

Financial Statements and Report of Independent  
Certified Public Accountants

**AU Health System, Inc.**  
*(a component unit of the State of Georgia)*

June 30, 2018 and 2017

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# Management's discussion and analysis (unaudited)

(dollars in thousands)

## Introduction

AU Health System, Inc. (the Health System) is a nonprofit corporation organized to further the health sciences, patient care, research and education missions of Augusta University (the University or AU). The Health System's operations and contributions can be briefly summarized as follows:

Table 1 – Summary Statistics and Investments in Missions by Health System

A summarized comparison of the Health System's volume statistics and amounts invested in missions for the years ended June 30, 2018 and 2017 follows:

	2018	2017
<b>Discharges</b>	21,646	21,346
<b>Outpatient visits</b>	336,951	338,294
<b>Physician based clinic visits</b>	118,785	105,317
<b>Worked Relative Value Units (RVUs)</b>	1,832,800	1,829,403
	\$	\$
<b>Service fee</b>	6,638	-
<b>Charity at cost</b>	42,021	40,569
<b>Capital expenditures</b>	20,311	35,140

## Overview of the Financial Statements and Financial Analysis

The following discussion and analysis provides an overview of the financial position and performance of the Health System as of and for the years ended June 30, 2018 and 2017. It includes the financial statements of AU Medical Center, Inc. (AUMC); AU Medical Associates, Inc.; Roosevelt Warm Springs Rehabilitation and Specialty Hospitals, Inc.; PPG Properties, LLC; AU Medical Associates Anesthesia Billing Services, LLC; Georgia Esoteric and Molecular Labs, LLC; MCG-PPG Cancer Research Center, LLC; AU Medical Associates Emergency Billing Services, LLC; MCGH/PPG Reproductive Lab, LLC; AU Health SPC; AU Health SPC-AU Medical Center SP and AU Health SPC-AU Medical Associates SP. This discussion has been prepared by management and should be read in conjunction with the audited financial statements and the notes therein. Unless otherwise indicated, dollar amounts are in thousands.

The Health System's annual financial report includes: statements of net position, statements of revenues, expenses, and changes in net position, statements of cash flows and the notes to the financial statements. These basic financial statements and related notes provide information about the financial activities of the Health System.

### The Health System's Net Position

The statement of financial position presents the financial position of the Health System at the end of the fiscal year and includes all of the Health System's assets and liabilities. The difference between total assets and total liabilities is net position. Net position is one indicator of the current financial condition of the Health System at a point in time, while the change in net position is an indication of whether the Health System's overall financial condition improved or worsened during the year. Assets and liabilities are generally measured using current or net realizable value. One notable exception is capital assets, which are stated at historical cost less accumulated depreciation.

Table 2 – Assets, Liabilities and Net Position

A summarized comparison of the Health System's assets, liabilities and net position at June 30, 2018, and 2017, follows:

	2018	2017
	\$	\$
<b>Current assets</b>	300,193	280,090
<b>Noncurrent assets</b>	407,401	419,518
Total assets	707,594	699,608
<b>Current liabilities</b>	128,474	141,798
<b>Noncurrent liabilities</b>	244,808	238,491
Total liabilities	373,282	380,289
<b>Invested in capital assets, net of related debt</b>	87,762	85,030
<b>Unrestricted</b>	246,550	234,289
Total net position	334,312	319,319

### Assets

Table 3 – Components of Current Assets

A comparison of current assets as of June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
<b>Cash and cash equivalents</b>	62,016	44,832
<b>Short-term investments</b>	37,962	46,739
<b>Internally designated cash, cash equivalents and short-term investments</b>	5,945	7,994
<b>Cash and investments held by trustee</b>	1,923	1,805
<b>Patient accounts receivable, net</b>	112,895	106,781
<b>Third-party payor receivables</b>	22,413	17,603
<b>Other receivables</b>	19,338	17,556
<b>Inventory</b>	19,105	19,003
<b>Net investment in direct financing lease</b>	1,187	1,151
<b>Other current assets</b>	17,409	16,626
	300,193	280,090

Significant changes to current assets are due to the following:

- Cash and cash equivalents increased \$17.2 million or 38.3% from 2017 to 2018. The increase in cash is a result of timing of payments and the Health System entering into a line of credit in 2018 to fund working capital.
- Short-term investments decreased \$8.8 million or 18.8% from 2017 to 2018. The decrease is due to the liquidation of various short-term assets for the Health System. Detailed information regarding changes to cash and cash equivalents and short-term investments is included in the statements of cash flows.

- Patient accounts receivables, net of allowance for doubtful accounts, increased \$6.1 million or 5.7% in 2018 due to increased net patient revenue.
- Third-party payor receivables increased \$4.8 million or 27.3% in 2018 due to timing of supplemental payments from the State of Georgia. These balances reflect payments due from third-party programs.

Table 4 – Components of Noncurrent Assets

A comparison of noncurrent assets as of June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
<b>Investments</b>	108,259	120,661
<b>Capital assets, net</b>	256,138	269,764
<b>Net investment in direct financing lease, less current portion</b>	22,520	23,706
<b>Notes receivable from related party</b>	-	201
<b>Other</b>	20,484	5,186
	<b>407,401</b>	<b>419,518</b>

Significant changes to noncurrent assets are due to the following:

- Capital assets decreased \$13.6 million or 5.1% in 2018. Capital expenditures were \$20.3 million in 2018 and \$35.1 million in 2017, net of amounts accrued at year-end and amounts financed under capital lease obligations. These additions to capital assets were offset by asset depreciation and disposals. Changes in the balances from year-to-year are primarily due to capital expenditures offset by asset depreciation.
- Long-term investments decreased \$12.4 million or 10.3% due to the liquidation of a portion of the Health System's assets in 2018.
- Other noncurrent assets increased \$15.3 million or 295.0% due to increases in the collateral posted with the interest rate swap counterparty.

### Liabilities

Total liabilities decreased \$7.0 million or 1.8% from June 30, 2017 to June 30, 2018, primarily due to a combination of several factors, including a decrease in accounts payable and accrued expenses related to the timing of payments from 2017 to 2018, scheduled principal payments under capital lease and long-term debt arrangements and a reduction in the Health System's interest rate swap liability as a result of changes in interest rates. These decreases were partially offset by an increase in amounts drawn under the Health System's line of credit.

### Net Position

The increase in net position invested in capital assets of \$2.7 million or 3.2% from June 30, 2017 to June 30, 2018, was primarily due to capital expenditures made from operating funds. Debt-financed capital assets are not reflected in net assets invested in capital assets until the related debt is paid down.

Unrestricted net position increased by \$12.3 million or 5.2% from June 30, 2017 to June 30, 2018 due primarily to Health System's positive results of operations in 2018, which were partially offset by a \$33.2 million reduction in net position due to the adoption of a new accounting standard for other post-employment liabilities.

### Operating Results and Changes in the Health System's Net Position

The statement of revenues, expenses and changes in net position represents the results of the Health System's operations and other changes in net position for the year.

Table 5 – Operating Results and Changes in Net Position

A summarized comparison of revenues, expenses and changes in net position for the years ended June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
<b>Change in financial position:</b>		
Operating revenues	861,769	808,341
Operating expenses	802,151	822,967
Operating income	59,618	(14,626)
<b>Nonoperating revenue (expense):</b>		
Interest expense	(8,514)	(8,598)
Investment income, net	5,074	5,732
Contribution to Augusta University	-	(25,076)
Unrealized gain on interest rate swap	5,994	10,072
Net (loss) gain on disposition of capital assets	(395)	360
Supplemental contribution to the AU Early Retirement Program	(6,791)	(6,826)
<b>Increase (decrease) in net position before service fee, additions to permanent endowments, restricted contributions and restricted investment income</b>	54,986	(38,962)
<b>Nonoperating expense – Service fee</b>	(6,638)	-
<b>Increase (decrease) in net position before additions to permanent endowments, restricted contributions and restricted investment income</b>	48,348	(38,962)

## Operating Revenues

Table 6 – Operating Revenues

A summarized comparison of the components of operating revenues for the years ended June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
<b>Net patient service revenue</b>	754,470	724,716
<b>Revenue from contractual services</b>	29,932	31,410
<b>Other operating revenue</b>	77,367	52,216
	861,769	808,342

Table 7 – Operating Revenues Percentages

A summarized comparison by percentage of the components of operating revenues for the years June 30, 2018 and 2017 follows:

	2018	2017
<b>Net patient service revenue</b>	87.5%	89.7%
<b>Revenue from contractual services</b>	3.5%	3.9%
<b>Other operating revenue</b>	9.0%	6.4%
	100.0%	100.0%

Net patient service revenue is primarily driven by the volume and payor mix of patients treated. A comparative summary of patient activity statistics for the years ended June 30, 2018 and 2017 follows:

Table 8 – Patient Activity Statistical Summary

	2018	2017
<b>Inpatient admissions</b>	21,281	20,929
<b>Outpatient visits</b>	336,951	338,294
<b>Physician based clinic visits</b>	118,785	105,317
<b>Emergency room visits</b>	83,860	84,556

The Health System's inpatient admissions increased from 2017 to 2018 by 1.7%. The combined total for emergency room visits, physician based clinic visits and outpatient visits increased by 2.2% from 2017 to 2018.

The majority of patient care revenue is received under contractual arrangements with governmental payors and managed care insurers. The following charts show the distribution of gross patient service revenue by primary payor source for the years ended June 30, 2018 and 2017:

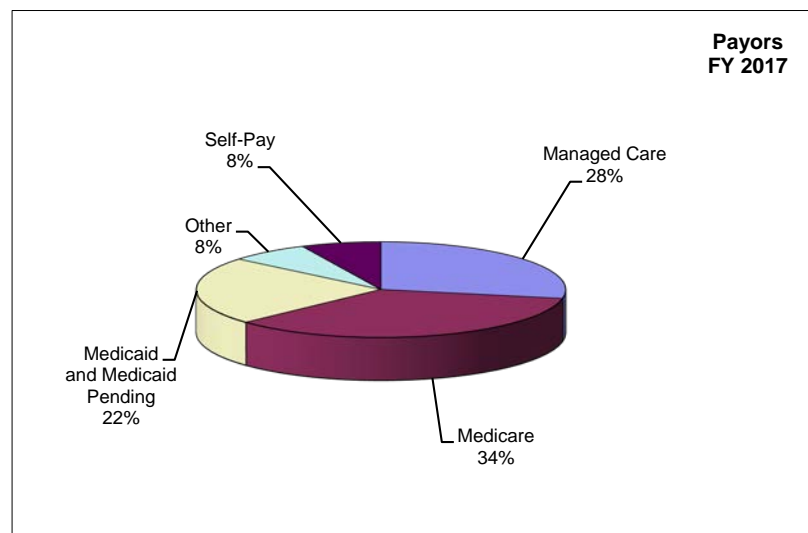
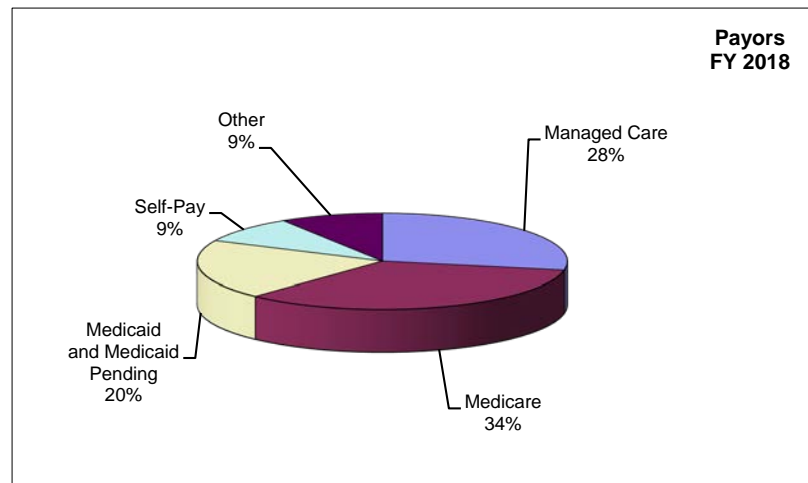


Table 9 – Components of Net Patient Service Revenue

A comparison of the components of net patient service revenue for the years ended June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
Gross patient service revenue	2,885,248	2,834,375
Georgia Medicaid Indigent Care Trust Fund revenue	10,112	6,500
Georgia Medicaid upper payment limits revenue	22,137	17,341
South Carolina Medicaid disproportionate share revenue	5,882	3,952
Provision for contractual adjustments (includes charity care)	(2,077,771)	(2,039,166)
Provision for doubtful accounts	(91,138)	(98,286)
	754,470	724,716

Gross patient service revenue increased by \$50.9 million or 1.8% from 2017 to 2018 due to an increase in the severity and complexity of inpatient cases.

The Health System is generally reimbursed by governmental and third-party payors based on negotiated fixed rates that are not dependent on the Health System's billed gross charges. Annual increases in these rates are set through government regulation or third-party contracts and tend to not keep pace with the Health System's implemented rate increases. This results in increases to the provision for contractual adjustments that outpace increases in gross charges on a percentage basis. The provision for contractual adjustments increased \$38.6 million or 1.9% in 2018.

The Health System makes a provision for accounts on which collection is deemed doubtful. Changes in this provision occur due to rate increases implemented by the Health System, changes in payor mix, collection performance and the classification of account write-offs as bad debt (which is a component of the provision for doubtful accounts) and charity care (which is a component of provision for contractual adjustments). The provision for doubtful accounts decreased \$7.1 million or 7.3% in 2018 due to improvements made to self-pay collection processes during the year.

Certain state programs include supplemental payments that are made outside of individual claim reimbursements. Changes associated with these state programs resulted from annual reimbursement determinations that are made at the discretion of the state responsible for administering the associated program. The net reimbursement benefits associated with these programs are recognized as a reduction in the associated contractual adjustments. A summary of changes in these components follows:

- Georgia Medicaid Indigent Care Trust Fund revenue increased \$3.6 million or 55.6% in 2018.
- Georgia Medicaid upper payment limit revenue increased \$4.8 million or 27.7% in 2018.
- South Carolina Medicaid disproportionate share program revenue increased \$1.9 million or 48.8% in 2018.

Other operating revenues increased by \$25.2 million or 48.2% in 2018. The increase in 2018 is primarily attributable to growth and expansion of the Health System's contract, specialty and retail pharmacy programs, which increased by \$14.8 million.



