

**Kennedy Health System, Inc.
and Subsidiaries**

Financial Statements and
Supplementary Information

August 31, 2017 and December 31, 2016



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Kennedy Health System, Inc. and Subsidiaries

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Independent Auditors' Report

Board of Directors
Kennedy Health System, Inc. and Subsidiaries

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Kennedy Health System, Inc. and Subsidiaries, which comprise the consolidated balance sheet as of August 31, 2017 and December 31, 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the period from January 1, 2017 through August 31, 2017, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kennedy Health System, Inc. and Subsidiaries as of August 31, 2017 and December 31, 2016, and the results of their operations and changes in their net assets, and their cash flows for the period from January 1, 2017 through August 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying 2017 and 2016 consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, changes in net assets, and cash flows of the individual entities and is not a required part of the consolidated financial statements. Such 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated 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 financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Iselin, New Jersey
May 31, 2018

Kennedy Health System, Inc. and Subsidiaries

Consolidated Balance Sheet

(In Thousands)

August 31, 2017 and December 31, 2016

	<u>2017</u>	<u>2016</u>		<u>2017</u>	<u>2016</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 67,750	\$ 71,258	Long-term debt, current portion	\$ 7,491	\$ 6,095
Accounts receivable:			Accounts payable	42,048	42,493
Patients (net of estimated allowance for doubtful collections of \$24,297 in 2017 and \$24,791 in 2016)	71,300	69,353	Accrued expenses:		
Other	9,713	5,899	Payroll and benefits	28,539	26,383
Assets whose use is limited	3,060	5,481	Other	8,127	8,972
Inventories	10,286	10,216	Accrued interest	442	1,355
Prepaid expenses and other current assets	9,489	6,348	Estimated settlements with third party payors	775	21
			Deferred revenue	3,142	1,532
Total current assets	171,598	168,555	Total current liabilities	90,564	86,851
Property and Equipment, Net	328,756	307,830	Long-Term Debt, Net	147,086	135,764
Assets Whose Use is Limited	206,112	190,039	Accrued Pension Cost	42,698	39,307
Investments in Joint Ventures	619	627	Other Liabilities	16,157	12,532
Other Assets	7,829	7,829	Total liabilities	296,505	274,454
			Net Assets		
			Unrestricted	416,869	399,234
			Temporarily restricted	1,540	1,192
			Total net assets	418,409	400,426
Total assets	<u>\$ 714,914</u>	<u>\$ 674,880</u>	Total liabilities and net assets	<u>\$ 714,914</u>	<u>\$ 674,880</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Operations

(In Thousands)

Period from January 1, 2017 through August 31, 2017

	<u>2017</u>
Unrestricted Revenues, Gains, and Other Support	
Net patient service revenues	\$ 432,190
Provision for doubtful collections	<u>(19,155)</u>
Net patient service revenue less provision for doubtful collections	413,035
Other revenues	7,109
Net assets released from restrictions	<u>267</u>
Total unrestricted revenues, gains, and other support	<u>420,411</u>
Expenses	
Employee salaries	187,228
Physician salaries and fees	19,756
Employee benefits	39,025
Supplies and expenses	141,992
Interest	2,153
Depreciation and amortization	<u>18,832</u>
Total expenses	<u>408,986</u>
Non-controlling Interest, Garden State Radiology	<u>(55)</u>
Income from Operations	11,370
Nonoperating Income	
Interest, dividends, and net realized gains and losses on investments	<u>1,761</u>
Revenue in Excess of Expenses	13,131
Change in Net Unrealized Gains and Losses on Securities	8,488
Transfer to Temporarily Restricted Net Assets	(493)
Change in Investment in Garden State Radiology	55
Pension Liability Adjustment	<u>(3,546)</u>
Increase in unrestricted net assets	<u><u>\$ 17,635</u></u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Changes in Net Assets

(In Thousands)

Period from January 1, 2017 through August 31, 2017

	<u>2017</u>
Unrestricted Net Assets	
Revenues in excess of expenses	\$ 13,131
Change in net unrealized gains and losses on securities	8,488
Transfer to temporarily restricted net assets	(493)
Change in Investment in Garden State Radiology	55
Pension liability adjustment	<u>(3,546)</u>
Increase in unrestricted net assets	<u>17,635</u>
Temporarily Restricted Net Assets	
Contributions	615
Net assets released from restrictions used for operations	<u>(267)</u>
Increase in temporarily restricted net assets	<u>348</u>
Increase in net assets	17,983
Net Assets, Beginning	<u>400,426</u>
Net Assets, Ending	<u><u>\$ 418,409</u></u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Consolidated Statement of Cash Flows

(In Thousands)

Period from January 1, 2017 through August 31, 2017

	<u>2017</u>
Cash Flows from Operating Activities	
Increase in net assets	\$ 17,983
Adjustments to reconcile increase in net assets to net cash provided by operating activities:	
Provision for bad debts	19,155
Depreciation and amortization	18,832
Noncash interest - amortization of deferred financing costs	40
Net unrealized and realized gains on securities	(8,488)
Pension liability adjustment	3,546
Changes in assets and liabilities:	
Patient accounts receivable	(21,102)
Other receivables	(3,813)
Inventories	(70)
Prepaid expenses and other current assets	(3,140)
Accounts payable	(445)
Accrued expenses	1,310
Accrued interest	(913)
Estimated settlements with third-party payors	3,923
Other long-term liabilities	537
Deferred revenue	1,528
Accrued pension costs	(155)
Net cash provided by operating activities	<u>28,728</u>
Cash Flows from Investing Activities	
Purchases of property and equipment	(39,758)
Net purchases of assets whose use is limited	(5,164)
Net loss on joint ventures	8
Net cash used in investing activities	<u>(44,914)</u>
Cash Flows from Financing Activities	
Principal payments on capital leases	(2,835)
Proceeds from long-term borrowings	17,793
Repayment of long-term debt	(2,280)
Net cash provided by financing activities	<u>12,678</u>
Net decrease in cash and cash equivalents	(3,508)
Cash and Cash Equivalents, Beginning	<u>71,258</u>
Cash and Cash Equivalents, Ending	<u>\$ 67,750</u>
Supplemental Disclosure of Cash Flow Information	
Interest paid	<u>\$ 2,199</u>
Supplemental Disclosure of Noncash Investing and Financing Activities	
Purchases of property and equipment in accounts payable	<u>\$ 14,814</u>

See notes to consolidated financial statements

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

1. Nature of Operations

Kennedy Health System, Inc. and Subsidiaries (the “System”) has a combined profit, not-for-profit structure. The System’s Board of Directors is responsible for the appointment of trustees for the subsidiary corporations. The System coordinates fund-raising activities and the management of other revenue generating opportunities as follows:

