Consolidated Financial
Statements and Other
Financial Information

Mary Washington Healthcare and Subsidiaries

December 31, 2017 and 2016

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Contents

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Mary Washington Healthcare and Subsidiaries
Fredericksburg, Virginia

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Mary Washington Healthcare and Subsidiaries (MWHC), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MWHC as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Other Financial Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying obligated group information as of and for the year ended December 31, 2017, is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the obligated group and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Arnett Corbis Toothman LLP

New Castle, Pennsylvania
April 10, 2018

Mary Washington Healthcare and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2017	**2016**
Assets		
Current assets:		
Cash and cash equivalents	**$ 50,869,030**	$ 102,242,106
Accounts receivable:		
Patient accounts receivable, less allowance for uncollectable accounts of $35,700,000 in 2017 and $36,700,000 in 2016 *(Note 11)*	**76,307,657**	68,928,860
Other	**2,989,867**	1,835,236
	79,297,524	70,764,096
Notes receivable	**47,993**	53,915
Inventories	**13,148,062**	13,473,912
Prepaid expenses and other	**8,651,170**	7,244,868
Total current assets	**152,013,779**	193,778,897
Assets whose use is limited *(Note 2):*		
Internally designated for healthcare programs and capital acquisitions	**250,080,529**	179,098,343
Internally restricted for malpractice claims	**12,688,411**	11,227,898
Externally restricted by donors	**13,111,087**	13,427,904
	275,880,027	203,754,145
Property, plant and equipment, less accumulated depreciation and amortization *(Note 4)*	**314,885,586**	299,239,020
Other non-current assets	**2,209,008**	2,592,715
Total assets	**$ 744,988,400**	$ 699,364,777

(continued)

See Notes to Consolidated Financial Statements

Mary Washington Healthcare and Subsidiaries

Consolidated Balance Sheets (continued)

	December 31	
	2017	**2016**
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	**$ 42,631,385**	$ 40,882,973
Employee compensation and professional fees	**30,861,618**	34,689,750
Interest payable	**460,319**	448,372
Current maturities of long-term obligations *(Notes 5 and 10)*	**10,014,937**	9,500,706
Current maturities of long-term accounts payable	**2,958,518**	-
Total current liabilities	**86,926,777**	85,521,801
Long-term obligations, less current maturities *(Notes 5 and 10)*	**254,874,382**	263,924,888
Other liabilities:		
Long-term accounts payable, less current maturities	**5,751,029**	-
Accrued losses on malpractice claims *(Note 7)*	**13,985,752**	14,030,118
Pension liability *(Note 6)*	**54,932,788**	61,055,435
Other	**505,392**	25,863
	75,174,961	75,111,416
Total liabilities	**416,976,120**	424,558,105
Net assets:		
Unrestricted - general	**309,204,271**	255,625,568
Unrestricted - noncontrolling interest	**5,696,922**	5,753,200
Temporarily restricted *(Note 3)*	**11,852,877**	12,169,694
Permanently restricted *(Note 3)*	**1,258,210**	1,258,210
	328,012,280	274,806,672
Total liabilities and net assets	**$ 744,988,400**	$ 699,364,777

See Notes to Consolidated Financial Statements

Mary Washington Healthcare and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Years ended December 31	
	2017	**2016**
Unrestricted net assets		
Revenues and other support:		
Net patient service revenue:		
Patient service revenue (net of contractual allowances and discounts)	**$ 660,945,352**	$ 654,793,746
Provision for bad debts	**(66,946,847)**	(73,354,231)
	593,998,505	581,439,515
Retail and pharmacy sales	**5,589,080**	5,444,311
Rental of facilities	**2,289,450**	2,696,841
Management and personnel services	**7,257,719**	4,822,526
Investment income *(Note 2)*	**5,893,047**	3,269,855
Unrestricted contributions	**562,931**	532,714
Other	**19,423,476**	11,977,558
	635,014,208	610,183,320
Expenses *(Note 9):*		
Salaries and wages	**230,840,528**	224,943,491
Employee benefits *(Note 6)*	**46,970,510**	46,310,551
Contract personnel	**14,104,351**	7,101,844
Professional fees	**57,278,808**	44,120,658
General and administrative	**16,516,395**	15,137,268
Provisions for depreciation and amortization	**39,619,971**	40,892,196
Interest *(Note 5)*	**9,778,130**	11,448,836
Cost of goods sold from retail operations	**4,723,222**	4,361,868
Contract services	**58,656,113**	57,729,335
Supplies	**105,962,271**	102,267,332
Utilities	**5,312,946**	5,403,711
Insurance *(Note 7)*	**4,660,471**	4,156,783
Rent	**9,264,713**	9,633,664
Other	**4,590,852**	4,415,854
	608,279,281	577,923,391
Income from operations	**26,734,927**	32,259,929
Nonoperating gains (losses):		
Net appreciation (depreciation) of investments *(Note 2)*	**31,011,488**	7,806,347
Gain on extinguishment of debt *(Note 5)*	**-**	3,776,249
Gain (loss) on investments in partnerships and other	**420,700**	(328,845)
Excess of revenues, gains and other support over expenses and losses	**58,167,115**	43,513,680

(continued)

See Notes to Consolidated Financial Statements

Mary Washington Healthcare and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued)

	Years ended December 31	
	2017	**2016**
Unrestricted net assets		
Excess of revenues, gains and other support over expenses and losses	**$ 58,167,115**	$ 43,513,680
Other changes in unrestricted net assets:		
Noncontrolling interest	**(7,777,086)**	(7,109,784)
Adjustments to net pension liability exclusive of net periodic pension cost *(Note 6)*	**3,190,689**	(4,541,873)
Other	**(2,015)**	(3,065)
Increase in unrestricted net assets	**53,578,703**	31,858,958
Noncontrolling interest		
Distributions	**(7,833,364)**	(7,009,541)
Change in ownership	**-**	(646,759)
Income	**7,777,086**	7,109,784
	(56,278)	(546,516)
Temporarily restricted net assets		
Contributions	**497,909**	312,826
Investment income *(Note 2)*	**486,877**	264,375
Net assets released from restrictions used in operations	**(1,279,223)**	(1,616,050)
Net appreciation (depreciation) of investments *(Note 2)*	**-**	126,780
Other	**(22,380)**	(29,692)
Decrease in temporarily restricted net assets	**(316,817)**	(941,761)
Increase in net assets	**53,205,608**	30,370,681
Net assets at beginning of year	**274,806,672**	244,435,991
Net assets at end of year	**$ 328,012,280**	$ 274,806,672

See Notes to Consolidated Financial Statements

Mary Washington Healthcare and Subsidiaries

Consolidated Statements of Cash Flows

	Years ended December 31	
	2017	**2016**
Cash flows from operating activities and nonoperating gains (losses)		
Increase (decrease) in net assets	**$ 53,205,608**	$ 30,370,681
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities and nonoperating gains (losses):		
Net (appreciation) depreciation of investments	**(31,011,488)**	(7,806,347)
Other nonoperating (gains) losses	**(267,308)**	312,531
(Gain) loss on disposal of fixed assets	**(153,392)**	16,314
(Gain) on refunding of bonds	**-**	(3,776,249)
Provisions for depreciation and amortization	**39,619,971**	40,892,196
Accretion of original issue premium	**(1,431,974)**	(1,254,031)
Amortization of deferred financing costs	**153,935**	333,626
Amortization of physician loans receivable	**66,092**	69,403
Provision for bad debts	**66,946,847**	73,354,231
Change in pension obligation other than net periodic pension cost	**(3,190,689)**	4,541,873
(Increase) decrease in:		
Accounts receivable	**(75,480,275)**	(70,759,065)
Settlements due from third parties	**-**	1,306,561
Inventories	**325,850**	(1,640,037)
Prepaid expenses and other	**(1,406,302)**	632,938
Other	**280,571**	(1,060,152)
Increase (decrease) in:		
Accounts payable and accrued expenses	**(307,588)**	2,686,960
Employee compensation and professional fees	**(3,828,132)**	2,374,481
Interest payable	**11,947**	(108,581)
Insurance claims	**(44,366)**	668,169
Pension liability	**(2,931,958)**	180,576
Net cash provided by operating activities and nonoperating gains (losses)	**40,557,349**	71,336,078