### Operating Expenses

A summarized comparison of operating expenses for the years ended June 30, 2018 and 2017 follows:

Table 10 – Operating Expenses

	2018	2017
	\$	\$
Salaries and wages	357,872	364,010
Employee benefits and payroll taxes	49,108	77,984
Purchased services	40,641	51,818
Medical and surgical supplies	176,497	165,008
Insurance	14,100	10,375
Non-medical supplies and other expenses	67,748	67,696
Depreciation and amortization	36,175	34,419
IT and telecommunications	45,184	38,535
Repairs and maintenance	14,826	13,122
	802,151	822,967

The primary components of changes in operating expenses are:

- Decreases in salaries and wages (\$6.1 million or 1.7% in 2018)
- Decreases in employee benefits and payroll taxes (\$28.9 million or 37.0% in 2018)
- Decreases in purchased services (\$11.2 million or 21.6% in 2018)
- Increases in medical and surgical supplies expense (\$11.5 million or 7.0% in 2018)
- Increases in nonmedical supplies and other expense (\$53,000 or 0.1% in 2018)
- Increases in IT and telecommunications expense (\$6.6 million or 17.3% in 2018)
- Increases in insurance (\$3.7 million or 35.9% in 2018)

The decrease in purchased services expense in 2018 is primarily the result of a reduction in graduate medical education expenses.

Medical and surgical supplies increased due to growth and expansion of the contract, retail and specialty pharmacy programs.

In 2018, the net decrease in total operating expenses of \$20.8 million or 2.5% is primarily the result of the decrease in employee benefits and payroll taxes due to a restructuring of the other post-employment benefits plan, which resulted in a reduction to the associated liability.

### Nonoperating Revenues and Expenses

As presented in Table 5, nonoperating revenues and expenses consist of interest expense, investment income, unrealized gain on interest rate swap, net loss on disposition of capital assets, net loss on asset impairment, supplemental contribution to the Augusta University (AU or the University) Early Retirement Program and service fee. In addition, in 2017, nonoperating revenue and expenses included a \$25.1 million additional contribution to AU.

### Interest Expense

The Health System incurs interest expense on its short-term borrowings, long-term borrowings and the service fee to AU.

The Health System experienced a decrease in interest expense in 2018, net of capitalized interest, of \$85 thousand or 0.1%. The decrease in interest expense is primarily the result of a decrease in the balance of capital lease obligations.

**Investment Income**

Table 11 – Components of Net Investment Income

A summarized comparison of net investment income for the years ended June 30, 2018 and 2017 follows:

	2018	2017
	\$	\$
Dividend and interest income	3,812	4,465
Net realized gain on investments	722	3,491
Net change in unrealized gains (losses) on investments	1,006	(1,585)
Management fees	(466)	(639)
	5,074	5,732

During the year ended June 30, 2018, as compared to fiscal 2017, the Health System experienced a decrease in net investment income of \$658,000 or 11.5%. This decrease is a result of the decrease in dividends and interest income due to the reduction of long-term investment balances.

**Unrealized Gain / Loss on Interest Rate Swap**

In 2018 and 2017, the Health System recorded changes to the fair value of the interest rate swap associated with the Series 2014A and 2014B Bonds as unrealized gains or losses. Changes to the fair value of the interest rate swap occur due to changes in the London Inter Bank Offered Rate (LIBOR) and the reduction of the notional amount outstanding that have occurred since the initiation of the swap on April 1, 2008. Decreases in LIBOR result in unrealized losses and increases in LIBOR result in unrealized gains. The Health System recorded an unrealized gain of \$6.0 million in 2018 and \$10.1 million in 2017.

**Net Losses and Gains on Disposition of Capital Assets**

On the routine disposition of capital assets, the Health System recorded a net loss of approximately \$395,000 and a net gain of approximately \$360,000 in 2018 and 2017, respectively.

**Supplemental Contribution to AU's Early Retirement Program**

Supplemental contributions made to a related party, AU, for individuals who participated in an early retirement program offered prior to the official commencement of operations by the Health System on July 1, 2000, are included in nonoperating expenses. The expense for the early retirement program was \$6.8 million for 2018 and 2017. For additional information, refer to Note 13 to the accompanying financial statements.

**Service Fee**

On July 1, 2016, the Health System and Regents amended and restated the Master Lease Agreement with the Board of Regents of the University System of Georgia (Regents). Under this operating agreement, the Health System is required to pay an annual performance-based service fee.

The performance-based service fee is defined as a percentage of AUMC's defined net income. Based on AUMC's statement of revenues, expenses and changes in net position, defined net income is the change in unrestricted net position, excluding unrealized gains and losses related to changes in the fair value of the interest rate swap. The service fee is a variable-rate fee based on AUMC's defined income as a percentage of operating revenue.

Table 12 – Service Fee

A comparative summary of the performance-based service fee for the years ended June 30, 2018 and 2017, follows:

	2018	2017
	\$	\$
<b>Performance-based service fee</b>	6,638	-

The increase in the service fee in 2018 compared to 2017 was due to AUMC's improved operating results in 2018.

### **Operations and Services Agreement**

The Health System has entered into an operations and services agreement with Regents in connection with the Affiliation Agreement. Regents, through AU, has agreed to provide to and purchase from the Health System certain administrative and support services at their estimated cost (which have historically been provided to each other) in order to achieve efficiencies, economies of scale and other benefits.

#### **Use of Nomenclature**

Regents and the Health System agree that the use of consistent nomenclature promotes a positive external image. As part of the annual renewal of the Operating and Services Agreement effective July 1, 2016, in exchange for an annual lump-sum payment, Regents granted AUMC the nonexclusive, nontransferable right to use the AU nomenclature and the right to grant sublicenses to the Health System's subsidiaries and affiliates. Amounts paid to AU by the Health System for use of nomenclature for fiscal years 2018 and 2017 were \$3.5 million. This expense is included in the statement of revenues and expenses and changes in net position as purchased services as part of operating expense.

#### **Foundation and Advancement Services**

With the 2018 renewal of the Operations and Services Agreement, the Health System is obligated to pay an annual lump sum to the Georgia Health Sciences Foundation, Inc. (GHSF) for foundation and advancement services performed on the Health System's behalf. Amounts paid to GHSF by the Health System for these services for the fiscal years 2018 and 2017 were \$500,000. This expense is included in the statement of revenues and expenses and changes in net position as purchased services as part of operating expense.

### **Capital Asset and Debt Administration**

#### **Capital Assets**

As of June 30, 2018 and 2017, the Health System had \$256.1 million and \$269.8 million, respectively, invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the accompanying financial statements. In 2018 and 2017, the Health System purchased new capital assets totaling \$20.3 million and \$35.1 million, respectively.

#### **Debt**

In 2004, the MCG-PPG Cancer Research Center, LLC (CRC), a company formed by the Health System to construct, own and operate a portion of a building to house a cancer research center on the campus of AU, issued a total of \$32,870,000 Development Authority of Richmond County Education Facilities Revenue Bonds (the 2004 CRC Bonds), Series 2004A and Series 2004B. Proceeds from the 2004 CRC Bonds provided the funds to finance the cost of the construction of a portion of a cancer research center building on the campus of AU. Semi-annual interest payments are due at interest rates range from 2.5% to 5.0%.

On October 30, 2014, CRC issued the Development Authority of Richmond County Revenue Refunding Bonds (the 2014 CRC Bonds), Series 2014A, in the amount of \$24,490,000. Proceeds of the Series 2014 CRC Bonds were used to refund all of the 2004 Bonds, fund a debt service reserve fund for the Series 2014 CRC Bonds, and pay the cost of issuing the 2014 CRC Series Bonds. Semi-annual interest payments are due at interest rates range from 3.0% to 5.0%.

The effective interest rate for June 30, 2017 and 2018 was 4.2%. Principal payments are due annually through December 2034.

On April 1, 2008, the Health System issued a total of \$135 million of Development Authority of Richmond County Revenue Bonds (2008 Bonds), Series 2008A and 2008B. Proceeds from the 2008 Bonds were to be used to fund certain construction and renovation projects and to purchase new and replacement equipment. The 2008 Bonds were also used to refund outstanding capital lease obligations and pay for certain costs associated with the issuance of the 2008 Bonds.

Concurrently with the issuance of the Series 2008A and 2008B variable-rate Bonds, the Health System entered into a variable-to-fixed interest rate swap. The intention of the swap was to effectively change the Health System's variable interest rate on the 2008 Bonds to a synthetic fixed rate of 3.302%. This swap was entered into as a means of lowering the Health System's borrowing costs, as compared to traditional fixed-rate bonds.

On July 15, 2014, the Health System refunded the 2008A and 2008B Bonds with the 2014A and 2014B Bonds, which are a direct bank placement of bonds in the amount of \$60,945,000 for each of the 2014A and 2014B Bonds. The amortization of the 2014A and 2014B Bonds is approximately the same as the amortization of the 2008A and 2008B Bonds. The 2014A Bonds are variable rate bonds that incur interest at a rate of 68% of LIBOR plus 79 basis points and are placed with their bank through July 1, 2024. The 2014B Bonds are variable rate bonds that incur interest at a rate of 68% of the sum of LIBOR and 125 basis points and are placed with their bank through July 1, 2026.

On June 27, 2012, the Health System entered into a note in the amount of \$50 million. Funds from the note were to be used to fund certain construction and renovation projects and to purchase new and replacement equipment.

On June 30, 2015, the Health System entered into a modification of the terms of the note. The note was modified to a variable interest rate note and was extended until July 1, 2018. On June 30, 2018, the Health System entered into a modification of the terms of the note to extend the note through July 1, 2019. Due to the modifications, the note incurred interest at a rate of LIBOR plus 0.65% effective July 1, 2015 and incurred interest at a rate of LIBOR plus 0.75% effective July 1, 2018. Interest on the note is due monthly.

On June 27, 2013, the Health System entered into capital lease obligations as part of a Management Services Agreement to purchase certain types of medical equipment and technology. As of June 30, 2018, the balance of obligations under capital leases was \$19.8 million.

On September 1, 2014, the Health System entered into a capital lease obligation to purchase a unified communication system. As of June 30, 2018, the balance of this obligation under capital lease was \$1.1 million.

On August 2, 2016, the Health System entered into a capital lease obligation as part of a Management Services Agreement to purchase certain types of diagnostic laboratory equipment and technology. As of June 30, 2018, the balance of obligations under capital leases was \$2.3 million. For additional information of these capital lease obligations, refer to Note 10 to the accompanying financial statements.

On October 18, 2017, the Health System entered into a line of credit in the amount of \$35,000,000. Funds from the line of credit are to be used to fund working capital and other general corporate purposes. The line of credit is a variable interest rate note and incurs interest at a rate equal to the higher of the Prime Rate or LIBOR plus 2.50% per annum. Interest rates are reset monthly. As of June 30, 2018, the balance of the line of credit was \$27.1 million.

### **Net Investment in Direct Financing Lease**

In connection to the 2004 CRC Bonds and 2014 CRC Bonds, in January 2006, CRC entered into a lease with AU for a portion of a building that houses a cancer research center. The lease term is one year with 29 consecutive annual renewals, at the option of AU. The lease qualifies as, and has been recorded as, a direct financing lease by CRC.

The effective interest rate on the lease is 2.93% as of June 30, 2018.

### **Contacting the Health System's Financial Management**

The Health System's financial statements are designed to present users with a general overview of the Health System's finances and to demonstrate the Health System's accountability. If you have any questions about the annual financial report or need any additional information, please contact Greg Damron, Vice President and Chief Financial Officer, 1120 15th Street (BI 2086), Augusta, Georgia 30912.



## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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The Board of Directors of  
AU Health System, Inc.:

### Report on the financial statements

We have audited the accompanying financial statements of the business-type activities of **AU Health System, Inc.** (a component unit of the State of Georgia) (the "Health System"), as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Health System's basic financial statements as listed in the table of contents.

### Management's responsibility for the financial statements

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

### Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Health System's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Health 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 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of AU Health System, Inc. as of June 30, 2018 and 2017, and the changes in net position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

#### Emphasis of matter

As further described in Note 1 to the financial statements, the Health System adopted the Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, during the year ended June 30, 2018. Our opinion is not modified with respect to this matter.

#### Other matters

##### Required supplementary information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 11 be presented to supplement the basic financial statements. Such information, although not a required part of the 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 basic financial statements in an appropriate operational, economic, or historical context. This required supplementary information is the responsibility of management. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America. These limited procedures 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 basic financial statements, and other knowledge we obtained during our audit of the 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.

As discussed in Note 1 to the financial statements, management has elected to omit the 2016 management's discussion and analysis that the Government Accounting Standards Board requires to be presented to supplement the basic financial statements. Such omitted information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this omitted information.

**Supplementary information**

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Health System's basic financial statements. Schedule I – Combining statement of net position and Schedule II – Combining statement of revenues, expenses and changes in net position on pages 50 through 53 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the basic financial statements or to the 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 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

**Other reporting required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report, dated August 31, 2018, on our consideration of the Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Health System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Health System's internal control over financial reporting and compliance.



