# Lee Memorial Health System

**Consolidated Basic Financial Statements,**
**Required Supplementary Information, and**
**Supplemental Consolidating Information**
**September 30, 2018 and 2017**

# Lee Memorial Health System
## Index
## September 30, 2018 and 2017

**Page(s)**

**Introduction**

This section of Lee Memorial Health System's (the "System") annual financial report presents management's discussion and analysis of the financial position and performance of the System for the year ended September 30, 2018 with comparative information as of and for the years ended September 30, 2017 and 2016. This discussion has been prepared by management and should be read in conjunction with the consolidated basic financial statements and related footnote disclosures.

The System is governed by a ten-member, publicly elected Board of Directors (the "Board"). Each Board member can be elected to an unlimited number of four-year terms with six members being up-for-election normally in the presidential election year and four in the nonpresidential election year. This assists in providing leadership continuity among the Board members.

The System is an integrated health care provider which consists of 1,542 acute care hospital beds located at four campuses, which includes a 128-bed designated children's hospital, a 60-bed rehabilitation hospital, and an 18-bed skilled nursing unit. In addition, the System operates a 112-bed skilled nursing facility, a home health agency, outpatient treatment and diagnostic centers, and physician offices. For further detail on these entities, refer to Note 1 of the consolidated basic financial statements.

The Board's mission is to be a trusted partner, empowering healthier lives through care and compassion. The Board's vision is to inspire hope and be a national leader for the advancement of health and healing. To achieve this vision, the Board works within a strategic plan and evaluates existing and new services based upon community needs and economic viability.

The Board's strategic plan to achieve the System's mission and vision includes four strategic priorities which are (1) to deliver an exceptional patient experience every time, (2) provide excellent health outcomes to those we serve, (3) empower healthier lives through personalized coordinated care and (4) assure ongoing financial viability by lowering costs and growing revenues. These strategic priorities will be achieved by resourcing and deploying strategies and tactics that are fully aligned and deployed to operations through our lean operating system. The strategies will be driven by data analytics to improve processes, standardize to best practices, and utilize human capital and technology to achieve the highest probability of success in improving outcomes and lowering costs.

**Overview of the Consolidated Basic Financial Statements**

Our annual report consists of a series of consolidated basic financial statements prepared in accordance with accounting standards generally accepted in the United States of America.

**Required Financial Statements**

The required statements are the consolidated basic statements of net position, the consolidated basic statements of revenues, expenses and changes in net position and the consolidated basic statements of cash flows. These statements offer short and long-term financial information about System activities.

The consolidated basic statements of net position reflect all of the System's assets, liabilities, deferred inflows and outflows and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). Assets, liabilities and deferred activity are presented in a classified format, which distinguishes between their current and long-term time frame. The difference between the assets plus deferred outflows and liabilities plus deferred inflows is reported as "net position."

As more fully described in Note 1, the System adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("GASB No. 75"), as of October 1, 2017 and, adjusted net position as of October 1, 2017, resulting in a decrease of approximately $19.9 million, which is reflected in the accompanying consolidated basic statement of net position as of September 30, 2018, and is summarized below:

*(in thousands of dollars)*

| | |
|---|---|
| Net position at September 30, 2017, as reported | $ 1,459,208 |
| Adoption of GASB No. 75 | (19,943) |
| Net position at October 1, 2017 | $ 1,439,265 |

The consolidated basic statements of revenues, expenses and changes in net position present the change in net position resulting from revenues earned and expenses incurred. All changes in net position are reported as revenues are earned and expenses are incurred, regardless of the timing of related cash flows.

The consolidated basic statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, financing (capital and non-capital), and investing activities. The purpose of the statements is to reflect the key sources and uses of cash during the reporting period.

**Condensed Consolidated Basic Statements of Revenues, Expenses and Changes in Net Position**

A summary of the System's consolidated basic statements of revenues, expenses and changes in net position are presented below.

| *(in thousands of dollars)* | **2018** | **2017** | **2016** |
|---|---|---|---|
| Operating revenues | $ 1,789,982 | $ 1,735,193 | $ 1,630,927 |
| Operating expenses | 1,715,143 | 1,645,035 | 1,519,829 |
| Operating income | 74,839 | 90,158 | 111,098 |
| Nonoperating items | 25,065 | 106,179 | 77,844 |
| Contributions and grants | 1,135 | (27,063) | (14,182) |
| Total nonoperating income (loss) | 26,200 | 79,116 | 63,662 |
| Increase in net position | $ 101,039 | $ 169,274 | $ 174,760 |

A summary of the System's key operating ratios is presented below. All ratios are expressed as a percentage of total net operating revenue.

| | **2018** | **2017** | **2016** | **% Variance 2017-2018** | **% Variance 2016-2017** |
|---|---|---|---|---|---|
| Salaries, wages and benefits | 54.6% | 54.7% | 52.8% | -0.2% | 3.6% |
| Supplies and other services | 25.2% | 24.6% | 25.3% | 2.4% | -2.8% |
| Purchased services | 10.5% | 10.0% | 10.1% | 5.0% | -1.0% |
| Capital costs (depreciation, amortization and interest expense) | 6.8% | 6.8% | 6.4% | 0.0% | 6.3% |

*Operating Revenues*
Total operating revenues increased in 2018 and 2017 by $54.8 million, or 3.2%, and $104.3 million, or 6.4%, respectively. In 2018, net patient service revenue increased by $55.0 million, 3.2% reflecting an increase in adjusted admissions of 2.1%, and an average rate increase of 5.0% with favorable payor mix changes. During 2017, net patient service revenue increased by $107.2 million, or 6.8%, reflecting an increase in adjusted admissions of 2.0%, and an average rate increase of 5.0% with favorable payor mix changes.

Other operating revenue decreased by $0.3 million, or 0.6%, in 2018 due primarily to the end of the Medicare and Medicaid electronic health record ("EHR") incentive payment program and the expiration of grants received in relation to Federally Qualified Health Centers for care for the low-income patient population. In 2017, other operating revenue decreased by $0.8 million, or 1.9%, due primarily to decreases in Medicare and Medicaid funding of the EHR incentive payments in the amount of $3.0 million.

*Operating Expenses*
Total operating expenses increased in fiscal year 2018 by $70.1 million, or 4.3%. Salaries, wages and benefits increased by approximately $28.1 million, or 3.0%. The increase in salaries and wages is due to an increase in average hourly rate of 2.1%, staffing increases due to an increase in patient volumes of 2.1%, as well as continued expansion in outpatient services and other programs aimed at improving community health and patient access. Benefit costs increased by $8.7 million, or 6.7%, and increased from 2017 as a percent of salaries and wages to 16.4%. Salaries, wages and benefits, as a percent of total net operating revenues, decreased by 0.1% to 54.6%. In 2017, total operating expenses increased by $125.2 million, or 8.2%. Salaries, wages and benefits increased by approximately $86.8 million, or 10.1%. The increase in salaries and wages is due to an increase in average hourly rate of 4.4%, staffing increases due to an increase in patient volumes of 2.0%, as well as the opening of the new Golisano Children's Hospital of Southwest Florida facility in May of 2017, continued expansion in outpatient services and other programs aimed at improving community health and patient access. Benefit costs increased by $11.9 million, or 10.2%, and remained constant from 2016 as a percent of salaries and wages at 15.7%.

Capital costs, which include depreciation and amortization, increased to $100.4 million in fiscal year 2018, a $4.4 million increase over the prior year. Capital costs, expressed as a percentage of total operating revenues, increased to 5.6%. In 2017, capital costs increased to $96.0 million, a $14.1 million increase over the prior year. This increase was due mainly to the opening of the Golisano Children's Hospital in May 2017. Capital costs, expressed as a percentage of total operating revenues, increased to 5.5% over the previous year.

*Nonoperating items, net*
Nonoperating items decreased in 2018 by $52.9 million, or 66.9%. Included in this category are investment performance and fair value changes on investments, which can vary significantly from year to year, and interest expense. Investment income decreased by $45.0 million. During fiscal year 2018, there were unrealized gains of $20.6 million from financial market performance, coupled with interest income and realized gains of $21.9 million. Realized gains and interest earned on investments decreased by $18.3 million. Interest expense decreased by $0.4 million, largely due to more favorable rates obtained through financing. In 2017, nonoperating items increased by $15.5 million, or 24.3%. Included in this category are investment performance and fair value changes on investments, which can vary significantly from year to year, and interest expense. Investment income increased by $15.7 million. During fiscal year 2017, there were unrealized gains of $47.4 million resulting from strong financial markets, coupled with interest income and realized gains of

$40.1 million. Realized gains and interest earned on investments increased by $2.3 million. Interest expense decreased by $0.7 million, largely due to more favorable rates obtained through financing.

The System's net position as of September 30, 2018 increased approximately $101.0 million since the prior year, resulting in a profit margin of 5.6%. In 2017, the increase in net position over the previous year was approximately $169.3 million, resulting in a profit margin of 9.8%.

Below is a table outlining our Board defined and monitored operating ratios. These ratios are compared with Moody's A-rated hospitals.

| | 2017 Moody's Median | FYE 2018 | FYE 2017 | FYE 2016 |
|---|---|---|---|---|
| **Profitability Ratios** | | | | |
| Operating margin (%) | 2.3% | 3.0% | 4.0% | 5.5% |
| Excess margin (%) | 5.2% | 5.5% | 9.2% | 10.2% |
| EBITDA margin (%) | 8.6% | 9.8% | 10.7% | 11.8% |
| **Liquidity Ratios** | | | | |
| Days cash on hand | 226.5 | 195.6 | 231.6 | 253.3 |
| Cushion ratio | 23.9 | 13.1 | 16.2 | 16.3 |
| Cash-to-debt (%) | 169.6% | 133.2% | 146.5% | 143.1% |
| **Capitalization Ratios** | | | | |
| Debt to capitalization (%) | 32.9% | 30.5% | 32.4% | 36.5% |
| Annual debt service coverage | 5.4 | 3.1 | 4.2 | 4.2 |
| Debt to cash flow | 3.0 | 3.6 | 3.1 | 3.2 |

* Operating margin is calculated as operating income less interest expense divided by total operating revenues.

* Excess margin is calculated as the increase in net position divided by [total operating revenues plus nonoperating revenues plus interest expense].

* EBITDA margin is calculated as [operating income plus depreciation and amortization divided by total operating revenues].

Annually, the Board establishes targets for these key ratios and then monitors these ratios each month to ensure that the System remains an A-rated organization. The days cash on hand, cushion ratio, cash-to-debt, annual debt service coverage, and debt to cash flow ratios fall outside the range of the Moody's 2017 Medians.

**Cash Flows**

Cash and cash equivalents increased $20.3 million in fiscal year 2018.

Net cash provided by operating activities was $161.3 million for fiscal year 2018 and $121.0 million for the prior year. The main factors contributing to the $40.3 million increase in operating cash flow during fiscal year 2018 as compared to fiscal year 2017 are as follows:

- $93.7 million in additional cash received from patient care services, offset by

- $37.0 million in additional cash payments made to employees and suppliers.

- $16.1 million in additional payments to suppliers.

Net cash provided by noncapital financing activities was $20.6 million for fiscal year 2018 versus $23.3 million provided by noncapital financing activities in the prior year.

Net cash used in capital and related financing activities was $330.2 million in fiscal year 2018 and $249.1 million in fiscal year 2017. This $81.1 million change in the use of cash is primarily the result of an increase in the purchase of capital assets of $103.8 million, from $173.3 million in fiscal year 2017 to $277.1 million in fiscal year 2018.

Net cash provided by investing activities was $168.6 million for fiscal year 2018 versus $74.5 million in the prior year. The majority of the change in the cash provided by investing activities was due to the reduction in short term investments from 2017 to 2018 of $126.3 million. For fiscal year 2018, $22.8 million in investment income was received through interest earnings and realized gains. For fiscal year 2017, $41.2 million in investment income was received through interest earnings and realized gains. Short-term and long-term investments in the portfolio decreased $34.7 million during fiscal year 2017.

**General Trends**

As reflected in the revenue table below, the System is dependent on the State and Federal governments for the majority of its revenues with 65.7% of the System's revenue being derived from the Medicare and Medicaid programs. Over the past several years, the Medicare rate increases have not kept pace with overall medical expense increases. Management expects these trends to continue. This will put continued pressure on operating margins necessitating continued efforts to enhance operating efficiencies. The System has created a department with highly trained Lean Management personnel to implement process standardization and waste elimination through the use of Lean methodologies.

| | **2018** | **2017** | **2016** |
|---|---|---|---|
| Medicare | 52.1% | 52.0% | 51.8% |
| Medicaid | 13.6% | 13.8% | 13.7% |
| Commercial | 23.8% | 24.0% | 24.6% |
| Other | 10.5% | 10.2% | 9.9% |
| | 100.0% | 100.0% | 100.0% |

**Capital Assets**

At September 30, 2018, the System had $1,149.2 million in net capital assets. A breakdown of these assets can be found in Note 6 to the consolidated basic financial statements. This represents an increase of $190.1 million over the prior year's net capital assets of $959.1 million.

The System expects to make total capital expenditures of $164.9 million in fiscal year 2019. Of this amount, an estimated $41.5 million is related to construction of the Lee Health Coconut Point in Estero, Florida and $80.0 million pertains to the expansion of Gulf Coast Medical Center. The remaining capital expenditures are primarily for facility upgrades, information systems and patient care equipment. These capital purchases will be funded directly from operations.

**Debt Outstanding**

As of September 30, 2018, the System had $658.2 million in debt (bonds, notes, etc.) outstanding. The long-term debt is comprised of a number of bond issues, notes payable, and capital leases described in more detail in Note 8 and Note 9 to the consolidated basic financial statements. In 2018, sixty-five percent (65%) of the System's total debt outstanding has fixed interest rates, while one-hundred percent (100%) of the System's bonds outstanding have fixed interest rates. As of September 30, 2017, the System had $680.2 million in debt (bonds, notes, etc.) outstanding. In 2017, sixty-five percent (65%) of the System's total debt outstanding has fixed interest rates, while one-hundred percent (100%) of the System's bonds outstanding have fixed interest rates. The System's bonds carry an A/Positive and an A2 rating from S&P and Moody's, respectively.

**Community Benefits**

As a special purpose unit of government, the System is committed to meeting the needs and improving the health status of the people of Southwest Florida. The essential services that are provided throughout the health system were created from our commitment to the community and not because of an economic opportunity. Therefore, the System regularly assesses the needs of the community so that even the most vulnerable of its citizens are provided care even though a particular service might generate a low or negative margin.

The entire cost of providing care to low income citizens or to fund unprofitable services is subsidized through our tax exempt status. Therefore, the System regularly estimates the benefit of its tax exempt status as compared to the "community benefits" that are provided to the citizens as well as identifying the types of services that are provided often at significant financial loss to meet the needs of the community.

The analysis of the community benefit reveals that the System's financial benefit of its tax exempt status was approximately $52.9 million for fiscal year 2018, $58.8 million for fiscal year 2017 and $66.6 million for fiscal year 2016. This includes the savings that are derived from not having to pay certain state and federal taxes, real estate taxes, sales and intangible taxes as well as lower malpractice costs due to sovereign immunity as a governmental entity, and lower cost of capital due to the use of tax-exempt financing.

The System estimates the benefits of the services provided to the community exceeded $470.0 million in fiscal year 2018, $419.2 million in fiscal year 2017, and $375.3 million in fiscal year 2016. The increase in benefits for services provided to the community from 2017 to 2018 of $50.8 million was largely due to Medicaid retro rate adjustments from prior years and implementation of the Enhanced Ambulatory Patient Group ("EAPG") methodology for determining Medicaid claims payments. This community benefit consists of charity care provided to patients whom might not have access to health care; low income services that are provided at less than cost (e.g., Medicaid); other services that are provided at a loss such as community wellness and health education programs.

The System's commitment to the community is summarized into the following community benefit categories for the years ended September 30, 2018, 2017 and 2016 as follows:

| *(in thousands of dollars)* | **2018** | **2017** | **2016** |
|---|---|---|---|
| Cost of charity care for low income patients | $ 63,592 | $ 62,986 | $ 54,822 |
| Cost of community outreach and educational programs and one-of-a-kind medical services | 58,445 | 61,082 | 55,437 |
| Cost of unpaid Medicaid services | 91,449 | 74,509 | 58,427 |
| Cost of unpaid Medicare and other government programs | 256,607 | 220,580 | 206,642 |
| | $ 470,093 | $ 419,157 | $ 375,328 |

In summary, the System continues to provide benefits to the community well in excess of the value of its tax exempt status. The System continues to be focused on the provision of essential services to all of its citizens and uses its financial surplus to further its charitable purpose.

