

EXHIBIT 16

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Luminis Health, Inc. and Subsidiaries
Years Ended June 30, 2020 and 2019
With Report of Independent Auditors

Ernst & Young LLP



Luminis Health, Inc. and Subsidiaries

Consolidated Financial Statements and Supplementary Information

Years Ended June 30, 2020 and 2019

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Report of Independent Auditors

The Board of Trustees
Luminis Health, Inc.

We have audited the accompanying consolidated financial statements of Luminis Health, Inc. (a Maryland not-for-profit corporation) and subsidiaries, which comprise the consolidated balance sheets as of June 30, 2020 and 2019, 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 Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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 did not audit the financial statements of Doctors Community Medical Center and subsidiaries, a wholly owned subsidiary, which statements reflect total assets of \$320,453,000 as of June 30, 2020, and revenues and gains in excess of expenses of \$4,460,000, for the year then ended or the financial statements of Cottage Insurance Company, Ltd., a wholly owned subsidiary, which statements reflect total assets of \$38,974,000 and \$39,535,000 as of June 30, 2020 and 2019, respectively, and net loss after elimination of intercompany revenues of \$10,246,000 and \$10,149,000, respectively, for the years then ended. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Doctors Community Medical Center and subsidiaries and Cottage Insurance Company, Ltd., are based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Luminis Health, Inc. and subsidiaries at June 30, 2020 and 2019, and the consolidated results of their operations, changes in their net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Adoption of New Accounting Pronouncements

As discussed in Note 2 to the consolidated financial statements, Luminis Health, Inc. and subsidiaries changed its method of accounting for leases as a result of the adoption of the amendments to the Financial Accounting Standards Board Accounting Standards Codification resulting from Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, effective July 1, 2019. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary consolidating information is presented for purposes of additional analysis 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

October 23, 2020

Luminis Health, Inc. and Subsidiaries

Consolidated Balance Sheets

	June 30	
	2020	2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 178,795,000	\$ 15,100,000
Short-term investments	1,365,000	15,261,000
Current portion of assets whose use is limited	15,912,000	15,190,000
Patient receivables, net	118,882,000	80,307,000
Current portion of pledges receivable, net	945,000	494,000
Inventories	21,789,000	8,650,000
Prepaid expenses and other current assets	19,857,000	14,125,000
Total current assets	<u>357,545,000</u>	<u>149,127,000</u>
Property and equipment	1,096,845,000	918,666,000
Less accumulated depreciation and amortization	<u>(538,353,000)</u>	<u>(493,004,000)</u>
Net property and equipment	<u>558,492,000</u>	<u>425,662,000</u>
Other assets:		
Investments	338,985,000	386,056,000
Investments in joint ventures	14,024,000	8,886,000
Pledges receivable, net	3,192,000	2,802,000
Assets whose use is limited	41,020,000	35,973,000
Restricted collateral for interest rate swap contract	110,002,000	67,404,000
Right of use asset	44,995,000	—
Other assets	53,613,000	34,374,000
Total assets	<u>\$ 1,521,868,000</u>	<u>\$ 1,110,284,000</u>

Luminis Health, Inc. and Subsidiaries

Consolidated Balance Sheets (continued)

	June 30	
	2020	2019
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 40,441,000	\$ 30,458,000
Accrued salaries, wages, and benefits	53,438,000	37,814,000
Other accrued expenses	32,413,000	18,389,000
Current portion of long-term debt	16,440,000	11,029,000
Advances from third-party payors	182,697,000	23,903,000
Current portion of lease liability	8,753,000	—
Total current liabilities	<u>334,182,000</u>	<u>121,593,000</u>
Long-term debt, less current portion and unamortized original issue premium	470,308,000	359,735,000
Interest rate swap contracts	117,037,000	78,479,000
Accrued pension liability	29,276,000	6,076,000
Lease liability, less current portion	37,429,000	—
Other long-term liabilities	47,032,000	37,010,000
Total liabilities	<u>1,035,264,000</u>	<u>602,893,000</u>
Net assets:		
Without donor restrictions	460,552,000	482,661,000
With donor restrictions	23,861,000	24,730,000
Non-controlling interest	2,191,000	—
Total net assets	<u>486,604,000</u>	<u>507,391,000</u>
Total liabilities and net assets	<u>\$ 1,521,868,000</u>	<u>\$ 1,110,284,000</u>

See accompanying notes.

Luminis Health, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30	
	2020	2019
Operating revenue:		
Net patient service revenue	\$ 969,105,000	\$ 742,876,000
Other operating revenue	78,393,000	33,180,000
Total operating revenue	<u>1,047,498,000</u>	<u>776,056,000</u>
Operating expenses:		
Salaries and wages	479,880,000	349,660,000
Employee benefits	75,930,000	56,356,000
Supplies	197,487,000	159,489,000
Purchased services	226,375,000	137,557,000
Depreciation and amortization	45,994,000	36,833,000
Interest	16,151,000	13,118,000
Transaction costs	—	3,279,000
Total operating expenses	<u>1,041,817,000</u>	<u>756,292,000</u>
Operating income	<u>5,681,000</u>	<u>19,764,000</u>
Other (loss) income:		
Investment (loss) income, net	(9,700,000)	13,873,000
Loss from joint ventures and other, net	(673,000)	(545,000)
Inherent contribution	61,715,000	—
Pension credit (expense), net	1,116,000	(4,777,000)
Unrealized (losses) gains on trading securities, net	(15,151,000)	10,034,000
Realized and unrealized losses on interest rate swap contracts, net	(43,149,000)	(23,361,000)
Total other loss, net	<u>(5,842,000)</u>	<u>(4,776,000)</u>
(Deficit) excess of revenue over expenses	<u>\$ (161,000)</u>	<u>\$ 14,988,000</u>

Luminis Health, Inc. and Subsidiaries

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

	Without Donor Restrictions	With Donor Restrictions	Total
Net assets, June 30, 2018	\$ 469,018,000	\$ 26,304,000	\$ 495,322,000
Excess of revenues over expenses	14,988,000	—	14,988,000
Pension liability adjustment	(2,784,000)	—	(2,784,000)
Released from restrictions used for			
purchase of property and equipment	163,000	—	163,000
Transfers and other, net	1,276,000	—	1,276,000
Restricted gifts, bequests, and contributions	—	5,451,000	5,451,000
Unrealized losses on investments	—	(18,000)	(18,000)
Restricted investment income	—	60,000	60,000
Net assets released from restrictions	—	(7,964,000)	(7,964,000)
Other	—	897,000	897,000
Changes in net assets	<u>13,643,000</u>	<u>(1,574,000)</u>	<u>12,069,000</u>
Net assets, June 30, 2019	482,661,000	24,730,000	507,391,000
Net assets acquired	2,265,000	487,000	2,752,000
Deficit of revenues over expenses	(161,000)	—	(161,000)
Pension liability adjustment	(24,810,000)	—	(24,810,000)
Released from restrictions used for			
purchase of property and equipment	1,837,000	—	1,837,000
Transfers and other, net	951,000	(598,000)	353,000
Restricted gifts, bequests, and contributions	—	9,518,000	9,518,000
Unrealized losses on investments	—	(3,394,000)	(3,394,000)
Restricted investment income	—	693,000	693,000
Net assets released from restrictions	—	(7,575,000)	(7,575,000)
Changes in net assets	<u>(19,918,000)</u>	<u>(869,000)</u>	<u>(20,787,000)</u>
Net assets, June 30, 2020	<u>\$ 462,743,000</u>	<u>\$ 23,861,000</u>	<u>\$ 486,604,000</u>

See accompanying notes.

Luminis Health, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2020	2019
Operating activities		
(Decrease) increase in net assets	\$ (20,787,000)	\$ 12,069,000
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities:		
Change in net unrealized losses (gains) on investments	18,545,000	(10,016,000)
Realized and unrealized losses on interest rate swap contracts, net	43,149,000	23,361,000
Pension liability adjustment	24,810,000	2,784,000
Equity in earnings of joint ventures and other	804,000	854,000
Restricted contributions and pledges, net	(9,518,000)	(5,374,000)
Depreciation and amortization	45,994,000	36,833,000
Restricted investment income	(693,000)	(60,000)
Decrease (increase) in investments – trading	60,680,000	(86,894,000)
(Increase) decrease in assets whose use is limited, net – trading	(5,164,000)	625,000
Inherent contribution and net assets acquired	(64,467,000)	–
Net change in operating assets and liabilities	154,413,000	6,846,000
Net cash provided by (used in) operating activities	<u>247,766,000</u>	<u>(18,972,000)</u>
Investing activities		
Purchases of property and equipment	(62,284,000)	(34,686,000)
Payments on interest rate swaps	(4,591,000)	(4,185,000)
Cash acquired	34,168,000	–
Net cash used in investing activities	<u>(32,707,000)</u>	<u>(38,871,000)</u>
Financing and fundraising activities		
Payoff amount for 2008 Term and Construction Loans	–	(61,920,000)
Proceeds received from real estate loan	–	61,920,000
Repayments of long-term debt	(17,530,000)	(11,310,000)
Restricted contributions received and other	8,676,000	6,193,000
Restricted income received	693,000	60,000
Net cash used in financing and fundraising activities	<u>(8,161,000)</u>	<u>(5,057,000)</u>
Net increase (decrease) in cash, cash equivalents, and restricted cash	206,898,000	(62,900,000)
Cash, cash equivalents, and restricted cash at beginning of year	98,930,000	161,830,000
Cash, cash equivalents, and restricted cash at end of year	<u>\$ 305,828,000</u>	<u>\$ 98,930,000</u>
Cash and cash equivalents	\$ 178,795,000	\$ 15,100,000
Restricted cash, included in restricted collateral and assets whose use is limited	127,033,000	83,830,000
Cash, cash equivalents, and restricted cash at end of year	<u>\$ 305,828,000</u>	<u>\$ 98,930,000</u>