(continued)

See Notes to Consolidated Financial Statements

Mary Washington Healthcare and Subsidiaries

Consolidated Statements of Cash Flows (continued)

	Years ended December 31	
	2017	**2016**
Cash flows from investing activities		
Change in assets whose use is limited:		
Net increase (decrease) in cash and cash equivalents	**284,484**	(2,815,507)
Purchases of investments	**(199,627,229)**	(453,646,937)
Proceeds from sale of investments	**156,679,132**	452,907,272
Payments received on pledges receivable	**1,549,219**	211,600
Acquisition of property, plant and equipment	**(40,925,042)**	(25,708,629)
Proceeds from sale of property, plant and equipment	**1,545,300**	100,200
Changes in notes receivable	**179,358**	162,766
Net cash used in investing activities	**(80,314,778)**	(28,789,235)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	**-**	159,150,962
Repayment of long-term obligations	**(11,615,647)**	(160,604,442)
Increase in deferred financing costs	**-**	(1,742,683)
Net cash used in financing activities	**(11,615,647)**	(3,196,163)
Net (decrease) increase in cash and cash equivalents	**(51,373,076)**	39,350,680
Cash and cash equivalents at beginning of year	**102,242,106**	62,891,426
Cash and cash equivalents at end of year	**$ 50,869,030**	$ 102,242,106
Non-cash Transactions:		
Property, plant and equipment acquired through vendor financing	**13,066,958**	-
Property, plant and equipment acquired through accounts payable	**2,056,000**	2,392,000

See Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Organization

Mary Washington Healthcare (MWHC) is the parent corporation for Mary Washington Hospital, Inc. (Mary Washington), Stafford Hospital, LLC (Stafford), MediCorp Properties, Inc. (Properties), Mary Washington Healthcare Clinical Services, Inc. (Clinical Services), Mary Washington Healthcare Services, Inc. (Services), Fredericksburg Professional Risk Exchange (ProRex), MWHC SIR, LLC (SIR), Mary Washington Health Alliance, LLC (MWHA), and Rappahannock Health Connect, LLC (RHC). MWHC is a nonstock, tax-exempt, not-for-profit organization. Mary Washington, Stafford, Properties, and Clinical Services are wholly-controlled, nonstock, tax-exempt, not-for-profit subsidiaries of MWHC. Services is a wholly-owned, taxable subsidiary of MWHC. ProRex is a wholly-owned risk retention group and a taxable subsidiary of MWHC. MWHC was the sole member of both SIR and MWHA, which were considered disregarded entities for tax purposes as of December 31, 2017. RHC is a wholly-controlled, tax-exempt, health information exchange subsidiary of MWHC.

Mission Statement

The primary purpose of MWHC and its subsidiaries is to improve the health of the people within the communities served. As a result, operating revenues include those generated from direct patient care and sundry revenues related to the operation of MWHC's programs and facilities.

Operating Indicators

MWHC's excess of revenues, gains, and other support over expenses and losses include all unrestricted revenue, gains, expenses, and losses for the reporting period except for contributions of long-term assets, discontinued operations, additional adjustments to net pension liability exclusive of net periodic pension cost, and noncontrolling interest.

Other activities that result in gains or losses unrelated to MWHC's primary mission are considered to be nonoperating. Nonoperating gains and losses principally include income and expenses associated with investments in partnerships and joint ventures, as well as the net appreciation (depreciation) on investments.

Basis for Consolidation

The consolidated financial statements include the accounts of MWHC and its wholly controlled (tax-exempt) or owned (taxable) subsidiaries and majority-owned partnerships. Significant intercompany accounts and transactions are eliminated in consolidation.

1. Summary of Significant Accounting Policies (continued)

Service to the Community

MWHC provides medical services to the city of Fredericksburg and surrounding counties. Established in 1899 and 2009, respectively, Mary Washington (a 451 bed acute care facility) and Stafford (a 100 bed acute care facility) offer comprehensive healthcare and multiple clinical service lines including cardiology and cardiovascular surgery, psychiatry, and women and infant health. Mary Washington and Stafford (collectively, the Hospitals) are accredited by the Joint Commission and licensed by the Virginia Department of Behavioral Health and Developmental Services. Mary Washington also provides advanced radiation therapy through the Cancer Center of Virginia and home health services through Mary Washington Home Health.

Uncompensated Care

MWHC provides a full spectrum of inpatient and outpatient services to members of their community and accepts all patients regardless of their ability to pay. Patients are classified as eligible for charity care according to MWHC's established policies. Amounts determined to qualify as charity care are not pursued for collections and, accordingly, are not reported as patient revenue. In assessing a patient's inability to pay, MWHC utilizes 200% (138% prior to 2017) of the poverty level established by the federal government. MWHC also provides additional discounts on a sliding scale up to 300% of the poverty level. Charges for charity care provided for the years ended December 31, 2017 and 2016, were approximately $49,340,000 and $63,900,000, respectively. The costs associated with this care equated to approximately $14,997,000 in 2017 and $19,100,000 in 2016. The cost of uncompensated care includes both direct and indirect costs calculated on a ratio of cost to charges basis.

Support for Medical Education Programs

The Mary Washington Hospital Foundation and Stafford Hospital Foundation (collectively, the Foundations) award educational scholarships to individuals enrolled in a nursing program or who wish to pursue a career in a healthcare field. MWHC encourages and provides financial support for certain employees who wish to increase their healthcare knowledge. MWHC also provides financial assistance to employees to attend training to acquire skills and knowledge that will assist in providing healthcare education and/or conduct health fairs that will improve the health status of the community. Mary Washington serves as a clinical training site for undergraduate students enrolled in various healthcare programs with colleges and universities throughout Virginia.

1. Summary of Significant Accounting Policies (continued)

Other Community Services

MWHC also provides:

- funding to community organizations that are health-focused, such as the Lloyd Moss Free Clinic,
- clinical programs that assist many people who would not otherwise be able to access care,
- health promotion programs and services, such as smoking cessation, blood pressure screenings, and wellness programs, and
- social services to assist patients in arranging for non-hospital health care services.

Noncontrolling Interest

Noncontrolling interest represents the noncontrolling partners' proportionate share of Medical Imaging of Fredericksburg (MIF), owned 51% by Clinical Services; and Fredericksburg Ambulatory Surgery Center, LLC (FASC), owned 54% by Clinical Services.

Use of Estimates

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

Cash Equivalents

MWHC considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents are maintained in commercial banks, for which the aggregate of $250,000 per commercial bank is insured by the Federal Deposit Insurance Corporation (FDIC). MWHC's cash balance routinely exceeds the maximum amount insured by the FDIC. MWHC has not experienced any losses related to funds held in excess of the FDIC limit.