- Kennedy Health System, Inc. home office (“KHS”) is a not-for-profit corporation which is responsible for the overall policy, management and financial support of all entities.
- Kennedy University Hospital, Inc. (“Hospital”) is a non-profit New Jersey corporation which owns and operates a 607-bed multi-campus hospital system with hospital facilities in Stratford, Cherry Hill and Turnersville (Washington Township), New Jersey. The Hospital is the major teaching affiliate of the Rowan University School of Osteopathic Medicine. The Hospital provides inpatient, outpatient and emergency care services, as well as home health, dialysis, radiation oncology and rehabilitation services, principally to residents of Camden and Gloucester Counties, New Jersey.
- Kennedy Healthcare Foundation (“KHCF”) is a not-for-profit corporation which is responsible for the fundraising activities of the Health System.
- STAT Medical Transport, Inc. (“STAT”) is a not-for-profit ambulance company which owns and operates ambulances that service the Hospital and the community.
- Kennedy Property Corporation (“KPC”) is a not-for-profit property and development company. This corporation owns and operates buildings within the service area of the Hospital.
- Kennedy Health Facilities, Inc. (“Facility”) is a not-for-profit nursing home company and currently has 190 beds consisting of 130 long-term care beds and 60 sub-acute beds.
- Kennedy Medical Group Practice PC, d/b/a Kennedy Health Alliance, is a tax-exempt professional corporation and operates as a network of primary physician groups and specialists with offices located throughout the South Jersey region.
- Kennedy Management Group, Inc. (“KMG”) is a for-profit corporation that invests in for-profit businesses to further its mission. KMG accounts for investments under the equity method and has a 50% interest in the operations of Healthtrax Fitness Gym, LLC, a 20% interest in MAB Building Associates, and a 26% interest in KHS Ambulatory Surgery Center, LLC. KMG files its federal tax return in consolidation with Professional Medical Management, Inc. For financial statement presentation purposes, the retained earnings and capital stock (no par value, 1,000 common shares authorized, 100 issued and outstanding) have been consolidated with net assets.
- Professional Medical Management, Inc. (“PMM”) is a subsidiary of Kennedy Management Group, Inc. This corporation is a for-profit collection service company which has been operational since September of 1984. For financial statement presentation, the retained earnings and capital stock (no par value, 100 common shares authorized, issued and outstanding) have been consolidated with net assets.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

- On November 1, 2014, the System acquired 51 percent of the ownership in Garden State Radiology Network, L.L.C (“Garden State Radiology”). Kennedy Health System has established control of this company and as such includes the financial position and results of operations and changes in net assets of this company in its consolidated financial statements. Garden State Radiology will develop, own, operate and manage a diagnostic imaging network for the System. The balance of net assets attributable to the non-controlling interest and included in unrestricted net assets in the consolidated balance sheet was \$1,835,000 and \$1,780,000 at August 31, 2017 and December 31, 2016, respectively.

On August 9, 2016, the System and Thomas Jefferson University (“Jefferson”) executed a system integration agreement. The System and Jefferson have agreed that an integrated system will support the enhancement and benefit of healthcare in the South Jersey region. This integration agreement was finalized on September 1, 2017 and the System is now controlled by Jefferson, who became the sole member of the System.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include accounts of KHS, its not-for-profit entities and its for-profit entities, as described in Note 1. All significant intercompany transactions and accounts are eliminated.

Footnote Presentation

Numerical schedules included in the notes to the consolidated financial statements are presented in thousands (000). All numbers included in the narrative portion of the notes are presented as whole numbers.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by Board designation or other arrangements under trust agreements.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Accounts Receivable, Patients

Accounts receivable, patients are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. The allowance for doubtful collections is estimated based upon a periodic review of the accounts receivable aging, payor classifications, and application of historical write-off percentages. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractual amounts due and provides an allowance for doubtful collections and a provision for doubtful collections, if necessary. For receivables associated with self-pay patients, the System records a significant provision for doubtful collections in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful collections.

The System's allowance for doubtful collections for self-pay patients was approximately 88% and 87% of self-pay accounts receivable at August 31, 2017 and December 31, 2016, respectively. The System's self-pay account write-offs (net of recoveries) were \$19,861,000 for the period ended August 31, 2017. The System has not changed its financial assistance policy in 2017 or 2016.

Other Receivables

Other receivables are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. No allowance for doubtful collections was recorded due to management's belief that realization losses on other receivables would be immaterial.

Investments and Investment Risk

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility risks. Due to the level of risks associated with certain investment securities, it is reasonably possible that changes in the value of investments could occur in the near term and that such changes could materially affect the amounts reported in the accompanying consolidated balance sheets.

The System reports investments in marketable equity securities with readily determinable fair values and all investments in debt securities at fair value in the consolidated balance sheet.

Investment income (including net realized gains and losses, interest, and dividends) on Board designated funds are recorded as nonoperating income. Certain declines in market value that are deemed to be other-than-temporary are reported as impairment losses in investment income (see note 5). Investment income on trustee held funds is recorded net against interest expense in the consolidated statement of operations. Investment income from all other unrestricted investments is recorded as nonoperating income.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Assets Whose Use is Limited

Assets whose use is limited include assets held by trustee under bond indenture agreements, designated assets set aside by the Board of Directors for future capital improvements or for other purposes at the Board's discretion, and assets of donor restricted funds. Amounts required to meet current liabilities of the System have been reclassified to current assets.

Inventories

In 2017, the System adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU") No. 2015-11, *Simplifying the Measurement of Inventory*. As a result of ASU No. 2015-11, the System is required to measure inventory, other than inventory measured using the last-in, first-out or retail inventory methods, at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonable predictable costs of completion, disposal, and transportation. The effect of the required prospective application of this change did not have a material effect on the System's consolidated financial statements.

Inventories, which primarily consist of medical supplies, are stated at the lower of cost or net realizable value, using the first-in, first-out (FIFO) method.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Normal repairs and maintenance expenses are charged to operations as incurred. Gains and losses on sales or retirements are included in other operating revenue. Capitalized computer software costs are amortized over the estimated useful or economic lives of the software.

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

Deferred Financing Costs

Deferred financing costs, consisting of the cost of issuing revenue bonds, are expensed over the period the obligation is outstanding using the straight-line method. This does not result in a significant difference from the effective interest rate method.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Bond Premiums and Discounts

Bond premiums and discounts are amortized using the straight-line method. This does not result in a significant difference from the effective interest rate method.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Resources restricted by donors for property and equipment are reclassified to unrestricted net assets to the extent expended within the period.

Revenues in Excess of Expenses

The consolidated statement of operations includes the determination of revenues in excess of expenses. Changes in unrestricted net assets which are excluded from the determination of revenues in excess of expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, pension liability adjustments, transfers to affiliates, and equity transfers.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Estimated Malpractice Costs

The System is insured for medical malpractice claims under a claims-made policy and excess loss policies. The System records an estimated liability for medical malpractice costs related to reported claims that exceed insurance coverage, if any, and incurred claims that have not been reported. Anticipated insurance recoveries associated with reported claims are reported separately in the System's consolidated balance sheet at net realizable value.

Income Taxes

KHS and its not-for-profit subsidiaries qualify as tax-exempt organizations under section 501(c)(3) of the Internal Revenue Code, and accordingly, no provision for income taxes with respect to these entities has been made in the accompanying consolidated financial statements. The for-profit subsidiaries (as described in note 1) account for income taxes in accordance with the provisions of ASC Topic 740, *Accounting for Income Taxes*, which requires the establishment of a deferred tax asset or liability for the recognition of future deductible or taxable amounts. Deferred tax expense or benefit is recognized as a result of the changes in the deferred tax assets or liabilities during the period.

The System accounts for uncertainty in income taxes using a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Measurement of the tax uncertainty occurs if the recognition threshold is met. Management determined there were no tax uncertainties that met the recognition threshold for the period ended August 31, 2017 and the year ended December 31, 2016.