Luminis Health, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2020	2020
Changes in operating assets and liabilities		
(Decrease) increase in operating assets:		
Patient receivables, net	\$ 265,000	\$ (1,418,000)
Inventories	(8,896,000)	(674,000)
Prepaid expenses and other	3,869,000	(2,734,000)
Other assets	11,797,000	10,425,000
	<u>7,035,000</u>	<u>5,599,000</u>
Increase in operating liabilities:		
Accounts payable	(5,845,000)	8,543,000
Accrued salaries, wages, and benefits	(422,000)	1,714,000
Other accrued expenses	14,024,000	(3,089,000)
Advances from third-party payors	151,029,000	2,898,000
Other long-term liabilities	(11,408,000)	(8,819,000)
	<u>147,378,000</u>	<u>1,247,000</u>
Net change in operating assets and liabilities	<u>\$ 154,413,000</u>	<u>\$ 6,846,000</u>
Supplemental disclosures of cash flow information		
Cash paid for interest	<u>\$ 15,541,000</u>	<u>\$ 13,118,000</u>

See accompanying notes.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2020

1. Organization and Basis of Presentation

Luminis Health, Inc. (Luminis or the System), formerly known as Anne Arundel Health System, Inc. (AAHS), is a Maryland not-for-profit corporation. Luminis has the following wholly owned subsidiaries: Anne Arundel Medical Center, Inc. (the Hospital or AAMC) and its subsidiaries, Anne Arundel General Treatment Services, Inc. (GTS), Anne Arundel Mental Health Hospital, Inc., and Cottage Insurance Company, Ltd. (Cottage); Anne Arundel Medical Center Foundation, Inc. (the Foundation); Anne Arundel Health Care Services, Inc. (HCS); Anne Arundel Health Care Enterprises, Inc. (HCE); Physician Enterprise, LLC (PE) and its subsidiaries, Anne Arundel Physician Group, LLC, Orthopedic Physicians of Annapolis, Anne Arundel Medical Group Physical Therapy, LLC, and Community Clinics; Anne Arundel Real Estate Holding Company, Inc. (the Real Estate Company) and its subsidiaries, Pavilion Park, Inc. (PPI), Annapolis Exchange, LLC, and Blue Building, LLC; Anne Arundel Health System Research Institute, Inc. (RI); and Anne Arundel Medical Center Collaborative Care Network, LLC. AAMC is a private, not-for-profit corporation that operates a 349-licensed bed acute care hospital. AAMC, the Real Estate Company, and PPI own an interest in Kent Island Medical Arts, LLC (KIMA), a limited liability company that owns and operates a medical office building. PPI is the managing member of KIMA and has substantive participation rights in KIMA. The financial statements of KIMA are consolidated in the accompanying consolidated financial statements. The non-controlling interest in KIMA was 50% as of June 30, 2020 and 2019. The interest was \$929,000 and \$884,000 at June 30, 2020 and 2019, respectively, and is included within net assets without donor restriction on the accompanying consolidated balance sheets.

On July 1, 2019, Anne Arundel Health System, Inc. and Doctors Community Hospital and subsidiaries executed an affiliation agreement (the Agreement) providing for an affiliation between AAHS and Doctors Community Hospital and subsidiaries. In September 2019, Doctors Community Hospital and subsidiaries changed its name to Doctors Community Medical Center and subsidiaries (DCMC). This affiliation agreement resulted in DCMC becoming a wholly owned subsidiary of AAHS. DCMC is a Maryland health system that includes an acute care hospital and a network of other health care providers serving residents of Prince Georges County region near Lanham, Maryland, east of Washington, DC. On the date of the affiliation, the articles of incorporation and bylaws of DCMC were amended such that AAHS became the sole corporate member of the Doctors Community Medical Center and its subsidiaries. As part of the Agreement, AAHS committed approximately \$138,000,000 over a five-year period in strategic investments to DCMC to expand health care services.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Basis of Presentation (continued)

DCMC includes the following: Doctors Community Hospital, Inc. and its subsidiaries Doctors Community Medical Group, LLC; Doctors Community Healthcare Programs, LLC; Doctors Community Hospital Clinic, LLC; Doctors Community Health Ventures, Inc.; Doctors Regional Cancer Center LLC; Southern Maryland Integrated Care LLC; and Doctors Community Hospital Foundation, Inc. Doctors Community Hospital, Inc. is a nonprofit corporation that operates an acute care general hospital facility licensed for 190 beds. The accompanying consolidated financial statements include non-controlling interest held by third parties in less than wholly owned subsidiaries. The interest at DCMC was \$2,191,000 at June 30, 2020, and is included within net assets without donor restriction on the accompanying consolidated balance sheets.

In September 2019, Anne Arundel Health System, Inc. changed its name to Luminis Health, Inc.

Global Pandemic

In response to the ongoing COVID-19 pandemic, the Governor of the state of Maryland proclaimed a state of emergency and catastrophic health emergency within the state of Maryland on March 5, 2020, and renewed on March 17, 2020, April 10, 2020, and May 6, 2020. Effective March 16, 2020, all Maryland hospitals were ordered by the Maryland Department of Health to cease all elective and non-urgent medical procedures for the duration of the catastrophic health emergency. The Governor issued a state-wide stay-at-home order effective March 30, 2020.

Effective May 7, 2020, the Maryland Department of Health allowed resumption of elective and non-urgent medical procedures, and effective May 15, 2020, major provisions of the Governor's stay-at-home order were rescinded.

In response to the global pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, was signed into law on March 27, 2020. The CARES Act authorized funding to hospitals and other health care providers to be distributed through the Public Health and Social Services Emergency Fund (Relief Fund). Payments from the Relief Fund are to be used to prevent, prepare for, and respond to coronavirus, and shall reimburse the recipient for health care related expenses or lost revenues/margins attributable to coronavirus and are not required to be repaid, provided the recipients attest to and comply with the terms and conditions.

The HSCRC has publicly announced its intention to support Maryland hospitals during the state of emergency and catastrophic health emergency within the state of Maryland and its collaboration with other Maryland regulatory agencies to remove licensure, regulatory, and other barriers to

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Organization and Basis of Presentation (continued)

hospitals in the provision of emergency health care services. Recognizing that hospitals will experience volume decline due to self-quarantining and canceled elective surgeries, the HSCRC has stated that Maryland hospitals will be permitted to increase rate corridors up to the 10% threshold or by an additional 5% from their current charging position, whichever is greater. This action is intended to allow hospitals that are undercharged under their Global Budget Revenue due to volume losses to increase their charges in order to make up for lost revenue and prepare for the eventual increase in COVID-19-related patient volume. The HSCRC has stated that this rate corridor increase will be a temporary, onetime adjustment to ensure financial viability of Maryland hospitals as they prepare for increased volume in COVID-19 patients. The HSCRC has also stated that it will consider additional corridor relief beyond this new policy on a case-by-case basis.

To further accommodate any Global Budget Revenue that Maryland hospitals may be unable to bill in fiscal year 2020 due to fluctuating volumes resulting from the COVID-19 pandemic, the HSCRC has stated that it will suspend undercharge penalties and allow Maryland hospitals to recoup those undercharges over the 12 months of fiscal year 2021 as a onetime adjustment net of the application of CARES Act relief funding. The HSCRC is proposing to reduce the System's undercharge by an amount derived from the CARES Act funding. Maryland hospitals will be allowed to bill any net undercharge in the next fiscal year, thus allowing them to recoup a portion of lost revenue associated with the catastrophic health emergency period. Further action by the HSCRC is expected in order to aid Maryland hospitals with regard to the increased expenses resulting from the COVID-19 pandemic.

The COVID-19 pandemic has severely impacted global financial markets and travel and commerce generally. As a result of the COVID-19 pandemic, many businesses and retail establishments in the United States, including Maryland, have closed or reduced business activity. Many potential patients are now unemployed, have been furloughed or their work hours have been reduced, which results in reduced wages and potential loss of health care insurance. The System cannot determine at this time the long-term impact of the COVID-19 pandemic on the System's ability to conduct its operations and the costs of its operations, its financial condition, or the returns and value of its investments and any effect on its pension funding and contribution obligations. In addition, while the suspension with respect to elective and non-urgent medical procedures was lifted, to date the volume of elective and non-urgent medical procedures, and the revenues resulting from such procedures, have not returned to pre-suspension levels and the amount of time needed to establish the volume of such procedures to pre-suspension levels cannot be determined.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Luminis and its wholly owned subsidiaries. The financial results of Doctors Community Medical Center and subsidiaries are only included from the date of acquisition, which was July 1, 2019. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Acquisition of Doctors' Hospital, Inc.

On July 1, 2019, AAHS completed a transaction that resulted in Doctors Community Hospital and subsidiaries becoming a wholly owned subsidiary of AAHS. This transaction was accounted for as an acquisition under Accounting Standards Codification (ASC) 958-805, *Not-for-Profit Mergers and Acquisitions*, during the year ended June 30, 2020.