1. Summary of Significant Accounting Policies (continued)

Allowance for Uncollectable Accounts

Accounts receivable are reported at estimated net realizable value after deduction of allowances for uncollectable accounts. The provision for uncollectable accounts is based upon management's judgmental assessment of historical and expected net collections considering business and general economic conditions in its service area, trends in healthcare coverage, and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectable accounts based upon its review of accounts receivable payor composition and aging, taking into consideration recent write-off experience by payor category, payor agreement rate changes and other factors. The results of these assessments are used to make modifications to the provision for bad debts and to establish an appropriate allowance for uncollectable accounts receivable.

For receivables associated with services provided to patients who have third-party coverage (which includes patients with deductible and payment balances for which third-party coverage exists for part of the bill), MWHC analyzes contractually due amounts and provides a contractual allowance, if necessary. For uninsured patients, MWHC records a significant portion of the balance as a provision for uncollectable accounts. The provision is based on an analysis of past experience related to the recent historical collection rate of uninsured patient balances. MWHC follows established guidelines for placing certain past-due patient balances with external collection agencies. As of December 31, 2017 and 2016, the allowance for uncollectable accounts represented approximately 97% of the uninsured patients due accounts receivable balance. As of December 31, 2017 and 2016, MWHC's allowance for uncollectable accounts amounted to approximately $35,700,000 and $36,700,000. During the years ended December 31, 2017 and 2016, MWHC's write-offs to provision for bad debts amounted to approximately $67,900,000 and $80,654,000.

Inventories

Inventories of drugs, medical supplies, and retail goods are stated at the lower of cost (first-in, first-out) or net realizable value.

Assets Whose Use is Limited

Unrestricted resources appropriated or designated by the Board of Trustees for long-term purposes are reported as assets whose use is limited. Such long-term purposes include acquisition of capital assets, payment of malpractice insurance claims, and a community service fund. Assets whose use is limited also includes resources restricted for malpractice claims and resources restricted by donors.

Assets whose use is limited are comprised of cash, investments, and pledges receivable and are carried at fair value in the accompanying consolidated financial statements. Realized and unrealized gains and losses are excluded from income from operations. Cost used in the determination of gains and losses on sales of investments is based on the specific cost of the investment sold.

1. Summary of Significant Accounting Policies (continued)

Property, Plant, and Equipment

Property, plant, and equipment purchased are reported on the basis of cost. Donated items are recorded at fair market value at the date of contribution. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. The general range of useful lives estimated for buildings and building improvements is ten to forty years and for equipment is five to twenty-five years.

Deferred Financing Costs

Financing costs incurred in connection with issuance of long-term obligations are deferred and amortized using the effective interest method over the term of the related indebtedness. The deferred financing costs are included in long-term obligations on the accompanying consolidated balance sheets.

Net Patient Service Revenue

Net patient service revenue is reported at the 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. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Major third-party payors include Anthem Blue Cross and Blue Shield of Virginia (Anthem), the Centers for Medicare and Medicaid Services (Medicare), and the Virginia Medical Assistance Program (Medicaid). Revenue from these payors accounted for 24%, 37%, and 8%, respectively, of MWHC's net patient service revenue for the year ended December 31, 2017 (23%, 35%, and 8%, respectively, in 2016).

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

- *Anthem.* Inpatient and outpatient services rendered to Anthem subscribers are reimbursed at prospectively determined discounted rates. The prospectively determined rates are not subject to retroactive adjustment.

1. Summary of Significant Accounting Policies (continued)

- *Medicare.* Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Most outpatient services related to Medicare beneficiaries are also paid at prospectively determined rates based on clinical and diagnostic factors. The Hospitals are reimbursed for certain indirect cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospitals and audits thereof by the Medicare Administrative Contractor. The Hospitals' Medicare cost reports have been final settled by the Medicare Administrative Contractor through December 31, 2013. Tentative desk settlements have been received through December 31, 2016, for the Hospitals.

- *Medicaid.* Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Inpatient non-acute services and certain outpatient services rendered to Medicaid beneficiaries are paid based on a cost reimbursement methodology. The Hospitals are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospitals and desk reviews thereof by Medicaid. Tentative desk settlements have been received through December 31, 2016, for both Hospitals.

Meaningful Use

MWHC recognizes revenue for incentives earned under the HITECH Meaningful Use Electronic Health Records (EHR) Medicare program in the period in which it is reasonably assured that it will comply with the applicable EHR meaningful use requirements. Incentive revenues are recognized at the conclusion of the applicable meaningful use demonstration period. Incentive payments received under the Medicare program include a discharge-related portion, which is calculated by the Centers for Medicare and Medicaid Services (CMS) based on the Hospitals' most recently filed cost reports. Such amounts are subject to adjustment at the time of settling the 12-month cost report for the Hospitals' fiscal years that begins after the beginning of the payment year. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The EHR funding received is subject to CMS audit. The results of that audit and settlement could result in a potential payback in future periods.

MWHC recognized other revenues of approximately $919,600 and $2,763,000 on the consolidated statements of operations and changes in net assets for the years ended December 31, 2017 and 2016, respectively, related to this program.

Temporarily and Permanently Restricted Net Assets

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

1. Summary of Significant Accounting Policies (continued)

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to MWHC are reported at fair value at the date the promise is received.

The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported on the consolidated statement of operations and changes in net assets as other revenue.

Income Taxes

MWHC was recognized as a public charity generally exempt from federal income taxation under 501(c)(3) of the Internal Revenue Code pursuant to a determination letter issued by the IRS in March 1992. MWHC is entitled to rely on this determination as long as there are no substantial changes in its character, purposes, or methods of operation. Management has concluded that there have been no such changes and, therefore, MWHC's status as a public charity exempt from federal income taxation remains in effect. The state in which MWHC operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation.

However, MWHC is subject to both federal and state income taxation at corporate tax rates on its unrelated business income. Exemption from other state taxes, such as real and personal property taxes, is separately determined. Certain entities under MWHC are taxable entities.

MWHC had no unrecognized tax benefits or liabilities, or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. Tax periods for which no return is filed remain open for examination indefinitely. All required tax filings have been filed on a timely basis.

Reclassifications

Certain reclassifications have been made to the 2016 consolidated financial statements in order to conform to the 2017 presentation.

Subsequent Events

Management has evaluated subsequent events through April 10, 2018, which is the date the consolidated financial statements were issued.

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Update (FASB) issued guidance related to recognition of revenue from contracts with customers. This guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers and requires certain qualitative and quantitative disclosures regarding revenue arising from contracts with customers. This Accounting Standards Update (ASU) will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The guidance permits the use of either a retrospective or modified retrospective (cumulative effect) transition method. In August 2015, the FASB issued an amendment to defer the effective dates for all entities by one year. During 2016, the FASB has issued varied guidance with the purpose of clarifying Topic 606: Revenue from Contracts with Customers. Such clarifications included: improving the operability and understandability of the implementation guidance on principal versus agent considerations; identifying performance obligations and also to improve the operability and understandability of the licensing implementation guidance; clarifying the objective of the collectability criterion for applying paragraph 606-10-25-7; permitting an entity to exclude amounts collected from customers for all sales (and other similar) taxes from the transaction price; specifying that the measurement date for noncash consideration is contract inception; providing a practical expedient that permits an entity to reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented when identifying the satisfied and unsatisfied performance obligations; determining the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligations; clarifying that a completed contract for purposes of transition is a contract for which all (or substantially all) of the revenue was recognized under legacy GAAP before the date of initial application; and clarifying that an entity that retrospectively applies the guidance in Topic 606 to each prior reporting period is not required to disclose the effect of the accounting change for the period of adoption. This guidance is effective for public entities with annual reporting periods beginning after December 15, 2017. Early application is not permitted. MWHC does not believe this will have a material impact on their consolidated financial statements.

