
The Methodist Hospitals, Inc.

Consolidated Financial Report
December 31, 2018

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Independent Auditor's Report

To the Board of Directors
The Methodist Hospitals, Inc.

We have audited the accompanying consolidated financial statements of The Methodist Hospitals, Inc. (the "Hospital"), which comprise the consolidated balance sheet as of December 31, 2018 and 2017 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Emphasis of Matter

As described in Note 2 to the consolidated financial statements, the Hospital adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, using the modified retrospective adoption method, as of January 1, 2018 and Accounting Standards Codification (ASC) (Topic 958), *Presentation of Financial Statements of Not-for-Profit Entities*, using the retrospective adoption method, for the year ended December 31, 2018. Our opinion is not modified with respect to these matters.

Plante & Moran, PLLC

May 6, 2019

Consolidated Balance Sheet

December 31, 2018 and 2017

	2018	2017
Assets		
Current Assets		
Cash and cash equivalents	\$ 27,344,669	\$ 612,061
Short-term investments (Note 6)	585,543	576,070
Patient accounts receivable (Note 3)	42,367,404	48,913,705
Cost report settlements receivable (Note 4)	16,091,097	22,724,126
Other current assets (Note 9)	22,776,840	16,189,252
Total current assets	109,165,553	89,015,214
Assets Limited as to Use (Note 6)	108,629,625	125,884,579
Property and Equipment - Net (Note 10)	138,651,937	145,870,116
Other Assets	4,743,159	4,833,351
Total assets	\$ 361,190,274	\$ 365,603,260
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	\$ 16,434,509	\$ 11,292,470
Current portion of long-term debt (Note 12)	2,552,245	2,436,521
Cost report settlements payable (Note 4)	6,645,566	7,577,574
Accrued liabilities and other (Note 11)	16,616,765	17,483,748
Total current liabilities	42,249,085	38,790,313
Long-term Debt - Net of current portion (Note 12)	58,689,196	61,519,535
Other Liabilities (Note 13)	13,140,240	20,995,640
Total liabilities	114,078,521	121,305,488
Net Assets		
Net assets without donor restrictions	246,681,823	243,922,279
Net assets with donor restrictions	429,930	375,493
Total net assets	247,111,753	244,297,772
Total liabilities and net assets	\$ 361,190,274	\$ 365,603,260

Consolidated Statement of Operations

Years Ended December 31, 2018 and 2017

	2018	2017
Revenue, Gains, and Other Support		
Net patient service revenue		\$ 310,939,690
Provision for bad debts		<u>(20,384,296)</u>
Patient service revenue less provision for bad debts	\$ 297,969,942	290,555,394
Excess of fair value of assets acquired over consideration paid in acquisition of Advanced Imaging Center, LLC	-	1,947,592
Other operating revenue	5,596,444	4,954,056
Medicaid disproportionate share revenue	58,627,542	52,277,548
Net assets released from restrictions used for operations	<u>275,982</u>	<u>201,179</u>
Total revenue, gains, and other support	362,469,910	349,935,769
Operating Expenses		
Salaries and wages	150,820,953	152,262,553
Employee benefits and payroll taxes	37,490,684	37,537,681
Supplies	63,834,280	61,364,096
Outside services	49,453,676	46,278,663
Professional and other liability costs	3,134,173	3,032,767
Utilities	7,075,262	6,989,957
Repairs and maintenance	9,228,497	10,019,352
Medicaid assessment fee (Note 4)	15,885,317	13,881,669
Depreciation and amortization	19,140,637	18,855,286
Interest expense	3,286,993	3,470,054
Other	<u>8,625,561</u>	<u>7,077,035</u>
Total operating expenses	<u>367,976,033</u>	<u>360,769,113</u>
Operating Loss	(5,506,123)	(10,833,344)
Nonoperating Income		
Investment income	4,405,915	16,214,524
Other income	<u>35,000</u>	<u>32,083</u>
Total nonoperating income	<u>4,440,915</u>	<u>16,246,607</u>
Excess of Revenue (Under) Over Expenses	(1,065,208)	5,413,263
Pension-related Changes Other than Net Periodic Cost (Note 16)	<u>3,824,752</u>	<u>2,794,118</u>
Increase in Net Assets without Donor Restrictions	<u><u>\$ 2,759,544</u></u>	<u><u>\$ 8,207,381</u></u>

The Methodist Hospitals, Inc.