The System elected to apply pushdown accounting whereby individual assets and liabilities were adjusted to the new basis of accounting as of the acquisition date.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The following information summarizes the recorded fair values of the assets acquired and liabilities assumed as of the date of the acquisition:

Cash and cash equivalents	\$ 34,168,000
Patient accounts receivable, net	38,840,000
Other receivables	5,620,000
Inventories	4,243,000
Prepaid expenses	3,981,000
Marketable securities	18,258,000
Joint ventures and equity investments	5,942,000
Property and equipment	116,540,000
Other noncurrent assets	30,093,000
Total assets acquired	<u>257,685,000</u>
Accounts payable and accrued expenses	31,875,000
Advances from third-party payors	7,765,000
Current portion of long-term debt	4,448,000
Long-term debt	128,123,000
Net pension liability	5,001,000
Deferred compensation and claims incurred but not reported	16,006,000
Total liabilities assumed	<u>193,218,000</u>
Non-controlling interest	2,265,000
Net assets acquired, net of non-controlling interest	<u>\$ 62,202,000</u>

An inherent contribution of \$61,715,000 was recorded by Luminis on its consolidated statements of operations and changes in net assets resulting from the difference between the net assets acquired, net of non-controlling interest and net assets with donor restrictions at Doctors Community Hospital and subsidiaries as of the acquisition date. Net assets with donor restrictions of \$487,000 was recorded within changes in net assets with donor restrictions.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include cash held in checking and savings accounts, money market accounts, and short-term certificates of deposit with original maturities of 90 days or less, excluding those held in short-term investments and those classified as long-term investments. Cash balances and collateral held by a counterparty are principally uninsured and are subject to normal credit risks. At June 30, 2020 and 2019, and at various times during the year, the System maintained cash-in-bank balances in excess of the \$250,000 federally insured limits.

Derivative Instruments

On May 10, 2006, the Hospital entered into a forward variable-to-fixed interest rate swap agreement with an effective date of November 1, 2008. This contract was entered into in an effort to reduce the risk of variable interest rate debt and has a term through July 1, 2048. Under ASC 815, *Derivatives and Hedging*, the Hospital has recognized its derivative instruments as either assets or liabilities on the accompanying consolidated balance sheets at fair value. As these derivative instruments are not designated as hedges, the unrealized gain or loss on these contracts has been recognized on the accompanying consolidated statements of operations and changes in net assets as realized and unrealized gains (losses) on interest rate swap contracts, net. The fair market values of the derivative instruments include a credit valuation adjustment (CVA) as required by ASC 820, *Fair Value Measurement*. When applying the CVA, the valuation of the variable-to-fixed interest rate swap contract was decreased by \$375,000 and \$361,000 as of June 30, 2020 and 2019, respectively.

On March 23, 2016, in an effort to reduce the amount of restricted cash pledged as collateral with the original counterparty, the Hospital entered into a novation agreement with a second counterparty. Immediately prior to the novation agreement, the System modified the existing swap to bifurcate the existing swap into a five-year swap with the remainder into a 2021 through 2048 swap. The terms of the bifurcated swap remain identical to the original swap. The novation agreement resulted in the return of \$29,164,000 as of June 30, 2016.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

A summary of the Hospital's derivative instruments and related activity at June 30 and for the years then ended, is as follows:

<u>Description of Derivative Instrument</u>	<u>Fair Value Liability</u>	
	<u>2020</u>	<u>2019</u>
Variable-to-fixed interest rate swap contract (maturity date March 2021)	\$ (4,442,000)	\$ (8,126,000)
Variable-to-fixed interest rate swap contract (maturity date July 2048)	<u>(112,595,000)</u>	<u>(70,353,000)</u>
	<u>\$(117,037,000)</u>	<u>\$ (78,479,000)</u>

The change in unrealized losses recognized in (deficit) excess of revenues over expenses for the years ended June 30, 2020 and 2019, were \$38,558,000 and \$19,176,000, respectively.

At June 30, 2020 and 2019, the net termination value (i.e., mark-to-market value) of the derivative instruments totaled \$119,671,000 and \$78,840,000, respectively. The Hospital may be exposed to credit loss in the event of nonperformance by the other party to the interest rate swap agreements, the risk of which is reflected in the fair value of the instruments under ASC 820. However, the Hospital does not anticipate nonperformance by the counterparty.

During fiscal year 2020 and 2019, the Hospital paid net payments under its interest rate swap program of \$4,591,000 and \$4,185,000, respectively. These amounts are included within realized and unrealized gains (losses) on interest rate swap contracts, net on the accompanying consolidated statements of operations and changes in net assets and within investing activities on the accompanying consolidated statements of cash flows.

Under the derivative contract for the 2021 through 2048 swap, the Hospital must transfer collateral for the benefit of the counterparty, to the extent that the termination values exceed certain limits. The Hospital's collateral requirement for the benefit of the counterparty was approximately \$110,002,000 and \$67,404,000 at June 30, 2020 and 2019, respectively. The ongoing mark-to-market values and resulting collateral requirements of the Hospital's interest rate swap contract are subject to variability based on market factors (primarily changes in interest rates). Collateral requirements under this interest rate swap contract are excluded from unrestricted cash and investments for purposes of determining the System's compliance with its liquidity covenants

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

under its Maryland Health and Higher Educational Facilities Authority (MHHEFA or the Authority) revenue bond agreements and its derivative agreements. Collateral amounts are included in noncurrent assets on the accompanying consolidated balance sheets. Approximately \$575,000 and \$2,795,000 of collateral was due to the financial institution as of June 30, 2020 and 2019.

The amount due to the financial institution is included in other accrued expenses on the accompanying consolidated balance sheet as of June 30, 2020 and 2019, and is reflected within investing activities on the accompanying consolidated statement of cash flows.

Assets Whose Use is Limited and Investments

Assets whose use is limited are principally composed of certain funds established to be held and invested by a trustee. These funds are related to the issuance of the Hospital's revenue bonds, investments held at Cottage, and certain permanently restricted endowment assets.

	June 30	
	2020	2019
Current:		
Principal, interest and other – bonds	\$ 12,382,000	\$ 12,258,000
Investments held at trustee	3,530,000	2,932,000
	\$ 15,912,000	\$ 15,190,000
Noncurrent:		
Endowment assets	\$ 15,482,000	\$ 16,641,000
Investments held at trustee	25,538,000	19,332,000
	\$ 41,020,000	\$ 35,973,000

The fair values of publicly traded securities and mutual funds are based on quoted market prices of individual securities or investments or estimated amounts using quoted market prices of similar investments. Alternative investments, some of which are structured so that the System holds limited partnership interests, are stated at fair value as estimated in an unquoted market. Valuations of these investments, and therefore the System's holdings, may be determined by the investment manager or general partner and for fund-of-funds investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

other estimates that require varying degrees of judgment. Investment income or loss from all unrestricted investments is included on the accompanying consolidated statements of operations and changes in net assets as part of other income (loss).

Investment income or loss on investments of assets with donor restrictions is added to or deducted from the restricted fund balance if the income is restricted. The cost of securities sold is based on the specific-identification method.

All investment balances are principally uninsured and subject to normal credit risk. Investments are classified as either current or noncurrent based on the maturity dates and the availability for current operations. Investments included in noncurrent assets consist of board-designated investment funds of \$338,985,000 and \$386,056,000 as of June 30, 2020 and 2019, respectively. Based on the System's investment policy, such amounts could be liquidated, at the discretion of the board, to satisfy short-term requirements.

Substantially all investments, other than borrowed funds required to be expended for capital projects, are classified as trading securities, with unrealized gains and losses included in (deficit) excess of revenues over expenses.

Borrowed funds required to be expended for capital projects are classified as other-than-trading and are included in assets whose use is limited.

Patient Receivables

Patient receivable include charges for amounts due from all patients less price concessions relating to allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid, and other insurers. The provision for price concessions is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the price concessions based upon historical experience of self-pay accounts receivable, including those balances after insurance payments and not covered by insurance.

Insurance coverage and credit information are obtained from patients, when available. No collateral is obtained for accounts receivable.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Inventories

Inventories, which primarily consist of medical supplies and drugs, are carried at the lower of cost or market. Cost is determined using the first-in, first-out method (FIFO) or a similar method that approximates FIFO.

Property and Equipment

Property and equipment are stated at cost or fair value as of the acquisition date for DCMC property and equipment. Included in computers and software are capitalized labor costs of \$14,344,000 and \$11,594,000 as of June 30, 2020 and 2019, respectively. Depreciation and amortization, including amortization of assets recorded under capital leases, are recorded on the straight-line method over the estimated useful lives of the assets.

The following is a summary of property and equipment:

	Estimated Useful Lives	June 30 2020	2019
Land		\$ 22,823,000	\$ 14,901,000
Land improvements	20 years	23,480,000	22,413,000
Buildings and improvements	20–40 years	592,593,000	491,022,000
Fixed equipment	5–20 years	55,510,000	10,824,000
Leasehold improvements	5–10 years	62,389,000	55,651,000
Movable equipment	7–10 years	221,851,000	203,404,000
Computers and software	3–5 years	96,079,000	88,528,000
Construction-in-progress	–	22,120,000	31,923,000
		\$ 1,096,845,000	\$ 918,666,000

Construction-in-progress consists of direct costs associated with hospital department renovations, certain leasehold improvements, and smaller capital projects. As these projects are completed, the related assets are transferred out of construction-in-progress and into the appropriate asset category and are depreciated over the applicable useful lives.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investments in Joint Ventures

Luminis accounts for its investments in joint ventures using the equity method of accounting. During 2011, the Real Estate Company and another party formed West County, LLC, a joint venture that owns and operates a medical office building that opened in December 2012. The Real Estate Company has a 50% interest in this joint venture, with each owner's investment being \$7,575,000 and \$7,242,000 as of June 30, 2020 and 2019, respectively.