In July 2015, the FASB issued guidance with the purpose of simplifying that inventory currently be measured at the lower of cost or market. This guidance does not apply to inventory that is measured using last-in, first-out or the retail inventory method. This guidance does apply to other inventory, which includes inventory that is measured using first-in, first-out or average cost. This guidance states that an organization should measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling price used in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance was effective for all entities for fiscal years beginning after December 15, 2016. Early adoption was permitted. MWHC adopted this guidance during the year ended December 31, 2017. Adoption of this guidance did not have a material impact on MWHC's consolidated financial statements.

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In February 2016, the FASB issued guidance related to recognition by a lessee of assets and liabilities on leases with terms of more than 12 months on the balance sheet. Consistent with U.S. GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease; however, unlike current U.S. GAAP, which requires that only capital leases be recognized on the balance sheet, the ASU requires that both types of leases be recognized on the balance sheet. The ASU also requires disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. Lessor accounting remains largely unchanged from current U.S. GAAP, but the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in May 2014. Transition guidance is provided within the ASU and generally requires a retrospective approach. This guidance is effective for public business entities, not-for-profit entities that have issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and employee benefit plans that file financial statements with the U.S. Securities and Exchange Commission (SEC) with annual reporting periods beginning after December 15, 2018. For all other entities, the amendments in these ASUs will be effective for annual reporting periods beginning after December 15, 2019. Early application of the amendments in this guidance is permitted for all entities. MWHC is currently evaluating the impact, if any, that adoption will have on their consolidated financial statements.

In August 2016, the FASB issued guidance to address eight specific cash flow issues with the objective of reducing the existing diversity in the practice. This guidance indicates how certain cash receipts and cash payments are presented and classified on the statement of cash flows as follows: (1) Cash payments for debt prepayment or debt extinguishment costs should be classified as cash outflows or financing activities. (2) At the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, the issuer should classify the portion of the cash payment attributable to the accreted interest related to the debt discount as cash outflows for operating activities, and the portion of the cash payment attributable to the principal as cash outflows for financing activities. (3) Cash payments not made soon after the acquisition of a business combination by an acquirer to settle a contingent consideration liability should be separated and classified as cash outflows for financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date should be classified as financing activities; any excess should be classified as operating activities. Cash payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be classified as cash outflows for investing activities. (4) Cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that are received in a lump-sum settlement, an entity should determine the classification on the basis of the nature of each loss included in the settlement. (5) Cash proceeds received from the settlement of corporate-owned life insurance policies should be classified as cash inflows

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

from investing activities. The cash payments on premiums on corporate-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities. (6) When a reporting entity applies the equity method, it should make an accounting policy election to classify distributions received from equity method investees using either the cumulative earnings approach or the nature of the distribution approach. This amendment does not address equity method investments measured using the fair value option. (7) A transferor's beneficial interest obtained in a securitization of financial assets should be disclosed as a noncash activity, and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities. (8) The classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined first by applying specific guidance in Generally Accepted Accounting Principles. In the absence of specific guidance, an entity should determine each separately identifiable source or use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. This guidance is effective for all public business entities for fiscal years beginning after December 15, 2017. For all other entities, this guidance is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. MWHC is currently evaluating the impact, if any, that adoption will have on their consolidated financial statements.

In August 2016, the FASB issued guidance to improve certain current financial reporting for not-for-profits (NFPs). The main provisions of this ASU will require an NFP to present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. NFPs will report amounts for net assets with donor restrictions and net assets without donor restrictions, as well as the currently required amount for total net assets. This ASU will also require NFPs to present on the face of the statement of activities the amount of change in each of the two classes of net assets noted above. NFPs will continue to present on the face of the statement of cash flows the net amount for operating cash flows using either the direct or indirect method, but will no longer require indirect method reconciliation if using the direct method. NFPs will report investment return net of external and direct internal investment expenses and no longer be required to disclose these netted expenses. NFPs will also be required to use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations or restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset and reclassify any amounts from net assets with donor restriction to net assets without donor restrictions for such long-lived assets that have been placed in service as of the beginning of the period of adoption (thus eliminating the current option to release the donor-imposed restriction over the estimated useful life of the acquired asset).

This ASU will further require an NFP to provide the following enhanced disclosures about: (a) amounts and purposes of governing board designations, appropriations, and similar actions as of the end of the period; (b) composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources; (c) qualitative information that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the statement of financial position date; (d) quantitative information, either on the face the statement of financial position or in the notes, and additional qualitative information in the notes as necessary that communicates the availability of

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

an NFP's financial assets at the statement of financial position date to meet cash needs for general expenditures within one year of the statement of financial position date; (e) amounts of expenses by both their natural classification and their functional classification; and (f) method used to allocate costs among program and support functions. This guidance is effective for NFPs with fiscal years beginning after December 15, 2017. MWHC does not believe that adoption of this guidance will have a material impact on their consolidated financial statements.

In November 2016, the FASB issued guidance on the statement of cash flows: restricted cash. Generally Accepted Accounting Principles currently do not include specific guidance on the cash flow classification and presentation of changes in restricted cash or restricted cash equivalents other than limited guidance for not-for-profit entities. The statement of cash flows must explain the change in restricted cash or restricted cash equivalents along with cash and cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Amendments should be applied retrospectively. This guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and for all other entities for fiscal years beginning after December 15, 2018. MWHC does not believe that adoption of this guidance will have a material impact on their consolidated financial statements.

In March 2017, the FASB issued guidance relative to compensation for retirement benefits. This guidance require that an employer disaggregate the service cost component from the other components of net benefit cost. The amendments also provide explicit guidance on how to present the service cost component and the other components of net benefit cost on the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. This guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and for all other entities for fiscal years beginning after December 15, 2018. MWHC does not believe that adoption of this guidance will have a material impact on their consolidated financial statements.

2. Assets Whose Use is Limited

The fair market values of assets whose use is limited as of December 31 are summarized as follows:

		2017		2016
Internally designated for healthcare programs and capital acquisitions:				
Cash and cash equivalents	**$**	**537,737**	$	336,052
Equity securities		**246,633,267**		160,993,369
Pledges receivable		**3,825**		-
Alternative investments		**2,905,700**		17,768,922
		250,080,529		179,098,343
Internally designated for insurance claims:				
Cash and cash equivalents		**63,658**		65,389
Equity securities		**12,624,753**		11,162,509
		12,688,411		11,227,898
Externally restricted by donors:				
Cash and cash equivalents		**109,809**		25,278
Pledges receivable		**553,549**		2,106,586
Equity securities		**12,447,729**		11,296,040
		13,111,087		13,427,904
	$	**275,880,027**	$	203,754,145

Investment income and gains on assets whose use is limited are comprised of the following for the years ended December 31:

		2017		2016
Revenue and other support:				
Interest and dividends	**$**	**5,893,047**	$	3,269,855
Nonoperating gains:				
Net appreciation of investments		**31,011,488**		7,806,347
		36,904,535		11,076,202
Changes in temporarily restricted net assets:				
Interest and dividends		**486,877**		264,375
Net appreciation (depreciation) of investments		**-**		126,780
		486,877		391,155
	$	**37,391,412**	$	11,467,357

2. Assets Whose Use is Limited (continued)

MWHC's investment portfolio is classified as "trading." As a result, all gains and losses on investments, including realized, unrealized, and impairment losses, are reported on the consolidated statements of operations and changes in net assets as non-operating gains and losses. Net appreciation (depreciation) of investments includes realized and unrealized gains (losses) on investments.