Miami, Florida  
August 31, 2018



# Statements of net position

June 30	2018	2017
	\$	\$
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	62,015,768	44,831,738
Short-term investments	37,961,738	46,739,155
Cash equivalents internally designated for self-insurance liability funding	3,195,038	3,692,802
Short-term investments internally designated for self-insurance liability funding	2,749,690	4,301,674
Cash held by trustee under indenture agreement	1,001,007	880,184
Investments held by trustee under indenture agreement	922,009	925,231
Patient accounts receivable, net of allowance for doubtful accounts of approximately \$109,330,000 in 2018 and \$97,196,000 in 2017	112,894,656	106,780,671
Due from third-party payors	22,412,644	17,603,221
Other receivables	19,337,826	17,555,807
Inventory	19,105,346	19,002,610
Net investment in direct financing lease	1,186,728	1,151,040
<b>Other current assets</b>	<b>17,410,195</b>	<b>16,625,556</b>
<b>Total current assets</b>	<b>300,192,645</b>	<b>280,089,689</b>
<b>Noncurrent assets:</b>		
Investments internally designated for self-insurance liability funding	9,640,231	8,797,633
Long-term investments	98,618,769	111,862,996
Capital assets, net	256,138,375	269,764,409
Net investment in direct financing lease, less current portion	22,519,524	23,706,252
Notes receivable from related party	-	201,290
<b>Other assets</b>	<b>20,484,378</b>	<b>5,185,383</b>
<b>Total assets</b>	<b>707,593,922</b>	<b>699,607,652</b>

## Statements of net position (cont'd)

June 30	2018	2017
	\$	\$
<b>Liabilities and net position</b>		
<b>Current liabilities:</b>		
Accounts payable	33,210,519	47,556,171
Accrued salaries and wages	6,849,534	11,784,899
Accrued compensated absences	19,392,373	18,843,484
Accrued expenses and other current liabilities	8,345,941	9,102,997
Due to related party - Service fee	6,638,215	-
Due to related parties	34,518,899	31,301,537
Due to third-party payors	3,593,263	5,498,515
Current portion of accrued professional liability costs	4,256,803	3,516,998
Current portion of obligations under capital lease	5,469,281	5,932,665
Current portion of long-term debt	6,199,167	8,260,833
Total current liabilities	128,473,995	141,798,099
<b>Noncurrent liabilities:</b>		
Long-term debt, net of current	189,698,791	171,311,528
Obligations under capital lease, net of current	17,777,061	24,048,493
Accrued postemployment benefits	6,165,679	11,531,792
Accrued professional liability costs, net of current	12,770,407	10,550,991
Interest rate swap liability	14,818,596	20,812,794
Other liabilities	3,577,890	234,848
Total liabilities	373,282,419	380,288,545
<b>Net position:</b>		
Invested in capital assets, net of related debt	87,762,033	85,029,917
Unrestricted	246,549,470	234,289,190
Total net position	334,311,503	319,319,107

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

# Statements of revenues, expenses and changes in net position

For the years ended June 30	2018	2017
	\$	\$
<b>Operating revenues:</b>		
Net patient service revenue (net of provision for doubtful accounts of approximately \$91,138,000 in 2018 and \$98,287,000 in 2017)	754,470,005	724,716,020
Revenue from contractual services	29,932,138	31,409,501
Other operating revenue	77,367,261	52,216,118
Total operating revenues	861,769,404	808,341,639
<b>Operating expenses:</b>		
Salaries and wages	357,871,918	364,010,292
Employee benefits and payroll taxes	49,107,650	77,984,202
Purchased services	40,640,973	51,818,198
Medical and surgical supplies	176,497,004	165,007,627
Insurance	14,100,487	10,374,837
Non-medical supplies and other expenses	67,748,655	67,696,079
Depreciation and amortization	36,175,226	34,418,623
Information technology and telecommunications	45,183,822	38,535,110
Repairs and maintenance	14,825,575	13,122,268
Total operating expenses	802,151,310	822,967,236
Operating income (loss)	59,618,094	(14,625,597)
<b>Nonoperating revenue:</b>		
Interest expense	(8,513,680)	(8,598,403)
Investment income, net	5,073,772	5,731,826
Contributions to Augusta University	-	(25,076,005)
Unrealized gain on interest rate swap	5,994,197	10,071,993
Net (loss) gain on disposition of capital assets	(395,045)	360,074
Supplemental contribution to the Augusta University Early Retirement Program	(6,790,805)	(6,826,193)
<b>Increase (decrease) in net position before service fee, additions to permanent endowments, restricted contributions and restricted investment income</b>	54,986,533	(38,962,305)
<b>Nonoperating expense - Service fee</b>	(6,638,215)	-
<b>Increase (decrease) in net position before restricted contributions and restricted investment income</b>	48,348,318	(38,962,305)
<b>Change in restricted contributions</b>	(185,163)	2,044,584
<b>Increase (decrease) in net position</b>	48,163,155	(36,917,721)
<b>Net position, beginning of year, as previously reported</b>	319,319,107	356,236,828
Net impact of GASB Statement No. 75 implementation	(33,170,759)	-
<b>Net position, as restated beginning of year</b>	286,148,348	356,236,828
<b>Net position, end of year</b>	334,311,503	319,319,107

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

# Statements of cash flows

For the years ended June 30	2018	2017
	\$	\$
<b>Cash flows from operating activities:</b>		
Cash received from and on behalf of patients	741,819,622	723,375,325
Other receipts from operations	105,339,103	71,759,009
Cash paid to employees	(445,321,442)	(429,119,619)
Cash paid to suppliers	(369,804,548)	(330,462,351)
Net cash provided by operating activities	32,032,735	35,552,364
<b>Cash flows from noncapital financing activities:</b>		
Interest paid on service fee	-	(66,539)
Interest payments on amounts due to third-party payors	-	(21,457)
Payment to related party – Service fee	-	(3,989,043)
Supplemental contribution to the Augusta University Early Retirement Program	(6,790,805)	(6,826,193)
Net cash used in noncapital financing activities	(6,790,805)	(10,903,232)
<b>Cash flows from capital and related financing activities:</b>		
Principal paid on revenue bonds	(6,855,000)	(4,655,000)
Principal paid on term loan	(3,733,333)	(3,387,500)
Purchases of capital assets	(20,730,490)	(32,800,295)
Proceeds from line of credit	27,100,000	-
Proceeds from disposition of capital assets	2,608	3,308
Payment of principal on obligations under capital leases	(9,381,143)	(15,257,016)
Interest payments	(9,233,628)	(8,510,407)
(Payment) receipt of collateral on interest rate swap mark to market	(6,200,000)	9,600,000
Principal received from direct financing lease	1,151,040	1,116,321
Interest received from direct financing lease	719,948	752,909
Capital contributions	(185,163)	1,730,125
Net cash used in capital and related financing activities	(27,345,161)	(51,407,555)
<b>Cash flows from investing activities:</b>		
Interest and dividends on investments	3,690,120	3,264,512
Payment on notes receivable	201,290	-
Purchases of investments	(99,277,507)	(149,542,396)
Proceeds from sales of investments	114,296,417	180,982,108
Net cash provided by investing activities	18,910,320	34,704,224
<b>Net increase in cash and cash equivalents</b>	<b>16,807,089</b>	<b>7,945,801</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>49,404,724</b>	<b>41,458,923</b>
<b>Cash and cash equivalents, end of year</b>	<b>66,211,813</b>	<b>49,404,724</b>

## Statements of cash flows (cont'd)

For the years ended June 30	2018	2017
	\$	\$
<b>Reconciliation of operating income (loss) to net cash provided by operating activities:</b>		
Operating income (loss)	59,618,093	(14,625,597)
Adjustments:		
Depreciation	36,175,226	34,418,623
Provision for doubtful accounts	91,138,525	98,286,124
Amortization of loan payable premium	(186,070)	(191,103)
Changes in:		
Patient accounts receivable	(97,252,510)	(105,746,593)
Due to/from third-party payor	(6,714,675)	4,682,486
Other receivables	(1,782,019)	(11,886,635)
Inventory	(102,736)	(29,067)
Other current assets	(784,639)	6,538,299
Accounts payable	(13,915,682)	12,160,591
Due to related parties	3,217,362	(2,597,824)
Accrued expenses and other current liabilities	(5,143,531)	8,675,800
Other liabilities	3,343,042	252,120
Other postemployment benefits	(38,536,872)	6,256,863
Accrued professional liability	2,959,221	(641,723)
Net cash provided by operating activities	32,032,735	35,552,364
<b>Reconciliation of cash and cash equivalents to the statements of net position:</b>		
Cash and cash equivalents	62,015,768	44,831,738
Cash equivalents internally designated for self-insurance liability funding	3,195,038	3,692,802
Cash held by trustee under indenture agreement	1,001,007	880,184
Total cash and cash equivalents	66,211,813	49,404,724
<b>Supplemental schedule of noncash investing and financing activities:</b>		
Capital additions included in accounts payable	(429,970)	1,713,061
Capital additions under capital lease obligation	2,646,327	6,987,756
Increase in fair value of investments	1,982,309	2,052,723
Decrease in fair value of stock	323,964	(56,859)

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

# Notes to financial statements

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

### **Reporting Entity**

AU Health System, Inc. (the Health System), located in Augusta, Georgia, was incorporated under the laws of the State of Georgia as a nonprofit corporation on June 1, 2010. The Health System qualifies as a tax-exempt corporation under Section 501(c)(3) of the Internal Revenue Service Code. The purpose of the Health System is to further the health science education missions and other tax-exempt functions and purposes of Augusta University (the University or AU), AU Medical Associates, Inc. (AUMA), AU Medical Center, Inc. (AUMC), Roosevelt Warm Springs Rehabilitation & Specialty Hospitals, Inc. (RWSH) and other cooperating organizations and entities with the University.

In a Joint Operating Agreement (the Agreement) dated July 1, 2010, AUMC and AUMA agreed that, in order to advance jointly the mission of clinical integration of the various healthcare services provided by them to the community and the University, the Health System will have the responsibility for the strategic planning, strategic direction and strategic coordination of the operations of AUMC and AUMA. The Agreement was subsequently amended on June 26, 2014 to incorporate Roosevelt Warm Springs Rehabilitation & Specialty Hospitals, Inc. (RWSH) and on August 28, 2014 to incorporate AU Health Professions Associates, Inc. (Health Professions Associates), Augusta University Nursing Associates, Inc. (Nursing Associates) and AU – Dental Associates (Dental Associates).

In accordance with the criteria in GASB No. 39, *“Determining Whether Certain Organizations Are Component Units,”* the Health System is a legally separate tax-exempt organization whose activities support the University, a unit of the Board of Regents of the University System of Georgia (Regents) (an organizational unit of the State of Georgia). The Health System is considered an affiliated organization of the University. The State Accounting Office determined component units of the State of Georgia, as required by GASB No. 39, should not be assessed in relation to their significance to the University. Accordingly, the Health System’s financial activities are not included in the financial statements of the University. The Health System qualifies for treatment as a component unit of the State of Georgia.

During the year ended June 30, 2018, the Health System, AUMC, RWSH and AUMA completed a series of corporate and governance changes (the Reorganization) to better align the entities within the Health System and allow for efficient and integrated funds flow and accounting. As a result of the Reorganization, AUMA became a blended component unit of the Health System. Prior to the Reorganization, AUMA was a component unit of the University and AUMA’s financial position and operating results were not included in the Health System financial statements. In addition, as a result of the Reorganization, AUMC and RWSH became blended component units of the Health System. Prior to the Reorganization, AUMC and RWSH were discretely presented component units within the Health System’s financial statements. The Health System has retrospectively restated its financial statements for this change in reporting entity as if it had occurred as of the beginning of the year ended June 30, 2017. As a result of the Reorganization, the 2017 / 2016 year-to-year comparison and related Management Discussion and Analysis (MD&A) for 2016 has been excluded from this report.

### **Basis of Presentation**

The Health System's financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The GASB has issued Statement No. 35, *"Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities and GASB 39, Determining Whether Certain Organizations Are Component Units."* The financial statement presentation required by these statements provides a comprehensive, entity-wide perspective of the Health System's assets, liabilities, net position, revenues, expenses, changes in net position and cash flows and replaces the fund-group perspective previously required. In addition, these statements require the Health System to present MD&A. The MD&A is considered to be required supplemental information and precedes the financial statements.

### **Basis of Accounting**

For financial reporting purposes, the Health System is considered a special-purpose government entity engaged only in business-type activities. Accordingly, the financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as operating revenues and operating expenses. All other activities are reported as nonoperating activities.

The Health System's financial statements are prepared on the accrual basis of accounting using the economic resources measurement focus and are based on accounting principles applicable to governmental units as established by the GASB and the provisions of the American Institute of Certified Public Accountants, *"Audit and Accounting Guide, Health Care Entities,"* to the extent that they do not conflict with GASB.

### **Scope of Statements**

The accompanying financial statements include the financial position and activities of AUMC, a nonprofit corporation organized to further the health sciences, patient care, research and education missions of AU. AUMC consists of a 632-bed acute care hospital and related outpatient care facilities principally located in Augusta, Georgia.

AUMA is a nonprofit organization formed for the purpose of enhancing the clinical, research and education missions of AU and billing and collecting for medical services provided to patients.

RWSH is a nonprofit corporation organized to further the health sciences, patient care, research and education missions of AU primarily through management of a long-term acute care hospital and inpatient rehabilitation hospital. RWSH operates a licensed 32-bed acute care hospital and a 52-bed licensed inpatient rehabilitation hospital located in Warm Springs, Georgia.

PPG Properties, LLC is a limited liability company formed to manage real estate rental properties. This entity has no termination date.

AUMA Alternative Collections, LLC is a limited liability company formed to bill and collect for anesthesia services provided to patients. This entity has no termination date.

Georgia Esoteric and Molecular Labs, LLC is a limited liability company formed to operate a specialized pathology laboratory with genetic and molecular testing capabilities. This entity has no termination date.

MCG-PPG Cancer Research Center, LLC (CRC) is a limited liability company formed to construct, own and operate a portion of a building to house a cancer research center on the campus of AU. CRC has no termination date.

Affiliated Billing Services, LLC, is a limited liability company formed to bill and collect for emergency services provided to patients. This entity has no termination date.

AUMA is the sole equity member and has sole voting control of each of the LLC's.

MCG/PPG Reproductive Lab, LLC is a limited liability company and a joint venture formed between AUMC and AUMA to operate a medical laboratory engaged primarily in reproductive endocrinology and in-vitro fertilization.

AU Health SPC, with AU Health SPC-AU Medical Center SP, and AU Health SPC-AU Medical Associates, SP are an offshore captive insurer.

The Health System holds noncontrolling interests in the following companies as of June 30:

	2018	2017
REACH Call, Inc.	0.00%	2.89%
University Health Resources, Inc.	33.00%	33.00%

The Health System accounts for its interest in both of these companies using the equity method of accounting. The related investments are included within other assets in the Health System's statements of net position. The related share of earnings or losses are included within nonmedical supplies and other expenses in the Health System's statements of revenues, expenses and changes in net position.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Significant items subject to such estimates include the determination of the allowances for doubtful accounts and contractual adjustments, reserves for employee healthcare claims, accrued professional liability costs, interest rate swap, other postemployment benefits and estimated third-party payor settlements. In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs will change by a material amount in the near term.

Revisions to prior year's estimates of third-party liabilities resulted in an increase in operating income of \$4,434,000 and \$1,149,000 for the years ended June 30, 2018 and 2017, respectively.

### Cash and Cash Equivalents and Investments

Cash and cash equivalents include highly liquid investments (with an original maturity of three months or less) and money market accounts.

Investments consist of money market funds, certificates of deposit with original maturities greater than three months, marketable securities, corporate bonds and treasury obligations. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying statements of net position based on the quoted market prices of underlying securities comprising the individual investments. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in nonoperating revenue.

The Health System classifies all equity securities and debt securities maturing within one year of the statement of net position, not otherwise designated for long-term use, as current assets. Investments in securities with maturity dates beyond one year from the statement of net position date and other investments designated for long-term use are classified as noncurrent assets.

### Inventories

Inventories, consisting primarily of pharmaceuticals and medical supplies, are stated using the average cost method or market value, whichever is lower.



## Capital Assets

Capital assets are stated at cost on the date of acquisition. The Health System's capitalization policy for assets includes all items with a unit cost of more than \$5,000. Depreciation on capital assets is calculated using the straight-line method over the estimated useful lives of the assets, as determined utilizing "*Estimated Useful Lives of Depreciable Hospital Assets, Revised 2008 Edition*" published by the American Hospital Association.