Doctors Community Health Ventures, Inc. (Health Ventures) has a \$5,388,000 joint venture investment in Magnolia Gardens LLC. This investment is consistent with the mission and strategic plan of Doctors Community Medical Center. The investment in Magnolia Gardens LLC represents a 51% interest and is not consolidated with the financial statements of Luminis because Health Ventures does not control the investee.

Deferred Debt Issuance Costs

Administrative, legal, financing, underwriting discount, and other miscellaneous expenses that were incurred in connection with debt financings were deferred and are being amortized over the lives of the bond issues using the straight-line method, which approximates the effective-interest method in all material respects. The amortization expense of the deferred debt issue costs was \$479,000 and \$297,000 for the years ended June 30, 2020 and 2019, respectively.

Net Assets

Net resources that are not restricted by donors are included in net assets without donor restrictions. Gifts of long-lived operating assets, such as property, plant, or equipment, are reported as net assets without donor restrictions and excluded from income. Resources restricted by donors for a specified time or purpose are reported as net assets with donor restrictions.

When the specific purposes are met, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to other operating revenues on the statement of operations and changes in net assets. Resources restricted by donors for additions to property, plant, and equipment are initially reported as net assets with donor restrictions and are transferred to net assets without donor restrictions when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as net assets with donor restrictions.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Investment income related to net assets with donor restrictions is classified as net assets without donor restrictions based on the intent of the donor.

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. This includes regulatory discounts allowed to Blue Cross, Medicare, Medicaid, and other third-party payors and charity care.

During 2020 and 2019, approximately 39% and 35%, respectively, of net patient service revenue was received under the Medicare program, 25% and 28% from Blue Cross, 26% and 30% from contracts with other third parties, and 10% and 7% from other sources.

The following table sets forth the detail of net patient service revenue:

	Year Ended June 30	
	2020	2019
Gross patient service revenue	\$ 1,262,664,000	\$ 955,469,000
Revenue deductions:		
Charity care	15,409,000	5,326,000
Contractual and other allowances	278,148,000	207,267,000
Net patient service revenue	\$ 969,105,000	\$ 742,876,000

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard related to revenue recognition. The System adopted the new standard effective July 1, 2018, using the modified retrospective method of transition. The most significant change from the adoption of the new standard relates to the System's estimation for the allowance for doubtful accounts. Under the previous standards, the System's estimate for amounts not expected to be collected based upon historical experience, were reflected as provision for bad debts and deducted from net patient service revenue to arrive at net patient service revenue less provision for bad debts. Under the new standard, those amounts will continue to be recognized as a reduction to net patient service revenue, however, not reflected separately as provision for bad debts, and accordingly the caption net patient service revenue less provision for bad debts will no longer be presented on the consolidated statements of operations and changes in net assets. Subsequent changes in the

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

estimate of collectibility due to a change in the financial status of a payor, for example a bankruptcy, will be recognized as bad debt expense in operating expenses. This adoption of the new standard did not have a material impact on the accompanying consolidated financial statements.

Additionally, the System's revenues may be subject to adjustment as a result of examination by government agencies or contractors and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor and the System's historical settlement activity, including an assessment to ensure it is probable a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled or are no longer subject to such audits, reviews and investigations.

The System has elected the practical expedient allowed under FASB ASC 606-10-32-18, *Revenue from Contracts with Customers*, and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the System's expectation that the period between the time the service is provided to a patient and the time that the patient or third-party payor pays for that service will be one year or less.

The estimates for implicit price concessions are based upon management's assessment of historical write-offs and expected net collections; business and economic conditions; trends in federal, state, and private employer health care coverage; and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections at facilities that represent a majority of the System's revenues and patient receivable as a primary source of information in estimating the collectibility of patient receivable.

Luminis employs physicians in several hospital-based specialties (including, but not limited to, obstetrics, intensive care, and hospitalists). Net physician revenue is recognized when the services are provided and recorded at the estimated net realizable amount based on the contractual arrangements with third-party payors and the expected payments from the third-party payors and

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

the patients. The difference between the billed charges and the estimated net realizable amounts are recorded as a reduction in physician revenue when the services are provided. The System recognized net physician revenue of \$149,933,000 and \$141,202,000 for the years ended June 30, 2020 and 2019, respectively. At June 30, 2020 and 2019, \$15,097,000 and \$10,764,000, respectively, of net physician accounts receivable are included in patient receivables on the accompanying consolidated balance sheets.

Charity Care

AAMC provides charity care to patients who meet certain criteria established under its charity care guidelines. Because members of AAMC do not pursue the collection of amounts determined to qualify as charity care, they are not reported as revenue on the accompanying consolidated statements of operations and changes in net assets. The direct and indirect costs associated with providing this care are \$4,531,000 and \$4,493,000 for the years ended June 30, 2020 and 2019, respectively. These costs are calculated by applying a ratio of operating expenses over gross patient charges to the charity care provided at established rates. The state of Maryland's rate system includes components within the rates to partially compensate hospitals for uncompensated care.

The cost of charity care provided by DCMC totaled \$9,528,010 for the year ended June 30, 2020. Rates charged by DCMC for regulated services are determined based on assessment of direct and indirect cost calculated pursuant to the methodology established by the Commission, and therefore the cost of charity services noted above for DCMC are equivalent to its established rates for those services. For any charity services rendered by subsidiaries other than from the DCMC, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the DCMC's non-Hospital affiliates. These charges are excluded from consolidated net patient service revenue.

Other Operating Revenue

Other operating revenue is composed of grant revenue, cafeteria revenue, net assets released from restrictions for operating purposes, and other miscellaneous items.

On April 2, 2020, the System received \$45,472,000 in provider relief funds authorized in the CARES Act from the U.S. Department of Health and Human Services (HHS). The System expects that these relief funds will be forgivable, but uncertainty exists as to the final outcome of the terms

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

and conditions associated with the relief funds. Management will continue to monitor compliance with the terms and conditions of the Relief Fund and the impact of the pandemic on the System's revenues and expenses. If unable to attest to or comply with current or future terms and conditions, the System's ability to retain some or all of the distributions received may be impacted. Furthermore, the HSCRC is proposing to reduce the System's ability to recoup undercharges from its GBR reimbursement program in future years by an amount derived from these provider relief funds. The final outcome of the HSCRC's decisions on treatment of the undercharge resulting from the Global Budget Reimbursement Revenue program and application of CARES Act funding to GBR limits is still being evaluated. Luminis recognized these funds in other operating revenue during the period as the conditions for use were deemed to have been met.

Advances From Third-Party Payors

On April 10, 2020, the System received \$151,767,000 from the Centers for Medicare and Medicaid Services (CMS) Accelerated and Advance Payment Program. This program provides hospitals with working capital advances that begin to become payable 120 days from the date of receipt of the funds and must be fully repaid within one year through an automatic reduction of claims receipts from CMS. As of June 30, 2020, none of these funds have been used. These funds, which represent contract liabilities as defined in ASC 606, have been recorded within advances from third-party payors on the accompanying consolidated balance sheet at June 30, 2020.

Transaction Costs

During fiscal year 2019, the System incurred \$3,279,000 for administrative and marketing costs that resulted from the transaction for Doctors Community Medical Center and subsidiaries becoming a wholly owned subsidiary of Luminis Health, Inc.

Donations and Bequests

Unconditional promises to give cash and other assets are reported at fair value on the date the promise is received. Conditional promises to give, and indications of intentions to give, are reported at fair value on the date the gift is received. The gifts are reported as donor-restricted 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 a purpose restriction is accomplished, the asset is reclassified to without donor restrictions on the accompanying consolidated statements of operations and changes in net assets. Donor-restricted contributions

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements. Contributions that are unrestricted are reflected as other operating revenue on the accompanying consolidated statements of operations and changes in net assets.

Scheduled payments for pledges receivable for the years ending June 30 are as follows:

2021	\$ 2,599,000
2022–2024	658,000
2025 and thereafter	1,605,000
Less:	
Impact of discounting pledges receivable to net present value	352,000
Allowance for uncollectible pledges	373,000
Net pledges receivable	<u>\$ 4,137,000</u>

Pledges receivable are discounted using rates between 1.2% and 2.5%.

(Deficit) Excess of Revenues Over Expenses

The accompanying consolidated statements of operations and changes in net assets include (deficit) excess of revenues over expenses. Changes in net assets without donor restrictions that are excluded from (deficit) excess of revenues over expenses, consistent with industry practice, include contributions received and used for additions of long-lived assets and certain changes in pension liabilities.

Group Purchasing Organization Initial Public Offering

The Hospital has participated and owned equity in the Premier Limited Partnership (Premier), which has served as a group purchasing organization for many years. This participation provides purchasing contract rates and rebates the System would not be able to obtain on its own. The Hospital accounts for its investment in Premier using the equity method of accounting.