Current accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establish a framework for measuring fair value and establish a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

Level 1: Observable inputs such as quoted prices in active markets

Level 2: Inputs other than quoted prices in active markets that are either directly or indirectly observable

Level 3: Unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumption

Assets and liabilities are classified in their entirety based on the level of input that is significant to the fair value measurement. MWHC's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no changes in valuation techniques during the current year.

Prices for certain money market funds, fixed income, mutual funds, exchange-traded funds, and managed futures that are readily available in the active markets in which those securities are traded and the resulting fair values are categorized as Level 1. Prices for certain commingled trust funds are determined on a recurring basis based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets and are categorized as Level 2. Prices for certain private equity funds, real estate funds, limited partnerships, and fund of funds are categorized as Level 3. Because of the inherent uncertainty of valuations of Level 3 investments, their estimated values may differ significantly from the values that would have been used had a ready market for the Level 3 investments existed, and the difference could be material.

The following discussion describes the valuation methodologies used for financial assets measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used, including discount rates, and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about MWHC's business, its value, or financial position based on the fair value information of financial assets presented below.

2. Assets Whose Use is Limited (continued)

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values for MWHC's fixed maturity securities (corporate bonds, government debt securities, and government mortgage and asset backed securities) are based on prices provided by its investment managers, who use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience.

Fair values of equity securities have been determined by MWHC from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

Alternative investments are recorded under the equity method of accounting using net asset value (NAV). The NAV of alternative investments is based on valuations provided by the administrators of the specific financial instrument. The underlying investments in these financial instruments may include marketable debt and equity securities, commodities, foreign currencies, derivatives, and private equity investments. The underlying investments themselves are subject to various risks, including market, credit, liquidity, and foreign exchange risk. MWHC believes the NAV is a reasonable estimate of its ownership interest in the alternative investments. MWHC's risk of alternative investments is limited to its carrying value. Alternative investments can be divested only at specific times in accordance with terms of the subscription agreements. Because these financial instruments are not readily marketable, the estimated carrying value is subject to uncertainty, and, therefore, may differ from the value that would have been used had a market for such financial instruments existed. Under current accounting standards, investments using the NAV are to be excluded from the fair value hierarchy. In addition to exclusion from the fair value hierarchy, current account standards also provide for additional qualitative disclosures, which management has determined to be immaterial to the users of the financial statements.

In the absence of any independent quotations, securities will be valued by the fund managers on the basis of data obtained from the best available sources. Although the various fund managers use their professional judgment at estimating the fair value of the alternative investments, there are inherent limitations in any valuation technique. Therefore, the value determined by fund managers is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of the fair value could be material.

2. Assets Whose Use is Limited (continued)

The following tables present MWHC's financial assets that are measured at fair value on a recurring basis as of December 31:

	2017			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 711,203	$ -	$ -	$ 711,203
Equity securities				
Mutual funds				
Global stock	51,374,985	-	-	51,374,985
Intermediate term bond	41,187,627	-	-	41,187,627
Small cap	9,887,656	-	-	9,887,656
Global developing market	13,670,626	-	-	13,670,626
Multi-sector bond	32,234,915	-	-	32,234,915
Multi-sector stock	123,349,941	-	-	123,349,941
Alternative investments	-	-	-	2,905,700
	$ 272,416,953	$ -	$ -	$ 275,322,653

	2016			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 426,719	$ -	$ -	$ 426,719
Equity securities				
Mutual funds				
Global stock	23,794,863	-	-	23,794,863
Intermediate term bond	17,027,285	-	-	17,027,285
Small cap	13,639,232	-	-	13,639,232
Global developing market	7,721,142	-	-	7,721,142
Multi-sector bond	37,153,074	-	-	37,153,074
Multi-sector stock	77,338,455	-	-	77,338,455
Real estate	6,777,867	-	-	6,777,867
Alternative investments	-	-	-	17,768,922
	$ 183,878,637	$ -	$ -	$ 201,647,559

2. Assets Whose Use is Limited (continued)

Total alternative investments as of December 31 are as follows:

	Fair Value	
	2017	**2016**
Private equity funds	**$ 950,333**	$ 930,747
Master fund	**-**	14,820,114
Private fund	**1,955,367**	1,763,175
Fund of funds	**-**	254,886
Total	**$ 2,905,700**	$ 17,768,922

	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Private equity funds	$ 110,000	after 3+ years	n/a
Private fund	50,000	n/a	n/a

Pledges receivable of approximately $557,000 and $2,107,000 as of December 31, 2017 and 2016, respectively, represent financial assets that are classified as assets whose use is limited in the accompanying consolidated financial statements that are not measured at fair value on a recurring basis.

3. Restricted Net Assets

Temporarily restricted net assets are available as of December 31 for the following purposes:

	2017	**2016**
Healthcare programs and services	**$ 10,974,339**	$ 11,050,660
Acquisition of building and equipment	**128,619**	120,767
Educational seminars, scholarships, and other	**749,919**	998,267
	$ 11,852,877	$ 12,169,694

When temporarily restricted net assets are released from restrictions, they are reclassified to unrestricted net assets and are reported as other operating income on the consolidated statements of operations and changes in net assets.

Permanently restricted net assets ($1,258,210 as of December 31, 2017 and 2016) are restricted to investments in perpetuity, the income from which is expendable to support charitable purposes specified by the donors.

Current accounting standards require certain disclosures for donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The Commonwealth of Virginia has adopted UPMIFA. In management's opinion, the adoption of UPMIFA had no impact on the accounting of MWHC's endowment.

4. Property, Plant, and Equipment

Property, plant, and equipment as of December 31 consist of the following:

	2017	2016
Land and land improvements	**$ 59,027,405**	$ 77,905,166
Buildings	**328,260,752**	330,091,646
Fixed equipment	**62,434,756**	90,508,026
Movable equipment	**293,397,557**	367,957,425
Construction in progress	**34,830,510**	4,966,516
	777,950,980	871,428,779
Less accumulated depreciation and amortization	**463,065,394**	572,189,759
	$ 314,885,586	$ 299,239,020

The estimated cost to complete construction in progress as of December 31, 2017, is approximately $67,968,000. This amount relates primarily to the cost of technology upgrades and replacements, as well as other construction projects and replacement of equipment. Approximately $2,056,000 and $2,392,000 of additions to property, plant, and equipment were included in accounts payable as of December 31, 2017 and 2016, respectively. During the years ended December 31, 2017 and 2016, MWHC recognized depreciation expense of approximately $39,010,000 and $40,871,000, respectively. During the years ended December 31, 2017 and 2016, MWHC disposed of approximately $147,500,000 and $3,200,000, of property, plant, and equipment, respectively, which was fully depreciated.