## Report of Independent Auditors

To the Board of Directors of
Lee Memorial Health System

We have audited the accompanying consolidated basic financial statements of Lee Memorial Health System (the "System") which comprise the consolidated basic statements of net position as of September 30, 2018 and 2017, and the related consolidated basic statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the consolidated basic financial statements.

### *Management's Responsibility for the Consolidated Basic Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated basic 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 basic financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the consolidated basic 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 consolidated basic financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated basic financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated basic financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the System's preparation and fair presentation of the consolidated basic 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 System'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 basic financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated basic financial statements referred to above present fairly, in all material respects, the financial position of Lee Memorial Health System as of September 30, 2018 and 2017, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP, 4040 West Boy Scout Blvd., Suite 1000, Tampa, FL 33607*
*T: (813)229-0221, F: (813)229 3646,* www.pwc.com/us

***Emphasis of Matter***

As discussed in Note 1 to the consolidated basic financial statements, the System changed the manner in which it accounts for postemployment benefits other than pensions in 2018. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*
The accompanying management's discussion and analysis (unaudited) on pages 1 through 7, the schedule of changes in the net pension liability and related ratios (unaudited) on page 52, the schedule of employer contributions (unaudited) on page 53, the schedule of investment returns (unaudited) on page 54, the schedule of changes in total other post-employment benefits ("OPEB") liability (unaudited) on page 55 and the schedule of total other post-employment benefits ("OPEB") contributions on page 56 are required by accounting principles generally accepted in the United States of America to supplement the consolidated basic financial statements. Such information, although not a part of the consolidated basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated basic financial statements, and other knowledge we obtained during our audits of the consolidated basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Supplemental Information*
Our audits were conducted for the purpose of forming opinions on the consolidated basic financial statements. The supplemental consolidating information on pages 58 through 63 is presented for purposes of additional analysis and is not a required part of the consolidated basic financial statements. The supplemental consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated basic financial statements. The supplemental consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated basic financial statements or to the consolidated basic financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental consolidating information is fairly stated, in all material respects, in relation to the consolidated basic financial statements taken as a whole.

PricewaterhouseCoopers L.L.P.

Tampa, Florida
January 31, 2019

# Lee Memorial Health System
## Consolidated Basic Statements of Net Position
## September 30, 2018 and 2017

*(in thousands of dollars)*

| | 2018 | 2017 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 33,195 | $ 12,890 |
| Short-term investments | 831,879 | 958,219 |
| Assets whose use is restricted | 5,598 | 5,582 |
| Patient accounts receivable, net of allowance for estimated uncollectibles of $79,647 in 2018 and $55,943 in 2017 | 243,232 | 229,909 |
| Inventories | 33,947 | 33,003 |
| Other current assets | 39,664 | 38,438 |
| Total current assets | 1,187,515 | 1,278,041 |
| Noncurrent assets | | |
| Assets whose use is restricted | 11,446 | 25,325 |
| Capital assets, net | 1,149,219 | 959,038 |
| Other assets, net | 29,213 | 44,122 |
| Total assets | 2,377,393 | 2,306,526 |
| **Deferred outflows of resources** | | |
| Deferred loss on debt refunding | 1,924 | 2,511 |
| Deferred outflows on pension | 1,026 | 1,026 |
| Excess consideration provided for acquisition | 98,481 | 101,577 |
| Total deferred outflows of resources | 101,431 | 105,114 |
| **Liabilities** | | |
| Current liabilities | | |
| Accounts payable | 61,537 | 54,280 |
| Current installments of long-term debt | 42,306 | 38,857 |
| Accrued expenses | | |
| Employee compensation | 59,532 | 43,353 |
| Interest | 7,366 | 6,913 |
| Other | 43,861 | 37,270 |
| Estimated third-party payor settlements | 7,204 | 35,695 |
| Total current liabilities | 221,806 | 216,368 |
| Noncurrent liabilities | | |
| Long-term debt, excluding current installments | 615,860 | 641,352 |
| Other liabilities | 98,240 | 91,800 |
| Total liabilities | 935,906 | 949,520 |
| **Deferred inflows of resources** | | |
| Deferred inflows on pension | 2,254 | 2,912 |
| Deferred inflows on split interest agreements | 360 | - |
| Total deferred inflows of resources | 2,614 | 2,912 |
| Commitments and contingencies | | |
| **Net position** | | |
| Restricted for | | |
| Nonexpendable | 6,356 | 6,269 |
| Expendable | 33,423 | 31,855 |
| Net investment in capital assets | 491,053 | 278,830 |
| Unrestricted | 1,009,472 | 1,142,254 |
| Total net position | $ 1,540,304 | $ 1,459,208 |

The accompanying notes are an integral part of these consolidated basic financial statements.

# Lee Memorial Health System
## Consolidated Basic Statements of Revenues, Expenses and Changes in Net Position
## Years Ended September 30, 2018 and 2017

*(in thousands of dollars)*

| | 2018 | 2017 |
|---|---|---|
| **Operating revenues** | | |
| Net patient service revenue, net of provision for doubtful accounts of $238,582 in 2018 and $214,235 in 2017 | $ 1,750,494 | $ 1,695,451 |
| Other revenue | 39,488 | 39,742 |
| Total operating revenues | 1,789,982 | 1,735,193 |
| **Operating expenses** | | |
| Salaries, wages and benefits | 976,610 | 948,526 |
| Supplies and other services | 450,225 | 427,639 |
| Purchased services | 187,942 | 172,867 |
| Depreciation and amortization | 100,366 | 96,003 |
| Total operating expenses | 1,715,143 | 1,645,035 |
| Operating income | 74,839 | 90,158 |
| **Nonoperating items** | | |
| Interest expense | (20,996) | (21,414) |
| Investment income, including realized and unrealized gains on investments | 42,521 | 87,550 |
| Contributions and grants | 1,135 | (27,063) |
| Investment activity on restricted nonexpendable investments | 515 | 961 |
| Loss on sale of capital assets | (907) | (417) |
| Other | 3,932 | 39,499 |
| Total nonoperating income | 26,200 | 79,116 |
| Increase in net position | 101,039 | 169,274 |
| **Net position** | | |
| Beginning of year, as reported | 1,459,208 | 1,289,934 |
| Adoption of GASB No. 75 (see Note 1) | (19,943) | - |
| Beginning of year, as restated | 1,439,265 | 1,289,934 |
| End of year | $ 1,540,304 | $ 1,459,208 |

The accompanying notes are an integral part of these consolidated basic financial statements.

# Lee Memorial Health System
## Consolidated Basic Statements of Cash Flows
## Years Ended September 30, 2018 and 2017

*(in thousands of dollars)*

| | 2018 | 2017 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Received from patient care services | $ 1,722,791 | $ 1,629,085 |
| Salaries and benefits paid to employees | (981,440) | (944,468) |
| Payments to suppliers | (619,090) | (602,992) |
| Other receipts from operations | 39,064 | 39,352 |
| Net cash provided by operating activities | 161,325 | 120,977 |
| **Cash flows from noncapital financing activities** | | |
| Restricted gifts received (noncapital related) | 2,742 | (14,672) |
| Assets donated via Lee Memorial Health System Foundation, Inc. | 5,582 | 36,304 |
| Miscellaneous nonoperating items | 12,268 | 1,626 |
| Net cash provided by noncapital financing activities | 20,592 | 23,258 |
| **Cash flows from capital and related financing activities** | | |
| Proceeds from long-term borrowings | 10,633 | - |
| Purchases of capital assets | (277,092) | (173,253) |
| Proceeds from sale of capital assets | 76 | 109 |
| Interest payments | (25,042) | (26,791) |
| Repayment of long-term debt | (39,223) | (37,949) |
| Restricted gifts received (capital related) | 422 | (11,223) |
| Net cash used in capital and related financing activities | (330,226) | (249,107) |
| **Cash flows from investing activities** | | |
| Investment income received | 22,846 | 41,210 |
| Decrease in investments | 146,955 | 34,689 |
| Joint venture funding and activity | (1,187) | (1,401) |
| Net cash provided by investing activities | 168,614 | 74,498 |
| Increase (decrease) in cash and cash equivalents | 20,305 | (30,374) |
| **Cash and cash equivalents** | | |
| Beginning of year | 12,890 | 43,264 |
| End of year | $ 33,195 | $ 12,890 |
| **Disclosure of supplemental cash flow information** | | |
| Capital assets financed through capital lease obligations | $ 7,723 | $ 14,824 |
| Long-term debt extinguished through refunding transaction | - | 101,290 |

The accompanying notes are an integral part of these consolidated basic financial statements.

# Lee Memorial Health System
## Consolidated Basic Statements of Cash Flows
## Years Ended September 30, 2018 and 2017

*(in thousands of dollars)*

| | 2018 | 2017 |
|---|---|---|
| **Reconciliation of operating income to net cash provided by operating activities** | | |
| Operating income | $ 74,839 | $ 90,158 |
| Adjustments to reconcile operating income to net cash provided by operating activities | | |
| Depreciation and amortization | 100,366 | 96,003 |
| Provision for bad debts | 238,582 | 214,235 |
| Changes in | | |
| Patient accounts receivable | (237,797) | (256,989) |
| Inventories | (944) | (2,342) |
| Other assets | (31) | (7,840) |
| Accounts payable | 7,257 | (1,412) |
| Accrued expenses | 1,104 | 3,844 |
| Estimated third-party payor settlements | (28,491) | (23,612) |
| Other liabilities | 6,440 | 8,932 |
| Net cash provided by operating activities | $ 161,325 | $ 120,977 |

The accompanying notes are an integral part of these consolidated basic financial statements.

## 1. Description of Reporting Entity and Summary of Significant Accounting Policies

### Description of Reporting Entity

Lee Memorial Health System (the "System") is a special purpose unit of local government created by special act of the Florida Legislature, Chapter 63-1552, Laws of Florida, Special Acts, 1963 as re-codified by Chapter 2000-439, Laws of Florida, Special Acts, 2000 (the "Enabling Act"). It is classified as an independent special district under the laws of Florida. The System operates pursuant to the Enabling Act, as amended.

The System includes four acute care hospitals, Lee Memorial Hospital, HealthPark Medical Center, Gulf Coast Medical Center and Cape Coral Hospital. Additionally, the System is comprised of other healthcare facilities and services, which include a 128-bed designated children's hospital, a 60-bed rehabilitation hospital, an 18-bed skilled nursing unit, a 112-bed skilled nursing facility, a home health agency, outpatient treatment and diagnostic centers, and physicians' offices. The System operates in Lee County, Florida.

Certain of these operations have been placed in subagencies for administrative purposes. Subagencies are created by resolution of the System's Board of Directors under authorization granted by its Enabling Act. These subagencies are not incorporated under the corporation laws of Florida.

Other System operations are carried out through subsidiary corporations, as follows:

- Cape Coral Hospital is managed through a not-for-profit organization, Cape Memorial Hospital, Inc. ("Cape Coral Hospital"). This corporation was created by the System's Board of Directors to receive and hold the assets purchased from Cape Coral Medical Center, Inc. ("CCMC") on July 1, 1996, upon acquisition of Cape Coral Hospital. Its Board of Directors consists of the ten members of the System's Board of Directors and this is presented as a blended component unit of the System (Note 13).

- HealthPark Care Center, Inc. ("HPCC") is a not-for-profit corporation, which owns and operates the System's skilled nursing facility. Its Board of Directors consists of the ten members of the System's Board of Directors.

- Lee Memorial Home Health, Inc. is a not-for-profit corporation, which owns and operates the System's home health agency. Its Board of Directors consists of the ten members of the System's Board of Directors.

- Lee Memorial Health System Foundation, Inc. (the "Foundation") is a not-for-profit corporation created by the System's Board of Directors and community leaders to serve as a fund-raising organization in support of the System. Its Board of Directors consists of persons prominent in the community and interested in serving the community and the System's needs. Two Board positions are also reserved on an ex officio basis for the Chairman of the Board of Directors of the System or members of such board designated by the Chairman and the Chief Executive Officer of the System or his/her designee.

- Lee County Trauma Services District (the "District") is a not-for-profit organization located in Fort Myers, Florida. The District is a special purpose unit of local government created by a special act of the 2003 Florida Legislature, Chapter 63-1552, Laws of Florida, Special Acts, 1963 as recodified by Chapter 2003-357, Laws of Florida, Special Acts 2003. The District is classified as an independent special district under the laws of Florida. The District serves as an integral member of the continuum of care offered by the System. Operations of the District began on October 1, 2003.

- The System provides vital patient care services through various access points. To promote access to comprehensive preventive and primary health services for medically underserved residents members of the community regardless of their ability to pay for such services, the System sought and received, from the Health Resources and Services Administration ("HRSA") of the United States Department of Health and Human Services, the designation of certain System clinic locations as public-entity model federally qualified health center look-alikes ("FQHC-LA"), known as public health centers. Lee Community Healthcare, Inc. ("LCH") is a separate tax exempt Florida not-for-profit corporation with a Board of Directors that meets independent governance (community board) standards and retains reserve powers relative to FQHC-LA operations. The System and LCH entered into a co-applicant arrangement to comply with the federal law requirements related to independent Board of Directors oversight of the designated centers. As the public entity, the System is responsible for the operation of the centers which are located in Cape Coral, North Fort Myers, East Fort Myers, South Fort Myers and Lehigh Acres.

**Summary of Significant Accounting Policies**
All intercompany transactions have been eliminated in the accompanying consolidated basic financial statements.

**Basis of Presentation**
The accompanying consolidated basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, including all applicable effective statements of the Governmental Accounting Standards Board ("GASB") on the accrual basis of accounting and include the accounts of the System and its subsidiaries. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

**Use of Estimates**
The preparation of consolidated basic 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 basic financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**
Cash and cash equivalents consist of amounts held as bank deposits and highly liquid investments with maturities of three months or less at date of purchase.

**Inventories**
Inventories consist principally of pharmaceuticals and medical and surgical supplies which are valued at the lower of net realizable value, on a first-in first-out basis, or market.

### Assets Whose Use Is Restricted

Assets whose use is restricted consist primarily of investments restricted under the terms of the System's bond indenture agreements, assets restricted by donor stipulations and assets held under other contractual agreements (Note 4). The current portion of assets whose use is restricted relates to the corresponding estimated current obligations.

### Capital Assets

Capital assets have been recorded at historical cost or fair market value at date of purchase or donation, respectively. Equipment under capital leases is stated at the present value of minimum lease payments at the inception of the lease. Routine maintenance and repairs are expensed when incurred. Expenditures that materially increase the value, change the capacity or extend the useful life of an asset are capitalized. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Major asset classifications and estimated useful lives are generally in accordance with those recommended by the American Hospital Association. The straight-line method of computing depreciation is used for all depreciable assets. Equipment under capital leases is amortized under the straight-line method over the shorter of the lease term or estimated useful life of the asset as summarized below:

| | |
|---|---|
| Buildings and improvements | 10–40 years |
| Equipment | 3–15 years |

### Impairment of Long-Lived Assets

Long-lived assets are evaluated for recoverability whenever adverse events or changes in business climate indicate that the expected undiscounted future cash flows from the related asset may be less than previously anticipated. If the net book value of the related asset exceeds the undiscounted future cash flows of the asset, the carrying amount would be reduced to the present value of its expected future cash flows and an impairment loss would be recognized. For the years ended September 30, 2018 and 2017, the System does not believe there were any adverse events or changes in business that would indicate that an impairment reserve is required.

### Bond and Note Issuance Costs

Bond issuance costs are expensed at time of issuance.

### Bond Premiums and Discounts

Bond premiums and discounts are amortized over the period the bonds are outstanding using the effective interest method.

### Net Patient Service Revenue and Patient Accounts Receivable

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

**Provision for Bad Debts and Allowance for Uncollectible Accounts**
The provision for bad debts is based on management's assessment of historical and expected net collections, considering business and economic conditions, trends in federal and state governmental health care coverage, and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon these trends. The results of this review are then used to make any modification to the provision for bad debts to establish an appropriate allowance for uncollectible accounts. Patient accounts receivable are written off after collection efforts have been followed under the System's policies.

**Charity Care**
The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not pursue collection of these amounts, they are not reported as net patient service revenue. The level of direct charity care provided during the years ended September 30, 2018 and 2017 consisted of foregone revenues of approximately $294.5 million and $286.4 million, respectively.

**Investments and Investment Income**
Investment securities held by the System, including investments in companies that are deemed to be alternative investment funds as addressed in GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and GASB Statement No. 72, *Fair Value Measurement and Application*, are carried at fair value. Realized gains and losses, based on the specific identification method, and unrealized gains and losses are included in investment income in the consolidated basic statements of revenues, expenses and changes in net position.