Ranges of estimated useful life for various capital asset categories are as follows:

Asset Class	Estimated Useful Lives
Building improvements	20 to 25 years
Buildings	25 years
Computer hardware	3 to 5 years
Medical equipment	3 to 20 years
Furniture and fixtures	10 to 20 years
Leasehold improvements	5 to 25 years
Software	3 to 5 years
Vehicles	4 to 10 years

Repairs and maintenance costs are charged to expense as incurred.

## Long-lived Asset Impairment

Long-lived assets are reviewed for impairment if circumstances suggest that there is a significant, unexpected decline in service utility of a long-lived asset. The service utility of a long-lived asset is the usable capacity that at acquisition was expected to be used to provide service. An assessment of recoverability is performed prior to any write-down of assets and an impairment charge is recorded on those assets for which the estimated fair value is below its carrying amount. No material impairment charges to long-lived assets were recorded for the years ended June 30, 2018 and 2017.

## Costs of Borrowing

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

## Net Position

Net position is classified as unrestricted, invested in capital assets, net of related debt and restricted, as follows:

- **Unrestricted Net Position**  
These net position balances represent resources that can be used at the Health System's discretion in carrying out its objectives.
- **Invested in Capital Assets, Net of Related Debt**  
These net positions represent capital assets, net of accumulated depreciation, and are reduced by the current balances of any outstanding borrowings used to finance the acquisition of those assets.

When the Health System has both restricted and unrestricted resources available to finance a particular program, it is the Health System's policy to use restricted resources before unrestricted resources.

### **Net Patient Service Revenue**

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits, reviews and investigations, as well as the provision for doubtful accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

### **Indigent and Charity Care**

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

### **Income Taxes**

The Health System has been recognized as exempt from federal income tax under Internal Revenue Code Section 501(a) as an organization described in Section 501(c)(3) and, therefore, related income is not subject to federal or state income taxes. AU Health SPC, AU Health SPC-AU Medical Center SP and AU Health SPC-AU Medical Associates SP operate in the Cayman Islands where no income, profit or capital gains taxes are currently levied. Accordingly, no provision for income taxes has been recorded.

### **Net Investment in Direct Financing Leases**

MCG-PPG Cancer Research Center, LLC records revenues from leases in accordance with GASB No. 87, "Leases." Under this standard, the lease with AU qualifies as a direct financing lease. Direct financing leases transfer substantially all of the costs and risks of ownership of the leased property to the lessee.

At inception of a direct financing lease, the minimum lease payments plus any estimated residual value are recorded as the gross investment in the lease. The difference between the gross investment in the lease and the cost, or carrying amount, of the leased property is recorded as unearned income. Unearned income is amortized to leasing revenues over the lease term to produce a constant rate of return over the term of the lease. Direct costs incurred to originate direct financing leases are expensed as incurred.

### **Statement of Revenues, Expenses and Changes in Net Position**

For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as operating revenues and operating expenses. Peripheral or incidental transactions, investment income and financing costs are reported as nonoperating revenue and expenses.

### **Advertising Expense**

Advertising is expensed as incurred. Total advertising expense incurred was approximately \$2,636,000 and \$2,712,000 for the years ended June 30, 2018 and 2017, respectively, and is included in nonmedical supplies and other expenses in the accompanying statements of revenues, expenses and changes in net position.

### Recently Adopted Accounting Pronouncements

In June 2015, the GASB issued Statement No. 75, “*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*.” Statement No. 75 establishes new accounting and reporting standards for other post-employment benefits (OPEB), such as health insurance provided to retirees. Under the new standard, governments that participate in OPEB plans are required to report in their statement of net position a net OPEB liability, which is the difference between the total OPEB liability and the assets set aside to pay OPEB. Statement No. 75 is effective for periods beginning after June 15, 2017. The Health System adopted Statement No. 75 for the period ending June 30, 2018, since the Health System determined that it was not practical to restate the year ended June 30, 2017 for the effect of Statement No. 75. As a result of adopting Statement No. 75, the Health System recorded an approximately \$33,171,000 reduction to net position at July 1, 2017.

In January 2016, the GASB issued Statement No. 80, “*Blending Requirements for Certain Component Units – an Amendment of GASB Statement No. 14*.” Statement No. 80 amended the blending requirements for the financial statement presentation of component units. Statement No. 80 added the criterion requiring the blending of a component unit incorporates as a not-for-profit corporation in which the primary government is the sole corporate member. The Health System adopted Statement No. 80 as of July 1, 2016 in conjunction with the reorganization and the change in reporting entity. Since the Health System is the sole corporate member of AUMA and meets the other criteria in Statement No. 80, AUMA has been included in the accompanying financial statements as a blended component unit for all periods presented.

### Pending Accounting Pronouncements

In November 2016, GASB issued Statement No. 83, “*Certain Asset Retirement Obligations*.” Statement No. 83 addresses accounting and financial reporting for certain asset retirement obligations (ARO). 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 the guidance in Statement No. 83. The requirements of Statement No. 83 are effective for reporting periods beginning after June 15, 2018. The Health System is evaluating the effect of Statement No. 83 on its financial statements.

In June 2017, GASB issued Statement No. 87, “*Leases*.” This statement provides guidance for lease contracts for nonfinancial assets – including vehicles, heavy equipment and buildings – but excludes nonexchange transactions, including donated assets, and leases of intangible assets (such as patents and software licenses). The lease definition now focuses on a contract that conveys control of the right to use another entity’s nonfinancial assets, which is referred to in the new Statement as the underlying asset. Under Statement No. 87, a lessee government is required to recognize (1) a lease liability and (2) an intangible asset representing the lessee’s right to use the leased asset. A lessor government is required to recognize (1) a lease receivable and (2) a deferred inflow of resources. A lessor will continue to report the leased asset in its financial statements. The requirements of the Statement are effective for reporting periods beginning after December 15, 2019 with early adoption permitted. The Health System has not adopted this Statement early. The Health System is still assessing the impact of Statement No. 87 on its financial statements.

## 2 Charity Care

The Health System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies under its charity care policy. The Health System estimates the cost of Charity Care by applying a ratio of overall costs to gross charges applied to the gross charity care charges.

Forgone charges and the cost of charity care is as follows for the year ended June 30:

	2018	2017
	\$	\$
<b>Charity care:</b>		
Forgone charges	151,145,000	139,946,000
Cost	42,021,000	40,569,000

## 3 Net Patient Service Revenue

The Health System has agreements with governmental and other third-party payors that provide for reimbursement to the Health System at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Health System's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

### Medicare

Substantially all inpatient acute care and outpatient services rendered to program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic and other factors. Additionally, the Health System is reimbursed for both its direct and indirect medical education costs (as defined), based principally on per-resident prospective payment amounts and certain adjustments to prospective rate-per-discharge operating reimbursement payments. The Health System generally is reimbursed for retroactively determined items at a tentative rate, with final settlement determined after submission of annual cost reports by the Health System and audits by the Medicare administrative contractor. The Health System's Medicare cost reports have been audited and settled for all years through fiscal 2013.

Revenue from the Medicare program accounted for approximately 34% of the Health System's gross patient service revenue for both the years ended June 30, 2018 and 2017.

### Medicaid

Inpatient services rendered to most Medicaid program beneficiaries are reimbursed based upon prospective reimbursement methodologies. Most outpatient services are reimbursed using a retrospective cost-based methodology. The Health System also contracts with certain managed care organizations to receive reimbursement for providing services to Medicaid beneficiaries. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges or prospectively determined per-diem rates. The Health System's Medicaid cost reports have been audited and settled for all years through fiscal 2013.

The State of Georgia administers the Medicaid Upper Payment Limit (UPL) program for providers participating in the State Medicaid program. The Health System's net reimbursement benefit associated with the UPL program totaled approximately \$22,137,000 and \$17,341,000 in fiscal 2018 and 2017, respectively.

The State of Georgia Indigent Care Trust Fund Voluntary Contribution Program is designed to expand Medicaid eligibility, to provide funding for indigent care and to support primary healthcare through increased funding facilitated by Federal Financial Participation when coupled with voluntary participating hospital contributions. Disproportionate share hospitals (as defined) are eligible to make voluntary contributions to the State's Indigent Care Trust Fund (the Trust Fund). During the years ended June 30, 2018 and 2017, the Health System recorded net revenue from this program of approximately \$10,112,000 and \$6,650,000, respectively.

The Health System also participates in a voluntary contribution program (similar to the Georgia program above) available to certain qualifying hospitals in the South Carolina Medicaid program. The net reimbursement benefit associated with this program totaled approximately \$5,882,000 and \$3,952,000 in fiscal 2018 and 2017, respectively.

The net revenue associated with each of the above-described reimbursement programs is recognized as a reduction of related contractual adjustments in the accompanying statements of revenues, expenses and changes in net position. There can be no assurance that the Health System will continue to qualify for future participation in these programs, or that such programs will not ultimately be discontinued or materially modified.

Revenue from the Medicaid program, including net disproportionate share reimbursement described above, accounted for approximately 20% and 22% of the Health System's gross patient service revenue for the fiscal years 2018 and 2017, respectively. Net disproportionate share reimbursement to the Health System under all of the programs described above totaled approximately \$38,131,000 in fiscal 2018 and \$27,943,000 in fiscal 2017. Material reductions in reimbursement from these programs may have a correspondingly material adverse impact on the Health System's results from operations.

### Regulatory Matters

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

### Other Payors

The Health System has entered into payment agreements with certain commercial insurance carriers, managed care organizations and preferred provider organizations. The basis for payment to the Health System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined per-diem rates.

The composition of net patient service revenue follows:

	2018	2017
	\$	\$
<b>Gross patient service revenue</b>	2,885,248,389	2,834,375,318
<b>Less - Provision for contractual and other adjustments</b>	(1,888,494,767)	(1,871,427,498)
<b>Less - Provision for doubtful accounts</b>	(91,138,525)	(98,286,124)
<b>Less - Provision for charity care</b>	(151,145,092)	(139,945,676)
<b>Net patient service revenue</b>	<b>754,470,005</b>	<b>724,716,020</b>

#### 4 Business and Credit Concentrations

The Health System provides healthcare services through its inpatient and outpatient care facilities principally located throughout the Central Savannah River Area (CSRA). The Health System grants credit to patients, substantially all of whom are residents of its service area. The Health System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid and commercial insurance policies).

The mix of net receivables from patients and third-party payors is as follows at June 30:

	2018	2017
<b>Commercial and other third-party payors</b>	48%	49%
<b>Medicaid</b>	20%	22%
<b>Medicare</b>	31%	28%
<b>Self pay</b>	1%	1%
Total	100%	100%

#### 5 Cash, Cash Equivalents and Investments

The Health System's bank balances are as follows at June 30:

	2018	2017
	\$	\$
<b>Insured (FDIC)</b>	5,100,313	3,157,449
<b>Uninsured, uncollateralized or collateralized by securities held by the pledging institution, its trust department or agent in other than the Health System's name</b>	73,052,764	52,719,994
Total	78,153,077	55,877,443
<b>Carrying amount (cash and cash equivalents)</b>	66,211,813	49,404,724

GASB No. 40, "Deposits and Investment Risk Disclosures," requires certain disclosures regarding policies and practices with respect to deposits and the custodial risk, credit risk, interest rate sensitivity and foreign investments associated with them.

The custodial credit risk for deposits is the risk that in an event of a bank failure, the Health System's deposits may not be returned to it. The Health System does not have a deposit policy for custodial credit risk. The Health System places its cash and cash equivalents on deposit with financial institutions in the United States. The Federal Deposit Insurance Corporations (FDIC) covers \$250,000 for substantially all depository accounts. As of June 30, 2018 and 2017, approximately \$73,036,000 and \$48,356,000, respectively, of the Health System's bank balance was uninsured or uncollateralized.

A summary of investments follows:

June 30, 2018	Fair Value	Investment Maturity				Percentage
		Less than 1 Year	1 to 5 Years	6 to 10 Years	More than 10 Years	
	\$	\$	\$	\$	\$	
<b>Investment type</b>						
<b>Debt securities:</b>						
U.S. treasuries	35,874,236	3,400,000	32,474,236	-	-	23.93%
U.S. agencies	12,621,370	1,597,832	9,825,736	365,105	832,697	8.42%
Corporate debt	49,497,626	2,436,531	46,912,501	148,594	-	33.03%
Mortgage/asset-backed securities	17,700,130	-	6,520,540	1,000,121	10,179,469	11.81%
	115,693,362	7,434,363	95,733,013	1,513,820	11,012,166	
<b>Equities and other:</b>						
Equity-domestic	25,123,375	-	-	-	-	16.76%
Equity-international	8,425,003	-	-	-	-	5.62%
Accrued interest and dividends	650,697	-	-	-	-	0.43%
Total investments	149,892,437	7,434,363	95,733,013	1,513,820	11,012,166	100.00%

June 30, 2017	Fair Value	Investment Maturity				Percentage
		Less than 1 Year	1 to 5 Years	6 to 10 Years	More than 10 Years	
	\$	\$	\$	\$	\$	
<b>Investment type</b>						
<b>Debt securities:</b>						
U.S. treasuries	32,202,193	1,990,808	30,211,385	-	-	18.65%
U.S. agencies	26,950,054	2,666,419	14,770,291	3,755,189	5,758,155	15.61%
Corporate debt	56,939,400	12,057,655	44,070,620	811,125	-	32.99%
Certificates of deposits	5,594,706	3,399,498	2,195,208	-	-	3.24%
Mortgage/asset-backed securities	19,088,656	-	5,046,128	1,254,059	12,788,469	11.06%
	140,775,009	20,114,380	96,293,632	5,820,373	18,546,624	
<b>Equities and other:</b>						
Equity-domestic	23,486,057	-	-	-	-	13.61%
Equity-international	7,701,970	-	-	-	-	4.46%
Accrued interest and dividends	663,653	-	-	-	-	0.38%
Total investments	172,626,689	20,114,380	96,293,632	5,820,373	18,546,624	100.00%

June 30, 2018	Fair Value	Investment Ratings					
		AAA	AA	A	BAA	CAA	N/A or Unrated
	\$	\$	\$	\$	\$	\$	\$
<b>Interest rates</b>							
<b>Investment type</b>							
<b>Debt securities:</b>							
U.S. treasuries	35,874,236	35,874,236	-	-	-	-	-
U.S. agencies	12,621,370	5,340,078	4,160,312	3,120,980	-	-	-
Corporate debt	49,497,626	4,883,688	3,211,631	32,696,684	8,705,623	-	-
Mortgage/asset-backed securities	17,700,130	16,088,933	1,611,197	-	-	-	-
	115,693,362	62,186,935	8,983,140	35,817,664	8,705,623	-	-

June 30, 2017	Fair Value	Investment Ratings					
		AAA	AA	A	BAA	CAA	N/A or Unrated
<b>Interest rates</b>		0.13%-6.00%	2.09%-6.81%	1.2%-8.50%	1.65%-6.88%		
	\$	\$	\$	\$	\$	\$	\$
<b>Investment type</b>							
<b>Debt securities:</b>							
U.S. treasuries	32,202,193	32,202,193	-	-	-	-	-
U.S. agencies	26,950,054	16,262,210	5,807,817	3,862,251	1,017,776	-	-
Corporate debt	56,939,400	5,190,791	2,509,592	32,816,458	16,422,559	-	-
Certificate of deposits	5,594,706	5,594,706	-	-	-	-	-
Mortgage/asset-backed securities	19,088,656	17,628,732	1,459,924	-	-	-	-
	140,775,009	76,878,632	9,777,333	36,678,709	17,440,335	-	-

As of June 30, 2018 and 2017, the Health System utilized three investment managers. These managers are required to make investments in adherence to the Health System's current investment policy and objectives.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to transact, the Health System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The entire balance of the Health System's investments is held by the investment managers in the Health System's name as of June 30, 2018 and 2017.