During the year ended June 30, 2014, Premier restructured from a privately held company to a public company in an initial public offering (IPO) and several financial transactions have occurred with those holding equity in Premier before the IPO, including the System. As a result, the System

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

received a cash payment of approximately \$1,500,000 in exchange for 16% of its previous ownership in Premier. In addition, in exchange for the extension of the group purchasing contract, the System received partial ownership of the new public company (the Class B units).

The System received 309,580 Class B units that are earned in seven separate tranches over an 85-month period ending October 31, 2020. At June 30, 2020 and 2019, this investment was \$10,388,000 and \$13,094,000, respectively, and is reflected in other assets on the consolidated balance sheets. The opportunity will exist in the future for these Class B units to be converted to the Premier public company stock. Prior to vesting, the Class B units may be transferred or sold with the approval of Premier. During the years ended June 30, 2020 and 2019, the System recognized approximately \$1,216,000 and \$1,988,000, respectively, of income related to tranches 6 and 7 of the Class B units, which is included as a reduction of supplies expense on the consolidated statement of operations and changes in net assets. The value of the Class B units is tied to the group purchasing contract and is considered a vendor incentive.

Income Tax Status

Luminis, the Hospital, the Foundation, HCS, GTS, PE, and RI have received determination letters from the Internal Revenue Service (IRS) stating that they are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (Code). The Real Estate Company has received a determination letter from the IRS stating that it is exempt from federal income taxes under Section 501(c)(2) of the Internal Revenue Code. Doctors Community Hospital and the Doctors Community Hospital Foundation are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code as public charities. Both entities are entitled to rely on this determination as long as there are no substantial changes in their character, purposes, or methods of operation. Management has concluded that there have been no such changes, and therefore the status of the various entities as public charities exempt from federal income taxation remain in effect.

Anne Arundel Mental Health Hospital is organized and operated as a tax-exempt organization, and has applied for IRS recognition of exemption from federal income tax under Section 501(c)(3) of the Code, but has not yet received IRS recognition of exemption.

The state in which the various entities operate also provides a general exemption from state income taxation for organizations that are exempt from federal income taxation. However, both entities are subject to federal and state income taxation at corporate tax rates on unrelated business income.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Exemption from other state and local taxes, such as real and personal property taxes is separately determined. The various entities had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which unrelated business income was recognized, a tax return was filed in order to report any unrelated business income as well as any taxes due.

HCE and PPI are subject to federal and state income taxes. These income taxes are immaterial to the accompanying consolidated financial statements.

Certain limited liability companies within the consolidated group are not subject to income taxes. Taxable income or loss is passed through to and reportable by the members individually.

Under the Cayman Islands Tax Concessions Law (Revised), the Governor-in-Cabinet issued an undertaking regarding Cottage on November 29, 2005, exempting it from all local income, profit, or capital gains taxes. The undertaking has been issued for a period of 20 years and, at the present time, no such taxes are levied in the Cayman Islands. Accordingly, no provision for taxes is made in these consolidated financial statements.

Doctors Regional Cancer Center, LLC (DRCC) and Southern Maryland Integrated Healthcare, LLC (ACO) are Maryland limited liability companies that have not elected to be taxed as corporations under current Treasury regulations. Both are owned by more than one member. DRCC and ACO are subject to the partnership tax rules under Subchapter K of the Internal Revenue Code of 1986 (IRC), as amended. Under these rules neither is subject to federal or state income tax, but must file annual information returns indicating their gross and taxable income to determine the tax results to their members.

The Doctors Community Sleep Center, LLC (Sleep Center) and Doctors Community Healthcare Programs (CHP) are Maryland limited liability companies that have not elected to be taxed as corporations under current treasury regulations. Sleep Center and CHP are wholly owned by the Hospital. As such, the Sleep Center and CHP are considered “disregarded entities” under current IRC regulations.

Under the requirements of ASC 740, *Income Taxes*, tax-exempt organizations could be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. Luminis has determined that it does not have any uncertain tax positions through June 30, 2020.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

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

Recent Accounting Pronouncements

Effective July 1, 2018, the System adopted FASB Accounting Standard Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method of transition. This ASU converged and replaced existing revenue recognition guidance, including industry-specific guidance and requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled in an exchange of goods or services. The adoption of this ASU did not materially impact the consolidated financial statements.

Effective June 30, 2019, the System adopted FASB ASU 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changed certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduce reporting complexity. The System adopted the ASU in the prior year and adjusted the presentation in these consolidated financial statements accordingly. The ASU was applied retrospectively to all periods presented.

Effective July 1, 2019, the System adopted the FASB ASU 2016-02, *Leases (Topic 842)*, using the modified retrospective transition approach as of the period of adoption, or fiscal year 2020. The FASB issued ASU 2016-02 in order to increase transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. The System's financial statements for periods prior to July 1, 2019, were not modified for the application of the new lease accounting standard. The main difference between the guidance in ASU 2016-02 and previous U.S. GAAP is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating under previous U.S. GAAP.

Upon the adoption of ASU 2016-02, the System recorded the following balances on the consolidated balance sheet: \$54,977,000 in right-of-use asset long term; \$10,056,000 of current liabilities in lease liability short term; and \$44,976,000 of long-term liabilities in lease liability

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

long term. The standard did not materially impact the System's accompanying consolidated statement of operations and changes in net assets or consolidated statement of cash flows for the year ended June 30, 2020.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted 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. Luminis has adopted ASU 2016-18 using a retrospective transition method, and as such, certain reclassifications were made to 2019 amounts previously reported on the consolidated statement of cash flows.

New Accounting Standards Not Yet Adopted

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments help entities evaluate the accounting for implementation costs paid by a customer in a cloud computing arrangement by providing guidance for determining when the service contract includes a software license. The System is evaluating the impact of this guidance, which will be effective in 2021.

3. Regulatory Environment

Medicare and Medicaid

The Medicare and Medicaid reimbursement programs represent a substantial portion of Luminis' revenues. Luminis' operations are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Over the past several years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. Compliance with fraud and abuse standards and other government regulations can be subject to future government review and interpretation. Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on Luminis.

In 1983, Congress approved a Medicare prospective payment plan for most inpatient services as part of the Social Security Amendment Act of 1983. Hospitals in Maryland were granted a waiver from the Medicare prospective payment system under Section 1814(b) of the Social Security Act. The waiver would remain in effect as long as the Maryland rate of increase in payments per admission remained below the national average rate of increase.

In January 2014, the Centers for Medicare and Medicaid Services approved a modernized waiver that includes both inpatient and outpatient revenue. The new waiver will be in place as long as Maryland hospitals achieve significant quality improvements and limit the per capita growth for all payors for Maryland residents.

Maryland Health Services Cost Review Commission

AAMC and Doctors Community Hospital's rate structure for all hospital-based services is subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC or the Commission). Under the HSCRC rate-setting system, the Hospital's inpatient and outpatient charges are the same for all patients, regardless of payor, including Medicare and Medicaid.

Beginning in fiscal year 2014, AAMC and Doctors Community Hospital entered into an agreement with the HSCRC to participate in the Global Budget Revenue (GBR) program. The GBR model is a revenue constraint and quality improvement system to provide hospitals with strong financial incentives to manage their resources efficiently and effectively in order to slow the rate of increase in health care costs and improve health care delivery processes and outcomes. Under the GBR, total revenue is capped at a predetermined fixed amount. The annual approved revenue is calculated using a permanent base revenue with positive or negative adjustments for inflation, assessments, performance in quality-based programs, infrastructure requirements, and population. Revenue may also be adjusted annually for market share levels and shifts of regulated services to unregulated settings.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

Starting in January 2019, Maryland's hospitals began operating under a new ten-year contract with the federal government entitled Maryland Performance Adjustment (MPA). The MPA is designed to test whether the improvements hospitals have made under the previous modernized waiver can be expanded to all health care providers. The GBR methodology will remain in place for hospital rate setting under the MPA. In addition, programs aimed to measure and reduce total health care spending for attributed Medicare patients, including pre- and post-acute care by all providers, are being introduced during this contract period.

The Commission's rate-setting methodology compares the approved rate with the actual average rate charged. Overcharges and undercharges due to either patient volume or price variances, adjusted for penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis. The System was undercharged by \$54,399,000 and overcharged by \$260,000 for the years ended June 30, 2020 and 2019, respectively. The undercharge of \$54,399,000 for the year ended June 30, 2020 did not include amounts recognized in CARES Act funding discussed in the other operating revenue section in Note 2.

While the System is expecting the HSCRC to allow for recovery in future periods of the undercharge experienced during the year, mainly due to lower volume as the result of the COVID-19 pandemic, uncertainty exists as to the final outcome of HSCRC rate-setting decision making.

The timing of HSCRC's rate adjustments for the System could result in an increase or reduction in rates due to the variances and penalties described above in a year subsequent to the year in which such items occur, and there is at least a possibility that the amounts may be material.

The AAMC and DCMC's policy is to recognize revenue based on actual charges for services to patients in the year in which the services are performed. The Hospital's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnoses, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until a subsequent period than which the services were rendered.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments

Investments, including assets whose use is limited, are stated at fair value. Borrowed funds that are required to be expended on specified capital projects under MHHEFA revenue bond agreements are classified as available for sale. All other investments and assets whose use is limited are classified as trading securities.