Consolidated Statement of Changes in Net Assets

Years Ended December 31, 2018 and 2017

	2018	2017
Net Assets without Donor Restrictions		
Excess of revenue (under) over expenses	\$ (1,065,208)	\$ 5,413,263
Pension-related changes other than net periodic cost	<u>3,824,752</u>	<u>2,794,118</u>
Increase in net assets without donor restrictions	2,759,544	8,207,381
Net Assets with Donor Restrictions		
Restricted contributions	330,419	123,064
Net assets released from restriction	<u>(275,982)</u>	<u>(201,179)</u>
Increase (decrease) in net assets with donor restrictions	<u>54,437</u>	<u>(78,115)</u>
Increase in Net Assets	2,813,981	8,129,266
Net Assets - Beginning of year	<u>244,297,772</u>	<u>236,168,506</u>
Net Assets - End of year	<u>\$ 247,111,753</u>	<u>\$ 244,297,772</u>

Consolidated Statement of Cash Flows

Years Ended December 31, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
Increase in net assets	\$ 2,813,981	\$ 8,129,266
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Depreciation and amortization	19,140,637	18,855,286
Net change in unrealized net losses (gains) on investments	12,951,589	(2,620,238)
Realized gains on investments	(13,852,558)	(9,475,491)
Pension-related changes other than net periodic costs	(3,824,752)	(2,794,118)
Gain on disposal of property and equipment	(94,712)	(158,516)
Amortization of bond premium	(318,677)	(318,677)
Provision for bad debts	-	20,384,296
Inherent contribution on purchase of remaining equity method investment	-	(1,947,592)
Amortization of debt issuance costs	40,582	40,583
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	6,546,301	(24,866,242)
Other current assets	(6,587,588)	(846,678)
Costs report settlements receivable	6,633,029	12,555,430
Other assets	90,192	594,975
Accounts payable	5,142,039	(10,256,379)
Accrued liabilities and other	(866,983)	637,688
Cost report settlements payable	(932,008)	(1,232,344)
Other liabilities	(4,030,648)	(7,197,068)
Net cash provided by (used in) operating activities	22,850,424	(515,819)
Cash Flows from Investing Activities		
Purchase of property and equipment	(11,932,609)	(19,575,817)
Proceeds from sale of property and equipment	104,863	191,667
Purchase of investments and assets limited as to use	(98,687,320)	(100,258,987)
Proceeds from sale and maturities of investments and assets limited as to use	116,833,770	122,991,371
Business acquisition of equity method investment - Net of cash acquired	-	(1,516,674)
Net cash provided by investing activities	6,318,704	1,831,560
Cash Flows from Financing Activities		
Payments on capital lease obligations	(186,520)	(172,018)
Principal payments on long-term debt	(2,250,000)	(2,612,375)
Net cash used in financing activities	(2,436,520)	(2,784,393)
Net Increase (Decrease) in Cash and Cash Equivalents	26,732,608	(1,468,652)
Cash and Cash Equivalents - Beginning of year	612,061	2,080,713
Cash and Cash Equivalents - End of year	\$ 27,344,669	\$ 612,061
Supplemental Cash Flow Information - Cash paid for interest	\$ 3,279,223	\$ 3,460,753

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1 - Nature of Business

The Methodist Hospitals, Inc. (the "Hospital") is an Indiana nonprofit corporation operating a 250-staffed bed general acute-care facility in Gary, Indiana (Northlake Campus) and a 290-staffed bed general acute-care facility in Merrillville, Indiana (Southlake Campus). The Hospital also provides physician services to patients through the following wholly owned limited liability companies: Methodist Cardiographics, LLC; Methodist Anesthesia, LLC; Methodist Pathology, LLC; and Advanced Imaging Center, LLC.

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

Note 2 - Significant Accounting Policies

Basis of Consolidation

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

Cash and Cash Equivalents

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

The Hospital's cash balances are only insured up to the Federal Deposit Insurance Corporation limit. As of December 31, 2018 and 2017, there was approximately \$32.0 million and \$11.1 million of uninsured cash, respectively. The Hospital evaluates the financial institutions with which it deposits funds; however, it is not practical to insure all cash deposits. The Hospital has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on its cash and cash equivalents.

Accounts Receivable

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges, reduced by explicit price concessions provided to third party payors, discounts provided to qualifying individuals as part of our financial assistance policy, and implicit price concessions provided primarily to self-pay patients. Estimates for explicit price concessions are based on provider contracts, payment terms for relevant prospective payment systems, and historical experience adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts.