At September 30, 2018 and 2017, the System's investments in companies deemed to be alternative investment funds and the approximate ownership interest in each company were as follows:

| | **2018** | **2017** |
|---|---|---|
| SEI Core Property Fund, LP ("Core Property Fund") | 2.78% | 2.55% |
| SEI Special Situations Fund, Ltd. ("Special Situations Fund") | 5.74% | 6.25% |
| SEI Core Property Fund, LP (held by the Foundation) | 0.05% | 0.05% |

**Joint Ventures**
The System has entered into various partnership agreements to form corporations that will provide additional health care services throughout the community. The System's equity interest in each corporation is 40-50%. The System's investments are reflected in other assets and are being accounted for under the equity method and each has been recorded at the amount of capital contributions, including cash contributions and the fair value of fixed assets contributed, adjusted for earnings or losses for each.

**Risk Management**
The System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in the current or preceding year.

Effective October 1, 2011, the sovereign immunity limits in Florida have been increased from $100,000 to $200,000 for any one person for one incident and from $200,000 to $300,000 in total for one incident.

**Self-Insurance Programs**
Estimated liabilities for self-insured medical malpractice, employee health and workers' compensation claims include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

**Income Taxes**
The System is a special purpose unit of local government created by the Enabling Act. Certain of the System's controlled subsidiaries have been recognized by the Internal Revenue Service as tax-exempt organizations described in Section 501(c)(3) of the Internal Revenue Code (the "Code"). Income earned in furtherance of the System's tax-exempt or governmental purpose is exempt from federal and state income taxes. The Code provides for taxation of unrelated business income under certain circumstances. The System has no significant unrelated business income; however, such status is subject to final determination upon examination of the related income tax returns by the appropriate taxing authorities.

**Deferred Outflows and Inflows of Resources**
Deferred outflows of resources represent a consumption of net assets that is applicable to a future reporting period. Deferred inflows of resources represent an acquisition of net assets that is applicable to a future reporting period. Deferred outflows of resources have a positive effect on net position, similar to assets, and deferred inflows of resources have a negative effect on net position, similar to liabilities. Notwithstanding those similarities, deferred outflows of resources are not assets and deferred inflows of resources are not liabilities and accordingly are not included in those sections of the accompanying consolidated basic statements of net position, but rather, separately reported.

**Net Position**
Net position of the System is classified in four components. Net investment in capital assets consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the System, including amounts deposited with trustees as required by revenue bond indentures. Restricted nonexpendable net assets equal the principal portion of permanent endowments. Unrestricted net assets are the remaining net assets that do not meet the definition of net investment in capital assets or restricted.

Resources restricted by donors or grantors for specific operating purposes are reported in other operating revenue to the extent used in the period.

**Operating Revenues and Expenses**
The System's consolidated basic statements of revenues, expenses and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the System's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating items. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

**Concentrations of Credit Risk**
Financial instruments which potentially subject the System to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments, equity method and other investments, patient accounts receivable, other assets and assets whose use is restricted under bond indenture agreements and by the Board of Directors for future use.

The System places its cash and cash equivalents with what management believes to be high credit quality financial institutions. Included in cash and cash equivalents are bank deposits in the amount of $5.0 million and $7.8 million as of September 30, 2018 and 2017, respectively. These deposits are in excess of the federal insured amount of $250,000. However, the System is a Qualified Public Depositor with the State of Florida. As such, deposits at Qualified Public Depositories are insured at the full amount on deposit. Management does not anticipate nonperformance risk by the financial institutions. The System's short-term investments and assets whose use is restricted are primarily invested in commercial paper and money market funds, U.S. Government agencies, mutual funds, and alternative investment funds.

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of September 30 is as follows:

| | 2018 | 2017 |
|---|---|---|
| Medicare | 29% | 30% |
| Medicaid | 13% | 16% |
| Managed care | 22% | 23% |
| Commercial insurance | 6% | 5% |
| Self-pay and other | 30% | 26% |
| | 100% | 100% |

**Fair Value of Financial Instruments**
The carrying value of net accounts receivable, accrued liabilities (other than liabilities for malpractice and workers' compensation claims), and accounts payable approximates fair value due to the short-term nature of these accounts. Long-term receivables under agreement, less allowance for doubtful accounts, are valued by management at approximate fair market value. Malpractice and workers' compensation liabilities are stated at estimated fair value.

The carrying amount of the Hospital Revenue Bonds issued at rates which vary with the market approximates the fair value of these instruments, as their interest rates approximate the rates available to the System for debt of similar types and maturities. The carrying value of the System's long-term debt, excluding capital leases, was approximately $535.2 million and $561.5 million at September 30, 2018 and 2017, respectively. The fair value of the System's long-term debt, excluding capital leases, was approximately $544.0 million and $572.1 million at September 30, 2018 and 2017, respectively.

**Excess Consideration Provided for Acquisition**
Excess consideration provided for acquisition represents the consideration paid by the System for various acquisitions in excess of the estimated fair value of net position acquired. Pursuant to GASB Statement No. 69, *Government Combinations and Disposals of Government Operations* ("GASB No. 69"), which the System adopted in 2015, this deferred outflow is being attributed to future periods (i.e., amortized) in a systematic and rational manner over the periods presented in

the table below. The System recognized approximately $3.1 million in amortization expense in 2018 and 2017, with such amounts being included as a component of the line item titled "depreciation and amortization," in the consolidated basic statements of revenues, expenses and changes in net position. The table below depicts the components of this balance, annual amortization, and the amortization period at the component level as well as System totals:

*(in thousands of dollars)*

| | 2018 Balance | Annual Amortization | Amortization Period (in years) |
|---|---|---|---|
| Lee Memorial Hospital | $ 3,339 | $ 209 | 20 |
| Gulf Coast Medical Center | 87,358 | 2,427 | 40 |
| Cape Coral Hospital | 7,784 | 486 | 20 |
| Total | $ 98,481 | $ 3,122 | |

**Accounting Pronouncements**

In November 2016, the GASB issued GASB Statement No. 83, *Certain Asset Retirement Obligations* ("GASB No. 83"). GASB No. 83 addresses accounting and financial reporting for certain asset retirement obligations ("AROs"). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on GASB No. 83. GASB No. 83 is effective for fiscal years beginning after June 15, 2018. The System is currently evaluating the impact GASB No. 83 will have on its consolidated basic financial statements.

In January 2017, the GASB issued GASB Statement No. 84, *Fiduciary Activities* ("GASB No. 84"). The principal objective of GASB No. 84 is to enhance the consistency and comparability of fiduciary activity reporting by state and local governments. GASB No. 84 is effective for fiscal years beginning after December 15, 2018. The System is currently evaluating the impact GASB No. 84 will have on its consolidated basic financial statements.

In June 2017, the GASB issued GASB Statement No. 87, *Leases* ("GASB No. 87"). GASB No. 87 establishes standards of accounting and financial reporting by lessees and lessors. GASB No. 87 will require a lessee to recognize a lease liability and an intangible right-to-use lease asset at the commencement of the lease term, with certain exceptions, and will require a lessor to recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions. GASB No. 87 is effective for fiscal years beginning after December 15, 2019. The System is currently evaluating the impact GASB No. 87 will have on its consolidated basic financial statements.

In April 2018, the GASB issued GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* ("GASB No. 88"). GASB No. 88 requires additional information related to debt to be disclosed in the notes to the financial statements. GASB No. 88 is effective for fiscal years beginning after June 15, 2018. The System is currently evaluating the impact GASB No. 88 will have on its consolidated basic financial statements.

In June 2018, the GASB issued GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period* ("GASB No. 89"). Upon adoption of GASB No. 89, interest cost incurred before the end of a construction period will be recognized as an expense in the period in which the cost is incurred. GASB No. 89 is effective for fiscal years beginning after December 15, 2019. The System is currently evaluating the impact GASB No. 89 will have on its consolidated basic financial statements.

In August 2018, the GASB issued GASB Statement No. 90, *Majority Equity Interests* ("GASB No. 90"). GASB No. 90 clarifies the accounting and financial reporting requirements for a state or local government's majority equity interest in an organization that remains legally separate after acquisition. GASB No. 90 is effective for fiscal years beginning after December 15, 2018. The System is currently evaluating the impact GASB No. 90 will have on its consolidated basic financial statements.

During the year ended September 30, 2018, the System adopted GASB Statement No. 81, *Irrevocable Split Interest Agreements,* GASB Statement No. 85, *Omnibus 2017,* and GASB Statement No. 86, *Certain Debt Extinguishment Issues.* The adoption of such statements did not have a material impact on the consolidated basic financial statements.

**Revision of Previously Issued Financial Statements**

During the year ended September 30, 2018, the System adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, ("GASB No. 75"). This statement supersedes GASB Statement No. 45 and establishes new requirements for calculating and reporting the System's postemployment benefits. GASB No. 75 was adopted in fiscal year 2018, resulting in an increase in obligations for postemployment benefits and a decrease in unrestricted net position of $19.9 million at October 1, 2017. The adoption of GASB No. 75 has not been reflected as of the beginning of the earliest period presented in the financial statements as the impact was not material to the financial statements.

Net position as of October 1, 2017 was restated for the effects of the System's adoption of GASB No. 75 as follows:

*(in thousands of dollars)*

| | September 30, 2017 As Previously Reported | GASB No. 75 Adoption | October 1, 2017 As Restated |
|---|---|---|---|
| **Noncurrent Liabilities** | | | |
| Other liabilities | $ 91,800 | $ 19,943 | $ 111,743 |
| **Net Position** | | | |
| Unrestricted | $ 1,142,254 | $ (19,943) | $ 1,122,311 |

## 2. Third-Party Payors

The System has agreements with third-party payors that provide for payment at amounts different from its established rates.

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

**Medicare**
Inpatient acute care services, rehabilitative services, psychiatric services, skilled nursing services, hospital outpatient services and home health 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 System's Medicare cost reports have been audited and final settlements determined by the Medicare intermediary for all years through September 30, 2013. Retroactive adjustments for cost report settlements are accrued on an estimated basis in the period when the related services are rendered and adjusted in future periods when final settlements are determined.

**Medicaid**
Inpatient and outpatient services (except for laboratory and pathology services) rendered to Medicaid program beneficiaries have historically been reimbursed under a cost based reimbursement methodology.

The System's Medicaid cost reports have been audited and final settlements determined by the Medicaid intermediary for all years through September 30, 2015. Effective July 1, 2013, the State of Florida converted to an All Patient Refined Diagnosis Related Groups ("APR DRG") methodology for determining Medicaid inpatient hospital payments. The payments made under APR DRG are paid on a per case basis based on the APR DRG assignment that reflects severity of illness and resources related to services rendered. Effective July 1, 2017, the State of Florida implemented the Enhanced Ambulatory Patient Groups ("EAPG") methodology for determining Medicaid outpatient claim payments. Patients in each EAPG have similar clinical characteristics and similar resource use and cost. This method converts payments from a cost-based system to a prospective payment system.

The System's classification of patients and the appropriateness of their admission are subject to review by the fiscal intermediaries administering the Medicare and Medicaid programs.

**Other**
The System has also entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates. Some of these arrangements provide for review of paid claims for compliance with the terms of the contract and result in retroactive settlement with third parties. Retroactive adjustments for other third-party claims are recorded in the period when final settlement is determined.

## 3. Net Patient Service Revenue

Net patient service revenue, including subagency service revenue, for the years ended September 30 consists of the following:

| *(in thousands of dollars)* | 2018 | 2017 |
|---|---|---|
| Gross patient service revenue | $ 8,000,778 | $ 7,434,440 |
| Third-party payor and other contractual adjustments | (6,011,702) | (5,524,754) |
| Provision for doubtful accounts | (238,582) | (214,235) |
| Net patient service revenue | $ 1,750,494 | $ 1,695,451 |

## 4. Assets Whose Use Is Restricted

Assets whose use is restricted, which are required to meet current obligations of the System, are reported in current assets. The fair market value of assets whose use is restricted at September 30 consists of the following:

| *(in thousands of dollars)* | 2018 | 2017 |
|---|---|---|
| Held by trustee under bond indenture agreements | $ 5,208 | $ 5,210 |
| Held by Board of Directors for future use | 1,590 | 372 |
| Held in trust for other uses | 925 | 990 |
| Designated by donors for specific purposes | 9,321 | 24,335 |
| Total assets whose use is restricted | 17,044 | 30,907 |
| Less: Amounts required to meet current obligations | (5,598) | (5,582) |
| Assets whose use is restricted, net of amounts required to meet current obligations | $ 11,446 | $ 25,325 |

Investments which comprise assets whose use is restricted are included in the general investment portfolios of the System.

## 5. Investments

The System primarily invests its resources in domestic and international equity and fixed income mutual funds, hedge funds, and money market funds. Such investments include amounts available for current operations as well as assets whose use is restricted under bond indenture agreements and by the Board of Directors for future use. The System's investment policy authorizes a strategic asset allocation that is designed to provide an optimal return over the System's investment horizon within the System's risk tolerance and cash requirements.

Interest, dividends, and gains and losses on investments, both realized and unrealized, are included in non-operating revenues when earned.

The System's mutual fund investments are carried at fair value as determined through the use of quoted market prices (market approach). As the System's investments in hedge funds do not have readily determinable fair values, the System has established the fair value of these investments by using each investment's net asset value ("NAV") per share.

The System categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No. 72, *Fair Value Measurement and Application* (“GASB No. 72”). The hierarchy is summarized in three levels:

Level 1 – Observable inputs that reflect quoted prices for identical investments.

Level 2 – Other significant observable inputs including quoted prices for similar investments, interest rates or credit risk.

Level 3 – Unobservable inputs including entity specific inputs or inputs derived through extrapolation or interpolation that cannot be derived from market data.

The recurring fair value measurement of investments at September 30, 2018 is as follows:

| *(in thousands of dollars)* | **Fair Value Measurement of Investments 2018** | | | |
|---|---|---|---|---|
| | **Fair Value** | **Quoted Prices in Active Markets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| **Investments by Fair Value Level** | | | | |
| Domestic equity mutual funds | $ 228,201 | $ 228,201 | $ - | $ - |
| International equity mutual funds | 159,409 | 159,409 | - | - |
| Domestic fixed income mutual funds | 352,155 | 352,155 | - | - |
| International fixed income mutual funds | - | - | - | - |
| **Total Investments by Fair Value Level** | $ 739,765 | $ 739,765 | $ - | $ - |
| **Investments Measured at the Net Asset Value (NAV)** | | | | |
| SEI Core Property Fund, LP | $ 61,458 | | | |
| SEI Special Situations Fund | 40,532 | | | |
| **Total Investments Measured at NAV** | $ 101,990 | | | |
| **Other** | | | | |
| Commercial paper and money market funds | 7,168 | | | |
| | $ 848,923 | | | |

The recurring fair value measurement of investments at September 30, 2017 is as follows:

| *(in thousands of dollars)* | Fair Value Measurement of Investments 2017 | | | |
|---|---|---|---|---|
| | **Fair Value** | **Quoted Prices in Active Markets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| **Investments by Fair Value Level** | | | | |
| Domestic equity mutual funds | $ 223,694 | $ 223,694 | $ - | $ - |
| International equity mutual funds | 165,573 | 165,573 | - | - |
| Domestic fixed income mutual funds | 387,672 | 387,672 | - | - |
| International fixed income mutual funds | 7 | 7 | - | - |
| **Total Investments by Fair Value Level** | $ 776,946 | $ 776,946 | $ - | $ - |
| **Investments Measured at the Net Asset Value (NAV)** | | | | |
| SEI Core Property Fund, LP | $ 52,274 | | | |
| SEI Special Situations Fund | 38,368 | | | |
| **Total Investments Measured at NAV** | $ 90,642 | | | |
| **Other** | | | | |
| Commercial paper and money market funds | 121,538 | | | |
| | $ 989,126 | | | |

The System has an investment management agreement with SEI Investments Company ("SEI") to manage approximately 99.1% of their investments. Approximately 0.1% of investments are monitored and managed through the Lee Memorial Health System Foundation, Inc., a not-for-profit corporation created by the System and community leaders to serve as a fundraising organization in support of the System, on a quarterly basis with the remainder residing in money markets and being monitored daily.

With the exception of the SEI Core Property and SEI Special Situation Funds, the System can liquidate funds within the trade date plus one business day. SEI does require a 30-day notice for termination and full liquidation of public market funds held in the portfolio. The SEI Core Property Fund, LP can liquidate 90% of holdings quarterly with a 95-day pre-notification. The SEI Special Situations Fund, Ltd. can liquidate 90% of holdings semi-annually with 95-days pre-notification. SEI holds 10% of total redemptions until completion of the funds' audit for both hedge funds.