The System's policy is to recognize interest related to unrecognized tax benefits in interest expense, and penalties in supplies and expenses.

Accounting for Long-Lived Assets

In accordance with ASC Topic 360, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the System assesses their assets for impairment whenever events or changes in circumstances indicate that the carrying amount of a respective asset that the System expects to hold and use may not be recoverable. Management believes no impairment has occurred and therefore no write-downs were necessary as of August 31, 2017 and December 31, 2016.

Advertising Costs

The System expenses advertising costs as incurred. For the period from January 1 through August 31, 2017, advertising costs totaled approximately \$1,730,000.

Investments in Joint Ventures, Equity Method

The System has a financial interest in several entities. Where the System has the ability to influence management or has a twenty percent or more interest in the entity, the investment is recorded at initial cost, adjusted to the System's proportionate share of their undistributed earnings or losses. All other investments in such entities are recorded at cost.

Subsequent Events

The System evaluated subsequent events for recognition or disclosure through May 31, 2018, the date the consolidated financial statements were issued.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 supercedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU No. 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The System will be required to retrospectively adopt the guidance in ASU No. 2014-09 for years beginning after December 15, 2017. The System has not yet determined the impact of adoption of ASU No. 2014-09 on its consolidated financial statements.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU No. 2016-01 requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. ASU No. 2016-01 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. Early adoption of certain amendments is permitted for financial statements of fiscal years or interim periods that have not yet been issued. The System is currently assessing the effect that ASU No. 2016-01 will have on its consolidated results of operations, financial position and cash flows.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the System's leasing activities. The System will be required to retrospectively adopt the guidance in ASU No. 2016-02 for years beginning after December 15, 2018. The System has not yet determined the impact of adoption of ASU No. 2016-02 on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. ASU 2016-14 is to be applied retroactively with transition provisions. The System has not yet determined the impact of this standard on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (Topic 715)*. ASU No. 2017-07 requires the service cost component to be reported in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost will be required to be presented in the statement of operations separately from the service cost component and outside of operating income. The System will be required to adopt the guidance in ASU No. 2017-07 for fiscal years beginning after December 15, 2017. The System has not yet determined the impact of this standard on its consolidated financial statements.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

3. Net Patient Service Revenue

Net patient service revenue is reported on an accrual basis at the estimated net realizable amounts from patients, third party payors and others for services rendered. The System provides care to all patients, regardless of their ability to pay. For uninsured patients that do not qualify for charity care, the System recognizes revenues on the basis of its standard rates, discounted in accordance with the System's policy. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable to pay for the services provided. Thus, the System records a significant provision for doubtful collections related to uninsured patients in the period the services are provided. Patient service revenues, net of contractual allowances and discounts (but before the provision for doubtful collections), recognized in 2017 from these major payor sources, are as follows:

	Period ended August 31, 2017			
	Third-Party Government Payors	Third-Party Commercial Payors	Self-Pay	Total All Payors
Patient service revenues (net of contractual allowances and discounts)	\$ 231,049	\$ 191,269	\$ 9,871	\$ 432,189

Inpatient acute care services for Medicare and Medicaid beneficiaries are paid at predetermined rates per discharge. Outpatient services for Medicare beneficiaries are paid at predetermined rates referred to as Ambulatory Payment Classifications (APC's). Medicaid outpatient services are paid at interim rates and reconciled to state specific payment amounts adjusted for certain hospital specific cost factors through submission and audit of the annual Medicaid cost report. Medicare Disproportionate Share (DSH), and Medicare Graduate Medical Education (GME) costs are paid at interim rates and reconciled to actual DSH eligible patient days and Intern and Resident-approved full time equivalents (FTEs) through Hospital submission and fiscal intermediary audit of the annual Medicare cost report. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as revisions or final settlements are determined. As a result, there is at least a reasonable possibility that recorded liabilities will change by a material amount in the near term. The estimated settlements recorded at August 31, 2017 and December 31, 2016, could differ from actual settlements based on the results of cost report audits. Net patient service revenues had no change for the period ended August 31, 2017 for net adjustments and settlements related to prior years. The Hospital's cost reports for Medicare have been audited and settled by the fiscal intermediary through December 31, 2014 with the exception of December 31, 2010 and December 31, 2013 which have not yet been settled. The Hospital's cost reports for Medicaid have been audited and settled by the fiscal intermediary through December 31, 2014.

The State provides certain subsidy payments to qualified hospitals to partially fund uncompensated care and certain other costs. Subsidy payments recognized as revenue amounted to approximately \$8,702,000 for 2017, and are included in net patient service revenue in the accompanying consolidated statements of operations. There can be no assurance that the subsidies received by the Hospital will continue at the same level in future years.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

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Charity Care

The System provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than the established rates. Criteria for charity care consider the patient's family income and net worth. The System maintains records to identify and monitor the level of charity care it provides. The estimated costs of providing charity care, which are based upon the direct and indirect costs identified with the specific charity care services provided, amounted to approximately \$4,131,000 for the period ended August 31, 2017. Charges for services rendered to patients who meet guidelines for charity care have been excluded from net patient service revenue.

4. Assets Whose Use is Limited

Under the provisions of the Hospital Revenue and Refunding Bonds, and Facility's 2009 Revenue and Refunding Bonds, certain trustee held funds were established to pay for the costs of certain capital projects and retirement of indebtedness. The terms of the bond indenture require that certain debt service funds be established and maintained by the System.

Assets whose use is limited at August 31, 2017 and December 31, 2016 consists of the following:

	<u>2017</u>	<u>2016</u>
Trustee held funds	\$ 3,060	\$ 5,481
Board designated funds	204,386	188,645
Special purpose funds - temporarily restricted	1,540	1,192
Patient security deposits	<u>186</u>	<u>202</u>
Total	209,172	195,520
Less current portion	<u>(3,060)</u>	<u>(5,481)</u>
Noncurrent portion	<u>\$ 206,112</u>	<u>\$ 190,039</u>

Interest and dividend income on assets whose use is limited was \$2,457,000 in 2017. Realized gain on sale of assets whose use is limited were \$20,000 in 2017. The change in net unrealized gain amounted to \$8,488,000 in 2017.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

5. Fair Value of Financial Instruments

The System follows the provisions of authoritative guidance relating to fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America, and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that this guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the System for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value is based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

The fair value of the System's cash and cash equivalents, assets whose use is limited and long-term debt were measured using the following inputs at August 31, 2017 and December 31, 2016:

	Carrying Value	Fair Value	2017		
			Level 1	Level 2	Level 3
Reported at Fair Value					
Assets whose use is limited:					
Cash and cash equivalents	\$ 4,666	\$ 4,666	\$ 4,666	\$ -	\$ -
U.S. Treasury obligations	60,766	60,766	60,766	-	-
Corporate bond obligations	69,933	69,933	-	69,933	-
Equity index fund	73,807	73,807	73,807	-	-
Total assets whose use is limited:	<u>\$ 209,172</u>	<u>\$ 209,172</u>	<u>\$ 139,239</u>	<u>\$ 69,933</u>	<u>\$ -</u>
Disclosed at Fair Value					
Cash and cash equivalents	\$ 67,750	\$ 67,750	\$ 67,750	\$ -	\$ -
Long-term debt:					
Bonds	73,556	78,624	-	78,624	-
Construction loan	71,000	71,000	-	71,000	-
Other	1,064	1,064	-	-	1,064
2016					
Reported at Fair Value					
Assets whose use is limited:					
Cash and cash equivalents	\$ 5,550	\$ 5,550	\$ 5,550	\$ -	\$ -
U.S. Treasury obligations	53,062	53,062	53,062	-	-
Corporate bond obligations	70,880	70,880	-	70,880	-
Equity index fund	66,028	66,028	66,028	-	-
Total assets whose use is limited:	<u>\$ 195,520</u>	<u>\$ 195,520</u>	<u>\$ 124,640</u>	<u>\$ 70,880</u>	<u>\$ -</u>
Disclosed at Fair Value					
Cash and cash equivalents	\$ 71,258	\$ 71,258	\$ 71,258	\$ -	\$ -
Long-term debt:					
Bonds	75,944	80,519	-	80,519	-
Construction loan	53,207	53,207	-	53,207	-
Other	1,359	1,359	-	-	1,359