	June 30	
	2020	2019
Assets whose use is limited:		
Endowment assets:		
Cash and cash equivalents	\$ 1,145,000	\$ 1,237,000
Equity mutual funds	9,279,000	9,661,000
Fixed income mutual funds	5,058,000	5,737,000
	<u>15,482,000</u>	<u>16,635,000</u>
Amounts held by trustee:		
Cash and cash equivalents	12,382,000	12,320,000
U.S. Government obligations	7,000	7,000
	<u>12,389,000</u>	<u>12,327,000</u>
Amounts held by Cottage:		
Cash and cash equivalents	3,504,000	2,869,000
Equity mutual funds	11,334,000	6,581,000
Fixed income mutual funds	14,223,000	12,751,000
	<u>29,061,000</u>	<u>22,201,000</u>
Total assets whose use is limited	<u>56,932,000</u>	<u>51,163,000</u>
Less current portion	<u>15,912,000</u>	<u>15,190,000</u>
	<u>\$ 41,020,000</u>	<u>\$ 35,973,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

Amounts held by the trustee are broken down as follows:

	June 30	
	2020	2019
Bond indenture	<u>\$ 12,389,000</u>	<u>\$ 12,270,000</u>
Other investments:		
	June 30	
	2020	2019
Cash and cash equivalents	\$ 14,388,000	\$ 15,368,000
Equity mutual funds	173,069,000	178,576,000
Fixed income mutual funds	100,475,000	133,747,000
Alternative investments	<u>52,418,000</u>	<u>73,626,000</u>
	340,350,000	401,317,000
Less short-term investments	<u>1,365,000</u>	<u>15,261,000</u>
Investments	<u>\$ 338,985,000</u>	<u>\$ 386,056,000</u>

The components of investment (loss) income, net are as follows:

	June 30	
	2020	2019
Interest and dividend income, net	\$ 132,000	\$ 10,257,000
Realized (losses) gains, net	(9,832,000)	3,616,000
	<u>\$ (9,700,000)</u>	<u>\$ 13,873,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements

ASC 820 defines fair value and establishes a framework for measuring fair value in accordance with U.S. GAAP. ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 – Defined as observable inputs, such as quoted prices in active markets
- Level 2 – Defined as inputs other than quoted prices in active markets that are either directly or indirectly observable
- Level 3 – Defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

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

ASC 820 requires that the fair value of derivative contracts include adjustments related to the credit risks of both parties associated with the derivative transactions. The fair value of Luminis' derivative contracts reflected in the accompanying consolidated financial statements includes adjustments related to the credit risks of the parties to the transactions.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

The following tables present the fair value hierarchy for Luminis' financial assets and liabilities measured at fair value on a recurring basis.

	June 30, 2020			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 178,795,000	\$ 178,126,000	\$ 669,000	\$ —
Trading securities and assets whose use is limited:				
Cash and cash equivalents	31,296,000	18,257,000	13,039,000	—
Equity securities	194,977,000	194,977,000	—	—
Fixed income securities	122,785,000	119,753,000	3,032,000	—
U.S. Government obligation securities	6,000	6,000	—	—
Alternative investments	52,418,000	22,663,000	—	29,755,000
Total	401,482,000	355,656,000	16,071,000	29,755,000
Collateral for interest rate swap:				
Cash and cash equivalents	110,002,000	110,002,000	—	—
Less investments included in other assets	4,200,000	4,200,000	—	—
Total assets	\$ 686,079,000	\$ 639,584,000	\$ 16,740,000	\$ 29,755,000
Liabilities				
Derivative instruments	\$ (117,037,000)	\$ —	\$ (117,037,000)	\$ —
Total liabilities	\$ (117,037,000)	\$ —	\$ (117,037,000)	\$ —

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

	June 30, 2019			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 15,100,000	\$ 15,100,000	\$ —	\$ —
Trading securities and assets whose use is limited:				
Cash and cash equivalents	31,794,000	31,794,000	—	—
Equity securities	194,818,000	194,818,000	—	—
Fixed income securities	152,235,000	152,235,000	—	—
U.S. Government obligation securities	6,000	6,000	—	—
Alternative investments	73,627,000	37,997,000	—	35,630,000
Total	452,480,000	416,850,000	—	35,630,000
Collateral for interest rate swap:				
Cash and cash equivalents	67,404,000	67,404,000	—	—
Total assets	\$ 534,984,000	\$ 499,354,000	\$ —	\$ 35,630,000
Liabilities				
Derivative instruments	\$ (78,479,000)	\$ —	\$ (78,479,000)	\$ —
Total liabilities	\$ (78,479,000)	\$ —	\$ (78,479,000)	\$ —

Luminis' Level 1 securities primarily consist of U.S. Treasury securities, exchange-traded mutual funds, and cash. Luminis determines the estimated fair value for its Level 1 securities using quoted (unadjusted) prices for identical assets or liabilities in active markets.

Luminis' Level 2 securities primarily consist of cash and cash equivalents. Luminis determines the estimated fair value for these Level 2 securities using the following methods: quoted prices for similar assets/liabilities in active markets, quoted prices for identical or similar assets in non-active markets (few transactions, limited information, noncurrent prices, high variability over time), inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates, yield curve volatilities, default rates), and inputs that are derived principally from or corroborated by other observable market data. Part of AAMC's alternative investments, approximately \$22,663,000 and \$35,800,000 at June 30, 2020 and 2019, respectively, are invested in international

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

equity funds and are considered Level 1 investments due to quoted price being readily available. The majority of the remaining alternative investments \$24,489,000 and \$29,653,000 at June 30, 2020 and 2019, respectfully are invested in a fund focused on energy infrastructure and are considered Level 3 investments due to quoted price not being readily available. The underlying assets of the fund are publicly traded energy-related master limited partnerships and equity securities. Certain alternative investments require written notification over a certain period prior to redemption.

Luminis' Level 2 securities also consist of derivative instruments, which are reported using valuation models commonly used for derivatives. Valuation models require a variety of inputs, including contractual terms, market-fixed prices, inputs from forward price yield curves, notional quantities, measures of volatility, and correlations of such inputs.

The following table sets forth a summary of changes in the fair value of the Level 3 assets:

Balance at June 30, 2019	\$ 35,630,000
Realized and unrealized gains and losses	(5,875,000)
Balance at June 30, 2020	<u>\$ 29,755,000</u>

Luminis also has pledges receivable, which are measured at fair value on a nonrecurring basis and are discounted to the net present value upon receipt using an appropriate risk-free discount rate based on the term of the receivable. Since these inputs are not observable, pledges receivable would be considered Level 3 fair value measurements upon their initial recording. Pledges receivable are recorded net of an allowance for uncollectible pledges. The following table provides a reconciliation of the beginning and ending balances of pledges receivable that used significant unobservable inputs.

	Year Ended June 30	
	2020	2019
Pledges receivable:		
Balance at July 1	\$ 3,296,000	\$ 4,115,000
New pledges	2,967,000	2,542,000
Collections of pledges	(2,028,000)	(3,146,000)
Write-off of pledges	(160,000)	(168,000)
Change in reserves	62,000	(47,000)
Balance at June 30	<u>\$ 4,137,000</u>	<u>\$ 3,296,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit

For AAMC and affiliates, long-term debt consists of the following:

	Interest Rate	Maturity Dates	June 30	
			2020	2019
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2017	2.0%–5.0%	2018–2043	\$ 56,905,000	\$ 58,935,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2014	2.0%–5.0%	2015–2040	113,817,000	116,200,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2012	2.0%–5.0%	2013–2035	56,991,000	59,735,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2009B	Variable	2041–2044	60,000,000	60,000,000
Kent Island term loan from a bank	Variable	2021	5,617,000	5,908,000
Real Estate Loan	Variable	2028	55,850,000	59,492,000
			<u>349,180,000</u>	<u>360,270,000</u>
Less current portion of long-term debt			11,461,000	11,029,000
Less deferred debt issue costs			3,531,000	3,803,000
Unamortized original issue premium, net			13,354,000	14,297,000
Long-term debt			<u>\$ 347,542,000</u>	<u>\$ 359,735,000</u>

These debt instruments are secured by the receipts of the AAMC obligated group and substantially all of the property and equipment of the consolidated Group.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

For AAMC and affiliates, principal payments due under all debt instruments as of June 30, 2020, are as follows:

2021	\$ 11,461,000
2022	16,589,000
2023	11,667,000
2024	11,987,000
2025	12,332,000
Thereafter	285,144,000
	<u>\$ 349,180,000</u>

Series 2017 Revenue Bonds

In November 2017, AAMC entered into a loan agreement with the MHHEFA for the issuance of Series 2017 Revenue Bonds (referred to as the 2017 Bonds). The proceeds of the 2017 Bonds were used to advance refund the Series 2010 Bonds previously provided by MHHEFA. The bonds being refunded were originally obtained to finance the expansion of the parking garage for AAMC's acute care pavilion, and costs related to the issuance. The 2017 Bonds provide for annual principal payments each July 1 from 2018 through 2043. Interest is payable annually each July 1 starting in July 2018. The 2017 Bonds bear stated interest rates between 2.00% and 5.00% and were issued at a premium of \$4,590,000, which is amortized over the life of the bonds using the straight-line method, which approximates the effective interest method. The effective annual interest rate for the 2017 Bonds for the year ended June 30, 2020 and June 30, 2019, was 3.64% and 1.93%, respectively.