As of September 30, 2018 and 2017, these investments in hedge funds made up approximately 12.0% and 9.2%, respectively, of total investments in the accompanying consolidated basic statements of net position.

The System has assessed the custodial credit risk, concentration of credit risk, credit risk and interest rate risk of its investments and assets whose use is restricted below.

a. Custodial Credit Risk – The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System's deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution or collateralized with securities held by the pledging financial institution's trust department or agent but not held in the System's name.

   At September 30, 2018 and 2017, the System's investments were not exposed to custodial credit risk since the full amount of investments were insured or registered, or securities held by the System or its agent, are in the System's name.

b. Concentration of Credit Risk – This is the risk of loss attributed to the magnitude of the System's investment in a single issuer. Disclosure is required for investments in any one issuer that represent 5% or more of total investments. Investments issued or explicitly guaranteed by the U.S. Government and investments in mutual funds, alternative investment funds, and other pooled investments are excluded from this requirement. The System has no investments from any one issuer that exceeds 5%. The System's investment policy states that no corporate fixed income issue shall represent more than 5% of any portfolio at the time of purchase, nor shall any single corporate position exceed 10%. Equity assets of any one issuer, when purchased, shall represent no more than 3% of the portfolio and shall not grow to exceed 10%.

c. Credit Risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The System's investment policy provides guidelines for its fund managers and lists specific allowable investments. The policy provides for the utilization of varying styles of managers so that portfolio diversification is maximized and total portfolio efficiency is enhanced.

   The System currently invests in mutual funds. Due to the nature of mutual funds, credit risk rating is not consistent with the credit risk ratings of individual stocks which are measured by Moody's Investors Services and Standard & Poor's. These rating agencies do not provide credit risk rating of mutual funds.

d. Interest Rate Risk – This is the risk that an investment's value will be adversely affected due to a change in the level of interest rates. The System's investment policy authorizes a strategic asset allocation that is designed to provide an optimal return over the System's investment horizon within the System's risk tolerance and cash requirements. The distribution of the System's short-term investments and assets whose use is restricted by maturity as of September 30, 2018 is as follows:

| *(in thousands of dollars)* | **Investment Maturities for 2018** | | | | | |
|---|---|---|---|---|---|---|
| | **Fair Value** | **Less than 1 Year** | **13 to 24 Months** | **25 to 60 Months** | **Greater than 60 Months** | **N/A** |
| Commercial paper and money market funds | $ 1,960 | $ 1,264 | $ - | $ - | $ - | $ 696 |
| U.S. Government agencies | 5,208 | - | - | - | - | 5,208 |
| Mutual funds | 739,765 | - | - | - | - | 739,765 |
| Alternative investment funds | 101,990 | - | - | - | - | 101,990 |
| | $ 848,923 | $ 1,264 | $ - | $ - | $ - | $ 847,659 |

The distribution of the System's short-term investments and assets whose use is restricted by maturity as of September 30, 2017 is as follows:

| *(in thousands of dollars)* | **Investment Maturities for 2017** | | | | | |
|---|---|---|---|---|---|---|
| | **Fair Value** | **Less than 1 Year** | **13 to 24 Months** | **25 to 60 Months** | **Greater than 60 Months** | **N/A** |
| Commercial paper and money market funds | $ 116,327 | $ 8,681 | $ 6,879 | $ - | $ - | $ 100,767 |
| U.S. Government agencies | 5,211 | - | - | - | - | 5,211 |
| Mutual funds | 776,946 | - | - | - | - | 776,946 |
| Alternative investment funds | 90,642 | - | - | - | - | 90,642 |
| | $ 989,126 | $ 8,681 | $ 6,879 | $ - | $ - | $ 973,566 |

During the years ended September 30, 2018 and 2017, the System recorded net realized gains of approximately $2.3 million and $22.4 million, respectively, from the sale of investments. The calculations of realized gains and losses are independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year.

The net increase in the fair value of investments for the year ended September 30, 2018 was approximately $20.7 million compared to a net increase in the fair value of investments of $48.1 million for the year ended September 30, 2017. These amounts take into account all changes in fair value (including purchases and sales) that occurred during the year.

The total unrealized gains on investments held at September 30, 2018 and 2017 were approximately $114.5 million and $93.8 million, respectively. Unrealized gains or losses on investments resulting from fair value fluctuations are recorded in the accompanying consolidated basic statement of revenues, expenses and changes in net position in the period such fluctuations occur.

## 6. Capital Assets

Capital asset additions, retirements and balances for the years ended September 30, 2018 and 2017 were as follows:

| *(in thousands of dollars)* | **Balance at September 30, 2017** | **Additions and Transfers** | **Retirements and Transfers** | **Balance at September 30, 2018** |
|---|---|---|---|---|
| Land | $ 118,982 | $ 18,956 | | $ 137,938 |
| Buildings and improvements | 720,993 | 57,634 | (2,657) | 775,970 |
| Equipment | 954,665 | 57,487 | (30,772) | 981,380 |
| Totals at historical cost | 1,794,640 | 134,077 | (33,429) | 1,895,288 |
| Less: Accumulated depreciation for | | | | |
| Buildings and improvements | (447,645) | (44,209) | 3,966 | (487,888) |
| Equipment | (468,580) | (53,034) | 25,847 | (495,767) |
| | (916,225) | (97,243) | 29,813 | (983,655) |
| Construction-in-progress | 80,623 | 284,565 | (127,602) | 237,586 |
| Capital assets, net | $ 959,038 | $ 321,399 | $ (131,218) | $ 1,149,219 |

| *(in thousands of dollars)* | **Balance at September 30, 2016** | **Additions and Transfers** | **Retirements and Transfers** | **Balance at September 30, 2017** |
|---|---|---|---|---|
| Land | $ 117,317 | $ 1,668 | $ (3) | $ 118,982 |
| Buildings and improvements | 578,909 | 142,084 | - | 720,993 |
| Equipment | 853,530 | 156,244 | (55,109) | 954,665 |
| Totals at historical cost | 1,549,756 | 299,996 | (55,112) | 1,794,640 |
| Less: Accumulated depreciation for | | | | |
| Buildings and improvements | (413,287) | (35,605) | 1,247 | (447,645) |
| Equipment | (463,038) | (57,117) | 51,575 | (468,580) |
| | (876,325) | (92,722) | 52,822 | (916,225) |
| Construction-in-progress | 186,798 | 140,670 | (246,845) | 80,623 |
| Capital assets, net | $ 860,229 | $ 347,944 | $ (249,135) | $ 959,038 |

Construction-in-progress (“CIP”) at September 30, 2018 consists primarily of expenditures for computer equipment, surgical equipment and building renovations and improvements. There were numerous projects underway at September 30, 2018, which were being funded both through operations and by assets designated by the System’s Board of Directors for the replacement of plant and equipment. For the years ended September 30, 2018 and 2017, the System capitalized interest of approximately $4.3 million and $4.1 million, respectively.

Depreciation expense was approximately $97.2 million and $92.7 million for the years ended September 30, 2018 and 2017, respectively.

## 7. Other Assets

Other assets as of September 30 consist of the following:

| *(in thousands of dollars)* | **2018** | **2017** |
|---|---|---|
| Long-term receivables | $ - | $ 38,816 |
| Allowance for doubtful accounts | - | (24,706) |
| Long-term accounts receivable, net | - | 14,110 |
| Deposits and other | 4,874 | 7,841 |
| Investments in joint ventures | 24,339 | 22,171 |
| Other assets, net | $ 29,213 | $ 44,122 |

Long-term receivables relate to medical charges for patients who have been identified as parties to litigation. Collections, which are pending determination by negotiation or legal proceedings, accordingly, are classified as noncurrent. There were no such long-term receivables as of September 30, 2018 as patient accounts receivable are classified as current. The allowance for doubtful accounts is based on the expected collectability of these receivables.

## 8. Long-Term Debt

Long-term debt as of September 30 consists of the following outstanding principal balances. Payment descriptions refer to principal payments only.

| *(in thousands of dollars)* | **2018** | **2017** |
|---|---|---|
| 2017 BAPCC Loan, payable in variable annual installments beginning April 2021 through April 2032. | $ 101,290 | $ 101,290 |
| 2016 BAPCC Loan, payable in variable monthly installments beginning July 2016 through June 2023. | 17,258 | 20,732 |
| 2015 BAPCC Loan, payable in variable monthly installments beginning October 2015 through September 2025. | 36,017 | 40,770 |
| 2015 Bank of America Loan, payable in variable annual installments beginning April 2016 through April 2024. | 49,980 | 50,185 |
| 2014 JP Morgan Chase Loan, payable in variable annual installments beginning April 2015 through April 2033. | 13,800 | 15,170 |
| 2013 BAPCC Loan, payable in variable monthly installments beginning July 2013 through June 2020. | 13,022 | 20,304 |
| 2012 BAPCC Loan, payable in variable annual installments beginning April 2013 through April 2029. | 35,445 | 38,345 |
| 2012 JP Morgan Chase Loan, payable in variable annual installments beginning April 2013 through April 2020. | 5,485 | 8,000 |
| 2011 Bank of America Loan , payable in variable annual installments beginning April 2012 through April 2033. | 77,011 | 84,661 |
| 2010 Bank Qualified Loan , payable in variable annual installments beginning April 2011 through April 2020. | 6,515 | 9,830 |
| Hospital Revenue Bonds, 2010 Series A ("2010 Series A Bonds"), payable in variable annual installments beginning April 2025 through April 2027. | 42,000 | 42,000 |
| Hospital Revenue Bonds, 2007 Series A ("2007 Series A Bonds"), payable in variable annual installments beginning April 2033 through April 2037. Net of unamortized premium of approximately $3,639 and $3,835 in 2018 and 2017, respectively. | 167,314 | 167,511 |
| Notes payable and capital leases | 93,029 | 81,411 |
| | 658,166 | 680,209 |
| Less: Current installments | (42,306) | (38,857) |
| | $ 615,860 | $ 641,352 |

Long-term debt activity for the years ended September 30, 2018 and 2017 were as follows:

| *(in thousands of dollars)* | **Balance September 30, 2017** | **Additions** | **Reductions** | **Balance September 30, 2018** | **Amounts Due Within One Year** |
|---|---|---|---|---|---|
| 2017 BAPCC Loan | $ 101,290 | $ - | $ - | $ 101,290 | $ - |
| 2016 BAPCC Loan | 20,732 | - | (3,474) | 17,258 | 3,528 |
| 2015 BAPCC Loan | 40,770 | - | (4,753) | 36,017 | 4,847 |
| 2015 Bank of America Loan | 50,185 | - | (205) | 49,980 | 215 |
| 2014 JP Morgan Chase Loan | 15,170 | - | (1,370) | 13,800 | 1,455 |
| 2013 BAPCC Loan | 20,304 | - | (7,282) | 13,022 | 7,398 |
| 2012 BAPCC Loan | 38,345 | - | (2,900) | 35,445 | 2,960 |
| 2012 JP Morgan Chase Loan | 8,000 | - | (2,515) | 5,485 | 2,670 |
| 2011 Bank of America Loan | 84,661 | - | (7,650) | 77,011 | 8,110 |
| 2010 Bank Qualified Loan | 9,830 | - | (3,315) | 6,515 | 3,300 |
| 2010 Series A Bonds | 42,000 | - | - | 42,000 | - |
| 2007 Series A Bonds | 167,511 | - | (197) | 167,314 | - |
| Other | 81,411 | 17,674 | (6,056) | 93,029 | 7,823 |
| Total long-term debt | $ 680,209 | $ 17,674 | $ (39,717) | $ 658,166 | $ 42,306 |

| *(in thousands of dollars)* | **Balance September 30, 2016** | **Additions** | **Reductions** | **Balance September 30, 2017** | **Amounts Due Within One Year** |
|---|---|---|---|---|---|
| 2017 BAPCC Loan | $ - | $ 101,290 | $ - | $ 101,290 | $ - |
| 2016 BAPCC Loan | 24,153 | - | (3,421) | 20,732 | 3,474 |
| 2015 BAPCC Loan | 45,430 | - | (4,660) | 40,770 | 4,753 |
| 2015 Bank of America Loan | 50,385 | - | (200) | 50,185 | 205 |
| 2014 JP Morgan Chase Loan | 16,460 | - | (1,290) | 15,170 | 1,370 |
| 2013 BAPCC Loan | 27,472 | - | (7,168) | 20,304 | 7,282 |
| 2012 BAPCC Loan | 41,190 | - | (2,845) | 38,345 | 2,900 |
| 2012 JP Morgan Chase Loan | 10,455 | - | (2,455) | 8,000 | 2,515 |
| 2011 Bank of America Loan | 91,841 | - | (7,180) | 84,661 | 7,650 |
| 2010 Bank Qualified Loan | 13,265 | - | (3,435) | 9,830 | 3,315 |
| 2010 Series A Bonds | 42,000 | - | - | 42,000 | - |
| 2007 Series A Bonds | 271,493 | - | (103,982) | 167,511 | - |
| Other | 71,838 | 14,824 | (5,251) | 81,411 | 5,393 |
| Total long-term debt | $ 705,982 | $ 116,114 | $ (141,887) | $ 680,209 | $ 38,857 |

Maturities under the long-term debt agreements, including corresponding interest, over the next five years and in five-year increments thereafter are as follows:

*(in thousands of dollars)*

| **Years Ending September 30,** | **Total** | **Principal** | **Interest** |
|---|---|---|---|
| 2019 | $ 66,688 | $ 42,306 | $ 24,382 |
| 2020 | 64,341 | 40,990 | 23,351 |
| 2021 | 58,487 | 35,841 | 22,646 |
| 2022 | 58,874 | 36,899 | 21,975 |
| 2023 | 57,967 | 36,818 | 21,149 |
| 2024-2028 | 243,509 | 157,986 | 85,523 |
| 2029-2033 | 210,427 | 158,070 | 52,357 |
| 2034-2038 | 161,679 | 143,378 | 18,301 |
| | $ 921,972 | $ 652,288 | $ 269,684 |

**2017 BAPCC Loan**
On March 30, 2017, the System's Board of Directors approved a partial refunding and refinancing of the 2007 Series A Bonds with the 2017 BAPCC Direct Bank Loan in the approximate amount of $101.3 million. Principal will be paid annually beginning April 2021 and is set to mature April 2032. Monthly interest payments are variable based on 67% LIBOR plus 70 basis points. Issuance costs were paid with internal funds. The refinancing resulted in a gain of approximately $2.4 million attributed to the derecognition of the 2007 Series A bonds-related premiums. Bonds-related premiums and the estimated economic gain (the difference between the present value of the old and new debt service payments) was approximately $17.6 million.

**2012 BAPCC Loan**
On June 20, 2016, the System's Board of Directors approved the modification of the 2012 BAPCC Loan in the amount of $41.2 million in which the tender date was extended from May 31, 2019 to May 31, 2023. Principal payments of the 2012 BAPCC Loan are paid annually in April while the interest payments are paid quarterly. Interest payments are variable based on 67% of LIBOR plus 62 basis points and matures in April 2029. On November 30, 2012, the System's Board of Directors approved the refunding and refinancing of the Compass Loan, utilizing a direct bank loan in the amount of $50.3 million. The 2012 BAPCC Loan bears a variable interest rate of 67% of LIBOR plus 95 basis points and matures in April 2029. Issuance costs were paid with internal funds. The advanced refunding resulted in the recognition of an accounting loss of approximately $100,000. Although the current refunding resulted in the recognition of an accounting loss of approximately $100,000, the System obtained an economic gain (the difference between the present values of the old and new debt service payments) of approximately $5.7 million. This loan was modified on June 20, 2016 in the amount of $41.2 million to extend the tender date.

**2016 BAPCC Loan**
On April 28, 2016, the System's Board of Directors approved the issuance of new debt in the amount of $25 million to reimburse the System for prior capital expenditures through a direct bank loan. The 2016 BAPCC Loan bears a fixed rate of 1.55% paid monthly and matures in June 2023. Issuance costs were paid with internal funds.

**2015 BAPCC Loan**
On August 27, 2015, the System's Board of Directors approved the issuance of new debt in the amount of $50 million to reimburse the System for prior capital expenditures through a direct bank loan. The 2015 BAPCC Loan bears a fixed interest rate of 1.97% paid monthly and matures in September 2025. Issuance costs were paid with internal funds.

**2015 Bank of America Loan**
On June 25, 2015, the System's Board of Directors approved the refunding and refinancing of the Hospital Revenue Refunding Bonds, 2005 Series A with a direct bank loan of $50.85 million. Principal payments of the 2015 Bank of America Loan are paid annually in April while the interest payments are paid semi-annually in October and April at a fixed rate of 2.79%. The 2015 Bank of America Loan is set to mature in April 2024. Although the refunding resulted in the recognition of an accounting loss of $0.2 million for the year ended September 30, 2015, the System obtained an economic gain of $6.39 million. Issuance costs were paid with internal funds.