There were no investments in 2017 or 2016 with inputs that cannot be corroborated by observable market data and therefore classified as Level 3. There were no significant transfers between Levels 1 and 2 during 2017 and 2016.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

The following table identifies securities with unrealized losses at August 31, 2017 and December 31, 2016. There are certain risks and uncertainties inherent in the System's impairment methodology, such as the financial condition of specific industry sectors and the effect of underlying security collateral values. Should the System subsequently determine a decline in the fair value below the cost basis to be other than temporary, the security would be written down to its fair market value and the difference would be included in earnings as a realized loss for the period such determination was made.

	2017 Total	
	Fair Value	Unrealized Losses
U.S. Treasury obligations	\$ 22,931	\$ 206
Corporate obligations	16,115	116
Total	<u>\$ 39,046</u>	<u>\$ 322</u>
	2016 Total	
U.S. Treasury obligations	\$ 35,302	\$ 529
Corporate obligations	39,491	554
Total	<u>\$ 74,793</u>	<u>\$ 1,083</u>

Based upon the System's impairment evaluation as of August 31, 2017 and December 31, 2016, it was concluded that the unrealized losses in the table above are not other than temporary.

The following methods and assumptions were used by the System in estimating fair value disclosures for the consolidated financial statements:

Cash and Cash Equivalents: The carrying amount of cash and cash equivalents, including amounts reported in assets whose use is limited, approximates fair value due to the short-term nature of these instruments.

Assets Whose Use Is Limited: The fair values for marketable equity, U.S. Treasury, and corporate bond obligations included in assets whose use is limited are based on quoted market prices for identical or similar investments.

Long-Term Debt Obligations: The fair value of long-term debt is based on quoted market prices or estimates using discounted cash flow analyses, based on the participating institution's incremental borrowing rates for similar types of borrowing arrangements.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

6. Investment in Joint Ventures

KMG has entered in joint venture relationships to further its missions. In 2007, KMG entered into an agreement with Washington Fitness Centers, LLC. for 50% interest in the operations of Healthtrax Fitness Gym, LLC., and a 20% interest in the real estate and construction of a seventy-two thousand square foot building located in Washington Township, New Jersey. The operations of Healthtrax Fitness Center, LLC commenced in February, 2009. The investment has been accounted for under the equity method. Under the operating agreement, KMG is part of a group of guarantors for the real estate joint venture's \$12,167,000 outstanding mortgage at August 31, 2017.

In 2008, KMG entered into an agreement with USP, a physician group, to form KHS/USP Surgery Centers, LLC ("JV"). The JV subsequently entered into an agreement for an interest in KHS Ambulatory Surgery Center (ASC), LLC. The purpose of the joint venture is to form a strategic alliance that will provide ambulatory services in South Jersey. KMG's effective share in ASC is 26%. The investment has been accounted for under the equity method.

On December 4, 2014, the Hospital acquired 51% of the ownership in Kennedy Cherry Hill Surgical Center, L.L.C. Due to the distribution of voting rights and super-majority clauses included in the operating agreement, the Hospital cannot exercise control over operations and therefore has included the investment in its financial statements under the equity method of accounting. In 2015, Kennedy University Hospital contributed \$765,000 as its equity contribution amongst the partners in this venture. The operations of the joint venture are expected to commence in 2018.

7. Property and Equipment

Property and equipment at August 31, 2017 and December 31, 2016 consists of the following:

	<u>2017</u>	<u>2016</u>
Land	\$ 6,445	\$ 6,445
Land improvements	6,601	6,523
Buildings	329,336	276,931
Fixed equipment	123,203	111,762
Major movable equipment	233,550	228,667
Capitalized leases	46,746	46,758
Leasehold improvements	4,176	4,176
Other properties	942	942
	<hr/>	<hr/>
Total property and equipment	750,999	682,204
Less accumulated depreciation and amortization	(440,351)	(421,737)
	<hr/>	<hr/>
	310,648	260,467
Construction in progress	18,108	47,363
	<hr/>	<hr/>
Property and equipment, net	<u>\$ 328,756</u>	<u>\$ 307,830</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

Total depreciation and amortization expense for the period ended August 31, 2017 is \$18,832,000. The amount of accumulated amortization related to capitalized leases was \$38,292,000 at August 31, 2017.

In 2017, the Hospital began preconstruction work on Phase II of the Cherry Hill renovation project, which will involve the creation of a brand new patient tower and demolition of the former medical office building. The total cost of the project is expected to be \$130.5 million, with another \$34.5 million budgeted for IT needs, signage, and other contingency funding.

In 2018, groundbreaking is expected to begin on Phase I of the Washington Township Project, which will involve construction of a new parking garage and is expected to cost \$23 million.

8. Long-Term Debt

A summary of long-term debt at August 31, 2017 and December 31, 2016 is as follows:

	<u>2017</u>	<u>2016</u>
<u>Kennedy University Hospital</u>		
Series 2012 New Jersey Health Care Facilities Authority (the "Authority"), Revenue and Refunding Bonds due in varying installments through 2042 plus interest at rates ranging from 2% to 5%	\$ 59,400	\$ 61,545
Loan and Security Agreement, with TD Bank, NA as agent. This debt will mature in September 2025. The interest rate at 8/31/17 was 2.08%	71,000	53,207
Note payable	-	239
Capitalized lease obligations	7,194	9,400
Unamortized original issued bond premium (net)	3,215	3,301
<u>Kennedy Health Facilities</u>		
Series 2009 Revenue and Refunding Bonds dated October 1, 2009, due in varying installments through October 1, 2039 plus interest of 4.55%	14,156	14,399
<u>Kennedy Property Corporation</u>		
3.75% fixed rate mortgage dated May 20, 2011 due September 1, 2022	204	226
3.75% fixed rate mortgage dated December 1, 2009 due December 1, 2029	598	623
3.75% fixed rate mortgage dated October 22, 2010 due November 1, 2030	262	272
Total	156,029	143,212
Less:		
Current portion	(7,491)	(6,095)
Deferred financing costs	(1,452)	(1,353)
Long-term debt	<u>\$ 147,086</u>	<u>\$ 135,764</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

In September 2015, the Hospital signed a Loan and Security Agreement in the amount of \$71,000,000 with TD Bank, NA as the agent for this loan. TD Bank has committed \$51,000,000 toward this loan while M & T Bank has committed the remaining \$20,000,000 of the loan. The anticipated total construction cost will approximate \$80,000,000 with the Hospital contributing \$8,000,000 per the Agent's assent and an additional \$7,900,000 that is not subject to the Agent's assent to complete the project. The proceeds of the loan will be drawn based on construction needs and are to be used for construction of a new parking garage, medical office building where operations for Kennedy Cherry Hill Surgical Center, L.L.C. are due to commence, and lobby at the hospital's Cherry Hill campus. Principal payments of this debt start in October 2017 and mature in September 2025. The interest rate is determined based on the 30-day LIBOR rate plus .85%.