5. Long-Term Obligations

Long-term obligations as of December 31 consist of the following:

	2017	2016
Note payable issued in June 2007 to the Economic Development Authority of the City of Fredericksburg, Virginia, who in turn issued Hospital Facilities Revenue and Refunding bonds (Series 2007). The bonds mature in graduated annual amounts ranging from $660,000 in 2007 to $7,600,000 in 2023 and bear interest at varying rates ranging from 5.00% to 5.25%.	**$ 40,180,000**	$ 45,740,000

5. Long-Term Obligations (continued)

	2017	2016
Note payable issued in May 2014 to the Economic Development Authority of the City of Fredericksburg. Virginia, which in turn issued Hospital Facilities Revenue and Refunding Bonds (Series 2014). The bonds mature in graduated annual amounts ranging from $4,375,000 in 2024 to $6,920,000 in 2033 and bear interest at varying rates ranging from 4.00% to 5.00%.	**56,210,000**	56,210,000
Note payable issued in January 2015 to Bank of America, N.A. (Series 2015 Note). Interest, which is adjustable monthly, is based upon the LIBOR rate. The interest rate averaged 2.33% and 1.73% during 2017 and 2016, respectively. Payments including interest and principal begin February 2015 and are due monthly through December 2019. A lump sum payment of $8,447,000 is due in January 2020.	**9,613,333**	10,126,667
Note payable issued in May 2016 to the Economic Development Authority of Stafford County, Virginia, which in turn issued Hospital Facilities and Refunding Bonds (Series 2016). The bonds mature in graduated annual amounts ranging from $470,000 in 2017 to $16,700,000 in 2037 and bear interest at varying rates ranging from 3.00% to 5.00%	**112,240,000**	112,710,000
Note payable issued in November 2016 to the Economic Development Authority of the City of Fredericksburg, Virginia, which in turn issued Hospital Facilities Refunding Revenue Bond (Series 2016a). The bonds mature in graduated annual amounts ranging from $960,000 in 2017 to $1,360,000 in 2038. The interest is adjustable monthly and is based on One-Month LIBOR. The interest rate averaged 1.64% and 1.34% during 2017 and 2016, respectively.	**29,445,000**	30,405,000
Capital leases	**1,712,469**	1,467,370
	249,400,802	256,659,037
Plus: Premium on Series 2007 Bonds	**778,962**	1,044,538
Plus: Premium on Series 2014 Bonds	**2,311,888**	2,516,019
Plus: Premium on Series 2016 Bonds	**14,184,806**	15,147,072
	266,676,458	275,366,666
Less: Deferred Financing Costs	**(1,787,139)**	(1,941,072)
Current maturities of long-term obligations	**(10,014,937)**	(9,500,706)
	$ 254,874,382	$ 263,924,888

5. Long-Term Obligations (continued)

The approximate aggregate maturities for long-term obligations as of December 31, 2017, are as follows:

Years Ending December 31:	
2018	$ 10,014,000
2019	10,060,000
2020	18,156,000
2021	10,034,000
2022	10,339,000
Thereafter	208,073,000

The Series 2016, 2016a, 2014, and 2007 bonds and the 2015 Note are secured by a pledge of the gross receipts of each member of the Obligated Group, which consists of MWHC, Mary Washington, Stafford, MWH Foundation, and Properties. The related master trust indenture contains certain restrictions, including an annual debt service coverage ratio requirement that the income available for debt service (as defined by the agreement) be not less than 115% of maximum annual debt service (as defined by the agreement). In the opinion of management, the Obligated Group was in compliance with the provisions of the master trust indenture for the years ended December 31, 2017 and 2016.

During the years ended December 31, 2017 and 2016, MWHC paid approximately $9,621,000 and $11,113,000, respectively, for interest.

6. Retirement Plans

MWHC sponsors two retirement plans for its Associates. The first is a traditional, noncontributory, defined benefit retirement plan (Plan). The second is a supplemental, defined contribution retirement plan (Supplemental Plan). Both plans cover substantially all of MWHC's employees and are subject to provisions of the Employee Retirement Income Security Act of 1974. Further details are provided for each Plan.

Defined Benefit Plan

Effective December 31, 2003, the Plan was frozen relative to allowing new participants. Employees of record as of December 31, 2003, continued to be eligible for benefits under the Plan. Employees hired on or after January 1, 2004, are not eligible to participate in the Plan. Effective May 22, 2010, the Plan was frozen relative to all future benefit accruals.

Benefits to eligible participants, which are based upon fixed percentages of a participant's average earnings for credited years of services, are paid when an employee reaches retirement age (normally 65). MWHC funding policy is to contribute amounts to the Plan sufficient to meet the minimum funding requirements under the Employee Retirement Income Security Act of 1974, plus such additional amounts as MWHC may determine to be appropriate from time to time.

6. Retirement Plans (continued)

Defined Benefit Plan (continued)

The overall financial objectives of the Plan's asset accumulation strategy are to provide funds for the timely payment of Plan obligations and to produce an investment rate of return that minimizes MWHC contributions.

The following table sets forth the Plan's funded status as of the measurement date, December 31:

	2017	2016
Reconciliation of Benefit Obligation and Plan Assets as of December 31:		
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	**$ 178,602,766**	$ 177,545,035
Interest cost	**7,432,590**	7,837,587
Actuarial (gain) loss	**8,487,588**	3,891,351
Benefits paid	**(12,681,409)**	(10,671,207)
Projected benefit obligation at end of year	**$ 181,841,535**	$ 178,602,766
Change in plan assets		
Fair value of plan assets at beginning of year	**$ 117,547,331**	$ 121,212,049
Return on plan assets	**15,741,603**	4,228,544
Employer contributions	**6,301,222**	2,777,945
Benefits paid	**(12,681,409)**	(10,671,207)
Fair value of plan assets at end of year	**$ 126,908,747**	$ 117,547,331
Funded Status Reconciliation and Key Assumptions as of December 31:		
Reconciliation of funded status		
Funded status of plan at end of year	**$ (54,932,788)**	$ (61,055,435)
Net amount recognized	**$ (54,932,788)**	$ (61,055,435)
Amounts recognized on the consolidated balance sheets		
Noncurrent (liabilities)	**$ (54,932,788)**	$ (61,055,435)
	$ (54,932,788)	$ (61,055,435)

6. Retirement Plans (continued)

Defined Benefit Plan (continued)

The 2017 projected benefit obligation presented above is based on the application of RP-2014 (Mortality Table) adjusted back to 2006 and then projected forward with Scale MP-2017 (Mortality Improvement Scale) for all years. The 2016 projected benefit obligation presented is based on the application of RP-2014 adjusted back to 2006 and then projected forward with Scale MP-2016 for all years.

	2017	2016
Cumulative amounts recognized in other changes in unrestricted net assets:	**$ 53,880,197**	$ 57,070,886
Weighted-average assumptions used to determine projected benefit obligation		
Measurement date	**December 31, 2017**	December 31, 2016
Discount rate	**3.75%**	4.25%
Rate of compensation increase	**N/A**	N/A
Components of net periodic benefit expense		
Interest cost	**$ 7,432,590**	$ 7,837,587
Expected rate of return on plan assets	**(8,787,496)**	(9,023,823)
Amortization of net (gain)/loss	**4,724,170**	4,144,757
Net periodic benefit expense	**3,369,264**	2,958,521
Other changes in plan assets and benefit obligations recognized in other changes in unrestricted in net assets		
Net actuarial (gain)/loss	**1,533,481**	8,686,630
Amortization of net (gain) or loss	**(4,724,170)**	(4,144,757)
Total recognized in other changes in unrestricted net assets	**(3,190,689)**	4,541,873
Total recognized in unrestricted net assets	**$ 178,575**	$ 7,500,394
Weighted-average assumptions used to determine net periodic benefit expense		
Measurement date	**December 31, 2016**	December 31, 2015
Discount rate	**4.25%**	4.50%
Expected return on plan assets	**7.50%**	7.50%
Rates of compensation increase	**N/A**	N/A

6. Retirement Plans (continued)

Defined Benefit Plan (continued)

The Plan's weighted-average asset allocations by asset category at the Plan's measurement date of December 31 are as follows:

	2017	2016
Equity securities	**63%**	57%
Debt securities	**36%**	38%
REIT	**0%**	3%
Other (primarily cash and cash equivalents and fund of funds)	**1%**	2%
Total	**100%**	100%

The following benefit payments are expected to be paid during the years ending December 31:

2018	$ 7,723,163
2019	7,983,604
2020	8,262,080
2021	8,540,451
2022	8,835,874
Years 2023-2027	48,624,342

As disclosed in Note 2, generally accepted accounting principles establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. Prices for mutual funds are readily available in the active markets in which those securities are traded and the resulting fair values are categorized as Level 1. Alternative investments are recorded under the equity method of accounting using net asset value. Under current accounting standards, investments using net asset value are to be excluded from the fair value hierarchy.