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 Hospital records significant implicit price concessions 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.

Investments

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

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

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Goodwill

The recorded amounts of goodwill from prior business combinations are based on management's best estimates of the fair values of assets acquired and liabilities assumed at the date of acquisition. The Hospital assesses goodwill annually for impairment. No impairment charge was recognized in the years ended December 31, 2018 and 2017. It is reasonably possible that management's estimates of the carrying amount of goodwill will change in the near term. Goodwill is recorded within other assets in the consolidated balance sheet.

Inventories

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

Assets Limited as to Use

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

Property and Equipment

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

Unamortized Financing Costs

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

Classification of Net Assets

Net assets of the Hospital are classified as net assets without donor restrictions or net assets with donor restrictions depending on the presence and characteristics of donor-imposed restrictions limiting the Hospital's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Donor-imposed restrictions may expire with the passage of time or be removed by meeting certain requirements. Additionally, donor-imposed restrictions may limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as changes in net assets without donor restrictions unless specifically restricted by the donor or by applicable state law.

Excess of Revenue (Under) Over Expenses

The consolidated statement of changes in net assets includes excess of revenue (under) over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenue (under) over expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets and pension-related changes other than periodic benefit costs.

Note 2 - Significant Accounting Policies (Continued)

Revenue Recognition

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

Performance obligations are determined based on the nature of the services provided. The majority of the Hospital's services represent a bundle of services that are not capable of being distinct and, as such, are treated as a single performance obligation satisfied over time as services are rendered.

The Hospital determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Hospital's policy, and implicit price concessions provided to uninsured patients. The Hospital determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Hospital determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Contributions

The Hospital reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statement of changes in net assets as net assets released from restriction.

The Hospital reports gifts of property and equipment as revenue, gains, and other support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Professional and Other Liability Insurance

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

Accounting for Conditional Asset Retirement Obligation

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

Note 2 - Significant Accounting Policies (Continued)

Charity Care

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

Federal Income Tax

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

Use of Estimates

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

Recently Adopted Accounting Pronouncements

Effective January 1, 2018, the Hospital adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09), using a modified retrospective method of application to all contracts existing on January 1, 2018. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of ASU 2014-09 resulted in changes to the Hospital's presentation for disclosure of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU 2014-09, a significant portion of our provision for doubtful accounts related to self-pay patients, as well as co-pays, co-insurance, and amounts and deductibles owed by patients with insurance. Under ASU 2014-09, the estimated uncollectable amounts due from these patients are generally considered implicit price concessions that are a direct reduction to operating revenue, with a corresponding material reduction in the amounts presented separately as provision for doubtful accounts. For the year ended December 31, 2018, the Hospital recorded approximately \$23,883,000 of implicit price concessions as a direct reduction of patient service revenue that would have been recorded as provision for doubtful accounts prior to the adoption of ASU 2014-09. At December 31, 2018, the Hospital recorded \$28,741,232 as a direct reduction of accounts receivable that would have been reflected as allowance for doubtful accounts prior to the adoption of ASU 2014-09. The adoption of ASU 2014-09 also resulted in changes to the Hospital's presentation and disclosure of customer contract assets and liabilities and the assessment of variable consideration under customer contracts, which are further discussed in Note 18.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Effective December 31, 2018, the Hospital adopted Accounting Standards Update No. 2016-14, *Not-for-Profit Entities*. This standard requires net assets to be classified in two categories, net assets without donor restrictions and net assets with donor restrictions, rather than the three previous classifications. In addition, the underwater portion of donor-restricted endowments is now reported as net assets with donor restrictions. This standard also requires changes in the way certain information is aggregated and reported by the Hospital, including disclosures of quantitative and qualitative information about the liquidity and availability of resources and the presentation of expenses by both functional and natural classification. The standard also clarifies the definition of management and general and prohibits certain expenses from being allocated out of management and general. As a result of the adoption of this standard, the financial information for the year ended December 31, 2017 has been restated, as follows: management and general expenses has increased \$12,595,374 from the amount previously reported, with a corresponding decrease in program expenses. Additionally, net assets of \$350,493 previously reported as temporarily restricted net assets and net assets of \$25,000 previously reported as permanently restricted net assets have been combined into net assets with donor restrictions.