In August 2012, the Authority issued \$66,035,000 of the tax-exempt 2012 Bonds on behalf of the Hospital. The proceeds of the 2012 Bonds were used to refund the Series 1997A and 2001 Revenue and Refunding Bonds, fund certain capital projects, and pay the costs of issuance of the 2012 Bonds. These bonds were refinanced as of December 22, 2017, and new bonds were issued by Thomas Jefferson University in conjunction with the Montgomery County Higher Education and Health Authority in the amount of \$64,720,000 for the Hospital.

In August 2012, the Hospital entered into a bank note for equipment purchases. The note bears interest of 4.01% and is payable in sixty monthly installments of \$30,285. This note was paid off during the period ended August 31, 2017.

In October, 2009, the Facility issued \$16,340,000 Revenue Bonds in conjunction with the New Jersey Health Care Facilities Financing Authority. The Series 2009 Revenue Bonds were issued to pay a portion of the costs for construction of approximately 44,000 square feet 60 bed sub-acute nursing unit addition to the existing facility. In addition, the funds were also used for the purchase of capital equipment, fund capitalized interest, acquisition of an interest rate cap agreement, and to pay bond issuance costs. These bonds were refinanced as of December 22, 2017, and new bonds were issued by Thomas Jefferson University in conjunction with the Montgomery County Higher Education and Health Authority in the amount of \$14,130,000 for the Facility.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

Scheduled principal repayments on long-term debt, as adjusted for subsequent refinancing as described above, and payments on capital lease obligations, for the next five years and thereafter are as follows:

	<u>Long-Term Debt</u>	<u>Capital Leases</u>
Years ending August 31:		
2018	\$ 2,320	\$ 2,990
2019	2,693	2,262
2020	3,629	1,313
2021	2,798	829
2022	3,283	30
Thereafter	<u>136,191</u>	<u>-</u>
Total	150,914	7,424
Adjustments for refinancing	(5,294)	-
Less amount representing interest	<u>-</u>	<u>230</u>
Total	<u>\$ 145,620</u>	<u>\$ 7,194</u>

9. Commitments and Contingencies

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred.

The following is a schedule by year of future minimum lease payments under operating leases as of August 31, 2017, that have initial or remaining lease terms in excess of one year:

Years ending August 31:	
2018	\$ 4,162
2019	3,812
2020	3,334
2021	3,091
2022	2,630
Thereafter	<u>855</u>
Total	<u>\$ 17,884</u>

Total rental expense for the period ended August 31, 2017 for all operating leases and other month-to-month leases was approximately \$3,093,000.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Litigation

The System is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, all such matters are adequately covered by commercial insurance or by accruals. If not so covered, these matters are without merit or are of such kind, or involve such amounts, as would not have a material adverse effect on the consolidated financial position or consolidated results of operations.

Regulatory Compliance

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The System believes that it is in compliance with all applicable laws and regulations through the period from January 1 through August 31, 2017 and the year ended December 31, 2016. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid program.

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance that have not been provided for in the accompanying consolidated financial statements; however, the possible future financial effects of this matter on the System, if any, are not presently determinable.

Workers Compensation

The Hospital has been granted a letter of credit issued by TD Bank, dated April 28, 2011, in the amount of \$2,800,000 in favor of Pennsylvania Manufacturer's Association Insurance Co. The letter of credit expires June 28, 2018.

10. Pension Plan

The Hospital froze participation in its cash balance defined benefit pension plan (the "Plan") for all employees hired or rehired on or after July 1, 2015. Employees hired prior to July 1, 2015, remain eligible for the benefits earned under this plan. The benefits are based on years of service and the employee's compensation during the last five years of employment. The Hospital's funding policy is to contribute annually an amount equal to at least the minimum required contribution in accordance with minimum funding standards established by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The funded status of the plan is measured as the difference between the plan assets at fair value and the projected benefit obligation or accumulated post retirement benefit obligation. At August 31, 2017 and December 31, 2016, the Hospital recognized \$3,546,000 and \$5,754,000, respectively, as the difference between actual amounts and estimates based on actuarial assumptions as a change in net assets.

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

The following table sets forth the funded status and amounts recognized in the Hospital's balance sheets for its defined benefit plan:

Change in Benefit Obligation

	<u>2017</u>	<u>2016</u>
Accumulated benefit obligation at the end of the year	<u>\$ 159,283</u>	<u>\$ 156,630</u>
Projected benefit obligation at the beginning of the year	\$ 157,675	\$ 148,152
Interest cost on projected benefit obligations	3,687	5,387
Service costs - during the year	4,470	6,479
Actuarial loss due to change in discount rates and updated mortality tables	11,212	6,732
Benefits paid	<u>(7,361)</u>	<u>(9,075)</u>
Projected benefit obligation at the end of the year	<u>169,683</u>	<u>157,675</u>

Change in Plan Assets

Fair value of plan assets at beginning of year	118,368	114,275
Actual return on plan assets	11,711	7,131
Hospital contribution	5,867	6,500
Benefits and administrative expenses paid	<u>(7,608)</u>	<u>(9,538)</u>
Fair value of plan assets at end of year	<u>128,338</u>	<u>118,368</u>
Amounts recognized in the balance sheet		
Non-current liabilities	<u>\$ (41,345)</u>	<u>\$ (39,307)</u>

Amounts Recognized in Unrestricted Net Assets

	<u>2017</u>	<u>2016</u>
Net actuarial loss	<u>\$ 66,675</u>	<u>\$ 63,129</u>

Weighted Average Assumption at the End of the Year

	<u>2017</u>	<u>2016</u>
Weighted average discount rate	3.88 %	4.31 %
Rate of increase in compensation levels	3.00 %	3.00 %

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Components of Net Periodic Benefit Cost

	<u>2017</u>	<u>2016</u>
Service cost - benefits earned during the period	\$ 4,470	\$ 6,479
Interest cost on projected benefit obligation	3,687	5,387
Expected return on plan assets	(6,166)	(9,064)
Recognized net actuarial loss	<u>2,367</u>	<u>3,374</u>
Total net periodic benefit cost	<u>4,358</u>	<u>6,176</u>
Net actuarial loss	5,913	9,128
Amortization of net loss	<u>(2,367)</u>	<u>(3,374)</u>
Total recognized in net assets	<u>3,546</u>	<u>5,754</u>
Total recognized in net benefit cost and net assets	<u>\$ 7,904</u>	<u>\$ 11,930</u>

The principal assumptions used in determining the net periodic benefit cost were as follows:

	<u>2017</u>	<u>2016</u>
Weighted average discount rate	4.33 %	4.59 %
Rate of increase in compensation levels	3.00	3.00
Expected long-term rate of return on assets	7.50	7.50

Expected Amortizations

	<u>8/31/2017</u>	<u>12/31/2016</u>
Expected amortization of net loss	\$ 4,290	\$ 3,592

Other Accounting Items

	<u>2017</u>	<u>2016</u>
Measurement date used	8/31/17	12/31/16

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

Plan Assets

Diversification across and within asset classes is the primary means by which the Hospital mitigates risk. The Hospital maintains guidelines for all asset and sub-asset categories in order to avoid excessive investment concentrations. Fund assets are monitored on a regular basis. If at any time the fund asset allocation is not within the acceptable allocation range, funds will be reallocated. The Hospital also reviews the fund on a regular basis to ensure that the investment returns received are consistent with the short-term and long-term goals of the fund and with comparable market returns.