6. Retirement Plans (continued)

Defined Benefit Plan (continued)

The following table sets forth by level the fair value hierarchy the Plan's financial assets accounted for at fair value as of December 31, 2017 and 2016. Investments are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. MWHC's assessment of the significance of a particular input to the fair value measurement for Plan assets requires judgment and may affect the valuation of fair value of Plan investments and their placement within the fair value hierarchy levels.

	2017			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 234,139	$ -	$ -	$ 234,139
Money market	1,364,785	-	-	1,364,785
Equity securities				
Mutual funds				
Multi sector bonds	19,115,691	-	-	19,115,691
Multi sector stock	51,366,924	-	-	51,366,924
Intermediate term bonds	26,156,362	-	-	26,156,362
Global stock	24,469,974	-	-	24,469,974
Other	4,147,603	-	-	4,147,603
Alternative investments	-	-	-	53,269
	$ 126,855,478	$ -	$ -	$ 126,908,747

	2016			
	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 254,632	$ -	$ -	$ 254,632
Money market	833,961	-	-	833,961
Equity securities				
Mutual funds				
Multi sector bonds	29,789,219	-	-	29,789,219
Multi sector stock	44,159,288	-	-	44,159,288
Intermediate term bonds	14,577,856	-	-	14,577,856
Global stock	14,860,463	-	-	14,860,463
Other	11,707,476	-	-	11,707,476
Alternative investments	-	-	-	1,364,436
	$ 116,182,895	$ -	$ -	$ 117,547,331

6. Retirement Plans (continued)

Defined Contribution Plan

The Supplemental Plan covers substantially all employees who are age twenty-one or older. The Supplemental Plan was adopted January 1, 1992, and is subject to the provisions of the Employee Retirement Income Security Act of 1974. The Supplemental Plan has received a favorable determination letter from the Internal Revenue Service exempting it from federal income taxation under the Internal Revenue Code.

Each year, MWHC contributes 50% of the first 6% of base compensation up to a maximum regular matching contribution of 3% of covered compensation for the payroll period that each participant contributes to the Supplemental Plan. In addition to the regular matching contribution, MWHC makes a transition matching contribution to certain predetermined participants based on the actuarial factors described in the Supplemental Plan agreement. At the Board of Trustees' discretion, additional amounts may be contributed. During 2017 and 2016, MWHC contributed approximately $3,873,000 and $3,823,000, respectively, to the Supplemental Plan.

As of May 22, 2010, participants are 100% vested in all contributions plus actual earnings thereon. New participants after May 22, 2010, vest in the matching contributions and earnings thereon after three years of eligible service. MWHC can terminate the Supplemental Plan at any time. At such time, participants remain entitled to their vested benefits.

7. Malpractice Insurance

MWHC manages its professional and general liability through a controlled risk retention group and, effective for claims made January 1, 2011, forward, a Self-Insured Retention Group (SIR). Fredericksburg Professional Risk Exchange (ProRex), a subsidiary of MWHC, is a reciprocal insurance company licensed in the State of Vermont. For claims reported in 2017 and 2016, ProRex retained risk for MWHC and its subsidiaries of $2,300,000 and $2,250,000 per claim, respectively, and $7,000,000 in the aggregate. Risks above those limits are covered by a commercial excess insurance policy with a $20,000,000 aggregate limit. As noted above, MWHC formed SIR to manage the first $550,000 ($600,000 in 2016) of each claim made after January 1, 2011. ProRex also retained risk for certain physicians who are related to the Hospitals.

MWHC owns 100% of SIR and ProRex, and their assets, liabilities, and operations are consolidated in the accompanying MWHC consolidated financial statements. SIR has accrued approximately $3,144,000 and $4,022,000 related to its share of estimated payments to be made for claims filed from January 1, 2011, through December 31, 2017 and 2016, respectively, as well as for estimated losses on unfiled claims which relate to events occurring in those years. ProRex has accrued approximately $7,000,000 and $6,200,000 related to its share of estimated payments to be made under its professional liability insurance program for claims filed through December 31, 2017 and 2016, respectively, as well as for estimated losses on unfiled claims which relate to events occurring in 2013 and prior years. The amount of liability accrued is based on independent actuarial estimates calculated on a discounted basis using a 1.46% and 1.56% interest rate

7. Malpractice Insurance (continued)

for 2017 and 2016, respectively. Assets held by ProRex are restricted by statute from being transferred to another subsidiary or obligated for any other purpose and, accordingly, are included in assets whose use is limited. In addition, MWHC has accrued approximately $3,649,000 and $3,517,000 through December 31, 2017 and 2016, respectively, related to estimated payments to be made for claims incurred but not yet reported. MWHC has also accrued approximately $206,000 and $292,000 through December 31, 2017 and 2016, respectively, related to losses on individual claims in the excess layer provided under ProRex for claims reported between October 1, 2006, and December 31, 2010, during which period the exposures were 100% reinsured.

8. Long-Term Accounts Payable

Long-term accounts payable consist of a long-term payable to Epic Systems Corporation. The payable consists of two obligations, the first is due in monthly payments of $117,021. The interest rate is a fixed 4.00% for the first 5 years. The interest rate is then based on the 30-Day LIBOR rate with monthly payments to include an additional time value of money adjustment. The balance of this obligation was approximately $7,155,000 as of December 31, 2017. The second obligation is related to implementation related costs and is due in monthly payments of $239,442. Upon completion of implementation, a final payment schedule will be created. The balance of this obligation was approximately $1,554,000 as of December 31, 2017.

9. Functional Expenses

MWHC provides healthcare and related services in its geographic location. Expenses related to providing these services for the years ended December 31 are as follows:

	2017	2016
Program services	**$ 591,788,957**	$ 562,256,009
Fundraising and charitable giving	**361,102**	343,082
Management and general	**16,129,222**	15,324,301
	$ 608,279,281	$ 577,923,391

10. Fair Value of Financial Instruments

The carrying amounts of the MWHC's financial instruments, excluding long-term obligations, approximate their fair values (see Note 2). The fair value of MWHC's long-term obligations is estimated based on the quoted market prices for the same or similar issues or using discounted cash flow analyses.

The carrying amounts and fair values of MWHC's long-term obligations as of December 31 are as follows:

	2017		2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term obligations	**$ 249,400,802**	**$ 279,508,919**	$ 256,659,037	$ 273,033,812

11. Concentration of Credit Risk

The Hospitals and Health Services grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net accounts receivable from patients and third-party payors as of December 31 was as follows:

	2017	2016
Other commercial	**43%**	38%
Medicare	**26%**	27%
Anthem	**19%**	21%
Medicaid	**8%**	8%
Patients and other	**4%**	6%
	100%	100%

12. Risks and Uncertainties

The U.S. healthcare industry continues to experience significant change. Today, the primary force for change is being created by a competitive marketplace resulting in rapid change in healthcare delivery and financing as well as significant regulatory change.

An increasing number of MWHC's third-party payors are adopting payment systems which shift financial risk from the payor/insurer to the healthcare provider. MWHC has signed provider contracts with several managed care organizations, which emphasize utilization control and cost containment. Managed care organizations either directly transfer risk to health care providers through capitation payment arrangements or pay for units of service on a steeply discounted basis.