The Health System's investment strategy utilizes the total return approach with respect to investment returns, which recognizes that total return is comprised of both income and capital gains (realized and unrealized). When considering investment performance, the Health System measures the total returns, including dividends on stock, interest on fixed-income securities and capital gains. The Health System's long-term return objective is stated at 2% plus the Consumer Price Index. AUMA's policy indicates their expectations are to achieve a total rate of return at a level equal to or in excess of the rate of return on government guaranteed or insured obligations.

The Health System allows for an overall level of investment risk sufficient to achieve the long-term return objective described above, managed primarily through its asset allocation policy. The Health System's investment policy requires cash levels adequate to meet all expected or unexpected cash flow needs by investing at least 90% of the Health System's assets in securities that can be sold readily and efficiently. The Health System's investment policy also states that the fixed income maturity for any single security should not exceed five years.

The Health System's investment policy provides for the following maximum and minimum ranges for each asset class as follows:

	Minimum Allocation	Target Allocation	Maximum Allocation
<b>Equities - Domestic and international stocks</b>	15%	20%	25%
<b>Domestic fixed income assets</b>	75%	80%	85%

### Fair Value Measurement – Investments

The Health System categorizes its fair value measurements within the fair value hierarchy established by general accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.



The Health System has the following recurring fair value measurements as of June 30:

	2018			Total
	Level 1	Level 2	Level 3	
	\$	\$	\$	\$
Equity - Domestic and international	33,548,768	-	-	33,548,768
U.S. treasuries	36,046,812	-	-	36,046,812
U.S. agencies	-	12,631,258	-	12,631,258
Corporate debt	-	49,934,394	-	49,934,394
Mortgage/asset-backed securities	-	17,731,205	-	17,731,205
Total Investments	69,595,580	80,296,857	-	149,892,437

	2017			Total
	Level 1	Level 2	Level 3	
	\$	\$	\$	\$
Equity - Domestic and international	31,777,563	-	-	31,777,563
U.S. treasuries	32,202,194	-	-	32,202,194
U.S. agencies	-	26,958,324	-	26,958,324
Corporate debt	-	57,005,247	-	57,005,247
Certificates of deposits	5,594,706	-	-	5,594,706
Mortgage/asset-backed securities	-	19,088,655	-	19,088,655
Total Investments	69,574,463	103,052,226	-	172,626,689

In addition, the following standards apply to specific asset classes according to the Health System's investment policy:

#### Traditional Equity Investments

Allowable assets include common stocks and other equity instruments that are restricted to readily marketable securities of corporations actively traded on the major exchanges.

#### Fixed Income Investments

Allowable assets include U.S. Government securities, corporate notes and bonds, mortgage-backed and asset-backed securities, convertible notes and bonds, Rule 144a bonds, Yankee bonds, collateralized mortgage obligations and Treasury inflation protected securities. The rating for each fixed income security in the portfolio must be "A" or better as established by a recognized rating service at the time of purchase. In addition, except for U.S. Government and agency obligations, each fixed income investment manager's portfolio should contain no more than 5% of any single issue, at cost.

#### Commingled or Mutual Funds

Commingled and mutual fund holdings must be readily marketable and are limited to those funds having total assets of \$100 million or more.

#### Prohibited Assets

Prohibited investments include commodities and futures contracts, private placement, options, limited partnerships, venture-capital investments, REITs and hedge funds. The Health System's investment policy also prohibits short selling and margin transactions.

Investment income, net is comprised of the following for the years ended June 30:

	2018	2017
	\$	\$
Dividend and interest income	3,811,173	4,465,416
Net realized gain on investments	722,492	3,491,359
Net change in unrealized gain (loss) on investments	1,006,120	(1,585,334)
Management fees	(466,013)	(639,615)
	5,073,772	5,731,826

## 6 Capital Assets

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

	Balance June 30, 2017	Additions	Retirements/ Transfers	Balance June 30, 2018
	\$	\$	\$	\$
<b>Capital assets not being depreciated:</b>				
Land	20,139,035	-	(23,766)	20,115,269
Construction in progress	26,153,187	20,074,105	(25,373,143)	20,854,149
	46,292,222	20,074,105	(25,396,909)	40,969,418
<b>Capital assets being depreciated:</b>				
Leasehold improvements	170,536,815	14,398,650	(150,719)	184,784,746
Equipment	319,586,640	13,857,666	(9,295,476)	324,148,830
	490,123,455	28,256,316	(9,446,195)	508,933,576
<b>Accumulated depreciation:</b>				
Leasehold improvements	(62,236,384)	(10,692,881)	131,051	(72,798,214)
Equipment	(204,414,884)	(25,482,345)	8,930,824	(220,966,405)
	(266,651,268)	(36,175,226)	9,061,875	(293,764,619)
<b>Capital assets, net</b>	<b>269,764,409</b>	<b>12,155,195</b>	<b>(25,781,229)</b>	<b>256,138,375</b>

	Balance June 30, 2016	Additions	Retirements/ Transfers	Balance June 30, 2017
	\$	\$	\$	\$
<b>Capital assets not being depreciated:</b>				
Land	15,311,867	5,072,926	(245,758)	20,139,035
Construction in progress	21,558,986	34,914,456	(30,320,255)	26,153,187
	36,870,853	39,987,382	(30,566,013)	46,292,222
<b>Capital assets being depreciated:</b>				
Leasehold improvements	164,946,889	6,237,450	(647,524)	170,536,815
Equipment	294,685,984	26,496,177	(1,595,521)	319,586,640
	459,632,873	32,733,627	(2,243,045)	490,123,455
<b>Accumulated depreciation:</b>				
Leasehold improvements	(53,065,258)	(9,818,650)	647,524	(62,236,384)
Equipment	(181,111,458)	(24,599,973)	1,296,547	(204,414,884)
	(234,176,716)	(34,418,623)	1,944,071	(266,651,268)
<b>Capital assets, net</b>	<b>262,327,010</b>	<b>38,302,386</b>	<b>(30,864,987)</b>	<b>269,764,409</b>

Depreciation expense, which includes amortization of assets under capital leases, totaled approximately \$36,175,000 and \$34,419,000 in 2018 and 2017, respectively.

Construction in progress at June 30, 2018 consists of construction and medical equipment projects and information technology upgrades scheduled to be completed by June 2020. Estimated costs to complete these various projects total approximately \$45,244,000 at June 30, 2018. The estimated costs will be funded with operating cash.

## 7 Accrued Expenses and Other Current Liabilities

The composition of accrued expenses and other current liabilities follows, as of June 30:

	2018	2017
	\$	\$
Accrued for employee healthcare claims	1,748,000	1,440,000
Accrued for workers' compensation claims	826,217	839,107
Interest payable	2,699,870	2,842,088
Advance billings	255,671	2,326,347
Other accrued expenses	2,816,183	1,655,455
	8,345,941	9,102,997

## 8 Debt

A summary of long-term debt follows, as of June 30:

	2018	2017
	\$	\$
Line of credit with variable interest rates reset monthly as described below	27,100,000	-
Note payable, principal payments in varying amount beginning in 2015 through 2019, with a fixed interest rate of 2.05% through June 30, 2015 then a variable interest rate, as described below	36,750,000	40,483,333
Development Authority of Richmond County Revenue Bonds, Series 2014A Tax Exempt Bonds, payable in varying amounts beginning in 2014 through 2037, with variable interest rates initially reset monthly, as described below	55,210,000	57,185,000
Development Authority of Richmond County Revenue Bonds, Series 2014B Tax Exempt Bonds, payable in varying amounts beginning in 2014 through 2037, with variable interest rates initially reset monthly, as described below	53,170,000	57,185,000
Development Authority of Richmond County Revenue Bonds, CRC Series 2014A, Tax Exempt Bonds, payable in varying amounts beginning in 2015 through 2034, with variable interest rates initially reset monthly, as described below, including unamortized premium of \$1,687,958 and \$1,874,028 at June 30, 2018 and 2017, respectively	23,667,958	24,719,028
	195,897,958	179,572,361
<b>Less - Current portion of long-term debt</b>	6,199,167	8,260,833
	189,698,791	171,311,528

Long-term debt activity for the year ended June 30, 2018, was as follows:

	Balance June 30, 2017	Additions	Reductions	Balance June 30, 2018	Amounts Due Within One Year
	\$	\$	\$	\$	\$
Line of credit	-	27,100,000	-	27,100,000	-
Note payable	40,483,333	-	(3,733,333)	36,750,000	3,254,167
Development Authority of Richmond County Revenue Bonds, Series 2014A Tax Exempt Bonds	57,185,000	-	(1,975,000)	55,210,000	2,040,000
Development Authority of Richmond County Revenue Bonds, Series 2014B Tax Exempt Bonds	57,185,000	-	(4,015,000)	53,170,000	-
Development Authority of Richmond County Revenue Bonds, CRC Series 2014A Tax Exempt Bonds	24,719,028	-	(1,051,070)	23,667,958	905,000
	179,572,361	27,100,000	(10,774,403)	195,897,958	6,199,167

Long-term debt activity for the year ended June 30, 2017, was as follows:

	Balance June 30, 2016	Additions	Reductions	Balance June 30, 2017	Amounts Due Within One Year
	\$	\$	\$	\$	\$
Note payable	43,870,833	-	(3,387,500)	40,483,333	3,445,833
Development Authority of Richmond County Revenue Bonds, Series 2014A Tax Exempt Bonds	59,095,000	-	(1,910,000)	57,185,000	1,975,000
Development Authority of Richmond County Revenue Bonds, Series 2014B Tax Exempt Bonds	59,095,000	-	(1,910,000)	57,185,000	1,975,000
Development Authority of Richmond County Revenue Bonds, CRC Series 2014A Tax Exempt Bonds	25,745,931	-	(1,026,903)	24,719,028	865,000
	187,806,764	-	(8,234,403)	179,572,361	8,260,833

#### Series 2008A and 2008B Bonds

On April 1, 2008, the Health System issued a total of \$135,000,000 of Development Authority of Richmond County Revenue Bonds, Series 2008A and 2008B (2008 Bonds). Proceeds from the 2008 Bonds were to be used to fund certain construction and renovation projects and to purchase new and replacement equipment. The proceeds were also used to refund outstanding capital lease obligations and to pay certain costs associated with the issuance of the 2008 Bonds. Each 2008 Bond series was generally secured through the trust indenture by the gross revenues of the Health System.

#### Series 2014A and 2014B Bonds

On July 15, 2014, the Health System refunded its 2008A and 2008B Bonds with the 2014A and 2014B Bonds (2014 Bonds), which are a direct bank placement of bonds in the amount of \$60,945,000 for each of the 2014A and 2014B Bonds.

The 2014A Bonds are variable rate bonds that incur interest at a rate of 68% of LIBOR plus 79 basis points and are placed with their bank through July 1, 2024. The 2014B Bonds are variable rate bonds that incur interest at a rate of 68% of the sum of LIBOR and 125 basis points and are placed with their bank through July 1, 2026. Upon the termination of the bank placement, the 2014A and 2014B Bonds will become subject to a remarketing agreement in the event that bank placement is not extended. The annual effective interest rate on the 2014 Bonds was 4.186% and 1.320% for fiscal years 2018 and 2017, respectively.

The bond indenture agreements contain certain terms and restrictive covenants typical of such agreements, including maintenance of certain debt service levels, limitations on indebtedness, maintenance of certain days' cash on hand and maintenance of a certain ratio of debt service coverage.

As of June 30, 2018 and June 30, 2017, the Health System was in compliance with all financial debt covenants.

### **Swap**

Concurrent with the issuance of the 2008 Bonds, the Health System entered into a variable-to-fixed interest rate swap (the Swap) to convert the Health System's variable interest rate on the 2008 Bonds into a synthetic fixed rate of 3.302%.

The Swap matures on July 1, 2037. The notional amount of the Swap at June 30, 2018 and 2017, was \$108,380,000 and \$114,370,000, respectively. The notional amount decreased from the initial notional amount of \$135,000,000. The notional value of the Swap declines in conjunction with payments of bond principal such that the outstanding balance of the bonds approximate the notional amount of the Swap at all times. Under the Swap, the Health System pays the counterparty interest at a fixed rate of 3.302% and receives interest payments at a variable rate computed as 68% of LIBOR.

The fair value of the Swap is recorded as an asset or liability, depending on whether the termination of the Swap would result in amounts due to the Health System or the Swap counterparty. At June 30, 2018 and 2017, the fair value of the Swap represented a liability to the Health System in the amount of \$14,819,000 and \$20,813,000, respectively. The Health System or the Swap counterparty is required to post collateral with the other party in the event that the fair value of the Swap exceeds certain thresholds, as defined. At June 30, 2018 and 2017, the Health System had \$14,966,000 and \$1,800,000 posted cash and investment collateral with the Swap counterparty, respectively, which is included in other assets in the accompanying statements of net position.

As of June 30, 2018 and 2017, the Health System was exposed to credit risk in the amount of the fair value of the Swap. The Health System has two Swap counterparties. As of June 30, 2018 and 2017, the Swap counterparties were rated A+ and A by Fitch Ratings, A1 and A2 by Moody's Investors Services and A+ and A+ by Standard & Poor's. To mitigate the potential for credit risk, various levels of collateralization by the counterparty may be required should the counterparty's credit rating be downgraded and the fair value of the Swap be in a liability position at a level above certain thresholds specified in the Swap agreement.

The Health System or the counterparty may terminate the Swap if the other party fails to perform under the terms of the agreement. If the Swap is terminated, the variable rate bonds would no longer carry a synthetic fixed interest rate. Also, if at the time of termination, the Swap has a negative fair value (unfavorable to the Health System), the Health System would be liable to the counterparty for a payment equal to the Swap's fair value.