Upcoming Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-to-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Hospital beginning January 1, 2019 and will be applied using a modified retrospective transition method to either the beginning of the earliest period presented or the beginning of the earliest period presented. The expected impact on the consolidated balance sheet is a significant increase in long-term assets and lease liabilities. The effects on the results of operations are not expected to be significant, as recognition and measurement of expenses and cash flows for leases will be substantially the same under the new standard.

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

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including May 6, 2019, which is the date the consolidated financial statements were issued.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 3 - Patient Accounts Receivable

Patient accounts receivable is based on the estimated transaction price for completed contracts, which total \$42,367,000 at December 31, 2018. Prior to the adoption of ASU 2014-09, patient accounts receivable at December 31, 2017 were \$73,403,304 less allowances for uncollectible accounts of \$24,489,599.

The composition of receivables from patients and third-party payors was as follows as of December 31:

	2018	2017
Medicare	51 %	49 %
Medicaid	12	17
Commercial and managed care	27	26
Self-pay	10	8
Total	100 %	100 %

Note 4 - Cost Report Settlements

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

Medicare

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

Medicaid and Hospital Assessment Fee

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

The Indiana Hospital Association (IHA) and the Office of Medicaid Policy and Planning (OMPP) worked together to develop and implement a hospital assessment fee program as enacted by the 2011 Session of the Indiana General Assembly. In 2012, the Centers for Medicare and Medicaid Services (CMS) approved the state plan amendment necessary to implement these changes with a retroactive effective date of July 1, 2011. The program expired on June 30, 2013. In March 2014, the program was again approved by CMS, with an effective date of July 1, 2013, and continued through June 30, 2017. Effective July 1, 2017, the program was extended through June 30, 2019. Under this program, OMPP will collect an assessment fee from eligible hospitals. The fee will be used in part to increase reimbursement to eligible hospitals for services provided in both fee-for-service and managed care programs, and as the state share of Disproportionate Share Hospital (DSH) payments. Starting in 2016, the Hospital will be assessed a Hospital Assessment Fee on the Indiana HIP (Healthy Indiana Plan) 2.0 program based on the Medicaid DSH eligibility surveys. Due to the shift in Medicaid population from FFS to managed care, since 2017, the collection of the existing assessment fee is being made through a combination of offsets from claims payment and check payments. During 2018 and 2017, the Hospital incurred \$15,885,317 and \$13,881,669, respectively, in Medicaid assessment fees under this program, which is reflected in total operating expenses in the accompanying consolidated statement of operations. At December 31, 2018 and 2017, there is \$2,902,023 and \$3,590,501, respectively, included in cost report settlement payable in the consolidated balance sheet related to the hospital assessment fee program.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4 - Cost Report Settlements (Continued)

Final reimbursement under the Medicare and Medicaid programs is subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements. The effect of prior year settlements received in 2018 and 2017 resulted in an increase in revenue of approximately \$1,905,000 and \$748,000, respectively.

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

At December 31, 2018 and 2017, the Hospital recorded approximately \$16,100,000 and \$22,700,000, respectively, in amounts due from the State of Indiana under the DSH program. These amounts are reflected in cost report settlements receivable in the accompanying consolidated balance sheet. The amounts recorded represent estimated reimbursement due to the Hospital for services provided through December 31, 2018. During the years ended December 31, 2018 and 2017, approximately \$28,374,000 and \$23,755,000, respectively, was received in cash related to the DSH program.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare and Medicaid programs that are subject to audit by fiscal intermediaries. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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

Other Third-party Payors

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

Note 5 - Charity Care

In support of its mission, the Hospital's policy is to treat patients in need of medical services without regard to their ability to pay for such services. Charity care covers services provided to persons who cannot afford to pay. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation that applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total operating expenses divided by gross patient service revenue. The Hospital estimates that it provided approximately \$11.9 million and \$10.0 million of services to indigent patients during 2018 and 2017, respectively.