**2014 JP Morgan Chase Loan**
On June 26, 2014, the System's Board of Directors approved the refunding and refinancing of the 2009 Series C Bonds with the 2014 JP Morgan Bank Loan in the amount of $18.445 million. This transaction closed October 8, 2014. Principal payments of the 2014 JP Morgan Bank Loan are paid annually in April while the interest payments are paid semi-annually in October and April. Interest payments are variable based on 67% of LIBOR plus 73 basis points. The 2014 JP Morgan Bank Loan is set to mature in April 2033. Although the advanced refunding resulted in the recognition of an accounting loss of approximately $1.96 million for the year ended September 30, 2015, the System was able to eliminate the need of the letter of credit securing the 2009 Series C Bonds and reduce the interest rate. Issuance costs were paid with internal funds.

**2013 BAPCC Loan**
On June 28, 2013, the System's Board of Directors approved the financing of the EPIC software system consisting of clinical and revenue cycle applications utilizing a direct bank loan in the amount of $50 million. The 2013 BAPCC Loan bears a fixed interest rate of 1.58% and matures in June 2020. Issuance costs were paid with internal funds.

**2012 JP Morgan Chase Loan**
On January 19, 2012, the System's Board of Directors approved the refunding and refinancing of the 2002 Series A Bonds, utilizing a direct bank loan in the amount of $25.9 million. The 2012 Bank Loan bears a fixed interest rate of 1.92% and matures in April 2020. Issuance costs were paid with internal funds. The advanced refunding resulted in the recognition of an accounting loss of approximately $2.2 million. Although the current refunding resulted in the recognition of an accounting loss of approximately $2.2 million, the System obtained an economic gain of approximately $2.9 million.

**2011 Bank of America Loan**
On September 1, 2011, the System's Board of Directors approved the refunding and refinancing of the 2009 Series A and 2009 Series B Bonds, utilizing a direct bank loan in the amount of approximately $109.5 million. The 2011 Bank Loan bears a variable interest rate of 65.1% of LIBOR plus 72 basis points and matures in April 2033. Issuance costs were paid with internal funds. This loan also terminated the line of credit ("LOC") that was in place for the 2009 Series A and 2009 Series B Bonds. Although the current advanced refunding resulted in the recognition of an accounting loss of $0.9 million, the System obtained an economic gain of approximately $8.7 million.

**2010 Bank Qualified Loan**
On November 18, 2010, the System's Board of Directors approved the refunding and refinancing of the 1997 Series C Bonds, utilizing a direct bank qualified fixed rate loan in the amount of $30.0 million. The 2010 Bank Loan bears a fixed interest rate of 2.794%, and matures in April 2020. The transaction was completed on December 22, 2010. Issuance costs were paid with internal funds. Although the advanced refunding resulted in the recognition of an accounting loss of approximately $2.2 million, the System in effect reduced its aggregate debt service payments by approximately $3.2 million and obtained an economic gain of approximately $2.9 million.

**2010 Series A Bonds**
In May 2010, the System issued Hospital Revenue Bonds, 2010 Series A (Build America Bonds - Direct Payment) in the amount of $42.0 million. The proceeds of the 2010 Series A Bonds were used to finance a portion of the costs of acquisition, equipping and construction of the System's healthcare facilities. The 2010 Series A Bonds were issued as fixed rate bonds with interest payable semiannually on April 1 and October 1 of each year at 7.281% with a 32.585% interest paid rebate from the IRS which becomes an effective rate of 4.9085%.

**2007 Series A Bonds**
In April 2007, the System issued Hospital Revenue Bonds, 2007 Series A, in the amount of $270.9 million. The 2007 Series A Bonds were issued as fixed-rate bonds with interest payable semiannually on April 1 and October 1 of each year. The proceeds of the 2007 Series A Bonds were used to replace the temporary bank loan established with Bank of America, N.A. to fund the purchase of Southwest Regional Medical Center and Gulf Coast Hospital. At the time of issuance, the 2007 Series A Bonds are comprised of approximately $262.4 million of serial bonds bearing interest at a rate ranging from 4.5% to 5.25% as the bonds mature, and approximately $8.5 million in term bonds bearing interest at 4.0% to 5.0%. Effective April 12, 2017, the System refunded and refinanced approximately $101.3 million of the 2007 Series A Bonds with a new 2017 BAPCC Loan. Prior to the refunding and refinancing, the 2007 Series A Bonds had an outstanding principal balance of approximately $265.0 million. Following the refunding and refinancing, the outstanding balance of the 2007 Series A Bonds was reduced to $163.7 million. The refinancing resulted in a gain of approximately $2.4 million, attributable to the derecognition of the related bond premium established at issuance.

**Other Long-Term Debt**
The Plantation Sleep Center lease allows for acceleration of rent upon a lessee default without terminating the lessee's right of possession. This is viewed as a contingent form of collateral which is a form of continuing involvement that would preclude sale-leaseback accounting under this guidance. According to lease guidance addressing sale-leaseback transactions involving real estate, the System has accounted for the debt obligations in its consolidated basic financial statements. At September 30, 2018, for the Plantation Sleep Center the effective interest rate was 9.0%, the long-term debt amounted to approximately $2.2 million and the related current portion of debt amounted to approximately $0.03 million. At September 30, 2017, the effective interest rate was 9.0%, the long-term debt amounted to approximately $2.3 million and the related current portion of debt amounted to approximately $0.2 million.

In September 2005, the System entered into a ground lease with CB Medical South, LLC and a ground lease with CB Medical North, LLC (collectively, the "Lessors"), whereby CB Medical South, LLC and CB Medical North, LLC are leasing constructed medical office buildings to the System. Since the System had continuing involvement with the assets as discussed in lease guidance addressing sale-leaseback transactions involving real estate, the System was unable to remove the assets and related debt from its consolidated basic statements of net position after construction of the assets were completed.

On August 26, 2010, the System's Board of Directors approved the acquisition of the ownership interest in CB Medical North, LLC, which owns the land and building housing the Lee Memorial Regional Cancer Center at the Sanctuary and CB Medical South, LLC, which owns the land and building housing the Outpatient Center at the Sanctuary. The System acquired full ownership effective October 1, 2010. As part of the transaction, the System assumed the mortgages on the properties which totaled approximately $62.0 million plus approximately $2.3 million in cash. The System was required to update the previous capital asset and long-term debt recordings to reflect the purchase transaction. The CB Medical South, LLC and CB Medical North, LLC values for capital assets and long-term debt reported as of September 30, 2010 reflected the lease guidance addressing sale-leaseback transactions. The CB Medical South, LLC and CB Medical North, LLC values for capital assets and long-term debt reported as of September 30, 2014 reflect the full ownership interest resulting from the October 1, 2010 acquisition transaction. At September 30, 2018 and 2017, the value included in capital assets, net of accumulated depreciation, amounted to approximately $23.2 million and $23.8 million, respectively, for the Sanctuary Regional Cancer Center, and the related long-term debt amounted to approximately $23.4 million and $24.0 million, respectively. At September 30, 2018 and 2017, the value included in capital assets, net of accumulated depreciation, amounted to approximately $26.5 million and $27.2 million, respectively, for the Sanctuary Outpatient Center, and the related long-term debt amounted to approximately $31.3 million and $32.4 million, respectively.

In April 2018, the System entered into a Purchase Money Mortgage with Lee Healthcare Resources, a Florida Not For Profit Corporation, in the amount of $10.3 million plus approximately $1.9 million in cash for the Med Plaza One Building. Principal payments of $2.1 million plus interest will be paid annually through April 2023. Interest on the principal sum of this note as of September 2018 was 2.72% per annum and is subject to annual adjustment based on the Applicable Federal Rate. The Med Plaza One Building is comprised of medical and administrative offices.

The bond agreements require the System to maintain specified financial ratios, the most restrictive of which are a minimum debt service coverage ratio, long-term debt to capital ratio, and minimum cash and investment balances, and provide a pledge of revenues of the System on a parity basis. The System was in compliance with the financial covenants for the years ended September 30, 2018 and 2017. The net assets of nonobligated group members, which are the Lee County Trauma Services District, Lee Memorial Home Health, Inc., HealthPark Care Center, Inc., and Lee Memorial Health System Foundation, Inc., included in the consolidated basic financial statements at September 30, 2018 and 2017 were approximately $-2.3 million and $8.7 million, respectively.

## 9. Capital Lease Obligations

At September 30, 2018 and 2017, assets under capital leases included in capital assets were approximately $44.1 million and $36.9 million, respectively. The accumulated amortization for these assets was approximately $17.3 million and $14.4 million as of September 30, 2018 and 2017, respectively. Amortization expense of approximately $3.2 million and $3.8 million is included in depreciation and amortization expense in the accompanying consolidated basic statements of revenues, expenses and changes in net position for the years ended September 30, 2018 and 2017, respectively. At September 30, 2018 and 2017, an approximate obligation of $24.2 million and $22.8 million, respectively, was outstanding under the capital leases. During the years ended 2018 and 2017, interest expense of approximately $2.2 million and $1.6 million, respectively, was incurred.

Future minimum lease payments are as follows:

*(in thousands of dollars)*

| **Years Ending** | |
|---|---|
| 2019 | $ 6,687 |
| 2020 | 5,947 |
| 2021 | 5,495 |
| 2022 | 5,551 |
| 2023 | 4,886 |
| Later years | 15,302 |
| Total minimum lease payments | 43,868 |
| Less: Amount representing interest | (19,629) |
| Present value of net minimum lease payments | $ 24,239 |

## 10. Retirement Plans

**Tax Sheltered Annuity Plan**

The System provides a single-employer tax deferred annuity program for all eligible employees who elect to participate in the program. The annuity program is administered by the System. The Lee Memorial Hospital Tax Sheltered Annuity Plan (the “Plan”) purchases annuity contracts for participating employees through salary reduction, thereby deferring taxability of these amounts. For employees with one year or more of eligible service, the System participates in the Plan by matching approximately 5% of the participating employees’ salaries. The Board of Directors of the System has the sole discretion to amend the Plan and change the contribution amount. Contribution expense incurred by the System in connection with the Plan was $21.7 million and $18.5 million for the years ended September 30, 2018 and 2017, respectively.

**Retiree Health Insurance Plan**

As of the year ending September 30, 2018, the System adopted GASB No. 75 for reporting of the System’s Self-Funded Retiree Health Insurance Plan (the “RHI Plan”), which is a post-employment benefit plan (“OPEB”). The System did not restate prior year financial statements in adopting GASB No. 75 as the amounts were not material. Thus, the years presented are not comparable. The new GASB disclosures for 2018 are presented first, followed by 2017.

**Plan Description**

As of September 30, 2018, the System's RHI Plan, which provides medical benefits to active employees, also provides medical benefits to eligible retired employees under a defined benefit postemployment healthcare plan.

The contribution requirements of the RHI Plan members and the System are established and may be amended by the System's Board of Directors. Current retiree RHI Plan members who are receiving benefits do not contribute to the RHI Plan as the System covered their health insurance based on current Medicare regulations which made the RHI Plan the secondary payer with Medicare paying as the primary payer.

Effective January 1, 2009, employees who retire at age 65 or later with 20 years of continuous full-time service or equivalent part-time service will receive, if they elect retiree health coverage, a $2,500 check each year for the rest of their life which will be increased in subsequent years by 2%.

**Benefits Provided**

The RHI Plan provides for a $2,500 per retiree benefit to be paid on an annual basis. The RHI Plan also sets forth an increase of 2% per year after retirement. To be eligible for benefits an employee must meet one of four eligibility requirements. The first is to retire after attaining age 65 with 20 years of continuous full-time (or equivalent) service and retire after January 1, 2009. The second is to be age 63 or older on May 1, 1993 and retire after attaining age 65 with 20 years full-time (or equivalent) service. The third is to become disabled with 20 years continuous full-time (or equivalent) service, before attaining age 65. Last, an employee would need to have 30 or more years of full-time (or equivalent) service on September 30, 2009. Part-time services count as one-half of full-time service. Temporary or PRN service is not eligible.

**Contributions**

The System's funding policy is to fund on a pay-as-you-go basis so there are no contributions.

**Employees Covered by Benefit Terms**

At January 1, 2017, the census date for the OPEB liability, the following employees were covered by the benefit terms:

| | |
|---|---|
| Participant data as of January 1, 2017 | |
| Retirees | 335 |
| Fully eligible | 902 |
| Other | 2,780 |
| | 4,017 |

**Net OPEB Liability**

The System's net OPEB liability was measured as of December 31, 2017. The service cost and total OPEB liability were measured as of the census date based on participant data as of the census date.

The total OPEB liability in the September 30, 2018 actuarial valuation was projected from the measurement date using standard methodology, adjusting for benefit payments, expected growth in benefit obligations, changes in key assumptions and plan provisions, and any significant changes in plan demographics that occurred during the year.

| | |
|---|---|
| Current Health Care Cost Trend Rate | 6.5% |
| Investment Rate of Return | 0.0%, due to the RHI Plan is a pay-as-you-go plan |
| Salary increases | 3.0% |

Mortality rates were based on RP-2014 Employee and Annuitant Mortality Tables for males and females with Scale MP-2014 backed out to 2006 and then projected forward from 2006 using generational projection Scale MP-2017 for males and females.

Effective October 1, 2017, the plan implemented GASB No. 75. The actuarial cost method was changed from the Projected Unit Credit Method ("PUC") to Entry Age Normal ("EAN") for the fiscal year ending September 30, 2018 per GASB No. 75.

The discount rate used to measure the total OPEB liability was 3.31%. The individual EAN Cost Method is used in completing the actuarial valuation. Under this method the normal cost is the level percentage of pay contribution that would have been required from age on the valuation date coincident with or next following the date the employee is hired in order to fund the employed participant's OPEB benefits if the current plan provisions regarding accrual of benefits had always been in effect. The total OPEB liability is the excess of the present value of future benefits over the present value of future service costs for employed participants. The service cost and total OPEB liability for the RHI plan are the sums of the individually computed service costs and OPEB liabilities for all plan participants.

As required by GASB No. 75, the discount rate for an unfunded OPEB plan is based on a 20-year high-quality municipal bond rate as of the last business day preceding the measurement date. The discount rate used in this valuation was determined using the 20-year yields on the Fidelity AA Municipal General Obligation Fund (rounded to 2 decimal places).

Changes in the net OPEB liability are summarized in the following table:

| *(in thousands of dollars)* | **Increase (Decrease)**<br>**Total OPEB Liability (a)** |
|---|---|
| Balance at October 1, 2017, as reported | $ 32,454 |
| Balance at October 1, 2017, as restated* | 52,758 |
| Changes for the year: | |
| Service cost | 683 |
| Interest cost | 1,728 |
| Changes in benefit terms | - |
| Differences between expected and actual experience | - |
| Changes of assumptions | - |
| Benefit payments | (1,104) |
| Net changes | 1,307 |
| Balance at September 30, 2018 | $ 54,065 |

* GASB No. 75 adoption balance at October 1, 2017, as restated (see Note 1).

**Sensitivity of the Net OPEB Liability to Changes in the Discount Rate**

The following table presents, as of September 30, 2018, the System's net OPEB liability calculated using the discount rate of 3.31%, as well as the net OPEB liability using a discount rate that is 1% lower (2.31%) or 1% higher (4.31%):

*(in thousands of dollars)*

| | 1% Decrease (2.31%) | Current Discount Rate (3.31%) | 1% Increase (4.31%) |
|---|---|---|---|
| Net OPEB liability | $ 47,350 | $ 54,065 | $ 62,272 |

**Sensitivity of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rate**

The following presents, as of September 30, 2018, the System's net OPEB liability calculated using the healthcare cost trend rate of 6.5%, as well as the net OPEB liability using a discount rate that is 1% lower (5.5%) or 1% higher (7.5%):

*(in thousands of dollars)*

| | 1% Decrease (5.5%) | Current Healthcare Cost Trend Rate (6.5%) | 1% Increase (7.5%) |
|---|---|---|---|
| Net OPEB liability | $ 60,467 | $ 54,065 | $ 48,592 |

The System is currently funding the OPEB obligation on a pay-as-you-go basis so no assets have been segregated and/or restricted to provide the postemployment benefits.

Significant actuarial assumptions used as of the measurement date are as follows:

Discount Rate on 20-Year General Obligation Municipal Bonds

- 3.31% as of the last business day preceding the measurement date of January 1, 2017.