Series 2014 Revenue Bonds

In November 2014, AAMC entered into a loan agreement with the MHHEFA for the issuance of Series 2014 Revenue Bonds (referred to as the 2014 Bonds). The proceeds of the 2014 Bonds were used to advance refund the Series 2009A Bonds previously provided by MHHEFA. The bonds being refunded were originally obtained to finance a portion of the costs of construction for an eight-story patient care building, two parking garages, and costs related to the issuance. The 2014 Bonds provide for annual principal payments each July 1 from 2015 through 2040. Interest is payable semiannually each July 1 and January 1, beginning in January 2015. The 2014 Bonds bear stated interest rates between 2.00% to 5.00% and were issued at a premium of \$7,520,000, which

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

is amortized over the life of the bonds using the straight-line method, which approximates the effective interest method. The effective annual interest rate for the 2014 Bonds for the years ended June 30, 2020 and 2019, was 4.49% and 2.24%, respectively.

Series 2012 Revenue Bonds

In October 2012, AAMC entered into a loan agreement with MHHEFA for the issuance of \$73,625,000 of Series 2012 Revenue Bonds (referred to as the 2012 Bonds). The proceeds of the 2012 Bonds were used to repay the Series 2004A Bonds and the Series 1998 Bonds previously provided by the Authority. The bonds being refinanced were originally obtained to finance a new replacement hospital (Series 1998 Bonds) and to finance major renovations to AAMC's Cancer Center and land acquisition (Series 2004A Bonds). The 2012 Bonds provide for annual principal payments each July 1 from 2013 through 2035. Interest is payable semiannually on each July 1 and January 1, beginning July 1, 2013. The 2012 Bonds bear stated interest at rates of 2.00% to 5.00% and were issued at a premium of \$6,746,000. The effective annual interest rates for the 2012 Bonds for the years ended June 30, 2020 and 2019, were 4.34% and 2.16%, respectively.

The provisions of the 2017, 2014, and 2012 Bonds, together with the Series 2009 Bonds, require Luminis and certain subsidiaries to comply with certain covenants on an annual basis, including a debt service coverage requirement, a debt-to-capitalization requirement, and a liquidity requirement. Luminis, AAMC, and HCS are members of the AAMC obligated group for all of the above stated revenue bonds issued by MHHEFA.

Series 2009 Revenue Bonds

In January 2009, AAMC entered into a loan agreement with the MHHEFA for the issuance of \$120,000,000 of Series 2009A Revenue Bonds (the 2009A Bonds) and in February 2009, \$60,000,000 of Series 2009B Revenue Bonds (the 2009B Bonds) (collectively referred to as the 2009 Bonds). The proceeds of the 2014 Bonds were used to advance refund the Series 2009A Bonds previously provided by the MHHEFA. The proceeds of the 2009 Bonds were used to finance a portion of the costs of construction of an eight-story patient care building, two new parking garages, and certain costs relating to the issuance. The 2009B Bonds provide for annual principal payments each July 1, from 2041 through 2044. Interest is payable semiannually on each July 1 and January 1, beginning July 1, 2009. The 2009B Bonds bear interest at variable rates, as set forth in the loan agreement. The maximum interest rate is 12% for the 2009B Bonds. The effective annual interest rates for the 2009B Bonds for the years ended June 30, 2020 and 2019,

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

were 1.18% and 1.65%, respectively. The principal and interest payments on the Series 2009B Bonds are secured by a letter of credit equal to the original principal of the bonds plus an amount equal to 40 days' interest thereon, calculated at the maximum rate. The current letter of credit, which was extended on May 1, 2019, expires on July 1, 2024. Under certain circumstances, AAMC would need to fully redeem the 2009B Bonds upon expiration of the letter of credit, unless a conforming replacement letter of credit was secured prior to such expiration.

The related balances are included in assets whose use is limited and consist of the following:

	June 30	
	2020	2019
Debt service funds	\$ 12,382,000	\$ 12,263,000
Construction fund and capitalized interest fund	7,000	7,000
	\$ 12,389,000	\$ 12,270,000

Bank Line of Credit and Real Estate Loan

AAMC maintains two lines of credit with a bank providing available credit of \$90,000,000. An agreement for \$50,000,000 with the bank is reviewed for renewal on February 28 of each year. Interest on any borrowings accrues at the one-month London Interbank Offered Rate (LIBOR) plus 0.75%. A second agreement for \$40,000,000 was completed on April 24, 2020, and is reviewed for renewal each year. Interest on any borrowing accrues at the one-month LIBOR plus 1.5%. At June 30, 2020 and 2019, AAMC had no balance on the lines of credit.

On October 23, 2008, the Real Estate Company secured a term loan in the amount of \$55,000,000 with a bank. The proceeds from the term loan were used to refinance line of credit proceeds and fund certain construction costs related to a medical office building. The loan bore interest at a variable rate, based on the LIBOR market index rate plus 1.25%. The term loan required monthly payments of \$235,000 with all remaining amounts due upon final maturity on November 5, 2018. The effective annual interest rate for the year ending June 30, 2019, was 2.25%. This loan was subsequently refinanced on October 17, 2018.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

On October 23, 2008, the Real Estate Company entered into a construction loan in the amount of \$30,000,000 with a bank to fund the construction of a medical office building. The loan was issued under the same loan agreement as the term loan discussed in the preceding paragraph. The debt is secured by the medical office building. Interest only was due during the construction period at a rate equal to the LIBOR market index rate plus 1.25%. The loan converted to a term loan after the completion of the construction in July 2009. The term loan provided for monthly principal and interest payments and has a final maturity of November 5, 2018. The effective annual interest rate for the year ended June 30, 2019, was 4.65%. This loan was subsequently refinanced on October 17, 2018.

On October 17, 2018, the Real Estate Company secured a real estate loan from the bank through a wholly owned subsidiary and the proceeds were used to pay off the 2008 Term Loan and 2008 Construction Loan previously provided by the bank. The loans being refinanced were originally obtained to finance certain medical office buildings owned by the Real Estate Company. The new loan requires flat monthly principal payments (amortized over 17 years) plus interest at one month Libor + 1.10% from 2018 through 2028 with a balloon payment due October 5, 2028, of \$25,800,000. The effective interest rates for the years ended June 30, 2020 and 2019, were 2.65% and 4.65%.

Kent Island Term Loan

In August 2007, KIMA entered into a construction loan agreement with a bank in the amount of \$9,000,000 that would convert to a term loan after the completion of the construction. The proceeds were used to construct a medical office building. The debt was secured by the medical office building. Interest only was due during the construction period at a rate of the 30-day LIBOR plus 1.0%. The construction was completed in June 2008.

On May 9, 2017, KIMA refinanced the term loan with a \$6,567,000 promissory note. The promissory note provides for monthly principal and interest payments and has a final maturity of December 2021. The promissory note bears interest at a variable rate, based on the 30-day LIBOR plus 1.2%. The effective annual interest rates for the years ended June 30, 2020 and 2019, were 2.88% and 3.58%, respectively.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

For DCMC, long-term debt consists of the following:

	Interest Rate	Maturity Dates	June 30, 2020
Maryland Health and Higher Education Facilities			
Authority Revenue Bonds, Series 2017B Bond	2.18%	2024	\$ 24,165,000
Authority Revenue Bonds, Series 2016 Bond:			
Series 2016A – Tax-Exempt Private Placement 2007 Refunding	2.57%	2030	16,795,000
Series 2016A – Tax-Exempt Private Placement 2010 Partial Refunding	2.57%	2030	15,150,000
Authority Revenue Bonds, Series 2017A:			
Term bond	5.00%	2031	6,720,000
Term bond	5.00%	2032	7,055,000
Term bond	5.00%	2033	7,410,000
Term bond	5.00%	2034	7,780,000
Term bond	5.00%	2038	35,234,000
			<u>120,309,000</u>
Less current portion of long-term debt			4,979,000
Less deferred debt issue costs			1,340,000
Premium, net of accumulated amortization			8,776,000
Long-term debt			<u>\$ 122,766,000</u>

For DCMC, principal payments due under all debt instruments as of June 30, 2020, are as follows:

2021	\$ 4,979,000
2022	5,070,000
2023	5,195,000
2024	5,265,000
2025	5,965,000
Thereafter	<u>93,835,000</u>
	<u>\$ 120,309,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

On June 28, 2016, MHHEFA issued \$73,445,000 principal amount of Revenue Bonds, Series 2016A (\$31,945,000), and Series 2016B (\$41,500,000). The proceeds of this issue were used to retire the Series 2007A Bonds and Series 2010 Bonds (partial) previously provided by the Authority. In 2017, the Series 2016B taxable note was converted as planned to Series 2017B. On March 23, 2017, the Series 2016 were converted to Series 2017B bonds as planned when the 2016B bonds were issued in June 2016.

On February 8, 2017, MHHEFA issued \$64,165,000 principal amount of Revenue Bonds, Series 2017A. The proceeds of this issue were used to retire the remainder of the Series 2010 Bonds previously provided by the Authority.

The obligated group for MHHEFA bond issuances issued to Doctors Community Medical Center includes Doctors Community Hospital, CHP, Foundation, Sleep Center, Doctors Community Medical Group and Doctors Integrated Healthcare Network and Health Ventures excluding the MAUI, Magnolia Gardens, DI LLC, ACO, and STM. The Series 2017A, Series 2017B, and Series 2016 Bonds are secured by the revenue and accounts receivable of the obligated group, and certain other property secured by a deed of trust. The obligated group is required to maintain certain compliance ratios and covenants as defined under the bond documents.