### **Series 2004A CRC Bonds**

In 2004, the CRC issued a total of \$32,870,000 Development Authority of Richmond County Education Facilities Revenue Bonds (the 2004 CRC Bonds), Series 2004A and Series 2004B. Proceeds from the 2004 CRC Bonds provided the funds to finance the cost of the construction of a portion of a cancer research center building on the campus of AU. Semi-annual interest payments at interest rates range from 2.5% to 5.0%.

### **Series 2014A CRC Bonds**

On October 30, 2014, CRC issued the Development Authority of Richmond County Revenue Refunding Bonds (the 2014 CRC Bonds), Series 2014A, in the amount of \$24,490,000. Proceeds of the Series 2014 CRC Bonds were used to refund all of the 2004 CRC Bonds, fund a debt service reserve fund for the Series 2014 CRC Bonds, and pay the cost of issuing the Series 2014 CRC Bonds. Semi-annual interest payments at interest rates range from 3.0% to 5.0%.

The effective interest rate at June 30, 2018 and 2017 was 4.2%. Principal payments are due annually through December 2034.

The following is a summary of the debt service requirements of the variable rate debt and net payments on the related swap, assuming current interest rates remain the same for their term. As rates vary, variable rate bond interest payments and net Swap payments will vary.

As of June 30, 2018, debt service requirements of the debts were as follows:

	2014A and 2014B Revenue Bonds			2014 CRC Bonds		
	Principal	Interest*	Interest Rate	Principal	Interest*	Total
			Swaps, Net*			
Fiscal year ending June 30:	\$	\$	\$	\$	\$	\$
2019	2,040,000	2,762,373	1,942,300	905,000	911,469	8,561,142
2020	4,220,000	2,649,365	1,859,403	945,000	874,669	10,548,437
2021	4,360,000	2,519,837	1,780,393	970,000	841,094	10,471,324
2022	4,510,000	2,398,596	1,692,037	1,010,000	796,444	10,407,077
2023	4,660,000	2,269,257	1,603,021	1,060,000	744,694	10,336,972
2024-2028	25,750,000	9,249,167	6,569,296	6,145,000	2,864,744	50,578,207
2029-2033	30,370,000	5,289,451	3,850,769	7,495,000	1,476,838	48,482,058
2034-2038	32,470,000	997,041	835,203	3,450,000	120,741	37,872,985
	108,380,000	28,135,087	20,132,422	21,980,000	8,630,693	187,258,202

\*Amounts included are based on rates in effect as of June 30, 2018.

The following is a summary of interest cost on borrowed funds held by the trustee under the Series 2014A and 2014B Revenue Bonds and Series 2014 CRC Bonds during the years ended June 30:

	2018	2017
	\$	\$
<b>Interest cost:</b>		
Charged to operations	5,715,364	5,575,781
	5,715,364	5,575,781

The 2014 CRC Bonds indenture agreements contain certain terms and restrictive covenants typical of such agreements, including maintenance of certain debt service levels, limitations on indebtedness and maintenance of a certain ratio of debt service coverage.

As of June 30, 2018, the CRC was in compliance with all financial debt covenants.

The CRC loan is secured by certain personal property constituting a portion of the building, recorded as net investment in direct financing lease in the statement of net position.

### Note Payable

On June 27, 2012, the Health System entered into a note in the amount of \$50,000,000. Funds from the note are to be used to fund certain construction and renovation projects and to purchase new and replacement equipment.

On June 30, 2015, the Health System entered into a modification of the terms of the note. The note was modified to a variable interest rate note and was extended until July 1, 2018. On June 30, 2018, the Health System entered into a modification of the terms of the note to extend the note through July 1, 2019. Due to the modifications, the note incurred interest at a rate of LIBOR plus 0.65% effective July 1, 2015 and incurred interest at a rate of LIBOR plus 0.75% effective July 1, 2018. Interest on the note is due monthly.

Interest rates are reset monthly. The annual effective interest rate on the note was 2.1371% and 1.359% for fiscal years 2018 and 2017, respectively.

	Variable Rate Debt		Total
	Principal	Interest	
<b>Fiscal year ending June 30:</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
2019	3,254,167	715,839	3,970,006
2020	33,495,833	-	33,495,833
	36,750,000	715,839	37,465,839

### Line of Credit

On October 18, 2017, the Health System entered into a line of credit in the amount of \$35,000,000. Funds from the line of credit are to be used to fund working capital and other general corporate purposes. The line of credit is a variable interest rate note and incurs interest at a rate equal to the higher of the Prime Rate or LIBOR plus 2.50% per annum. Interest rates are reset monthly. The annual effective interest rate on the note was 2.10% for fiscal year 2018. On June 30, 2018, the outstanding balance on the line of credit was \$27,100,000.

The following is a summary of interest cost on borrowed funds in notes payable during the years ended June 30:

	2018	2017
	\$	\$
<b>Interest cost:</b>		
Charged to operations	1,198,359	577,746
	1,198,359	577,746

## 9 Postemployment Benefits Other than Pension Benefits

### Plan Description and Funding Policy

The AU Medical Associates Retiree Plan (Plan) is a single-employer, defined-benefit healthcare plan administered by AUMA. On March 19, 2018, the AUMA Board approved significant changes to the Plan provisions. The impact of these changes are reflected in the calculation of the Plan liabilities as of the April 1, 2018 measurement date. The following description of the Plan reflects the 2018 changes in Plan provisions and provides only general information. Participants should refer to the Plan agreement for a complete description of the Plan's provisions.

### Non-faculty Participants

Employees must attain age 60 with 10 years of service at retirement. No retiree contributions are required for non-faculty employees who attain age 60 with 20 years of service. Spouses of eligible retirees are covered during the retiree's lifetime. All benefits cease upon the death of the retiree. Only those employees who are designated as "Grandfathered Employees" are eligible for benefits. Grandfathered Employees are those employees who will attain retirement eligibility by the end of 2020 or have 25 or more years of service as of the designation date.

### Faculty Participants

Employees must meet the AU's retirement eligibility of either the attainment of age 60 with 10 years of service with AU or the attainment of 25 years of service with AU. Only member-level employees are eligible for benefits. Spouses of eligible retirees are covered during the retiree's lifetime. Beneficiaries, VA members, and members who were covered under the Medical College of Georgia Early Retirement Program (ERP) are excluded from participation.

## Plan Provisions

### Non-Faculty Participants

Pre-65 Medical Benefits: Eligible retirees and their spouses are allowed to continue coverage under the group health insurance plan up to age 65. Retirees and their spouses must contribute 25% of the group premium rate if the retiree is eligible for benefits but has less than 20 years of service.

Post-65 Medical Benefits: Coverage under the group health insurance plan ends at age 65. After age 65, eligible retirees and their spouses are allowed to each receive a major medical reimbursement of up to \$500 per plan year.

### Faculty Participants

Pre-65 Medical Benefits: Eligible retirees and their spouses are allowed to each receive a reimbursement of up to \$1,000 per plan year to cover major medical and health plan premiums. All medical benefits (including premium reimbursements) end upon attainment of age 65.

Tuition Benefits: Eligible retirees are allowed to continue coverage under the college tuition benefit, which reimburses eligible dependents for up to four years in an undergraduate program and up to four years in a graduate program. Tuition reimbursements are subject to limitations based on the average program costs supplied by the university.

Membership of the Plan consisted of the following at June 30, 2018 and 2017:

	At June 30, 2017 (Prior to Amendment)	At June 20, 2018 (After Amendment)
<b>Non-faculty participants:</b>		
Actives (covered)	295	32
Actives (not covered)	43	306
Retirees (covered)	30	30
<b>Faculty participants:</b>		
Actives (covered)	472	371
Actives (not covered)	45	146
Retirees (covered)	218	57
Surviving spouses (covered)	36	-

The benefits of the Plan are funded on a pay-as-you-go basis. The Health System funds on a cash basis as benefits are paid. No assets have been segregated and restricted to provide for post-employment benefits.

Retiree contributions are assumed to increase at the healthcare cost trend rate. Non-faculty retirees and their spouses contribute 25% of the group premium rate below if the retiree is eligible for benefits but has less than 20 years of service. There are no other retiree contributions. For the years ended June 30, 2018 and 2017, the Health System contributed approximately \$956,000 and \$761,000, respectively, to the Plan for current premiums or claims. For the years ended June 30, 2018 and 2017, Plan members receiving benefits contributed approximately \$29,000 and \$26,000, respectively, for current premiums or claims.

	Retiree	Spouse
	\$	\$
Pre-65 non-faculty annual premium at June 30, 2018	7,149	8,936
Post-65 non-faculty annual premium at June 30, 2018	N/A	N/A



Medical and fringe benefits claims cost with trend rate for future increases:

	Annual Cost	Trend Rate
	\$	
<b>Non-faculty participants:</b>		
Pre-65 medical claims - Per retiree/spouse	13,788	7.7% graded*
Post-65 medical claims - Per retiree/spouse	500	No increase
<b>Faculty participants:</b>		
Pre-65 medical reimbursement - Per retiree/spouse	1,000	No increase
Post-65 total reimbursement - Per retiree/spouse	N/A	N/A
Tuition benefit - Per retiree (up to age 73)	1,613	7.0%

\* 7.7% graded uniformly to 5.0% over a 9-year period

### Annual OPEB Cost and Net OPEB Obligation

The annual OPEB cost (expense) (AOC) for the Plan is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB No. 75 in 2018 and GASB No. 45 in 2017. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

The following table presents the changes of the Health System's OPEB cost, the amount actually contributed and changes in the net OPEB obligation (NOO) for the Plan for the years ended June 30, 2018 and 2017:

	\$
Balance at June 30, 2017 (calculated pursuant to GASB No. 45)	5,274,929
Annual required contribution (calculated pursuant to GASB No. 45)	6,780,889
Interest on net OPEB obligation (NOO) (calculated pursuant to GASB No. 45)	237,372
Annual contribution toward OPEB cost	(761,398)
Balance at June 30, 2017 (calculated pursuant to GASB No. 45)	11,531,792
Adoption of GASB No. 75	33,170,759
<b>Balance at July 1, 2017</b>	<b>44,702,551</b>
Service cost	5,413,604
Interest	1,543,743
Benefit changes	(44,538,003)
Contributions - employer	(956,216)
Net changes	(38,536,872)
<b>Balance at June 30, 2018</b>	<b>6,165,679</b>

For the years ended June 30, 2018 and 2017, the Health System recorded a related (income) expense of approximately (\$37,600,000) and \$7,018,000, respectively, as shown below:

	2018	2017
	\$	\$
Service cost	5,413,604	6,780,889
Interest	1,543,743	237,372
Benefit changes	(44,538,003)	-
<b>OPEB (income) expense</b>	<b>(37,580,656)</b>	<b>7,018,261</b>

The following represents the net OPEB liability as of June 30, 2018 using the stated healthcare trend assumption, as well as what the OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1 percentage-point lower or 1 percentage-point higher than the assumed trend rate:

	1% Decrease decreasing to 4% over 9 years	Current 7.7% decreasing to 5% over 9 years	1% Increase 8.7% decreasing to 6% over 9 years
	\$		\$
<b>Net OPEB Liability</b>	<b>5,601,828</b>	<b>6,165,679</b>	<b>6,843,787</b>

The following represents the net OPEB liability at June 30, 2018 using the stated discount rate, as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease 2.11%	Current Rate 3.11%	1% Increase 4.11%
	\$	\$	\$
<b>Net OPEB Liability</b>	<b>6,731,187</b>	<b>6,165,679</b>	<b>5,664,844</b>

Actuarial assumptions of an ongoing plan involve estimates of the value of 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. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The multi-year trend schedules indicate whether the actuarial values of Plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. No assets have been segregated for the payment of Plan benefits, accordingly, no multi-year trend schedules have been presented.

### Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (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 of benefit costs between the employer and the 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 actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

### Summary of Actual Assumptions

**Valuation Date – July 1, 2017 with a measurement date of April 1, 2018 and reporting date of June 30, 2018**

- The results comply with assumptions, methods and procedures under Statement 75.

- Actuarial valuation method – Entry Age Normal Actuarial Cost Method. A method under which the actuarial value of the projected benefits of each individual included in the actuarial valuation is allocated in a level basis over the earnings of the individual between entry age and assumed exit age(s).

**Asset Valuation Method – Not Applicable**

- Mortality rates – RP-2014 mortality tables, adjusted to 2006, with generational mortality improvement projected after year 2006 using Scale MP-2016.

**Disability Rates – None Assumed**

**Withdrawal Rates:**

Age	Less than One Year of Service	1 to 3 Years of Service	4 to 8 Years of Service	9+ Years of Service
	%	%	%	%
25	10.87	8.57	6.48	4.37
30	9.31	6.79	4.19	2.42
35	8.39	5.51	3.57	2.51
40	7.95	5.17	3.01	2.07
45	7.74	4.73	2.91	1.87
50	7.80	4.45	2.66	1.75
55	6.76	3.91	1.29	0.44
60	6.81	3.92	1.06	0.10
65	-	-	-	-

**Retirement Rates:**

Age	Non-faculty	Faculty
	%	%
55-59	-	5
60	35	20
61-64	25	15
65	35	25
66-69	50	25
70-74	100	50
75	100	100

- Discount rate – 3.1% per annum for 2018 and 4.5% for 2017
- Salary increases – Not applicable
- Expected long-term rate of return on plan assets – Not applicable
- Age variance – Medical claims were adjusted downward 3.0% each year for aging for attained ages 55 to 65, while claims were increased by 3.0% each year for aging for attained ages 65 to 75.

## 10 Capital Leases

On June 27, 2013, the Health System entered into capital lease obligations as part of the Managed Services Alliance Agreement (MSA) with a global healthcare technology company (the Imaging Alliance Partner) to innovate the delivery of healthcare in a new business model. Under the MSA agreement, the Imaging Alliance Partner provides the Health System diagnostic imaging equipment, patient monitoring technology, maintenance services, education, performance improvement consulting and other services. The Health System and the Imaging Alliance Partner are jointly incentivized in the MSA for clinical and operational outcomes. The MSA was effective July 1, 2013, and has a term of 15 years. Equipment and technology financed through the MSA are recorded as capital lease obligations. The interest rate in the MSA is 6%.

In connection with the MSA, the Health System agreed to sell and leaseback certain equipment, which is accounted for as a capital lease, from the Imaging Alliance Partner. The net carrying value of the equipment sold was approximately \$20,920,000 on the date of sale. Since the net carrying value of the equipment sold was equal to their sales price, there was no gain or loss recognized on the sale.

The assets under capital lease are included in capital assets with a cost of \$60,958,000 and accumulated amortization of \$33,833,000 at June 30, 2018. Amortization of assets under capital lease is included in depreciation and amortization expense.

On September 1, 2014, the Health System entered into a capital lease obligation to purchase a unified communication system. As of June 30, 2018 and 2017, the balance of this obligation under capital lease was \$1,062,000 and \$1,547,000, respectively.