Rates of Increase in Compensation

- 3.0% based on the System's budgetary salary increase for the fiscal year 2019 budget year.

**OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB**

The System recognized OPEB expense of approximately $2.4 million for the year ended September 30, 2018. At September 30, 2018, the System reported zero deferred outflows and deferred inflows of resources related to defined benefit pension from the following sources:

| *(in thousands of dollars)* | **Deferred Outflows of Resources** | **Deferred Inflows of Resources** |
|---|---|---|
| Differences between expected and actual experience | $ - | $ - |
| Changes of assumptions | - | - |
| Total | $ - | $ - |

Amounts reported as deferred outflows of resources and deferred inflows of resources related to defined benefit pension will be recognized in pension expense as follows:

*(in thousands of dollars)*

| **Year Ending September 30,** | |
|---|---|
| 2019 | $ - |
| 2020 | - |
| 2021 | - |
| 2022 | - |
| Thereafter | - |

**Payable to the OPEB Plan**

As of September 30, 2018, there are no payables to the Plan.

**Prior Year Disclosure for Retiree Health Insurance Plan**

As of the accounting period ending September 30, 2018, the System adopted GASB No. 75. The information presented below is the prior year's disclosures based on GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("GASB No. 45"), which has not been restated and, therefore, is not comparable.

The System is required to expense the annual required contribution ("ARC") of the employer which is an amount that is actuarially determined in accordance with the parameters of GASB No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarially determined liabilities (or funding excess) over a period not to exceed thirty years. The System is currently funding the OPEB on a pay-as-you-go basis so no assets have been segregated and/or restricted to provide the postemployment benefits.

The System's annual OPEB expense of approximately $3.1 million for the year ended September 30, 2017 was equal to the ARC plus interest in the net OPEB obligation less adjustment to the ARC. The following table shows the components of the System's annual OPEB cost for the year ended September 30, 2017, the amount actually contributed to the plan and the changes in the net OPEB obligation:

| *(in thousands of dollars)* | **2017** |
|---|---|
| Annual required contribution | $ 3,619 |
| Interest on net OPEB obligation | 1,221 |
| Adjustment to annual required contribution | (1,765) |
| Annual OPEB expense | 3,075 |
| Amount funded | (1,150) |
| Increase in net OPEB obligation | 1,925 |
| Net OPEB obligation at beginning of year | 30,529 |
| Net OPEB obligation at end of year | $ 32,454 |

Annual OPEB cost, contribution information and net OPEB obligation for the last two fiscal years are as follows:

*(in thousands of dollars)*

| **Year Ended** | **Annual OPEB Cost** | **Percentage of Annual OPEB Cost Contributed** | **Net OPEB Obligation** |
|---|---|---|---|
| September 30, 2016 | $ 3,165 | 36.3% | $ 30,529 |
| September 30, 2017 | 3,075 | 37.4% | 32,454 |

The schedule of funding progress for the RHI Plan is as follows:

*(in thousands of dollars)*

| **Actuarial Valuation Date** | **Actuarial Accrued Liability (AAL)** | **Actuarial Value of Assets** | **Unfunded AAL (UAAL)** | **Funded Ratio** | **Covered Payroll** | **UAAL as a Percentage of Covered Payroll** |
|---|---|---|---|---|---|---|
| 1/1/2013 | $ 45,432 | $ - | $ 45,432 | 0% | $ 577,681 | 7.9% |
| 1/1/2015 | 42,069 | - | 42,069 | 0% | 609,102 | 6.9% |
| 1/1/2017 | 43,090 | - | 43,090 | 0% | 757,319 | 5.7% |

Actuarial valuations of an ongoing plan involve estimates of the value or reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contribution of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarially determined accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the September 30, 2017 expenses, the projected unit credit ("PUC") actuarial cost method was used as the valuation methodology. The objective under PUC is to fund each participant's benefits under the plan as they would accrue. The actuarial assumptions include a 4.0% discount rate and an annual healthcare trend rate of 6.5% initially, reduced each year until an ultimate rate of 5.0% is reached after 6 years. The mortality assumption is the RP 2000 table projected to 2018 using Scale AA. The unfunded actuarial accrued liability is being amortized as a level dollar open amortization over 30 years.

**Defined Benefit Pension Plan**

**Plan Description**
Effective July 1, 1996, the System became the sponsor of the frozen retirement plan of former Cape Coral Medical Center, Inc. employees (the "CCMC Plan"). The CCMC Plan was frozen on September 30, 1995 by the management in place at that time. The CCMC Plan is a noncontributory, single-employer defined benefit plan, administered by a committee appointed by the System. Under the provisions of the CCMC Plan, the System has the authority to make amendments. There have been no new members of the CCMC Plan since the date the CCMC Plan was frozen. The CCMC Plan provides Life-Only annuity benefits to plan members and beneficiaries. An actuarial report is prepared each year effective June 30 and is available from the System. The funding policy of the System is to contribute an amount at least equal to the annual required contribution prescribed by GASB Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25*, and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions and Amendment of GASB No. 27* ("GASB No. 68"), and determined by the actuary. For the years ended September 30, 2018 and 2017, the ARC was $0.7 million and $0.8 million, respectively.

**Benefits Provided**
The Plan provides for retirement and death benefits. Retirement benefits are determined based upon varying formulas dependent on years of service. All employees of the Employer were eligible to participate in the CCMC Plan as of the first day of the month coincident with or next following the date on which they completed one Year of Vesting Service. All other employees became participants as of the first day of the month coincident with or next following the completion of one year of service during which they accumulated at least 1,000 hours of service. No new participants entered after September 30, 1995, unless they had previously been participants before September 30, 1995.

The accrued benefit is calculated using the formula for the normal retirement benefit, based upon the average monthly compensation and years of benefit service as of the date of the calculation. The accrued benefit is payable at the normal retirement date in the normal form of payment. Accrued benefits were frozen as of September 30, 1995. The normal retirement benefit is calculated by taking 2% of the average monthly compensation multiplied by years of benefit service up to a maximum of 20 years. Benefit terms also provide for annual cost-of-living adjustments to retired participants based upon the Secretary of the Treasury for cost-of-living increases.

**Employees Covered by Benefit Terms**

At July 1, 2018, the measurement date for the pension liability, the following employees were covered by the benefit terms:

| | |
|---|---|
| Participant data as of July 1, 2018 | |
| Active | 99 |
| Terminated vested | 458 |
| Retired | 415 |
| | 972 |

**Contributions**

The CCMC plan sponsor's funding policy is to make contributions to meet the minimum funding requirements of Internal Revenue Code Sections 412(a) and 430 as determined by an independent actuary. Additionally, the Plan Sponsor may contribute an amount above the required contribution. The Plan Sponsor's contributions of approximately $0.7 million and $0.8 million for the years ended September 30, 2018 and 2017, respectively, meet the minimum funding requirements of ERISA.

**Net Pension Liability**

The System's net pension liability was measured as of July 1, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2018.

The total pension liability in the September 30, 2018 actuarial valuation was determined using the following actuarial assumptions, applied to all periods in the measurement:

| | |
|---|---|
| Inflation | 2.1% |
| Investment Rate of Return | 7.5%, net of pension plan investment expense, including inflation |
| Salary increases | Not applicable due to plan freeze |

Effective September 30, 2017, the assumption for mortality has been changed from RP-2014 mortality with fully generational projections using Scale MP-2015 to RP-2006 mortality with fully generational projections using Scale MP-2017. The change was made based on a recommendation of the Society of Actuaries.

The long-term expected rate of return on pension plan investments was determined using a building block method in which best-estimate ranges of expected real rates of return (expected returns, net of plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| **Asset Class** | **Target Allocation** | **Real Rate of Return** |
|---|---|---|
| Domestic Equity | 57.0% | 5.00% |
| Corporate Fixed Income | 12.0% | 1.80% |
| Government Fixed Income | 24.0% | 0.90% |
| Real Estate | 5.0% | 3.40% |
| Cash | 2.0% | 0.50% |
| Total | 100.0% | |

The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employer contributions will be made in amounts equal to the actuarially determined contributions. Based on that assumption, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. For the year ended September 30, 2018, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 7.1%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Changes in the net pension liability (asset) are summarized in the following table:

| *(in thousands of dollars)* | **Increase (Decrease)** | | |
|---|---|---|---|
| | **Total Pension Liability (a)** | **Plan Fiduciary Net Position (b)** | **Net Pension Liability (a)-(b)** |
| Balances at October 1, 2017 | $ 27,622 | $ 24,710 | $ 2,912 |
| Changes for the year: | | | |
| Interest | 2,072 | - | 2,072 |
| Difference between expected and actual experience | (108) | - | (108) |
| Changes of assumptions | 617 | - | 617 |
| Employer contributions | - | 687 | (687) |
| Net investment income | - | 1,720 | (1,720) |
| Benefit payments | (1,747) | (1,747) | - |
| Administrative expense | - | (140) | 140 |
| Net changes | 834 | 520 | 314 |
| Balances at September 30, 2018 | $ 28,456 | $ 25,230 | $ 3,226 |
| Plan Fiduciary net position as a percentage of the total pension liability | | | 88.66% |

**Sensitivity of the Net Pension Liability to Changes in the Discount Rate**
The following presents, as of September 30, 2018, the System's net pension liability calculated using the discount rate of 7.5%, as well as the net pension liability using a discount rate that is 1% lower (6.5%) or 1% higher (8.5%):

*(in thousands of dollars)*

| | 1% Decrease (6.5%) | Current Discount Rate (7.5%) | 1% Increase (8.5%) |
|---|---|---|---|
| Net pension liability | $ 5,949 | $ 3,226 | $ 892 |

**Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Defined Benefit Pension**
The System recognized pension benefit expense of approximately $0.7 million for the year ended September 30, 2018 and pension benefit income of $1.1 million for the year ended September 30, 2017. At September 30, 2018, the System reported deferred outflows of resources and deferred inflows of resources related to defined benefit pension from the following sources:

| *(in thousands of dollars)* | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Differences between expected and actual experience | $ - | $ - |
| Changes of assumptions | - | - |
| Net differences between projected and actual earnings on pension plan investments | 517 | - |
| Contributions made during the year ended September 30, 2018 not yet recognized in net fiduciary position | 165 | - |
| Total | $ 682 | $ - |

Amounts reported as deferred outflows of resources and deferred inflows of resources related to defined benefit pension will be recognized in pension expense as follows:

*(in thousands of dollars)*

| **Year Ending September 30,** | |
|---|---|
| 2019 | $ 449 |
| 2020 | 176 |
| 2021 | (134) |
| 2022 | 27 |
| Thereafter | - |

**Payable to the Defined Benefit Pension Plan**
As of September 30, 2018 and 2017, there are no payables to the CCMC Plan.

## 11. Commitments and Contingencies

### Operating Leases

The System leases various equipment, office space and land under operating leases, which expire at various times. Total rental expense for all operating leases was approximately $8.7 million and $9.0 million for the years ended September 30, 2018 and 2017, respectively.

The remaining rental commitments under operating leases that have initial or remaining noncancelable lease terms in excess of one year are approximately as follows:

*(in thousands of dollars)*

| **Year Ending September 30,** | |
|---|---|
| 2019 | $ 2,242 |
| 2020 | 1,355 |
| 2021 | 1,099 |
| 2022 | 892 |
| 2023 | 341 |
| Thereafter | 34,461 |
| | $ 40,390 |

### Professional Liability Insurance

The System is subject to various medical malpractice claims arising in the normal course of its business activities. The System is self-insured for professional liability claims and is relying on a limitation of its liability established by the Waiver of Sovereign Immunity Act of the State of Florida (the “Act”). The Act limits the amount of damages the Hospital would be required to pay up to $100,000 per claimant or $200,000 per incident. Effective October 1, 2011, the sovereign immunity limits in Florida have been increased to $200,000 per claimant or $300,000 per incident. In 1986, the Florida Supreme Court affirmed the constitutionality of the Act and its applicability to public hospitals. Various suits and claims arising in the ordinary course of business are pending against the System. Management is of the opinion that future potential uninsured losses from incidents occurring prior to September 30, 2018, if any, will not be materially different from the amounts recorded in the accompanying consolidated basic financial statements.

The System has been named as a defendant in a number of malpractice lawsuits. In the event that a claim exceeds its sovereign immunity level, the System may incur charges in excess of its established reserves that could have an adverse impact on the System's change in net position and net cash flows in the period in which it is recorded or paid. The Act provides that with regard to judgments exceeding those limits, that the plaintiff may seek enactment of a legislative claim bill by the Florida Legislature, seeking recovery of an amount in excess of those limits. A claims bill must be presented and sponsored by a Senator or Representative of the State of Florida, passed through Committee, and signed by the Governor of Florida according to Florida Statute 768.28. Without waiving its entitlement to the rights and benefits of the Florida Waiver of Sovereign Immunity Act, the System has insurance protection not to exceed $25 million, subject to a $5 million per claim self-insured retention. This excess insurance is written on a claims-made basis, effective August 1, 2012, with a retroactive date of May 1, 2010. In accordance with Florida law, the purchase of this insurance does not operate as a waiver of the limits on damages as described above. Management does not record a liability for estimated malpractice claims in excess of the liability established pursuant to the Act until claim is approved for settlement through the claims bill process.

Management of the System has established a liability that provides for estimated malpractice claims identified under the System's risk management program based on several factors including the nature of each claim, past experience, advice from legal counsel and actuarial studies which reflect liabilities discounted at 4% for the years ended September 30, 2018 and 2017. The estimated claims incurred, payments on claims, and the balance of the reserve for professional liability claims for the years ended September 30, 2018 and 2017, excluding the amounts payable pursuant to the claims bill process described above, were as follows:

| *(in thousands of dollars)* | **2018** | **2017** |
|---|---|---|
| Amount of claims liabilities at the beginning of the year | $ 15,660 | $ 15,225 |
| Incurred claims | 5,926 | 4,277 |
| Payments on claims attributable to events of both the current fiscal year and prior fiscal years | (5,492) | (3,842) |
| Amount of claims liabilities at the end of the year | $ 16,094 | $ 15,660 |

Cape Coral Hospital, Inc.'s and Lee Memorial Home Health, Inc.'s professional malpractice liability insurance is covered under the System's established program under the Act, effective for claims occurring on or after October 1, 2001 and January 1, 2005, respectively.

The System's Board of Directors opted to cover its nursing home for professional liability using its established program under the Act, effective for claims occurring on and after October 1, 2000.

As a provider of health care services, the System is subject to malpractice claims and litigation through the normal course of operations. Losses which are subject to the deductible provisions have been estimated and accrued in the accompanying consolidated basic financial statements. The System has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Management believes the established reserves are adequately stated as of September 30, 2018 and 2017.

**Health Insurance**

The System is self-insured for group health insurance. Expenses net of employee contributions under this program amounted to approximately $80.3 million and $71.2 million for the years ended September 30, 2018 and 2017, respectively. The total reserve for group health insurance claims payable, including an estimate for incurred but not reported claims, was approximately $7.7 million and $8.3 million at September 30, 2018 and 2017, respectively. Management believes the established reserve is adequately stated as of September 30, 2018 and 2017. The estimated claims incurred, payments on claims and the balance of reserves for group health insurance claims for the years ended September 30, 2018 and 2017 were as follows:

| *(in thousands of dollars)* | **2018** | **2017** |
|---|---|---|
| Amount of claims liabilities at the beginning of the year | $ 8,329 | $ 8,246 |
| Incurred claims | 95,730 | 84,818 |
| Payments on claims attributable to events of both the current fiscal year and prior fiscal years | (96,315) | (84,735) |
| Amount of claims liabilities at the end of the year | $ 7,744 | $ 8,329 |

**Workers' Compensation Insurance**
The System is self-insured for workers' compensation insurance. Management of the System has established a liability for these types of claims based on actuarial evaluations in 2018 and 2017. The reserve for workers' compensation claims included in the consolidated basic financial statements was discounted at a rate of 4% for the years ended September 30, 2018 and 2017. The estimated claims incurred, payments on claims and the balance of the reserve for workers' compensation claims for the years ended September 30, 2018 and 2017 were as follows:

| *(in thousands of dollars)* | **2018** | **2017** |
|---|---|---|
| Amount of claims liabilities at the beginning of the year | $ 15,291 | $ 13,209 |
| Incurred claims | 2,890 | 3,663 |
| Payments on claims attributable to events of both the current fiscal year and prior fiscal years | (2,811) | (1,581) |
| Amount of claims liabilities at the end of the year | $ 15,370 | $ 15,291 |

**Other Industry Risks**
The health care industry is subject to numerous complex laws and regulations imposed by federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretation by both the System with respect to implementation as well as the government with respect to retrospective review. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Such investigations and allegations often take multiple years to resolve. Violations of these laws and regulations could result in significant fines and penalties, including repayments for patient services previously reimbursed.