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

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 5 - Charity Care (Continued)

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

Note 6 - Assets Limited as to Use

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

	2018	2017
Funds designated by trustees under bond indenture	\$ 4,518,947	\$ 4,426,379
Funds held in trust for payment of professional and other liability claims	3,870,188	4,989,086
Funds designated by board for future capital improvements	100,215,490	116,444,114
Fund designated by donors for specific purposes	25,000	25,000
Total assets limited as to use	\$ 108,629,625	\$ 125,884,579

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

	2018	2017
Money market investments	\$ 24,068,405	\$ 9,998,092
Government securities	4,263,562	4,800,683
Mutual funds	54,913,713	83,475,216
Corporate bonds	17,319,778	24,769,977
Pooled funds	1,672,543	3,416,681
Common stock	6,977,167	-
Total	\$ 109,215,168	\$ 126,460,649
Classified as:		
Short-term investments	585,543	576,070
Assets limited as to use	108,629,625	125,884,579
Total	\$ 109,215,168	\$ 126,460,649

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

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

	2018	2017
Interest and dividends	\$ 3,504,946	\$ 4,118,795
Change in net unrealized (losses) gains	(12,951,589)	2,620,238
Realized gains - Net	13,852,558	9,475,491
Total	\$ 4,405,915	\$ 16,214,524

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 7 - Liquidity

The following reflects the Hospital's financial assets as of the consolidated balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the consolidated balance sheet date.

	2018	2017
Cash and cash equivalents	\$ 27,344,669	\$ 612,061
Short-term investments	585,543	576,070
Account receivables - Net	42,367,404	48,913,705
Cost report settlements receivable	16,091,097	22,724,126
Other current assets	5,288,836	1,145,991
Assets limited at to use:		
Funds held by trustees under bond indenture	4,518,947	4,426,379
Funds held in trust for payment of professional and other liability claims	3,870,188	4,989,086
Funds held by board for future capital improvements	100,215,490	116,444,114
Fund held by donors for specific purposes	25,000	25,000
Financial assets - At year end	200,307,174	199,856,532
Less those unavailable for general expenditures within one year, due to:		
Funds held by trustees under bond indenture	(4,518,947)	(4,426,379)
Funds held in trust for payment of professional and other liability claims	(3,870,188)	(4,989,086)
Funds held by board for future capital improvements	(100,215,490)	(116,444,114)
Fund held by donors for specific purposes	(25,000)	(25,000)
Financial assets available to meet cash needs for general expenditures within one year	\$ 91,677,549	\$ 73,971,953

The Hospital has certain board-designated assets limited to use, which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above for financial assets to meet general expenditures within one year. The Hospital has other assets limited to use for donor-restricted purposes, debt service, and for the professional and general liability insurance program. Additionally, certain other board-designated assets are designated for future capital expenditures and an operating reserve. These assets limited to use, which are more fully described in Notes 6, are not available for general expenditure within the next year. However, the board-designated amounts could be made available, if necessary.

As part of the Hospital's liquidity management plan, cash in excess of daily requirements are invested in short-term investments and money market funds. Occasionally, the board of directors designates a portion of any operating surplus to an operating reserve, which was \$586,000 as of December 31, 2018. This fund established by the board of directors may be drawn upon, if necessary, to meet unexpected liquidity needs.

As of December 31, 2018, the Hospital was in compliance with bond covenants as more fully described in Note 12.

Note 8 - Fair Value Measurements

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

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 8 - Fair Value Measurements (Continued)

The following tables present information about the Hospital's assets measured at fair value on a recurring basis at December 31, 2018 and 2017 and the valuation techniques used by the Hospital to determine those fair values.

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

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

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

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

Assets Measured at Fair Value on a Recurring Basis at
December 31, 2018

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2018
Short-term Investments				
Money market investments	\$ 350,179	\$ -	\$ -	\$ 350,179
Assets Limited as to Use				
Money market investments	23,484,896	-	-	23,484,896
Common stock	6,977,167	-	-	6,977,167
Mutual funds:				
U.S. companies	14,938,214	-	-	14,938,214
International companies	15,202,366	-	-	15,202,366
Fixed income	18,581,282	-	-	18,581,282
Balanced funds	6,191,851	-	-	6,191,851
Fixed income:				
U.S. Treasuries	-	4,258,501	-	4,258,501
Governmental agency bonds	-	5,061	-	5,061
Pooled funds	-	1,672,543	-	1,672,543
Asset-backed securities	-	7,636,034	-	7,636,034
Mortgage-backed securities	-	4,126,008	-	4,126,008
Corporate - Domestic	-	3,624,349	-	3,624,349
Corporate - International	-	1,933,387	-	1,933,387
Total assets limited as to use	85,375,776	23,255,883	-	108,631,659
Total	\$ 85,725,955	\$ 23,255,883	\$ -	\$ 108,981,838

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2018 included money market investments of \$233,330, which are not measured at fair value on a recurring basis and, therefore, are not in the table above.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 8 - Fair Value Measurements (Continued)

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

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

The fair value of fixed-income securities at December 31, 2018 and 2017 was determined primarily based on Level 2 inputs. The Methodist Hospitals, Inc. estimates the fair value of these investments using the fair market values as determined by the investment custodians.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2018 and 2017, there were no significant transfers between levels.