On August 2, 2016, the Health System entered into an agreement (the MSA) with a global healthcare diagnostics company (the Diagnostic Alliance Partner) to innovate the delivery of healthcare diagnostics in a new business model. Under the MSA agreement, the Diagnostic Alliance Partner provides Health System with diagnostic laboratory equipment, technology access management services, clinical education, management consulting and innovation. The Health System and the Diagnostic Alliance Partner are jointly incentivized in the MSA for clinical and operational outcomes related to the agreement. The MSA was effective August 2, 2016 and has a term of 15 years. Equipment and technology financed through the MSA are recorded as capital lease obligations. The interest rate in the MSA is 5%.

The assets under capital lease are included in capital assets with a cost of \$2,608,000 and accumulated amortization of \$302,000 at June 30, 2018. Amortization of assets under capital lease is included in depreciation and amortization expense.

Capital lease activity for the years ended June 30, 2018 and 2017, was as follows:

	Balance June 30, 2017	Additions	Reductions	Balance June 30, 2018	Amounts Due Within One Year
	\$	\$	\$	\$	\$
Capital lease obligations	29,981,158	2,646,327	(9,381,143)	23,246,342	5,469,281

	Balance June 30, 2016	Additions	Reductions	Balance June 30, 2017	Amounts Due within One Year
	\$	\$	\$	\$	\$
Capital lease obligations	38,250,418	6,987,756	(15,257,016)	29,981,158	5,932,665

Minimum future lease payments under capital leases as of June 30, 2018, follow:

	Amount
<b>Years ending June 30:</b>	<b>\$</b>
2019	6,707,799
2020	6,146,444
2021	4,703,533
2022	3,827,931
2023	2,501,146
2024-2028	2,991,627
Total minimum payments	26,878,480
Less amount representing interest	(3,632,138)
Present value of net minimum lease payments	23,246,342
Less - Current maturities of capital lease obligation	(5,469,281)
Long-term capital lease obligation	17,777,061

## 11 Operating Leases

The Health System also leases various equipment and real property under noncancelable operating leases that expire in various years through 2028. Future minimum rental payments required under such leases having an initial or remaining term of more than one year at June 30, 2018, are as follows:

	Amount
	<b>\$</b>
<b>2019</b>	1,707,372
<b>2020</b>	1,678,046
<b>2021</b>	1,661,415
<b>2022</b>	1,565,836
<b>2023</b>	1,278,972
<b>2024-2028</b>	2,632,087
Total minimum payments	10,523,728

Rental expense for the years ended June 30, 2018 and 2017, was approximately \$3,426,000 and \$3,036,000, respectively.

## 12 Employee Retirement Plans

The Health System sponsors two defined contribution retirement plans covering substantially all employees of the Health System except as needed employees, temporary employees and leased staff from AU (Note 13). One retirement plan is a 403(b) retirement plan that allows employee contributions up to 20% of annual compensation, subject to a maximum dollar limitation. The other retirement plan is a 401(a) retirement plan that allows employer contributions. The Health System matches 100% of participant contributions into the 403(b) plan up to 5% of compensation as defined by the plan. This match is contributed into the 401(a) plan. Employees vest immediately in company contributions. The Health System recorded approximately \$9,837,000 and \$9,739,000 of expense related to these plans during the years ended June 30, 2018 and 2017, respectively.

### 13 Related Parties

Related parties for the fiscal years ended June 30, 2018 and 2017, consist of the following:

#### State Allocation

In connection with the Affiliation Agreement, Regents has agreed to allocate to the Health System certain state appropriations monies received by Regents from the State of Georgia. Such funds reimburse the Health System for providing assistance to AU in medical education and training and for medical services rendered by the Health System to indigent and near indigent patients, all of which is contemplated in the Affiliation Agreement. These amounts are reported as revenue from contractual services in the accompanying statements of revenues, expenses and changes in net position.

In connection with the Affiliation Agreement, the Health System has entered into several other operating agreements with related parties. Following is a summary of the most significant transactions under these agreements:

#### Master Lease Agreement

The Health System leases certain patient care facilities, office space and employees from the Board of Regents of the University System of Georgia (Regents) under a Master Lease Agreement.

#### Service Fee

Effective July 1, 2016, the Master Lease Agreement was amended and restated for a 40-year term, which could be extended for two additional 10-year terms. Under the amended and restated Master Lease Agreement, the Health System is required to pay an annual performance-based service fee to support the delivery of services described in the Master Affiliation Agreement and provide the many resources needed to continue operation.

The service fee is based on the percentage of AUMC's net income to operating revenue as follows:

Net Income / Operating Revenue Percentage	Service Fee
Less than 2.5%	25.0% of Net Income
2.5% - 4.99%	22.5% of Net Income
5.0% - 7.49%	20.0% of Net Income
7.5% or greater	17.5% of Net Income

The following is a summary of the service fee for the years ended June 30, 2018 and 2017:

	2018	2017
	\$	\$
Performance-based service fee	6,638,215	-

#### Clinical, Educational and Research Services Agreement

The Health System has entered into a clinical, educational and research services agreement with Regents, whereby the Health System will continue to receive certain clinical, educational and research services associated with the AU Schools of Allied Health Sciences, Dentistry, Medicine, Nursing and Graduate Studies at their estimated cost. Net payments by the Health System for these services for the years ended June 30, 2018 and 2017, were approximately \$20,417,000 and \$38,982,000, respectively, and are included in purchased services in the accompanying statements of revenues, expenses and changes in net position. The Clinical, Education and Research Services Agreement was terminated on December 31, 2017.

### **Research, Education, and Professional Services Agreement**

Effective January 1, 2018, the Clinical, Education, and Research Services Agreement was replaced with the Research, Educational, and Professional Services Agreement. The Research, Educational, and Professional Services Agreement sets out the terms by which AU and the Health System provide clinical, educational and research services and the funding of graduate medical education programs for residents and fellows. Net payments by the Health System for these services for the year ended June 30, 2018, were approximately \$9,033,000. The total expense was reduced by a \$10 million credit from AU for graduate medical expenses.

The terms of the Research, Education, and Professional Services Agreement are renewed on an annual basis through the term of the Master Lease Agreement.

### **Operations and Services Agreement**

The Research, Educational, and Professional Services Agreement incorporates an amended Operations and Services Agreement. The Operations and Services Agreement governs shared administrative and support services among AU and the Health System in order to achieve efficiencies, economies of scale and other benefits. These services are provided at their estimated cost (which have historically been provided to each other). The terms of the Operations and Services Agreement are renewed on an annual basis through the term of the Master Lease Agreement.

Payments to AU by the Health System for these services for the years ended June 30, 2018 and 2017, were approximately \$8,458,000 and \$6,053,000, respectively. These payments are included in purchased services in the accompanying statements of revenues, expenses and changes in net position. Payments to the Health System by AU for these services for the years ended June 30, 2018 and 2017, were approximately \$225,000 and \$301,000, respectively.

The cost of the “shared service” level function services are allocated to each entity through the operations and services agreement. Payments to the Health System by AU for these services for the years ended June 30, 2018 and 2017, were approximately \$10,347,000 and \$13,663,000, respectively.

Regents and the Health System agree that the use of consistent nomenclature promotes a positive external image. As part of the annual renewal of the Operations and Services Agreement effective July 1, 2016, in exchange for an annual lump-sum payment, the Regents granted the Health System the nonexclusive, nontransferable right to use the AU nomenclature and the right to grant sublicenses to the Health System’s subsidiaries and affiliates. Amounts paid to AU by the Health System for use of nomenclature for the years ended June 30, 2018 and 2017 were \$3,500,000.

Under the 2017 renewal of the Operations and Services Agreement effective July 1, 2016, a new support structure was introduced obligating the Health System to pay an annual lump sum to GHSP for foundation and advancement services performed on the Health System’s behalf. Amounts paid to GHSP by the Health System for these services for both of the years ended June 30, 2018 and 2017 were \$500,000.

### **Personnel Agreement**

The Health System has entered into a personnel agreement whereby the Health System leases certain AU employees from Regents (the Personnel Agreement). The employees must have accrued at least 10 years of service at the effective date of the transfer and related agreements and choose not to become employees of the Health System. Leased employees remain employees of Regents. The Health System has the right to direct and control the leased employees in the performance of their duties and has the right to cancel or reject the assignment of any leased employee, provided that such is not otherwise prohibited by law. Included in salaries and wages and in employee benefits and payroll taxes, are approximately \$4,465,000 and \$1,543,000, respectively, for the year ended June 30, 2018, for costs paid to AU for the leased employees. Included in salaries and wages and in employee benefits and payroll taxes, are approximately \$6,009,000 and \$1,986,000, respectively, for the year ended June 30, 2017, for costs paid to AU for the leased employees.

On August 11, 1999, Regents established an early retirement program incentive for eligible AU employees. Effective beginning in fiscal 2002, the Health System agreed to pay AU a proportionate share of the annual funding and administrative cost expense related to the early retirement program. Actual payments to AU are determined annually and are expected to approximate \$6,800,000 per year through 2025. Nevertheless, the Health System does not have a long-term obligation under this arrangement and such funding is subject to the Health System's discretionary annual approval.

#### **Clinical and Administrative Professional Services Agreement**

The Health System and AU have entered into a formal Clinical and Administrative Professional Services Agreement to provide for the management of the flow of funds among the parties for professional medical services and medical administrative services and allocates responsibility to the Health System for billing and collections, management and payment of the expenses of clinical sites, and payment of certain Health System administrative and overhead costs. In prior years, the amounts were approved each year by the Dean and the AU Medical College of Georgia with no formal written agreement.

As a cooperative organization of AU, a portion of the Health System's net revenues were used to supplement AU faculty and staff salaries by approximately \$89,839,000 and \$85,521,000 for the years ended June 30, 2018 and 2017, respectively. This amount is included in salaries and wages and employee benefits and payroll taxes in the accompanying statement of revenues, expenses and changes in net assets.

#### **Contribution to Augusta University**

During the year ended June 30, 2017, the Health System contributed approximately \$25,076,000 of accumulated funds which were designated for the support of AU. There were no additional contributions for the year ended June 30, 2018.

#### **Net Investment in Direct Financing Lease**

Beginning in January 2006, MCG-PPG Cancer Research Center, LLC (CRC) entered into a lease with AU for a portion of a building that houses a cancer research center. The lease term is one year with 29 consecutive annual renewals, at the option of AU. The lease qualifies as, and has been recorded as, a direct financing lease by CRC. In connection with the issuance of Series 2014 CRC Bonds on October 30, 2014, CRC amended the lease to align the rental payments with the Series 2014 CRC Bonds and adjust payments in amount and schedule (from monthly to semi-annually).

The effective interest rate on the lease is 2.93% as of June 30, 2018 and 2017.

The components of the net investment in direct financing lease are as follows:

<b>June 30</b>	<b>2018</b>	<b>2017</b>
	<b>\$</b>	<b>\$</b>
Lease payments due	29,856,370	31,727,358
Unearned income	(6,150,118)	(6,870,066)
Net investment	23,706,252	24,857,292
Current portion	(1,186,728)	(1,151,040)
Long-term portion	22,519,524	23,706,252



Future minimum rentals to be received under this lease, including renewed terms at June 30, 2018 are as follows:

Year ending June 30	Amount
	\$
2019	1,872,692
2020	1,877,564
2021	1,870,708
2022	1,867,054
2023	1,866,190
Thereafter	20,502,162
Total	29,856,370

CRC receives various amounts each month for materials replacement and repair for the facility that is leased to AU. These amounts are recorded as rental income. Total amounts received were \$80,000 and \$81,000 for 2018 and 2017, respectively.

#### **Georgia Health Sciences Foundation, Inc.**

The Georgia Health Sciences Foundation, Inc. (GHSF) was established to serve the needs and interests of AU and to manage, invest and steward charitable gifts to AU. GHSF is a component unit of AU and is not included in the financial statements of the Health System. GHSF serves the needs of AU and the Health System. At June 30, 2018 and 2017, GHSF held net assets of approximately \$3,625,000 and \$3,907,000, respectively, which use by the Health System is limited by the intent of donors. At June 30, 2018, approximately \$56,000 of GHSF's net assets has been restricted by donors to be maintained in perpetuity. At June 30, 2017, approximately \$54,000 of GHSF's net assets has been restricted by donors to be maintained in perpetuity. As of June 30, 2018 and 2017, other receivables include \$139,000 and \$90,000 due from GHSF, respectively.

#### **Medical College of Georgia Foundation, Inc.**

The Medical College of Georgia Foundation, Inc. (the Foundation) was established to raise funds to support the mission of AU and the Health System. The Foundation is a component unit of AU and is not included in the financial statements of the Health System. At June 30, 2018 and 2017, the Foundation held net assets of approximately \$2,576,000 and \$2,383,000, respectively, which use by the Health System is limited by the intent of the donors. At June 30, 2018 and 2017, approximately \$1,466,000 and \$1,463,000, respectively, of the Foundation's net assets have been restricted by donors to be maintained in perpetuity.

## **14 Commitments and Contingencies**

The Health System is subject to legal proceedings and claims which arise in the ordinary course of business. Based on consultation with legal counsel and risk management professionals, management estimates that these matters will be resolved without material adverse effect on the Health System's future financial position or results of operations.

The Health System is exposed to various risks of loss related to torts: theft of, damage to, and destruction of assets, business interruption, errors and omissions, employee injuries and illness, natural disasters, medical malpractice and employee health, dental and accident benefits. The Health System is self-insured for employee health coverage, up to a limit of \$250,000 per individual claim. AUMC is self-insured for workers compensation coverage, up to a limit of \$250,000 per individual claim (both RWSH and AUMA currently are insured through commercial workers compensation insurance policies), but it is anticipated both entities will become participants in AUMC's plan, which will become the plan for the Health System, by December 31, 2018. Substantial coverage with third-party carriers is maintained for excess losses. Commercial insurance coverage is purchased for all other significant exposures, except for professional liability discussed below. Claims settled through June 30, 2018, have not exceeded this commercial coverage in any of the five preceding years.

AUMC is self-insured for professional liability risks, with an underlying layer of \$2 million per occurrence and \$9 million in the aggregate. RWSH has commercial first dollar professional liability coverage with limits of \$1,000/\$3,000, and a commercial policy providing excess coverage with limits of \$5,000. AUMA has a commercial policy providing professional liability first dollar coverage with limits of \$2,000/\$4,000; excess of that, AUMA shares a self-insured \$2,000 buffer and commercial excess coverage limits with AUMC. The self-insurance for both AUMC and AUMA is fully funded, and accrued professional liability costs and reserves are determined actuarially, based on claims filed and an estimate of claims incurred, but not yet reported. In July 2004, the Health System formed a wholly owned captive insurance company and transferred the self-insured professional liability to the captive.