The Joint Commission, a non-governmental privately owned entity, provides accreditation status to hospitals and other healthcare organizations in the United States. Such accreditation is based upon a number of requirements such as undergoing periodic surveys conducted by Joint Commission personnel. Certain managed care payors require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, CMS, the agency with oversight of the Medicare and Medicaid programs, provides "deemed status" for facilities having Joint Commission accreditation. By being Joint Commission accredited, facilities are "deemed" to be in compliance with the Medicare and Medicaid conditions of participation. Termination as a Medicare provider or exclusion from any or all of these programs/payors would have a materially negative impact on the future financial position, operating results, and cash flows of MWHC.

MWHC is involved in litigation arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters will be resolved without material adverse effect on MWHC's consolidated financial position.

12. Risks and Uncertainties (continued)

MWHC's investments are exposed to interest rate risk, market risk, performance risk, and liquidity risk. These conditions create uncertainty regarding the future valuation of MWHC's invested funds, its access to capital, and the resulting impact on the future financial position, operations, and cash flows of MWHC could be material.

The Commonwealth of Virginia must operate with balanced budgets and since the Medicaid program is one of the state's largest programs, it is possible that Virginia will enact or consider enacting legislation designed to reduce its Medicaid expenditures. In addition, the Virginia General Assembly is currently considering a budgetary process that may impose new financial assessments on hospitals.

13. Lease Obligations

MWHC leases various equipment and facilities under operating leases expiring at various dates through June 2035. Total rental expense in 2017 and 2016 for all operating leases was approximately $9,265,000 and $9,634,000, respectively. The following is a schedule by year of undiscounted future minimum obligations under all non-cancellable operating leases, net of income from subleases, for each of the next five years and thereafter:

Years Ending December 31:		
2018	$	1,136,000
2019		1,573,000
2020		1,733,000
2021		1,836,000
2022		1,312,000
Thereafter		12,638,000

Other Financial Information

Mary Washington Healthcare – Obligated Group

Consolidated Balance Sheet

	December 31 2017
Assets	
Current assets:	
Cash and cash equivalents	**$ 38,384,258**
Accounts receivable:	
Patient accounts receivable, less allowances	**63,658,176**
Due from affiliates	**10,795,557**
Other	**2,556,657**
	77,010,390
Notes receivable	**47,993**
Inventories	**12,027,488**
Prepaid expenses and other	**7,769,476**
Total current assets	**135,239,605**
Assets whose use is limited:	
Internally designated for healthcare programs and capital acquisitions	**245,453,032**
Externally restricted by donors	**12,102,657**
	257,555,689
Property, plant and equipment	**307,309,508**
Other assets:	
Notes receivable	**54,137**
Miscellaneous	**2,028,177**
Equity in subsidiaries	**16,670,913**
Total assets	**$ 718,858,029**

(continued)

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Mary Washington Healthcare – Obligated Group

Consolidated Balance Sheet (continued)

	December 31 2017
Liabilities and net assets	
Current liabilities:	
Accounts payable and accrued expenses	**$ 36,936,817**
Employee compensation and professional fees	**27,742,375**
Interest payable	**460,319**
Current maturities of long-term obligations	**9,569,752**
Current maturities of long-term accounts payable	**2,958,518**
Total current liabilities	**77,667,781**
Long-term obligations, less current maturities	**253,830,767**
Other liabilities:	
Long-term accounts payable, less current maturities	**5,751,029**
Accrued losses on insurance claims	**3,854,914**
Pension liability	**54,932,788**
Other	**505,392**
Total liabilities	**396,542,671**
Net assets:	
Unrestricted - general	**309,204,271**
Temporarily restricted net assets	**11,852,877**
Permanently restricted net assets	**1,258,210**
	322,315,358
Total liabilities and net assets	**$ 718,858,029**

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Mary Washington Healthcare – Obligated Group

Consolidated Statement of Operations

	Year ended December 31 2017
Revenue and other support:	
Net patient service revenue:	
Patient service revenue (net of allowance and discounts)	**$ 559,065,353**
Provision for bad debs	**(63,723,368)**
	495,341,985
Rental of facilities	**7,079,271**
Management and personnel services	**10,121,075**
Investment income	**5,453,676**
Unrestricted contributions	**429,166**
Other	**14,518,223**
	532,943,396
Expenses:	
Salaries and wages	**185,332,273**
Employee benefits	**38,855,604**
Contract personnel	**12,832,935**
Professional fees	**48,549,672**
General and administrative	**13,782,601**
Provision for depreciation and amortization	**37,436,506**
Interest	**9,663,794**
Contract services	**49,411,773**
Supplies	**96,700,639**
Utilities	**5,053,654**
Insurance	**2,213,594**
Rent	**7,414,130**
Other	**4,137,244**
	511,384,419
Income from operations	**21,558,977**
Nonoperating gains (losses):	
Net appreciation of investments	**29,214,906**
Gain on investments in partnerships and other	**326,161**
Excess of revenues, gains and other support over expenses and losses before equity in earnings of subsidiaries and noncontrolling interest	**$ 51,100,044**

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Mary Washington Healthcare – Obligated Group

Consolidated Statement of Cash Flows

	Year ended December 31 2017
Cash flows from operating activities and nonoperating gains (losses)	
Increase in net assets	**$ 53,261,886**
Adjustments to reconcile increase in net assets to net cash provided by operating activities and nonoperating gains (losses):	
Net (appreciation) of investments	**(29,214,906)**
Other nonoperating (gains)	**(183,156)**
(Gain) on disposal of fixed assets	**(143,005)**
Provisions for depreciation and amortization	**37,436,506**
Amortization of original issue premiums and discounts	**(1,431,973)**
Amortization of deferred financing costs	**153,933**
Amortization of physician loans receivable	**66,092**
Provision for bad debts	**63,723,368**
Change in pension obligation other than net periodic pension cost	**(3,190,689)**
(Increase) in:	
Accounts receivable	**(68,710,870)**
Inventories	**(180,332)**
Prepaid expenses and other	**(1,367,121)**
Due from non-obligated affiliates	**(2,866,819)**
Other	**(2,325,211)**
Increase (decrease) in:	
Accounts payable and accrued expenses	**(2,177,933)**
Employee compensation and professional fees	**(4,253,560)**
Interest payable	**12,915**
Insurance claims	**46,370**
Pension liability	**(2,931,958)**
Net cash provided by operating activities and nonoperating gains (losses)	**35,723,537**

(continued)

Mary Washington Healthcare – Obligated Group

Consolidated Statement of Cash Flows (continued)

	Year ended December 31 2017
Cash flows from investing activities	
Change in assets whose use is limited:	
Net increase in cash and cash equivalents	**286,216**
Purchases of investments	**(198,637,455)**
Sales of investments	**156,026,981**
Payments received on pledges receivable	**1,549,219**
Acquisition of property, plant and equipment	**(39,288,909)**
Proceeds from sale of property, plant and equipment	**1,247,538**
Changes in notes receivable	**179,358**
Net cash used in investing activities	**(78,637,052)**
Cash flows from financing activities	
Repayment of long-term obligations	**(11,283,300)**
Net decrease in cash and cash equivalents	**(54,196,815)**
Cash and cash equivalents at beginning of year	**92,581,073**
Cash and cash equivalents at end of year	**$ 38,384,258**
Non-cash Transactions:	
Property, plant and equipment acquired through vendor financing	**12,257,167**
Property, plant and equipment acquired through accounts payable	**1,971,156**

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