From time to time, the System receives requests for certain information from governmental agencies, and with the assistance of legal counsel, submits the required information. Management believes that the System is in compliance with current laws and regulations. To the extent that issues with noncompliance are identified, the System's management takes the appropriate steps to correct such matters. Management of the System believes that the exposure from any such matters would not have a material effect on the consolidated basic financial statements of the System.

**Litigation**
The System is involved in litigation and regulatory examinations arising in the normal course of business. After consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on the System's future consolidated financial position, results of operations or cash flows.

## 12. Related Party Transactions and Relationships

Prior to September 1, 2010, the System had a 50% membership interest in a not-for-profit organization with another local-area governmental health care system. On September 1, 2010, the System along with the other governmental health care system conveyed a combined 11.11% membership interest to a third healthcare system which resulted in a new membership interest for the System of 44.445%. The System is accounting for its interest in the not-for-profit organization under the equity method of accounting. The purpose of the membership was to develop a regional service center, LeeSar, Inc. ("LeeSar"), to meet the materials services and distribution needs of its member health care systems. The membership interest in LeeSar, which is included in long-term other assets, was approximately $19.6 million and $18.6 million at September 30, 2018 and 2017, respectively. Excess of revenues over expenses for LeeSar was approximately $2.2 million for both of the years ended September 30, 2018 and 2017.

The System has a 50% membership interest in Bonita Community Health Center ("BCHC"), a not-for-profit organization. BCHC operates an urgent care center, an ambulatory surgical care center, a diagnostic imaging center and an outpatient rehabilitation center in Estero, Florida. Additionally, BCHC leases office space to physicians and other healthcare providers. The membership interest in BCHC is accounted for using the equity method. In conjunction with the issuance of long-term debt for the construction and equipping of the BCHC facility, the System has provided an unconditional guarantee to pay 50% of the obligations related to this debt should BCHC default. As of September 30, 2018 and 2017, total long-term debt outstanding net of current installments at BCHC was approximately $18.4 million and $19.4 million, respectively. BCHC had net losses of approximately $2.4 million for the year ended September 30, 2018, and net losses of approximately $1.9 million for the year ended September 30, 2017.

## 13. Major Component Unit Information

GASB No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*, requires disclosure of condensed combining information for major blended component units, including a condensed statement of net position, a condensed statement of revenues, expenses and changes in net position, and a condensed statement of cash flows. Cape Memorial Hospital, Inc. is the System's only major component unit. A statement of net position and a statement of revenues, expenses and changes in net position are presented in the accompanying supplemental consolidating information. The condensed statement of cash flows of Cape Memorial Hospital, for the year ended September 30, 2018, is as follows:

| *(in thousands of dollars)* | **System (excluding Cape Memorial Hospital, Inc.)** | **Cape Memorial Hospital, Inc.** | **Total** |
|---|---|---|---|
| **Net cash provided by (used in)** | | | |
| Operating activities | $ 104,218 | $ 57,107 | $ 161,325 |
| Noncapital financing activities | 62,792 | (42,200) | 20,592 |
| Capital and related financing activities | (314,796) | (15,430) | (330,226) |
| Investment activities | 168,091 | 523 | 168,614 |
| | 20,305 | - | 20,305 |
| **Cash and cash equivalents** | | | |
| Beginning of year | 12,890 | - | 12,890 |
| End of year | $ 33,195 | $ - | $ 33,195 |

The condensed statement of cash flows of Cape Memorial Hospital, for the year ended September 30, 2017, is as follows:

| *(in thousands of dollars)* | **System (excluding Cape Memorial Hospital, Inc.)** | **Cape Memorial Hospital, Inc.** | **Total** |
|---|---|---|---|
| **Net cash provided by (used in)** | | | |
| Operating activities | $ 75,900 | $ 45,077 | $ 120,977 |
| Noncapital financing activities | 54,331 | (31,073) | 23,258 |
| Capital and related financing activities | (234,583) | (14,524) | (249,107) |
| Investment activities | 73,978 | 520 | 74,498 |
| | (30,374) | - | (30,374) |
| **Cash and cash equivalents** | | | |
| Beginning of year | 43,264 | - | 43,264 |
| End of year | $ 12,890 | $ - | $ 12,890 |

## 14. Subsequent Events

The System has assessed the impact of subsequent events through January 31, 2019, the date the audited consolidated basic financial statements were issued, and has concluded that there are no such events that require adjustment to or disclosure in the consolidated basic financial statements.

# REQUIRED SUPPLEMENTARY INFORMATION

(UNAUDITED)

# Lee Memorial Health System
## Schedule of Changes in the Net Pension Liability and Related Ratios (Unaudited)
## October 1, 2013 through September 30, 2018

| *(in thousands of dollars)* | **2018** | **2017** | **2016** | **2015*** | **2014*** |
|---|---|---|---|---|---|
| Total pension liability | | | | | |
| Service cost | $ - | $ - | $ - | $ - | $ - |
| Interest | 2,072 | 2,018 | 1,992 | 1,955 | - |
| Changes of benefit terms | - | - | - | - | - |
| Differences between expected and actual experience | (108) | 292 | 416 | 45 | - |
| Changes of assumptions | 617 | 130 | (402) | - | - |
| Benefit payments | (1,747) | (1,718) | (1,586) | (1,458) | - |
| Net change in total pension liability | 834 | 722 | 420 | 542 | - |
| Total pension liability – beginning | 27,622 | 26,900 | 26,481 | 25,939 | - |
| Total pension liability – ending (a) | $ 28,456 | $ 27,622 | $ 26,901 | $ 26,481 | $ 25,939 |
| Plan fiduciary net position | | | | | |
| Employer contributions | $ 687 | $ 774 | $ 903 | $ 977 | $ - |
| Net investment income | 1,720 | 2,561 | 260 | 463 | - |
| Benefit payments | (1,747) | (1,718) | (1,586) | (1,458) | - |
| Administrative expense | (140) | (108) | (105) | (108) | - |
| Net change in plan fiduciary net position | 520 | 1,509 | (528) | (126) | - |
| Plan fiduciary net position – beginning | 24,710 | 23,201 | 23,729 | 23,855 | - |
| Plan fiduciary net position – ending (b) | $ 25,230 | $ 24,710 | $ 23,201 | $ 23,729 | $ 23,855 |
| Net pension liability (asset) – ending (a)-(b) | $ 3,226 | $ 2,912 | $ 3,700 | $ 2,752 | $ 2,084 |
| Plan fiduciary net position as a percentage of total pension liability | 88.66% | 89.46% | 86.25% | 89.61% | 91.97% |

* 2015 opening balances and 2014 ending balances established for purpose of GASB No. 68 year-one disclosure requirements effective 10/1/2014.

### Notes to Schedule

Covered payroll information is not provided as the plan is frozen and contributions are not determined by current payroll as benefit accruals ceased September 30, 1995.

# Lee Memorial Health System
## Schedule of Employer Contributions (Unaudited)
## October 1, 2013 through September 30, 2018

| *(in thousands of dollars)* | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Actuarially determined contribution | $ 658 | $ 774 | $ 903 | $ 949 | $ 1,062 |
| Contributions in relation to the actuarially determined contribution | 658 | 774 | 903 | 949 | 1,062 |
| Contribution deficiency (excess) | $ - | $ - | $ - | $ - | $ - |

**Notes to Schedule**

Covered payroll information is not provided as the plan is frozen and contributions are not determined by current payroll as benefit accruals ceased September 30, 1995.

Assumptions and methods used to determine those contributions vary by year, but for the most recent year are:

| | |
|---|---|
| Valuation date | July 1 |
| Actuarial cost method | Unit Credit with various closed amortization periods for unfunded liability |
| Asset valuation method | 5 year smoothing |
| Investment rate of return | 7.5% net of pension plan investment expense, including inflation |
| Salary increase | Not Applicable due to plan freeze |
| IRS Limit Increases | 2.50% |
| Retirement age | 65 |

# Lee Memorial Health System
## Schedule of Investment Returns (Unaudited)
## October 1, 2014 through September 30, 2018

| | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|
| Annual money-weighted rate of return, net of investment expense | 7.1% | 11.3% | 1.1% | 2.0% |

* Reported returns for GASB No. 67 disclosure requirements effective October 1, 2014 or fiscal year 2015.

# Lee Memorial Health System
## Schedule of Changes in Total Other Post-Employment Benefits (“OPEB”) Liability (Unaudited)
## September 30, 2018

*(in thousands of dollars)*

| | | 2018 |
|---|---|---|
| Total OPEB liability | | |
| Service cost | $ | 683 |
| Interest | | 1,728 |
| Changes of benefit terms | | - |
| Differences between expected and actual experience | | - |
| Changes of assumptions | | - |
| Benefit payments | | (1,104) |
| Net change in total OPEB liability | | 1,307 |
| Total OPEB liability – beginning | | 52,758 |
| Total OPEB liability – ending (a) | $ | 54,065 |
| Plan fiduciary net position* | | |
| Employer contributions | $ | - |
| Net investment income | | - |
| Benefit payments | | - |
| Administrative expense | | - |
| Net change in plan fiduciary net position | | - |
| Plan fiduciary net position – beginning | | - |
| Plan fiduciary net position – ending (b) | $ | - |
| Net OPEB liability (asset) – ending (a)-(b) | $ | 54,065 |
| Plan fiduciary net position as a percentage of total OPEB liability | | 0.0% |
| Covered employee payroll | $ | 268,355 |
| Net OPEB liability as a percentage of covered employee payroll | | 20.1% |

**Notes to Schedule**

*Changes of assumptions.* In 2018, the discount rate was decreased 69 basis points from the prior valuation. Also, a salary increase assumption was added for the current valuation since it is needed for the Entry Age Normal Cost Method.

*The System is currently funding the Other Post-Employment Benefits (“OPEB”) obligation on a pay-as-you-go basis so no assets have been segregated and/or restricted to provide the postemployment benefits.

# Lee Memorial Health System
## Schedule of Total Other Post-Employment Benefits (“OPEB”) Contributions (Unaudited)
## September 30, 2018

*(in thousands of dollars)*

| | | 2018 |
|---|---|---|
| Actuarially determined contribution | $ | - |
| Contributions in relation to the actuarially determined contribution | | - |
| Contribution deficiency (excess) | $ | - |
| Covered-employee payroll | $ | 268,355 |
| Contributions as a percentage of covered-employee payroll | | 0.0% |

**Notes to Schedule**

Valuation date:

Actuarially determined contribution rates are calculated as of December 31, 2017.

Methods and assumptions used to determine contribution rates:

| | |
|---|---|
| Actuarial cost method | Entry Age |
| Amortization method | Average remaining service life of all participants |
| Asset valuation method | None, no plan assets |
| Inflation | 3.0 percent |
| Healthcare cost trend rates | 6.5 percent initial, decreasing 0.5 percent per year to an ultimate rate of 5.0 percent |
| Salary increases | 3.0 percent, average, including inflation |
| Investment rate of return | 0.0 percent, no plan assets |
| Retirement age | *Sunset Employees:* Employees who had 30 or more years of full-time (or equivalent) service as of September 30, 2009. These employees are entitled to retiree health plan coverage starting when they retire on or after age 55 or the $2,500 subsidy on or after retiring at age 65<br>*Non-Sunset Employees:* Employees hired prior to July 1, 2008 who had not attained 30 or more years of full-time (or equivalent) service as of September 30, 2009. These employees are only entitled to receive the $2,500 subsidy benefit when they retire on or after age 65 |
| Mortality | *Healthy mortality rates:* RP-2014 Employee and Annuitant Mortality Tables for males and females with Scape MP-2014 backed out to 2006 and then projected forward to 2006 using generational projection Scale MP-2017 for males and females<br>*Disabled mortality rates:* RP-2014 Disabled Mortality Tables for males and females with Scale MP-2014 backed out to 2006 and then projected forward from 2006 using generational Scale MP-2017 for males and females |

# SUPPLEMENTAL CONSOLIDATING INFORMATION

# Lee Memorial Health System
## Consolidating Basic Statement of Net Position
## September 30, 2018 — Schedule I

*(in thousands of dollars)*

| | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Vivida Health | Best Care Collaborative, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | | | |
| Current assets | | | | | | | | | | | | |
| Cash and cash equivalents | $ 1,277 | $ - | $ - | $ 19 | $ - | $ - | $ - | $ 29,621 | $ 304 | $ 1,974 | $ - | $ 33,195 |
| Short-term investments | 831,879 | - | - | - | - | - | - | - | - | - | - | 831,879 |
| Assets whose use is restricted | 390 | - | 5,208 | - | - | - | - | - | - | - | - | 5,598 |
| Patient accounts receivable, net | 150,074 | 34,235 | 53,973 | 561 | 2,110 | 1,584 | 695 | - | - | - | - | 243,232 |
| Inventories | 19,143 | 4,208 | 10,251 | - | 214 | 20 | 111 | - | - | - | - | 33,947 |
| Other current assets | 30,146 | 536 | 1,805 | 290 | 334 | 16 | - | 6,537 | - | - | - | 39,664 |
| Total current assets | 1,032,909 | 38,979 | 71,237 | 870 | 2,658 | 1,620 | 806 | 36,158 | 304 | 1,974 | - | 1,187,515 |
| Noncurrent assets | | | | | | | | | | | | |
| Assets whose use is restricted | 653 | - | - | - | - | 8 | - | 9,585 | 1,200 | - | - | 11,446 |
| Capital assets, net | 762,349 | 81,277 | 299,545 | 58 | 957 | 4,260 | 741 | 32 | - | - | - | 1,149,219 |
| Due from subsidiaries | - | 332,629 | - | - | (31,322) | - | - | - | - | - | (301,307) (a) | - |
| Other assets, net | (b) 24,779 | - | - | - | 4 | - | - | 4,430 | - | - | - | 29,213 |
| Total assets | 1,820,690 | 452,885 | 370,782 | 928 | (27,703) | 5,888 | 1,547 | 50,205 | 1,504 | 1,974 | (301,307) | 2,377,393 |
| **Deferred outflows of resources** | | | | | | | | | | | | |
| Deferred loss on debt refunding | 2,707 | 1,252 | (2,035) | - | - | - | - | - | - | - | - | 1,924 |
| Deferred outflows on pension | 1,026 | - | - | - | - | - | - | - | - | - | - | 1,026 |
| Excess consideration provided for acquisition | 3,339 | 7,784 | 87,358 | - | - | - | - | - | - | - | - | 98,481 |
| Total deferred outflows of resources | $ 7,072 | $ 9,036 | $ 85,323 | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ 101,431 |

(a) To eliminate intercompany receivables and payables.
(b) Elimination of investments in subsidiaries included in this item.

# Lee Memorial Health System
## Consolidating Basic Statement of Net Position
## September 30, 2018

**Schedule I**

*(in thousands of dollars)*

| | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Vivida Health | Best Care Collaborative, LLC | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | | | | | | |
| Current liabilities | | | | | | | | | | | | |
| Accounts payable | $ 58,015 | $ 1,379 | $ 1,465 | $ 586 | $ 52 | $ 40 | $ - | $ - | $ - | $ - | $ - | $ 61,537 |
| Current installments of long-term debt | 36,374 | 1,251 | 4,681 | - | - | - | - | - | - | - | - | 42,306 |
| Accrued expenses | | | | | | | | | | | | |
| Employee compensation | 51,496 | 2,950 | 3,977 | 119 | 486 | 319 | 92 | 93 | - | - | - | 59,532 |
| Interest | 865 | 786 | 5,715 | - | - | - | - | - | - | - | - | 7,366 |
| Other | 31,090 | 4,946 | 6,381 | 9 | - | 431 | - | 37 | - | 967 | - | 43,861 |
| Estimated third-party payor settlements | (1,062) | 2,306 | 5,960 | - | - | - | - | - | - | - | - | 7,204 |
| Total current liabilities | 176,778 | 13,618 | 28,179 | 714 | 538 | 790 | 92 | 130 | - | 967 | - | 221,806 |
| Noncurrent liabilities | | | | | | | | | | | | |
| Long-term debt, excluding current installments | 199,580 | 61,135 | 355,145 | - | - | - | - | - | - | - | - | 615,860 |
| Due to subsidiaries | 315,318 | - | (53,600) | 20 | - | 18,768 | 9,220 | 6,768 | 1,500 | 3,313 | (301,307) (a) | - |
| Other liabilities | 65,144 | 12,492 | 17,100 | 193 | 1,330 | 1,686 | 16 | 279 | - | - | - | 98,240 |
| Total liabilities | 756,820 | 87,245 | 346,824 | 927 | 1,868 | 21,244 | 9,328 | 7,177 | 1,500 | 4,280 | (301,307) | 935,906 |
| **Deferred inflows of resources** | | | | | | | | | | | | |
| Deferred inflows on pension | 2,254 | - | - | - | - | - | - | - | - | - | - | 2,254 |
| Deferred inflows on split interest agreements | - | - | - | - | - | - | - | 360 | - | - | - | 360 |
| Total deferred inflows of resources | 2,254 | - | - | - | - | - | - | 360 | - | - | - | 2,614 |
| **Net position** | | | | | | | | | | | | |
| Restricted for | | | | | | | | | | | | |
| Nonexpendable | - | - | - | - | - | - | - | 6,356 | - | - | - | 6,356 |
| Expendable | - | - | - | - | - | - | - | 33,423 | - | - | - | 33,423 |
| Net investment in capital assets | 526,395 | 18,892 | (60,282) | 58 | 957 | 4,260 | 741 | 32 | - | - | - | 491,053 |
| Unrestricted | (b) 542,293 | 355,784 | 169,564 | (58) | (30,528) | (19,616) | (8,522) | 2,857 | 4 | (2,306) | - | 1,009,472 |
| Total net position | $ 1,068,688 | $ 374,676 | $ 109,282 | $ - | $ (29,571) | $ (15,356) | $ (7,781) | $ 42,668 | $ 4 | $ (2,306) | $ - | $ 1,540,304 |

(a) To eliminate intercompany receivables and payables.
(b) Elimination of investments in subsidiaries included in this item.

