the amounts of charges foregone and estimates the losses incurred by the Corporation by county.

<u>County</u>	<u>Charges Foregone</u>	<u>Estimated Unreimbursed Cost</u>
Dougherty	\$ 36,000,000	\$ 12,000,000
Lee	5,000,000	1,800,000
Worth	3,300,000	1,000,000
Mitchell	2,500,000	800,000
Sumter	2,000,000	700,000
Terrell	1,800,000	600,000
Randolph	1,000,000	300,000
Tift	1,000,000	300,000
Calhoun	700,000	200,000
Macon	600,000	200,000
Other Georgia	5,700,000	2,000,000
Out of State	<u>400,000</u>	<u>100,000</u>
Total	<u>\$ 60,000,000</u>	<u>\$ 20,000,000</u>

See independent auditor's report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued
July 31, 2017

The following is a summary of the community benefit activities and health improvement services offered by the Corporation and illustrates the activities and donations during fiscal year 2017.

I. Community Health Improvement Services

A. Community Health Education

The Corporation provided health education services that reached 4,122 individuals in 2017 at a cost of \$250,436. These services included the following free classes and seminars:

- Nutrition and Diabetes Education
- Stroke Awareness
- Camp Good Grief
- Teen Maze
- Various School Based Health Fairs
- Go Noodle Activity Programs
- Health Teacher Training
- Cancer Prevention
- Heart Disease

Men's and Women's Health Conferences

The Men's and Women's Conferences attracted approximately 1,339 participants. These conferences provided blood pressure, glucose, and cholesterol and BMI screenings for each participant and were made possible by a broad coalition of providers such as Faith-based Initiative, Heart and Cancer Society, SWGA Cancer Coalition, and Public Health among others. The total costs for all conferences and other health fairs was \$18,180 to include 3,997 participants.

Network of Trust

This is a nationally recognized program aimed at teen mothers to provide parenting skills, attempt to reduce repeat pregnancies, and complete high school. This program also includes a teen father program along with other teenaged children programs. Internal evaluation shows teens participating in the program are less likely to repeat a pregnancy prior to graduation. Network of Trust enrolled 67 unduplicated teen parents during 2016/2017 school year at a cost of \$228,270.

See independent auditor's report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued
July 31, 2017

I. Community Health Improvement Services, Continued

B. Community Based Clinical Services

Flu Shots

The Corporation provides free flu shots to volunteers. In 2017, the Corporation administered 289 flu shots at an unreimbursed cost of \$5,562.

School Nurse Program

The Corporation places nurses in sixteen elementary schools, six middle schools, and four high schools in Dougherty County with a goal of creating access to care for students and staff, assessing the health care status of each population represented and effectively establishing referrals for all health care needs. Nurses also conducted the Eighth Grade Health Fairs. During the 2016/2017 school year, the school nurse program covered 14,250 student lives. This program is operated at a cost of \$288,994 in 2017.

C. Health Care Support Services

The Corporation provided 213 colorectal screenings [colonoscopy] to uninsured residents referred by Horizons Community Health Solutions at a cost of \$153,573. Of the 213 screened, more than 30% had high-risk adenomatous polyps removed during colonoscopy.

Government Sponsored Eligibility Applications to the Poor and Needy

The Corporation contracts with Change Healthcare (formerly Chamberlain Edmonds) to process eligibility applications on behalf of the poor and needy that may be eligible for Medicaid. In some cases, it can take up to two years to be deemed eligible. In 2017, the Corporation paid \$998,457 to Change Healthcare to process Medicaid applications.

- Indigent Financial Assistance

Patients whose household income is at or below 125% of the Federal Poverty Guidelines are classified as indigent and are eligible for free care as provided in the Financial Assistance Policy.

See independent auditor's report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued
July 31, 2017

I. Community Health Improvement Services, Continued

C. Health Care Support Services, Continued

Government Sponsored Eligibility Applications to the Poor and Needy, Continued

- Charity Financial Assistance

Patients whose household income is between 126% - 200% of the Federal Poverty Guidelines qualify for discounted charges for care based on a sliding schedule in the Financial Assistance Policy.