The weighted average asset allocations by asset category for the Hospital's pension plan, at August 31, 2017 and December 31, 2016, are as follows:

	Target	2017	2016
Equity securities	35-75 %	72 %	69 %
Debt securities	10-60 %	24 %	26 %
Cash & other	0-40 %	4 %	5 %
Total		<u>100 %</u>	<u>100 %</u>

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

The following table sets forth by level, within the fair value hierarchy, the Plan's investments at fair value as of August 31, 2017 and December 31, 2016:

	2017			
	Basis of Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalent	\$ 4,746	\$ -	\$ -	\$ 4,746
U.S. Treasury obligations	14,418	-	-	14,418
Corporate bonds	-	16,562	-	16,562
Equities:				
Industrials	4,505	-	-	4,505
Consumer discretionary	5,758	-	-	5,758
Consumer staples	2,990	-	-	2,990
Energy	1,870	-	-	1,870
Financial	7,994	-	-	7,994
Materials	1,620	-	-	1,620
Information technology	6,827	-	-	6,827
Utilities	577	-	-	577
Health care	7,307	-	-	7,307
Telecommunication services	434	-	-	434
Unclassified stock	100	-	-	100
Equity mutual funds	34,344	-	-	34,344
Equity ETF	16,567	-	-	16,567
Other	-	1,719	-	1,719
Total	\$ 110,057	\$ 18,281	\$ -	\$ 128,338
	2016			
Cash and cash equivalent	\$ 5,487	\$ -	\$ -	\$ 5,487
U.S. Treasury obligations	14,784	-	-	14,784
Corporate bonds	-	15,996	-	15,996
Equities:				
Industrials	4,053	-	-	4,053
Consumer discretionary	4,974	-	-	4,974
Consumer staples	2,904	-	-	2,904
Energy	2,042	-	-	2,042
Financial	7,194	-	-	7,194
Materials	1,421	-	-	1,421
Information technology	5,882	-	-	5,882
Utilities	541	-	-	541
Health care	5,914	-	-	5,914
Telecommunication services	426	-	-	426
Unclassified stock	92	-	-	92
Equity mutual funds	30,362	-	-	30,362
Equity ETF	14,538	-	-	14,538
Other	-	1,758	-	1,758
Total	\$ 100,614	\$ 17,754	\$ -	\$ 118,368

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

The following is a description of the valuation methodologies used for the plan's assets measured at fair value:

- Cash and cash equivalents - Include certain instruments in highly liquid debt instruments with original maturities of three months or less at date of purchase.
- Corporate debt securities and U.S. government obligations - Valued based on spreads of published interest rate curves.
- Equity securities & ETF's - Valued at closing price reported on the active market on which the individual securities are traded.
- Mutual funds - Valued at the net asset value ("NAV") of shares held by the Plan at year-end.
- Other investments are valued by an independent advisor that values the underlying investments of the securities, which are substantially invested in an active market in which the individual securities are traded.

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

There were no transfers between levels during the period ended August 31, 2017 and the year ended December 31, 2016.

The table below provides an estimate of the plan contributions for the next year. The table also presents the benefits expected to be paid in each of the next five fiscal years and in the aggregate for the five fiscal years thereafter.

Cash Flows

Contributions for the period of 09/01/2017 - 08/31/2018

Expected employer amount	\$	5,534
Expected employee amount		-
		<hr/>
Total	\$	<u>5,534</u>

Estimated future benefit payments reflecting expected future service:

09/01/2017 - 08/31/2018	\$	9,159
09/01/2018 - 08/31/2019		9,314
09/01/2019 - 08/31/2020		9,956
09/01/2020 - 08/31/2021		10,456
09/01/2021 - 08/31/2022		11,097
09/01/2022 - 08/31/2026		64,216

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
August 31, 2017 and December 31, 2016

11. Professional Liability Insurance

The System has malpractice insurance coverage on a claims-made basis under a guaranteed cost program. It is management's intention to continue existing coverage. The amount of malpractice coverage is \$1,000,000 per claim, with a \$3,000,000 annual aggregate. The System's umbrella policy and excess liability coverage is \$10,000,000 per occurrence with an annual aggregate of \$10,000,000 for its first layer of coverage. The System also maintains a second layer of coverage at \$10,000,000 per occurrence with an annual aggregate of \$10,000,000. The estimated liability for claims and incidents not reported to the insurance carrier at August 31, 2017 and December 31, 2016 was approximately \$3,114,000 and \$2,577,000, respectively. The medical malpractice accrual is discounted at 3.5% for 2017 and 2016. The System has recorded a receivable for anticipated insurance recoveries at August 31, 2017 and December 31, 2016 of \$6,040,000. The estimated insurance recoveries receivable is included in other assets on the consolidated balance sheet. The System has recorded a related claim liability for August 31, 2017 and December 31, 2016 of \$9,154,000 and \$8,617,000, respectively. The total claims liability is included in other liabilities in the consolidated balance sheet.

12. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at August 31, 2017 and December 31, 2016:

	<u>2017</u>	<u>2016</u>
Healthcare Services:		
Purchase of equipment	\$ 906	\$ 623
Health education	72	4
Research	51	56
Community wellness	324	325
Scholarships	187	184
	<u>1,540</u>	<u>1,192</u>
Total	\$ 1,540	\$ 1,192

13. Functional Expenses

In accordance with FASB ASC Topic 958, *Financial Statements of Not-for-Profit Organizations*, the System has elected to report its natural expenses on its consolidated statement of operations. Accordingly, the System's functional expenses are as follows:

	<u>2017</u>
Program services	\$ 352,615
Management and general	56,314
Fundraising	57
	<u>57</u>
Total	\$ 408,986

Kennedy Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

August 31, 2017 and December 31, 2016

14. Concentration of Credit Risk

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

	<u>2017</u>	<u>2016</u>
Medicare	21 %	23 %
Medicaid	3	2
Blue Cross	13	12
Other third-party payors	51	53
Patients (self-pay)	<u>12</u>	<u>10</u>
Total	<u>100 %</u>	<u>100 %</u>

The System routinely invests its excess cash with local banks. At August 31, 2017 and December 31, 2016, the System had cash balances with these local banks which exceeded Federal Depository insurance limits. Management believes that credit risk related to these deposits is minimal.