# Lee Memorial Health System
## Consolidating Basic Statement of Net Position
## September 30, 2017 — Schedule I

*(in thousands of dollars)*

| | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | |
| Current assets | | | | | | | | | | |
| Cash and cash equivalents | $ 7,005 | $ - | $ - | $ 20 | $ - | $ 1 | $ - | $ 5,864 | $ - | $ 12,890 |
| Short-term investments | 958,219 | - | - | - | - | - | - | - | - | 958,219 |
| Assets whose use is restricted | 372 | - | 5,210 | - | - | - | - | - | - | 5,582 |
| Patient accounts receivable, net | 152,214 | 29,176 | 43,706 | 198 | 2,344 | 1,976 | 295 | - | - | 229,909 |
| Inventories | 17,881 | 4,307 | 10,496 | - | 249 | 19 | 51 | - | - | 33,003 |
| Other current assets | 29,833 | 1,730 | 2,173 | - | 392 | 8 | - | 4,302 | - | 38,438 |
| Total current assets | 1,165,524 | 35,213 | 61,585 | 218 | 2,985 | 2,004 | 346 | 10,166 | - | 1,278,041 |
| Noncurrent assets | | | | | | | | | | |
| Assets whose use is restricted | 653 | - | - | - | - | 6 | - | 24,666 | - | 25,325 |
| Capital assets, net | 632,038 | 84,007 | 236,576 | 91 | 940 | 4,357 | 993 | 36 | - | 959,038 |
| Due from subsidiaries | - | 290,424 | - | - | (24,169) | - | - | - | (266,255) (a) | - |
| Other assets, net | (b) 34,191 | 587 | 1,982 | - | 4 | - | - | 7,358 | - | 44,122 |
| Total assets | 1,832,406 | 410,231 | 300,143 | 309 | (20,240) | 6,367 | 1,339 | 42,226 | (266,255) | 2,306,526 |
| **Deferred outflows of resources** | | | | | | | | | | |
| Deferred loss on debt refunding | 3,214 | 1,476 | (2,179) | - | - | - | - | - | - | 2,511 |
| Deferred outflows on pension | 1,026 | - | - | - | - | - | - | - | - | 1,026 |
| Excess consideration provided for acquisition | 3,522 | 8,270 | 89,785 | - | - | - | - | - | - | 101,577 |
| Total deferred outflows of resources | $ 7,762 | $ 9,746 | $ 87,606 | $ - | $ - | $ - | $ - | $ - | $ - | $ 105,114 |

(a) To eliminate intercompany receivables and payables.
(b) Elimination of investments in subsidiaries included in this item.

# Lee Memorial Health System
## Consolidating Basic Statement of Net Position
## September 30, 2017

**Schedule I**

*(in thousands of dollars)*

| | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | | | | |
| Current liabilities | | | | | | | | | | |
| Accounts payable | $ 51,362 | $ 1,042 | $ 917 | $ 686 | $ - | $ 272 | $ - | $ 1 | $ - | $ 54,280 |
| Current installments of long-term debt | 33,151 | 1,220 | 4,486 | - | - | - | - | - | - | 38,857 |
| Accrued expenses | | | | | | | | | | |
| Employee compensation | 40,188 | 1,204 | 1,594 | 23 | 148 | 131 | 23 | 42 | - | 43,353 |
| Interest | 611 | 763 | 5,539 | - | - | - | - | - | - | 6,913 |
| Other | 26,048 | 4,761 | 5,986 | 9 | - | 424 | - | 42 | - | 37,270 |
| Estimated third-party payor settlements | 22,744 | 4,400 | 8,551 | - | - | - | - | - | - | 35,695 |
| Total current liabilities | 174,104 | 13,390 | 27,073 | 718 | 148 | 827 | 23 | 85 | - | 216,368 |
| Noncurrent liabilities | | | | | | | | | | |
| Long-term debt, excluding current installments | 218,943 | 62,386 | 360,023 | - | - | - | - | - | - | 641,352 |
| Due to subsidiaries | 333,098 | - | (88,018) | (634) | - | 14,263 | 6,120 | 1,426 | (266,255) (a) | - |
| Other liabilities | 63,443 | 11,337 | 13,804 | 224 | 1,312 | 1,322 | 92 | 266 | - | 91,800 |
| Total liabilities | 789,588 | 87,113 | 312,882 | 308 | 1,460 | 16,412 | 6,235 | 1,777 | (266,255) | 949,520 |
| **Deferred inflows of resources** | | | | | | | | | | |
| Deferred inflows on pension | 2,912 | - | - | - | - | - | - | - | - | 2,912 |
| Total deferred inflows of resources | 2,912 | - | - | - | - | - | - | - | - | 2,912 |
| **Net position** | | | | | | | | | | |
| Restricted for | | | | | | | | | | |
| Nonexpendable | - | - | - | - | - | - | - | 6,269 | - | 6,269 |
| Expendable | - | - | - | - | - | - | - | 31,855 | - | 31,855 |
| Net investment in capital assets | 379,943 | 20,401 | (127,934) | 91 | 942 | 4,358 | 993 | 36 | - | 278,830 |
| Unrestricted | (b) 667,725 | 312,463 | 202,802 | (91) | (22,642) | (14,403) | (5,889) | 2,289 | - | 1,142,254 |
| Total net position | $ 1,047,668 | $ 332,864 | $ 74,868 | $ - | $ (21,700) | $ (10,045) | $ (4,896) | $ 40,449 | $ - | $ 1,459,208 |

(a) To eliminate intercompany receivables and payables.
(b) Elimination of investments in subsidiaries included in this item.

# Lee Memorial Health System
## Consolidating Basic Statement of Revenues, Expenses and Changes in Net Position
## September 30, 2018 — Schedule II

*(in thousands of dollars)*

| | Lee Memorial Hospital | Physicians | Others | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Vivida Health | Best Care Collaborative, LLC | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Operating revenues** | | | | | | | | | | | | | | |
| Net patient service revenue | $ 917,674 | $ 134,636 | $ 88 | $ 1,052,398 | $ 260,628 | $ 392,173 | $ 2,756 | $ 21,045 | $ 16,180 | $ 5,314 | $ - | $ - | $ - | $ 1,750,494 |
| Other revenue | 11,721 | 2,778 | 11,511 | 26,010 | 3,105 | 2,643 | 470 | 2,155 | 20 | - | 5,085 | - | - | 39,488 |
| Total operating revenues | 929,395 | 137,414 | 11,599 | 1,078,408 | 263,733 | 394,816 | 3,226 | 23,200 | 16,200 | 5,314 | 5,085 | - | - | 1,789,982 |
| **Operating expenses** | | | | | | | | | | | | | | |
| Salaries, wages and benefits | 460,058 | 184,473 | 5,615 | 650,146 | 112,655 | 166,564 | 6,253 | 17,154 | 14,609 | 6,667 | 2,562 | - | - | 976,610 |
| Supplies and other services | 236,077 | 23,340 | 3,081 | 262,498 | 58,067 | 111,932 | 129 | 11,342 | 3,774 | 888 | 1,408 | - | 187 | 450,225 |
| Purchased services | 96,980 | 14,733 | 245 | 111,958 | 32,930 | 40,975 | (4,658) | 1,775 | 1,898 | 508 | 456 | - | 2,100 | 187,942 |
| Depreciation and amortization | 53,916 | 7,385 | 561 | 61,862 | 12,659 | 24,414 | 33 | 477 | 737 | 118 | 40 | - | 26 | 100,366 |
| Total operating expenses | 847,031 | 229,931 | 9,502 | 1,086,464 | 216,311 | 343,885 | 1,757 | 30,748 | 21,018 | 8,181 | 4,466 | - | 2,313 | 1,715,143 |
| Operating income (loss) | 82,364 | (92,517) | 2,097 | (8,056) | 47,422 | 50,931 | 1,469 | (7,548) | (4,818) | (2,867) | 619 | - | (2,313) | 74,839 |
| **Nonoperating items** | | | | | | | | | | | | | | |
| Interest expense | (6,047) | (1,508) | - | (7,555) | (1,946) | (11,483) | - | 23 | 16 | (18) | (33) | - | - | (20,996) |
| Investment income, including realized and unrealized gains on investments | 42,065 | - | 120 | 42,185 | 37 | 174 | - | - | - | - | 114 | 4 | 7 | 42,521 |
| Contributions and grants | - | - | (6) | (6) | - | - | - | - | - | - | 1,141 | - | - | 1,135 |
| Investment activity on restricted nonexpendable investments | - | - | - | - | - | - | - | - | - | - | 515 | - | - | 515 |
| Loss on sale of capital assets | (564) | (6) | (15) | (585) | (148) | (125) | - | (29) | (20) | - | - | - | - | (907) |
| Other | 6,319 | 1 | (878) | 5,442 | 47 | - | (1,469) | - | - | - | (88) | - | - | 3,932 |
| Total nonoperating income (loss) | 41,773 | (1,513) | (779) | 39,481 | (2,010) | (11,434) | (1,469) | (6) | (4) | (18) | 1,649 | 4 | 7 | 26,200 |
| Increase (decrease) in net position | $ 124,137 | $ (94,030) | $ 1,318 | 31,425 | 45,412 | 39,497 | - | (7,554) | (4,822) | (2,885) | 2,268 | 4 | (2,306) | 101,039 |
| **Net position** | | | | | | | | | | | | | | |
| Beginning of year, as reported | | | | 1,047,668 | 332,864 | 74,868 | - | (21,700) | (10,045) | (4,896) | 40,449 | - | - | 1,459,208 |
| Adoption of GASB No. 75 (see Note 1) | | | | (10,405) | (3,600) | (5,083) | - | (317) | (489) | - | (49) | - | - | (19,943) |
| Beginning of year, as restated | | | | 1,037,263 | 329,264 | 69,785 | - | (22,017) | (10,534) | (4,896) | 40,400 | - | - | 1,439,265 |
| End of year | | | | $ 1,068,688 | $ 374,676 | $ 109,282 | $ - | $ (29,571) | $ (15,356) | $ (7,781) | $ 42,668 | $ 4 | $ (2,306) | $ 1,540,304 |

* For purposes of the consolidating basic statement of revenues, expenses and changes in net position, "Total Lee Memorial Hospital" is comprised of Lee Memorial Hospital, Physicians, and Others and is shown separately for Agency for HealthCare Administration reporting purposes only.

# Lee Memorial Health System
## Consolidating Basic Statement of Revenues, Expenses and Changes in Net Position
## September 30, 2017 — Schedule II

*(in thousands of dollars)*

| | Lee Memorial Hospital | Physicians | Others | Total Lee Memorial Hospital | Cape Memorial Hospital, Inc. | Gulf Coast Medical Center | Lee County Trauma Services District | Lee Memorial Home Health, Inc. | Health Park Care Center, Inc. | Lee Community Healthcare, Inc. | Lee Memorial Health System Foundation, Inc. | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Operating revenues** | | | | | | | | | | | | |
| Net patient service revenue | $ 855,884 | $ 188,474 | $ 1,161 | $ 1,045,519 | $ 242,400 | $ 369,017 | $ 1,618 | $ 19,922 | $ 15,327 | $ 1,648 | $ - | $ 1,695,451 |
| Other revenue | 11,516 | 2,941 | 9,687 | 24,144 | 4,080 | 3,672 | 594 | 1,969 | 35 | 825 | 4,423 | 39,742 |
| Total operating revenues | 867,400 | 191,415 | 10,848 | 1,069,663 | 246,480 | 372,689 | 2,212 | 21,891 | 15,362 | 2,473 | 4,423 | 1,735,193 |
| **Operating expenses** | | | | | | | | | | | | |
| Salaries, wages and benefits | 389,605 | 230,656 | 5,935 | 626,196 | 113,004 | 165,624 | 6,138 | 18,280 | 13,393 | 3,563 | 2,328 | 948,526 |
| Supplies and other services | 222,816 | 27,661 | 2,832 | 253,309 | 54,567 | 104,904 | 127 | 9,672 | 3,283 | 396 | 1,381 | 427,639 |
| Purchased services | 69,602 | 56,019 | 610 | 126,231 | 19,723 | 28,949 | (6,930) | 2,055 | 1,984 | 459 | 396 | 172,867 |
| Depreciation and amortization | 51,526 | 6,344 | 568 | 58,438 | 12,033 | 24,161 | 39 | 501 | 658 | 139 | 34 | 96,003 |
| Total operating expenses | 733,549 | 320,680 | 9,945 | 1,064,174 | 199,327 | 323,638 | (626) | 30,508 | 19,318 | 4,557 | 4,139 | 1,645,035 |
| Operating income (loss) | 133,851 | (129,265) | 903 | 5,489 | 47,153 | 49,051 | 2,838 | (8,617) | (3,956) | (2,084) | 284 | 90,158 |
| **Nonoperating items** | | | | | | | | | | | | |
| Interest expense | (3,950) | (1,455) | - | (5,405) | (2,044) | (13,942) | - | (3) | (1) | (19) | - | (21,414) |
| Investment income, including realized and unrealized gains on investments | 87,090 | - | 108 | 87,198 | 34 | 104 | - | 2 | - | - | 212 | 87,550 |
| Contributions and grants | (2) | - | - | (2) | - | - | - | - | - | - | (27,061) | (27,063) |
| Investment activity on restricted nonexpendable investments | - | - | - | - | - | - | - | - | - | - | 961 | 961 |
| Loss on sale of capital assets | (70) | (6) | (25) | (101) | (42) | (271) | - | - | (3) | - | - | (417) |
| Other | 42,049 | - | 466 | 42,515 | - | 1 | (2,838) | - | - | - | (179) | 39,499 |
| Total nonoperating income (loss) | 125,117 | (1,461) | 549 | 124,205 | (2,052) | (14,108) | (2,838) | (1) | (4) | (19) | (26,067) | 79,116 |
| Increase (decrease) in net position | $ 258,968 | $ (130,726) | $ 1,452 | 129,694 | 45,101 | 34,943 | - | (8,618) | (3,960) | (2,103) | (25,783) | 169,274 |
| **Net position** | | | | | | | | | | | | |
| Beginning of year | | | | 917,974 | 287,763 | 39,925 | - | (13,082) | (6,085) | (2,793) | 66,232 | 1,289,934 |
| End of year | | | | $ 1,047,668 | $ 332,864 | $ 74,868 | $ - | $ (21,700) | $ (10,045) | $ (4,896) | $ 40,449 | $ 1,459,208 |

* For purposes of the consolidating basic statement of revenues, expenses and changes in net position, "Total Lee Memorial Hospital" is comprised of Lee Memorial Hospital, Physicians, and Others and is shown separately for Agency for HealthCare Administration reporting purposes only.

### Note to Supplemental Consolidating Information

The accompanying consolidating information presents the financial position and results of operations of each of the significant component operating units and affiliates of the System as of September 30, 2018 and 2017 and for the years then ended, in conformity with accounting principles generally accepted in the United States of America, including applicable statements of the GASB, on the accrual basis of accounting. The accompanying consolidating information presents adjustments necessary to eliminate significant intercompany accounts and transactions. The accompanying consolidating information is presented for purposes of additional analysis of the consolidated basic financial statements rather than to present the financial position and results of operations of the individual companies and is not a required part of the consolidated basic financial statements.