Note 9 - Other Current Assets

The details of other assets at December 31, 2018 and 2017 are as follows:

	2018	2017
Prepaid expenses	\$ 5,019,441	\$ 3,629,167
Inventory	12,468,563	11,414,094
Other	938,240	1,145,991
Contract assets	4,350,596	-
Total	\$ 22,776,840	\$ 16,189,252

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 10 - Property and Equipment

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

	2018	2017	Depreciable Life - Years
Land	\$ 5,373,674	\$ 5,373,674	-
Buildings	277,238,982	282,354,735	2-40
Equipment	203,520,341	200,151,060	3-5
Construction in progress	1,141,390	5,894,855	-
Total cost	487,274,387	493,774,324	
Accumulated depreciation	348,622,450	347,904,208	
Net property and equipment	<u>\$ 138,651,937</u>	<u>\$ 145,870,116</u>	

Depreciation and amortization expense, including assets under capital lease, totaled \$19,140,637 and \$18,855,286 in 2018 and 2017, respectively.

The Hospital holds buildings under capital leases with an original cost of approximately \$20,500,000 at December 31, 2018 and 2017. Accumulated amortization for buildings under capital lease obligations was approximately \$6,662,000 and \$6,150,000 at December 31, 2018 and 2017, respectively.

Construction in progress consists primarily of costs incurred for the pain center, outpatient pharmacy, building renovations, and installation of various clinical equipment. Remaining costs to complete the project are approximately \$817,000 as of December 31, 2018.

Note 11 - Accrued Liabilities and Other

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

	2018	2017
Payroll and related items	\$ 6,594,228	\$ 7,125,233
Compensated absences	9,300,366	9,621,085
Interest	565,469	598,281
Other	156,702	139,149
Total accrued liabilities	<u>\$ 16,616,765</u>	<u>\$ 17,483,748</u>

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 12 - Long-term Debt

The following is a summary of long-term debt and capital lease obligations at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Indiana Finance Authority Hospital Revenue Refunding Bonds, Series 2014A, interest ranging from 4.00 percent to 5.00 percent, due in installments through 2031	\$ 38,775,000	\$ 41,025,000
Medical office building capital lease obligations, expires December 31, 2045, collateralized by leased medical office buildings	18,938,701	19,125,222
Original issue premium	<u>4,036,573</u>	<u>4,355,250</u>
Total	61,750,274	64,505,472
Less current portion	2,552,245	2,436,521
Less unamortized debt issuance costs	<u>508,833</u>	<u>549,416</u>
Long-term portion	<u>\$ 58,689,196</u>	<u>\$ 61,519,535</u>

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

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

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

The Hospital has entered into a series of capital lease arrangements for a medical office building on the Merrillville hospital campus. The Hospital is leasing the underlying land to the developer under terms of a ground lease. The medical office building houses physician offices, laboratory and diagnostic facilities, and an ambulatory surgery center. The lease agreements have terms from 5 to 26 years.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 12 - Long-term Debt (Continued)

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

Years Ending December 31	Long-term Debt	Capital Lease Obligations
2019	\$ 2,350,000	\$ 1,732,968
2020	2,455,000	1,732,968
2021	2,570,000	1,732,968
2022	2,690,000	1,732,968
2023	2,815,000	1,732,968
Thereafter	<u>25,895,000</u>	<u>18,790,392</u>
Total	38,775,000	27,455,232
Less amount representing interest under capital lease obligations	<u>-</u>	<u>(8,516,531)</u>
Total debt and present value of minimum lease payments	<u>\$ 38,775,000</u>	<u>\$ 18,938,701</u>

Note 13 - Other Liabilities

The detail of other liabilities is shown below:

	2018	2017
Accrued pension cost (Note 16)	\$ 5,230,012	\$ 12,461,605
Accrued professional and other liability claims (Note 17)	7,143,452	7,864,669
Other	<u>766,776</u>	<u>669,366</u>
Total other liabilities	<u>\$ 13,140,240</u>	<u>\$ 20,995,640</u>

Note 14 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately \$2,336,000 and \$2,670,000 for the years ended December 31, 2018 and 2017, respectively.