- Catastrophic Financial Assistance

Patients whose income exceeds 200% of the Federal Poverty Guidelines, and whose balance owed exceeds 25% of their annual income, resulting in excessive hardship, qualify for discounted charges on a sliding scale basis ranging from 89% to 60% based on income and number of dependents. Terms and conditions are detailed in the Financial Assistance Policy.

II. Health Professions Education

The Corporation recognizes that to continuously improve the Corporation's long-term value to our community and our customers, to encourage life-long learning among employees and to achieve a world-class employer status, it is in the Corporation's best interest to provide opportunities that will assist eligible employees in pursuing formal, healthcare related educational opportunities. In fiscal year 2017, the Corporation provided \$1,154,464 in clinical supervision and training of nursing students, and an additional \$1,341,706 in clinical supervision and training to pharmacy, pharmacy techs and other allied health professionals. In all, approximately 829 students received clinical instruction from our facility.

See independent auditor's report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued

July 31, 2017

III. Subsidized Health Services

A. Other Subsidized Services

Inmate Care

The Corporation provides care to persons in jail for Dougherty County. In 2017 the Corporation provided \$221,064 of unreimbursed medical and drug treatment to 147 inmates.

Indigent Drug Pharmacy

Indigent Drug Pharmacy provides medication upon discharge to patients that are either indigent or uninsured. In 2017, the pharmacy filled 6,520 prescriptions at a cost of \$417,878.

IV. Financial and In-Kind Support

In 2017, The Corporation provided \$128,944 in cash donations and in-kind support to non-profit organizations in Southwest Georgia. Listed are some highlights:

- The Southwest Georgia Cancer Coalition received \$60,165 for staff support and various projects.
- The Sowega Council on Aging received \$25,000 for their ramp project to provide ramps to the elderly.
- In-kind support of Foregone Rent to non-profit organizations at an estimated cost of \$43,779.

V. Community Building Activities

A. Economic Development

The Corporation supports the Economic Development Commission of Dougherty County with funding to support improved employment and health coverage as a way to improve the overall health of the residents of the region.

See independent auditor's report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued
July 31, 2017

VI. Community Benefit Obligations

The Corporation incurred \$137,393 to support staff and community health needs assessment costs that included \$32,000 renewal of Healthy Communities Institute’s dashboard feature on our website:

<http://www.phoebehealth.com/health-matters/building-healthy-communities>

Summary

	<u>2017</u>
Community Health Improvement Services:	
Community Health Education	\$ 250,436
Community Based Clinical Services	294,556
Healthcare Support Services	<u>1,152,030</u>
Total community health improvement services	<u>1,697,022</u>
Health Professional Education:	
Nurses/nursing students	1,154,464
Other health professional education	<u>1,341,706</u>
Total health professional education	<u>2,496,170</u>
Subsidized Health Services:	
Other subsidized health services	<u>638,942</u>
Total subsidized health services	<u>638,942</u>
Financial and In-Kind Support:	
Cash donations	85,165
In-kind donations	<u>43,779</u>
Total financial and in-kind support	<u>128,944</u>
Community Benefit Operations:	
Dedicated staff and other resources	<u>137,393</u>
Total community benefit operations	<u>137,393</u>

See independent auditor’s report on supplemental information.

PHOEBE PUTNEY MEMORIAL HOSPITAL, INC.

SERVICE TO THE COMMUNITY, Continued

July 31, 2017

V. **Community Benefit Obligations, Continued**

Summary, Continued

	<u>2017</u>
Other:	
Traditional charity care – estimated unreimbursed cost of charity services	\$ 20,000,000
Unpaid cost of Medicare services – estimated unreimbursed cost of Medicare services	183,000,000
Unpaid cost of Medicaid services – estimated unreimbursed cost of Medicaid services	<u>66,000,000</u>
Total other	<u>269,000,000</u>
Total summary	<u>\$ 274,098,471</u>

This report has been prepared in accordance with the community benefit reporting guidelines established by Catholic Health Association (CHA) and VHA. The Internal Revenue Services' requirements for reporting community benefits are different than the guidelines under which this report has been prepared.

See independent auditor's report on supplemental information.