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

August 31, 2017

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport, Inc.	Kennedy Property Corporation	Kennedy Health Facilities, Inc.	Kennedy Management Group, Inc.	Professional Medical Management, Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Assets												
Current Assets												
Cash and cash equivalents	\$ 55,354	\$ 91	\$ 3,149	\$ 209	\$ 5,150	\$ 60	\$ 2,658	\$ 331	\$ 72	\$ 676	\$ -	\$ 67,750
Accounts receivable:												
Patients (net of estimated allowance for doubtful collections of \$24,297)	65,193	-	1,647	-	1,650	-	-	4,090	-	-	(1,280)	71,300
Other	7,856	-	-	26	-	32	1,053	641	-	494	(389)	9,713
Due from affiliates	5,914	2,636	1,071	-	-	-	-	12	-	-	(9,633)	-
Assets whose use is limited	3,060	-	-	-	-	-	-	-	-	-	-	3,060
Inventories	10,053	-	-	-	44	-	-	189	-	-	-	10,286
Prepaid expenses and other current assets	8,238	-	81	36	67	83	164	566	227	27	-	9,489
Total current assets	155,668	2,727	5,948	271	6,911	175	3,875	5,829	299	1,197	(11,302)	171,598
Property and Equipment	292,162	4	563	12,906	18,463	-	158	3,102	-	1,398	-	328,756
Assets Whose Use is Limited	198,025	3,235	832	-	864	-	2,437	-	719	-	-	206,112
Loans to Affiliates	-	1,311	-	-	-	-	-	-	-	-	(1,311)	-
Investments in Joint Ventures	619	1,910	-	-	-	-	-	-	-	-	(1,910)	619
Other Assets	5,859	-	3	-	181	62	-	-	-	1,724	-	7,829
Total assets	\$ 652,333	\$ 9,187	\$ 7,346	\$ 13,177	\$ 26,419	\$ 237	\$ 6,470	\$ 8,931	\$ 1,018	\$ 4,319	\$ (14,523)	\$ 714,914

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

August 31, 2017

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport, Inc.	Kennedy Property Corporation	Kennedy Health Facilities, Inc.	Kennedy Management Group, Inc.	Professional Medical Management, Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Liabilities and Net Assets (Deficit)												
Current Liabilities												
Long-term debt, current portion	\$ 7,021	\$ -	\$ -	\$ 1,609	\$ 382	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (1,521)	\$ 7,491
Accounts payable	43,738	-	41	13	37	-	13	743	30	14	(2,581)	42,048
Accrued expenses:												
Payroll and benefits	25,135	18	205	-	764	-	197	2,162	-	58	-	28,539
Other	5,593	1	26	3	1,345	-	665	-	35	459	-	8,127
Accrued interest	442	-	-	-	-	-	-	-	-	-	-	442
Due to affiliates	-	1,486	5	1,552	171	-	212	3,405	369	-	(7,200)	-
Estimated settlements with third party payors	739	-	-	-	36	-	-	-	-	-	-	775
Deferred revenue	439	-	-	124	85	-	-	2,451	-	43	-	3,142
Total current liabilities	83,107	1,505	277	3,301	2,820	-	1,087	8,761	434	574	(11,302)	90,564
Long-Term Debt, Net	132,697	-	-	2,287	13,413	-	-	-	-	-	(1,311)	147,086
Accrued Pension Cost	42,698	-	-	-	-	-	-	-	-	-	-	42,698
Other Liabilities	15,380	-	-	-	260	-	-	517	-	-	-	16,157
Total liabilities	273,882	1,505	277	5,588	16,493	-	1,087	9,278	434	574	(12,613)	296,505
Net Assets (Deficit)												
Unrestricted	377,630	7,682	7,069	7,589	9,926	237	5,383	(347)	(135)	3,745	(1,910)	416,869
Temporarily restricted	821	-	-	-	-	-	-	-	719	-	-	1,540
Total net assets (deficit)	378,451	7,682	7,069	7,589	9,926	237	5,383	(347)	584	3,745	(1,910)	418,409
Total liabilities and net assets (deficit)	\$ 652,333	\$ 9,187	\$ 7,346	\$ 13,177	\$ 26,419	\$ 237	\$ 6,470	\$ 8,931	\$ 1,018	\$ 4,319	\$ (14,523)	\$ 714,914

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2016

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Assets												
Current Assets												
Cash and cash equivalents	\$ 58,681	\$ 125	\$ 3,113	\$ 125	\$ 4,843	\$ 59	\$ 3,249	\$ 627	\$ 119	\$ 317	\$ -	\$ 71,258
Accounts receivable:												
Patients (net of estimated allowance for doubtful collections of \$24,791)	63,439	-	1,715	6	1,838	-	-	3,918	-	-	(1,563)	69,353
Other	4,615	-	-	-	-	30	1,304	98	-	425	(573)	5,899
Due from affiliates	3,601	2,460	884	-	-	-	8,089	4	-	-	(15,038)	-
Assets whose use is limited	5,481	-	-	-	-	-	-	-	-	-	-	5,481
Inventories	10,002	-	-	-	44	-	-	170	-	-	-	10,216
Prepaid expenses and other current assets	5,288	-	166	1	179	23	68	484	96	43	-	6,348
Total current assets	151,107	2,585	5,878	132	6,904	112	12,710	5,301	215	785	(17,174)	168,555
Property and Equipment	272,502	5	626	12,849	18,584	-	395	1,374	-	1,495	-	307,830
Assets Whose Use is Limited	182,223	3,033	810	-	861	-	2,248	-	864	-	-	190,039
Loans to Affiliates	-	1,452	-	-	-	-	-	-	-	-	(1,452)	-
Investments in Joint Ventures	619	1,852	-	-	-	8	-	-	-	-	(1,852)	627
Other Assets	5,859	-	3	-	181	62	-	-	-	1,724	-	7,829
Total assets	<u>\$ 612,310</u>	<u>\$ 8,927</u>	<u>\$ 7,317</u>	<u>\$ 12,981</u>	<u>\$ 26,530</u>	<u>\$ 182</u>	<u>\$ 15,353</u>	<u>\$ 6,675</u>	<u>\$ 1,079</u>	<u>\$ 4,004</u>	<u>\$ (20,478)</u>	<u>\$ 674,880</u>

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Balance Sheet

(In Thousands)

December 31, 2016

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Liabilities and Net Assets (Deficit)												
Current Liabilities												
Long-term debt, current portion	\$ 5,641	\$ -	\$ -	\$ 1,466	\$ 368	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (1,380)	\$ 6,095
Accounts payable	44,382	-	3	391	13	-	51	459	-	84	(2,890)	42,493
Accrued expenses:												
Payroll and benefits	22,911	18	191	-	650	-	204	2,365	-	44	-	26,383
Other	6,383	30	48	6	1,753	-	508	-	35	209	-	8,972
Accrued interest	1,355	-	-	-	-	-	-	-	-	-	-	1,355
Due to affiliates	-	493	30	1,300	251	8,089	1,175	1,442	124	-	(12,904)	-
Estimated settlements with third party payors	-	-	-	-	21	-	-	-	-	-	-	21
Deferred revenue	517	-	-	121	-	-	-	859	-	35	-	1,532
Total current liabilities	81,189	541	272	3,284	3,056	8,089	1,938	5,125	159	372	(17,174)	86,851
Long-Term Debt, Net	121,071	-	-	2,486	13,659	-	-	-	-	-	(1,452)	135,764
Accrued Pension Cost	39,307	-	-	-	-	-	-	-	-	-	-	39,307
Other Liabilities	11,973	-	-	-	249	-	-	310	-	-	-	12,532
Total liabilities	253,540	541	272	5,770	16,964	8,089	1,938	5,435	159	372	(18,626)	274,454
Net Assets (Deficit)												
Unrestricted	358,442	8,386	7,045	7,211	9,566	(7,907)	13,415	1,240	56	3,632	(1,852)	399,234
Temporarily restricted	328	-	-	-	-	-	-	-	864	-	-	1,192
Total net assets (deficit)	358,770	8,386	7,045	7,211	9,566	(7,907)	13,415	1,240	920	3,632	(1,852)	400,426
Total liabilities and net assets (deficit)	\$ 612,310	\$ 8,927	\$ 7,317	\$ 12,981	\$ 26,530	\$ 182	\$ 15,353	\$ 6,675	\$ 1,079	\$ 4,004	\$ (20,478)	\$ 674,880