The Health System's liability insurance coverages outside of self-insurance layers are provided under claims-made policies. Should the claims-made policies not be renewed or replaced with equivalent insurance, claims based on occurrences during their term, but reported subsequently, would be uninsured. Management anticipates that such coverages will be renewed or replaced with equivalent insurance as they expire.

Changes in self-insured liabilities for the years ended June 30, 2018 and 2017:

	Accrued Professional Liability Costs	Accrued Workers Compensation Claims	Accrued Employee Health Care Claims	Total
	\$	\$	\$	\$
<b>Balance at June 30, 2016</b>	14,709,945	782,000	1,561,000	17,052,945
Claims incurred and changes in estimates	11,118,711	517,393	12,974,111	24,610,215
Claims payments	(11,760,667)	(460,286)	(13,095,111)	(25,316,064)
<b>Balance at June 30, 2017</b>	14,067,989	839,107	1,440,000	16,347,096
Claims incurred and changes in estimates	8,086,058	830,382	15,741,307	24,657,747
Claims payments	(5,126,837)	(843,272)	(15,433,307)	(21,403,416)
<b>Balance at June 30, 2018</b>	17,027,210	826,217	1,748,000	19,601,427

To ease the process of licensing and servicing its multiple software programs, the Health System has signed a licensing and service agreement with a global supplier of health information technology solutions, services and hardware, dated August 14, 2014. Per this agreement, the Health System has committed to pay monthly payments for a period of 14 years for these various services. The Health System can terminate the contract at any time at which point the Health System would have to pay all outstanding invoices and a termination fee of \$11,500,000. The aggregate amount of required payments at June 30, 2018 (given no early termination), are as follows:

	Amount
<b>Fiscal year ending June 30:</b>	<b>\$</b>
2019	31,143,372
2020	31,576,991
2021	32,156,735
2022	27,228,677
2023	26,704,507
Thereafter	148,154,976
	296,965,258

## 15 Subsequent Events

On August 23, 2018, the Health System Board of Directors approved a resolution to change the obligated group for debt issuance to include AUMA and RWSH. The reason for the change to the obligated group is to create a platform for the management of debt across the Health System.

On August 3, 2018, the Augusta Economic Development Authority approved a resolution for the Health System to borrow up to \$230 million through a bond issuance with a 7% interest rate. The bond proceeds can primarily be used to refinance existing debt and reimburse the Health System for previous capital expenditures. A small portion of the proceeds can be used to finance renovations for AUMC in the nursing units and operating rooms.

On August 18, 2018, AU and the Health System announced that the organizations had experienced two cybersecurity attacks, which resulted in unauthorized access to personal and protected health information of approximately 417,000 individuals. The incidents occurred in September 2017 and July 2018. The Health System believes it is adequately insured for the expenses related to the incidents and no amounts have been recorded in the accompanying financial statements for these matters.

The Health System evaluated its June 30, 2018 financial statements for subsequent events through August 31, 2018, the date the financial statements were available to be issued. Other than the events noted above, the Health System is not aware of any additional subsequent events which would require recognition or disclosure in the financial statements.

# Schedule I – Combining statement of net position

June 30, 2018	Obligated Group						Nonobligated Group			Total AU Health System
	AUMC	AUHS	RWSH	AUMA	Eliminations	Total	Nonobligated Group	Eliminations	Total	
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Assets</b>										
<b>Current assets:</b>										
Cash and cash equivalents	49,095,444	4,226,160	570,384	1,201,878	-	55,093,866	6,921,902	-	6,921,902	62,015,768
Short-term investments	32,311,859	-	-	5,649,879	-	37,961,738	-	-	-	37,961,738
Cash equivalents internally designated for self-insurance liability funding	-	-	-	-	-	-	3,195,038	-	3,195,038	3,195,038
Short-term investments internally designated for self-insurance liability funding	-	-	-	-	-	-	2,749,690	-	2,749,690	2,749,690
Cash held by trustee under indenture agreement	-	-	-	-	-	-	1,001,007	-	1,001,007	1,001,007
Investments held by trustee under indenture agreement	-	-	-	-	-	-	922,009	-	922,009	922,009
Patient accounts receivable, net of allowance for doubtful accounts	103,139,155	6,232,656	3,562,676	-	(363,406)	112,571,081	337,210	(13,635)	323,575	112,894,656
Due from third-party payors	18,335,928	4,076,716	-	-	-	22,412,644	-	-	-	22,412,644
Other receivables	17,138,704	11,293,927	-	15,153,821	(24,274,949)	19,311,503	148,323	(122,000)	26,323	19,337,826
Inventory	19,000,362	-	104,984	-	-	19,105,346	-	-	-	19,105,346
Net investment in direct financing lease	-	-	-	-	-	-	1,186,728	-	1,186,728	1,186,728
Other current assets	21,417,116	144,618	53,130	-	(4,225,967)	17,388,897	21,298	-	21,298	17,410,195
Total current assets	260,438,568	25,974,077	4,291,174	22,005,578	(28,864,322)	283,845,075	16,483,205	(135,635)	16,347,570	300,192,645
<b>Noncurrent assets:</b>										
Investments internally designated for self-insurance liability funding	-	-	-	-	-	-	9,640,231	-	9,640,231	9,640,231
Long-term investments	84,686,677	-	-	13,932,092	-	98,618,769	-	-	-	98,618,769
Capital assets, net	249,318,549	1,221,342	152,430	-	-	250,692,321	5,446,054	-	5,446,054	256,138,375
Net investment in direct financing lease, less current portion	-	-	-	-	-	-	22,519,524	-	22,519,524	22,519,524
Intercompany receivables (payables)	-	4,562,974	-	-	9,766,323	14,329,297	20,218	(14,349,515)	(14,329,297)	-
Other assets	21,997,459	734,975	-	9,322,570	(11,570,626)	20,484,378	-	-	-	20,484,378
Total assets	616,441,253	32,493,368	4,443,604	45,260,240	(30,668,625)	667,969,840	54,109,232	(14,485,150)	39,624,082	707,593,922

# Schedule I – Combining statement of net position (cont'd)

June 30, 2018	Obligated Group						Nonobligated Group			Total AU Health System
	AUMC	AUHS	RWSH	AUMA	Eliminations	Total	Nonobligated Group	Eliminations	Total	
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Liabilities and net position</b>										
<b>Current liabilities:</b>										
Accounts payable	31,905,237	2,646,794	1,007,281	10,744	(2,513,809)	33,056,247	794,873	(640,601)	154,272	33,210,519
Accrued salaries and wages	6,007,249	541,192	162,183	134,575	-	6,845,199	4,335	-	4,335	6,849,534
Accrued compensated absences	15,204,761	2,926,111	581,863	671,693	-	19,384,428	7,945	-	7,945	19,392,373
Accrued expenses and other current liabilities	6,583,104	1,560,931	103,392	(113,006)	-	8,134,421	211,520	-	211,520	8,345,941
Due to related party - Service fee	6,638,215	-	-	-	-	6,638,215	-	-	-	6,638,215
Due to related parties	24,494,288	18,693,874	1,317,466	15,600,818	(25,605,763)	34,500,683	615,225	(597,009)	18,216	34,518,899
Due to third-party payors	-	-	3,593,263	-	-	3,593,263	-	-	-	3,593,263
Current portion of accrued professional liability costs	763,684	396,808	-	-	-	1,160,492	3,096,311	-	3,096,311	4,256,803
Current portion of obligations under capital lease	5,453,318	-	15,963	-	-	5,469,281	-	-	-	5,469,281
Current portion of long-term debt	5,294,167	-	-	-	-	5,294,167	905,000	-	905,000	6,199,167
Total current liabilities	102,344,023	26,765,710	6,781,411	16,304,824	(28,119,572)	124,076,396	5,635,209	(1,237,610)	4,397,599	128,473,995
<b>Noncurrent liabilities:</b>										
Long-term debt, net of current	166,935,833	-	-	-	-	166,935,833	22,762,958	-	22,762,958	189,698,791
Obligations under capital lease, net of current	17,751,252	-	25,809	-	-	17,777,061	-	-	-	17,777,061
Accrued postemployment benefits	-	6,165,679	-	-	-	6,165,679	-	-	-	6,165,679
Accrued professional liability costs, net of current	2,291,052	1,190,424	-	-	-	3,481,476	9,288,931	-	9,288,931	12,770,407
Interest rate swap liability	14,818,596	-	-	-	-	14,818,596	-	-	-	14,818,596
Other liabilities	3,500,935	76,955	-	-	-	3,577,890	-	-	-	3,577,890
Total liabilities	307,641,691	34,198,768	6,807,220	16,304,824	(28,119,572)	336,832,931	37,687,098	(1,237,610)	36,449,488	373,282,419
<b>Net position:</b>										
Invested in capital assets, net of related debt	80,983,979	1,221,342	110,659	-	-	82,315,980	5,446,053	-	5,446,053	87,762,033
Unrestricted	227,815,583	(2,926,742)	(2,474,275)	28,955,416	(2,549,053)	248,820,929	10,976,081	(13,247,540)	(2,271,459)	246,549,470
Total net position	308,799,562	(1,705,400)	(2,363,616)	28,955,416	(2,549,053)	331,136,909	16,422,134	(13,247,540)	3,174,594	334,311,503

## Schedule II – Combining statement of revenues, expenses and changes in net position

For the year ended June 30, 2018	Obligated Group						Nonobligated Group			Total AU Health System
	AUMC	AUHS	RWSH	AUMA	Eliminations	Total	Nonobligated Group	Eliminations	Total	
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Operating revenues:</b>										
Net patient service revenue	623,926,191	59,147,831	16,666,228	54,336,192	(1,320,298)	752,756,144	2,858,848	(1,144,987)	1,713,861	754,470,005
Revenue from contractual services	28,332,138	-	1,600,000	-	-	29,932,138	-	-	-	29,932,138
Other operating revenue	59,892,784	42,863,256	44,657	66,976,935	(92,490,016)	77,287,616	3,702,665	(3,623,020)	79,645	77,367,261
Intercompany revenue (expense)	-	-	-	-	(518,248)	(518,248)	-	518,248	518,248	-
Total operating revenues	712,151,113	102,011,087	18,310,885	121,313,127	(94,328,562)	859,457,650	6,561,513	(4,249,759)	2,311,754	861,769,404
<b>Operating expenses:</b>										
Salaries and wages	229,532,892	27,784,728	9,676,962	89,906,692	486,734	357,388,008	510,910	(27,000)	483,910	357,871,918
Employee benefits and payroll taxes	50,590,343	10,350,080	2,103,188	(14,258,475)	158,541	48,943,677	163,973	-	163,973	49,107,650
Purchased services	76,028,832	53,736,513	1,604,015	713,812	(91,442,199)	40,640,973	-	-	-	40,640,973
Medical and surgical supplies	174,587,968	716,715	1,798,288	429,740	(1,699,705)	175,833,006	663,998	-	663,998	176,497,004
Insurance	8,968,711	2,706,343	277,340	2,119,819	-	14,072,213	6,503,092	(6,474,818)	28,274	14,100,487
Non-medical supplies and other expenses	47,056,844	9,347,473	2,667,052	9,915,904	(1,724,957)	67,262,316	806,526	(320,187)	486,339	67,748,655
Depreciation and amortization	35,416,989	201,122	18,745	262,587	-	35,899,443	275,783	-	275,783	36,175,226
Information technology and telecommunications	43,424,914	685,129	469,215	680,506	(92,049)	45,167,715	16,107	-	16,107	45,183,822
Repairs and maintenance	14,144,990	138,591	330,015	136,085	(3,206)	14,746,475	79,100	-	79,100	14,825,575
Total operating expenses	679,752,483	105,666,694	18,944,820	89,906,670	(94,316,841)	799,953,826	9,019,489	(6,822,005)	2,197,484	802,151,310

## Schedule II – Combining statement of revenues, expenses and changes in net position (cont'd)

For the year ended June 30, 2018	Obligated Group						Nonobligated Group			Total AU Health System
	AUMC	AUHS	RWSH	AUMA	Eliminations	Total	Nonobligated Group	Eliminations	Total	
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Operating Income (loss)</b>	32,398,630	(3,655,607)	(633,935)	31,406,457	(11,721)	59,503,824	(2,457,976)	2,572,246	114,270	59,618,094
<b>Nonoperating revenue:</b>										
Interest expense	(7,718,713)	(9,468)	(2,999)	(9,468)	18,936	(7,721,712)	(791,968)	-	(791,968)	(8,513,680)
Investment income, net	3,492,981	23	-	822,865	-	4,315,869	1,348,473	(590,570)	757,903	5,073,772
Unrealized gain on interest rate swap	5,994,197	-	-	-	-	5,994,197	-	-	-	5,994,197
Net gain (loss) on disposition of capital assets	(117,780)	-	-	(200,638)	-	(318,418)	(76,627)	-	(76,627)	(395,045)
Supplemental contribution to the Augusta University Early Retirement Program	(5,597,573)	(596,616)	-	(596,616)	-	(6,790,805)	-	-	-	(6,790,805)
<b>Increase (decrease) in net position before service fee, additions to permanent endowments, restricted contributions and restricted investment income</b>	28,451,742	(4,261,668)	(636,934)	31,422,600	7,215	54,982,955	(1,978,098)	1,981,676	3,578	54,986,533
<b>Nonoperating expense - Service fee</b>	(6,638,215)	-	-	-	-	(6,638,215)	-	-	-	(6,638,215)
<b>Increase (decrease) in net position before restricted contributions and restricted investment income</b>	21,813,527	(4,261,668)	(636,934)	31,422,600	7,215	48,344,740	(1,978,098)	1,981,676	3,578	48,348,318
<b>Change in restricted contributions</b>	443,755	-	(628,918)	-	-	(185,163)	734,975	(734,975)	-	(185,163)
<b>Increase (decrease) in net position</b>	22,257,282	(4,261,668)	(1,265,852)	31,422,600	7,215	48,159,577	(1,243,123)	1,246,701	3,578	48,163,155
<b>Net position, beginning of year, as previously reported</b>	286,542,280	2,556,268	(1,097,764)	30,703,575	(2,556,268)	316,148,091	17,665,257	(14,494,241)	3,171,016	319,319,107
Net impact of GASB Statement No. 75 implementation	-	-	-	(33,170,759)	-	(33,170,759)	-	-	-	(33,170,759)
<b>Net position, as restated beginning of year</b>	286,542,280	2,556,268	(1,097,764)	(2,467,184)	(2,556,268)	282,977,332	17,665,257	(14,494,241)	3,171,016	286,148,348
<b>Net position, end of year</b>	308,799,562	(1,705,400)	(2,363,616)	28,955,416	(2,549,053)	331,136,909	16,422,134	(13,247,540)	3,174,594	334,311,503