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

Years Ending December 31	Amount
2019	\$ 1,886,183
2020	1,436,242
2021	695,044
2022	547,666
2023	367,977
Thereafter	<u>1,332,631</u>
Total	<u>\$ 6,265,743</u>

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 15 - Defined Contribution Plan

The Hospital established a defined contribution retirement plan effective January 1, 2006, which allows for employee contributions and requires a matching employer contribution of 50 percent of the first 6 percent of employees' earnings. Expense for the years ended December 31, 2018 and 2017 was approximately \$2,175,000 and \$1,977,000, respectively.

Note 16 - Pension Plan

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

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

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

Obligations and Funded Status

	Pension Benefits	
	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 137,678,895	\$ 131,237,041
Service cost	202,000	43,000
Interest cost	4,937,500	5,244,300
Actuarial (gains) loss	(12,754,116)	5,249,582
Benefits paid	(4,944,352)	(4,095,028)
Benefit obligation at end of year	125,119,927	137,678,895
Change in plan assets:		
Fair value of plan assets at beginning of year	125,217,290	110,080,970
Actual return on plan assets	(3,583,023)	12,831,348
Employer contributions	3,200,000	6,400,000
Benefits paid	(4,944,352)	(4,095,028)
Fair value of plan assets at end of year	119,889,915	125,217,290
Funded status at end of year	\$ (5,230,012)	\$ (12,461,605)

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

	Pension Benefits	
	2018	2017
Net Periodic Benefit Cost		
Service cost	\$ 202,000	\$ 43,000
Interest cost	4,937,500	5,244,300
Expected return on plan assets	(7,736,908)	(7,527,696)
Amortization of net loss	2,390,567	2,740,048
Total cost	\$ (206,841)	\$ 499,652

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16 - Pension Plan (Continued)

Included in net assets without donor restriction are the following amounts that have not yet been recognized in net periodic pension cost:

	Pension Benefits	
	2018	2017
Net gain	\$ (3,824,752)	\$ (2,794,118)

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

	Pension Benefits	
	2018	2017
Discount rate	4.30%	3.70%

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

	Pension Benefits	
	2018	2017
Discount rate	3.70%	4.10%
Expected long-term return on plan assets	6.25%	6.75%

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

Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the Hospital, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and assures timely payment of retirement benefits. Pension funds are invested in growth-oriented securities up to 30 percent in equities, including international equities.

The target allocation range of percentages for plan assets is 30 percent equity securities and 70 percent debt securities and 41 percent equity securities and 59 percent debt securities as of December 31, 2018 and 2017, respectively.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16 - Pension Plan (Continued)

The fair values of the Hospital's pension plan assets at December 31, 2018 and 2017 by major asset categories are as follows:

Asset Classes	Fair Value Measurements at December 31, 2018			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Equity securities:				
U.S companies	\$ 17,146,652	\$ -	\$ -	\$ 17,146,652
International companies	15,901,398	-	-	15,901,398
Debt securities	-	41,648,407	-	41,648,407
Fixed income - Pooled funds	-	1,109,907	-	1,109,907
Common collective trust - Equity fund	-	44,079,435	-	44,079,435
Total	\$ 33,048,050	\$ 86,837,749	\$ -	\$ 119,885,799

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

The pension plan assets shown above included cash and cash equivalents of \$4,116 and \$147,393 at December 31, 2018 and 2017, respectively. Cash and cash equivalents are not measured at fair value on a recurring basis and, therefore, are not included in the tables above.

The tables above present information about the pension plan assets measured at fair value at December 31, 2018 and 2017 and the valuation techniques used by the Hospital to determine those fair values.

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

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

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

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16 - Pension Plan (Continued)

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

The fair value of debt securities, fixed-income securities, and common collective trust at December 31, 2018 and 2017 was determined based on Level 2 inputs. The Methodist Hospitals, Inc. estimates the fair value of these investments using the fair market values as determined by the investment custodians.

The Hospital's policy is to recognize transfers in and transfers out of Level 1, 2, and 3 fair value classifications as of the end of the reporting period. For the years ended December 31, 2018 and 2017, there were no significant transfers between levels.

Cash Flow

Contributions

The Hospital expects to contribute \$3.2 million to the pension plan in 2019.