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

(In Thousands)

Period from January 1, 2017 through August 31, 2017

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Unrestricted Revenues, Gains, and Other Support												
Net patient services revenue	\$ 388,388	\$ -	\$ 3,007	\$ -	\$ 15,179	\$ -	\$ -	\$ 23,596	\$ -	\$ 2,835	\$ (815)	\$ 432,190
Provision for doubtful collections	(17,810)	-	(160)	-	(358)	-	-	(827)	-	-	-	(19,155)
Net patient service revenue less provision for doubtful collections	370,578	-	2,847	-	14,821	-	-	22,769	-	2,835	(815)	413,035
Other operating revenue	2,505	-	888	1,566	11	(504)	3,960	6,968	1,055	-	(9,340)	7,109
Net assets released from restrictions	-	-	-	-	-	-	-	-	267	-	-	267
Total unrestricted revenues, gains and other support	373,083	-	3,735	1,566	14,832	(504)	3,960	29,737	1,322	2,835	(10,155)	420,411
Expenses												
Employee salaries	148,853	647	2,143	-	6,260	-	1,547	26,861	277	640	-	187,228
Physician salaries and fees	25,156	3	-	-	-	-	-	-	-	421	(5,824)	19,756
Employee benefits	32,640	38	597	-	1,519	-	516	3,688	27	-	-	39,025
Supplies and expenses	126,153	321	773	769	5,680	(20)	1,309	8,873	908	1,515	(4,289)	141,992
Interest	1,825	-	-	70	300	-	-	-	-	-	(42)	2,153
Depreciation and amortization	17,235	-	203	348	673	-	23	204	-	146	-	18,832
Total expenses	351,862	1,009	3,716	1,187	14,432	(20)	3,395	39,626	1,212	2,722	(10,155)	408,986
Non-controlling Interest, Garden State Radiology	-	(55)	-	-	-	-	-	-	-	-	-	(55)
Income (Loss) from Operations	21,221	(1,064)	19	379	400	(484)	565	(9,889)	110	113	-	11,370
Nonoperating Income (Loss)												
Interest, dividends, and net realized gains and losses on investments	1,935	78	(5)	(1)	(47)	(1)	(129)	(61)	(8)	-	-	1,761
Revenues in excess of (less than) expenses	23,156	(986)	14	378	353	(485)	436	(9,950)	102	113	-	13,131
Change in Net Unrealized Gains on Securities	8,141	170	9	-	7	-	161	-	-	-	-	8,488
Transfer to Temporarily Restricted Net Assets	-	-	-	-	-	-	-	-	(493)	-	-	(493)
Pension Liability Adjustment	(3,546)	-	-	-	-	-	-	-	-	-	-	(3,546)
Change in Investment in Garden State Radiology	-	113	-	-	-	-	-	-	-	-	(58)	55
Transfer (to) from Affiliate	(8,563)	-	-	-	-	8,629	(8,629)	8,363	200	-	-	-
Increase (decrease) in unrestricted net assets	\$ 19,188	\$ (703)	\$ 23	\$ 378	\$ 360	\$ 8,144	\$ (8,032)	\$ (1,587)	\$ (191)	\$ 113	\$ (58)	\$ 17,635

Kennedy Health System, Inc. and Subsidiaries

Schedule of Consolidating Information, Statement of Operations

(In Thousands)

Year Ended December 31, 2016

(See Independent Auditors' Report on Supplementary Information)

	Kennedy University Hospital, Inc.	Kennedy Health System	STAT Medical Transport Inc.	Kennedy Property Corporation	Kennedy Health Facilities Inc.	Kennedy Management Group, Inc.	Professional Medical Management Inc.	Kennedy Health Alliance	Kennedy Healthcare Foundation	Garden State Radiology	Consolidation	
											Eliminations	Consolidated
Unrestricted Revenues, Gains, and Other Support												
Net patient services revenue	\$ 572,523	\$ -	\$ 5,244	\$ -	\$ 21,814	\$ -	\$ -	\$ 29,371	\$ -	\$ 3,458	\$ (2,401)	\$ 630,008
(Provision for) recovery of doubtful collections	(30,098)	-	(91)	-	(220)	-	-	(1,055)	-	-	-	(31,464)
Net patient services revenue less provision for doubtful collections	542,425	-	5,153	-	21,595	-	-	28,316	-	3,458	(2,401)	598,545
Other operating revenue	5,267	-	804	1,868	(11)	(820)	6,352	7,467	1,144	-	(8,159)	13,912
Net assets released from restrictions	60	-	-	-	-	-	-	-	-	-	-	61
Total unrestricted revenues, gains and other support	547,752	-	5,957	1,868	21,584	(820)	6,352	35,783	1,144	3,458	(10,560)	612,517
Expenses												
Employee salaries	214,841	949	3,171	-	9,353	-	2,449	30,411	408	817	-	262,398
Physician salaries and fees	35,779	-	-	-	-	-	-	-	-	438	(4,101)	32,116
Employee benefits	45,718	150	848	-	2,169	-	755	3,584	-	-	-	53,225
Supplies and expenses	187,084	1,504	1,065	996	8,533	232	2,048	10,231	1,098	2,339	(6,462)	208,666
Interest	2,774	-	-	114	415	-	-	-	-	-	(77)	3,226
Depreciation and amortization	25,198	1	322	388	948	-	86	252	-	235	-	27,429
Total expenses	511,394	2,604	5,406	1,497	21,418	232	5,338	44,476	1,507	3,829	(10,640)	587,061
Non-controlling Interest, Garden State Radiology	-	438	-	-	-	-	-	-	-	-	-	438
Income (Loss) from Operations	36,358	(2,166)	551	370	166	(1,051)	1,013	(8,694)	(362)	(371)	80	25,895
Nonoperating Income (Loss)												
Interest, dividends, and net realized gains and losses on investments	3,280	146	7	(2)	-	4	(31)	-	-	-	(77)	3,327
Revenues in excess of (less than) expenses	39,638	(2,020)	558	368	166	(1,047)	982	(8,694)	(362)	(371)	3	29,222
Change in Net Unrealized Gains (Losses) on Securities	5,716	(38)	(10)	-	(8)	-	(28)	-	-	-	-	5,632
Net Assets Released from Restrictions for Property for Property and Equipment	-	-	-	-	-	-	-	-	-	-	-	-
Pension Liability Adjustment	(5,754)	-	-	-	-	-	-	-	-	-	-	(5,754)
Change in Investment in Garden State Radiology	-	(894)	-	-	-	-	-	-	-	-	456	(438)
Transfer (to) from Affiliate	(11,464)	810	-	3,975	-	-	-	5,388	37	-	-	(1,254)
Increase (decrease) in unrestricted net assets	\$ 28,136	\$ (2,142)	\$ 548	\$ 4,343	\$ 158	\$ (1,047)	\$ 954	\$ (3,306)	\$ (325)	\$ (371)	\$ 459	\$ 27,408