Estimated Future Benefit Payments

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

<u>Years Ending</u>	<u>Pension Benefits</u>
2019	\$ 5,189,262
2020	5,475,132
2021	5,798,310
2022	6,194,355
2023	6,561,597
2023-2027	37,098,288

Note 17 - Professional Liability Self-insurance

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

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

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18 - Patient Care Service Revenue

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

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospitals receiving inpatient acute care services or patients receiving services in our outpatient centers or in their homes (home care). The Hospital measures the performance obligation from admission into the Hospital or the commencement of an outpatient service to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Hospital does not believe it is required to provide additional goods or services related to that sale. The Hospital's revenue that is satisfied at a point in time is insignificant for both years ended December 31, 2018 and 2017.

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

The Hospital determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Hospital's policy, and implicit price concessions provided to uninsured patients. The Hospital determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Hospital determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Hospital's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Hospital. In addition, the contracts the Hospital has with commercial payors also provide for retroactive audit and review of claims.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18 - Patient Care Service Revenue (Continued)

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Hospital also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Hospital estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2018 and 2017, changes in its estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Hospital's mission, care is provided to patients regardless of their ability to pay. Therefore, the Hospital has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Hospital expects to collect based on its collection history with those patients.

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

The Hospital has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors and service lines. Tables providing details of these factors are presented below.

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

	<u>2018</u>	<u>2017</u>
Payors:		
Blue Cross	\$ 56,923,727	\$ 55,952,095
Commercial	40,959,014	37,186,690
Medicaid	33,172,025	48,815,964
Medicare	137,262,418	120,629,971
Other	22,652,690	22,238,370
Uninsured	<u>7,000,068</u>	<u>5,732,304</u>
Total	<u>\$ 297,969,942</u>	<u>\$ 290,555,394</u>
Major service lines:		
Home health	\$ 3,014,530	\$ 2,678,192
Hospital	275,134,858	268,085,671
Provider services	<u>19,820,554</u>	<u>19,791,531</u>
Total	<u>\$ 297,969,942</u>	<u>\$ 290,555,394</u>

After a review of reimbursement methods and contract obligations, the Hospital deems all significant patient revenue to be fee for service and the performance obligation is met over time.

There is \$4,350,596 of contract assets included within other current assets on the consolidated balance sheet.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 19 - Functional Expenses

The Hospital is a general acute care facility that provides inpatient and outpatient healthcare services to patients in Lake County and several surrounding counties. Expenses related to providing these services for the years ended December 31, 2018 and 2017 are as follows:

	2018		
	Program Services	Management and General	Total
Salaries and wages	\$ 129,709,103	\$ 21,111,850	\$ 150,820,953
Employee benefits and payroll taxes	31,751,360	5,739,324	37,490,684
Supplies	59,601,495	4,232,785	63,834,280
Outside services	38,673,763	10,779,913	49,453,676
Professional and other liability costs	3,134,173	-	3,134,173
Utilities	5,364,349	1,710,913	7,075,262
Repairs and maintenance	3,320,803	5,907,694	9,228,497
Medicaid assessment fee	15,885,317	-	15,885,317
Depreciation and amortization	17,097,387	2,043,250	19,140,637
Interest expense	3,286,130	863	3,286,993
Other	5,988,644	2,636,917	8,625,561
Total 2018	\$ 313,812,524	\$ 54,163,509	\$ 367,976,033
	2017		
	Program Services	Management and General	Total
Salaries and wages	\$ 131,021,978	\$ 21,240,575	\$ 152,262,553
Employee benefits and payroll taxes	31,922,738	5,614,943	37,537,681
Supplies	56,668,490	4,695,606	61,364,096
Outside services	38,426,690	7,851,973	46,278,663
Professional and other liability costs	3,032,767	-	3,032,767
Utilities	5,499,291	1,490,666	6,989,957
Repairs and maintenance	1,866,414	8,152,938	10,019,352
Medicaid assessment fee	13,881,669	-	13,881,669
Depreciation and amortization	17,072,903	1,782,383	18,855,286
Interest expense	2,888,493	581,561	3,470,054
Other	5,673,156	1,403,879	7,077,035
Total 2017	\$ 307,954,589	\$ 52,814,524	\$ 360,769,113

The consolidated financial statements report certain functions or expense categories that support both program and support functions. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including revenue cycle, patient services, purchasing, and information technology expenses are allocated between program and support based on based pro rata percentage of expense to total expenses.

Note 20 - Related Party Transactions

For the year ended December 31, 2018, the Hospital incurred no significant project services purchased from affiliates. For the year ended December 31, 2017, the Hospital purchased construction project services from an affiliate, totaling approximately \$3,300,000.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 21 - Business Combinations

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

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

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

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