7. Retirement Plans

Anne Arundel Medical Center Plan

AAMC has a qualified noncontributory, defined benefit pension plan (the Plan) that covers substantially all employees. AAMC's policy is to fund pension costs as determined by its actuary. Adopted by the Board of Trustees on June 11, 2009, and effective September 1, 2009, AAMC amended the Plan to freeze future benefit accruals, and participants have not earned any additional benefits under the Plan since that date. However, subsequent to September 1, 2009, participants have continued to vest in benefits they have earned through September 1, 2009. The frozen benefit balance for the participants will only accrue interest credits until the participants' benefit commencement dates. FASB ASC 715, *Compensation – Retirement Benefits*, requires AAMC to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan on its consolidated balance sheet, with a corresponding adjustment to unrestricted net assets. The pension liability adjustment to net assets without donor restrictions represents the change in net unrecognized actuarial losses that have not

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

yet been recognized as part of (deficit) excess of revenues over expenses. These amounts are subsequently recognized as a net periodic benefit cost pursuant to AAMC's historical accounting policy for amortizing such amounts.

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended June 30 and the accumulated benefit obligation for the AAMC is as follows:

	June 30	
	2020	2019
Accumulated benefit obligation	<u>\$ 138,148,000</u>	<u>\$ 124,331,000</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 124,331,000	\$ 124,571,000
Service cost	—	—
Interest cost	4,047,000	4,758,000
Actuarial loss	16,039,000	8,705,000
Benefits paid	(2,446,000)	(2,332,000)
Settlements paid	(3,823,000)	(11,371,000)
Projected benefit obligation at end of year	<u>138,148,000</u>	<u>124,331,000</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	118,255,000	121,257,000
Actual return on plan assets	(1,421,000)	5,901,000
Employer contribution	4,832,000	4,800,000
Benefits paid	(2,446,000)	(2,332,000)
Settlements paid	(3,823,000)	(11,371,000)
Fair value of plan assets at end of year	<u>115,397,000</u>	<u>118,255,000</u>
Net liability recognized	<u>\$ (22,751,000)</u>	<u>\$ (6,076,000)</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

	June 30	
	2020	2019
Net amounts recognized on the consolidated balance sheets consist of:		
Accrued pension costs	<u>\$ (22,751,000)</u>	<u>\$ (6,076,000)</u>
Amounts recognized in unrestricted net assets that have not been recognized in net periodic benefit costs consist of:		
Net actuarial loss	<u>\$ 95,271,000</u>	<u>\$ 71,988,000</u>

The following table sets forth the weighted average assumptions used to determine the benefit obligations of AAMC:

	June 30	
	2020	2019
Discount rate	2.45%	3.35%
Rate of compensation increase	N/A	N/A

The following table sets forth the weighted average assumptions used to determine the net periodic benefit cost of AAMC:

	Year Ended June 30	
	2020	2019
Discount rate	3.35%	4.13%
Expected return on plan assets	6.25%	7.00%
Rate of compensation increase	N/A	N/A

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

AAMC's net periodic pension benefit cost included the following components:

	June 30	
	2020	2019
Service cost	\$ —	\$ —
Interest cost	4,047,000	4,758,000
Expected return on plan assets	(7,533,000)	(8,403,000)
Amortization of prior service cost	—	—
Recognized net actuarial loss	1,709,000	1,484,000
Loss recognized from partial settlement of projected benefit obligation	—	6,938,000
Net periodic cost (credit)	<u>\$ (1,777,000)</u>	<u>\$ 4,777,000</u>

The estimated net loss of the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year for AAMC is \$1,777,000.

AAMC's defined benefit plan invests in a diversified mix of traditional asset classes. Investments in certain types of U.S. equity securities and fixed-income securities are made to maximize long-term results while recognizing the need for adequate liquidity to meet ongoing benefit and administrative obligations. Risk tolerance of unexpected investment and actuarial outcomes is continually evaluated by understanding the pension plan's liability characteristics. Equity investments are used primarily to increase the overall plan returns. Debt securities provide diversification benefits and liability hedging attributes that are desirable, especially in falling interest rate environments.

AAMC's target asset allocation percentages as of June 30, 2020, were as follows: 60% investment grade bonds, 16% international equity, 13% large cap domestic stocks, 4% small cap domestic stocks, and 7% alternative investments and exchange-traded notes.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

The following tables present the fair value hierarchy of assets of the defined benefit pension plan of AAMC.

	June 30, 2020			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 669,000	\$ —	\$ 669,000	\$ —
Mutual funds:				
Equity	20,127,000	20,127,000	—	—
Corporate bonds	57,830,000	57,830,000	—	—
International equity	12,520,000	12,520,000	—	—
International bonds	8,715,000	8,715,000	—	—
Closed-end funds ETF	5,512,000	5,512,000	—	—
Alternative investments:				
Common/collective trust	2,398,000	2,398,000	—	—
Partnership	2,395,000	2,395,000	—	—
Other	5,231,000	—	—	5,231,000
	\$ 115,397,000	\$ 109,497,000	\$ 669,000	\$ 5,231,000

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

	June 30, 2019			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 4,025,000	\$ —	\$ 4,025,000	\$ —
Mutual funds:				
Equity	20,237,000	20,237,000	—	—
Corporate bonds	57,573,000	57,573,000	—	—
International equity	11,922,000	11,922,000	—	—
International bonds	9,382,000	9,382,000	—	—
Alternative investments:				
Common/collective trust	3,813,000	—	3,813,000	—
Partnership	3,248,000	—	3,248,000	—
Other	8,055,000	—	8,055,000	—
	<u>\$ 118,255,000</u>	<u>\$ 99,114,000</u>	<u>\$ 19,141,000</u>	<u>\$ —</u>

Level 1 securities primarily consist of exchange-traded mutual funds. Level 2 securities primarily consist of money market funds. Methods consistent with those discussed in Note 5 are used to estimate the fair values of these securities. Level 3 securities consist of a fund focused on energy infrastructure and are considered Level 3 investments due to quoted price not being readily available. The underlying assets of the fund are publicly traded energy-related master limited partnerships and equity securities.

The overall expected rate of return on assets assumptions was based on historical returns, with adjustments made to reflect expectations of future returns. The extent to which the future expectations were recognized considered the target rates of returns for the future, which have historically not changed.

AAMC currently intends to make voluntary contributions to the defined benefit pension plan of \$4,800,000 in fiscal year 2021.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

The following benefit payments for AAMC are expected to be paid:

2021	\$ 7,855,000
2022	7,470,000
2023	7,391,000
2024	7,071,000
2025	7,586,000
2026–2030	38,880,000

In addition to the noncontributory defined benefit pension plan, AAMC also offers an employee defined contribution plan. Participation in the plan is voluntary. Substantially all full-time employees of AAMC are eligible to participate. Employees may elect to contribute a minimum of 1% of compensation, and a maximum amount as determined by Sections 403(b) and 415 of the Internal Revenue Code. Any employee making contributions to the plan is entitled to a AAMC contribution that will match the employee contribution at the rate of 50% to 75%, depending on the number of years of service, up to a maximum of 5% of qualified compensation. Matching contributions under this defined contribution plan were \$8,830,000 and \$8,000,000 in fiscal years 2020 and 2019, respectively.

Doctors Community Hospital Plan

DCMC froze the defined benefit pension plan that it sponsors (the Plan) in 2011, which covered substantially all employees. The decision to terminate the Plan has not been made by the board of directors. The benefits are based on years of service and employee compensation during years of employment. DCMC's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 (ERISA). DCMC expects to contribute \$1,232,000 to the Plan during 2020 to keep the funding levels at the ERISA requirements. The measurement date of the Plan is June 30.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended June 30 and the accumulated benefit obligation at June 30, 2020 for DCMC is as follows:

Accumulated benefit obligation	<u>\$ 23,049,000*</u>
Change in projected benefit obligation:	
Projected benefit obligation at beginning of year	\$ 21,661,000
Service cost	
Interest cost	636,000
Actuarial loss	1,883,000
Benefits paid	(112,000)
Settlements paid	<u>(1,019,000)</u>
Projected benefit obligation at end of year	<u>23,049,000</u>
Change in plan assets:	
Fair value of plan assets at beginning of year	16,660,000
Actual return on plan assets	294,000
Employer contribution	664,000
Benefits paid	(112,000)
Settlements paid	<u>(982,000)</u>
Fair value of plan assets at end of year	<u>16,524,000</u>
Net liability recognized	<u>\$ (6,525,000)</u>
Net amounts recognized on the consolidated balance sheets consist of:	
Accrued pension costs	<u>\$ (6,525,000)</u>
Amounts recognized in unrestricted net assets that have not been recognized in net periodic benefit costs consist of:	
Net actuarial loss	<u>\$ 9,634,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

The following table sets forth the weighted average assumptions used to determine the benefit obligations of DCMC as of June 30, 2020:

Discount rate	2.05%
Rate of compensation increase	N/A

The following table sets forth the weighted average assumptions used to determine the net periodic benefit cost for the year ended June 30, 2020:

Discount rate	2.05%
Expected return on plan assets	6.00%
Rate of compensation increase	N/A

DCMC's net periodic pension benefit cost included the following components as of June 30, 2020:

Interest cost	\$ 636,000
Expected return on plan assets	(956,000)
Recognized net actuarial loss	570,000
Effect of settlement	411,000
Net periodic cost	<u>\$ 661,000</u>

The estimated net loss of the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year for DCMC is \$1,499,000.

DCMC's target asset allocation percentages as of June 30, 2020, were as follows: 62% investment grade bonds, 3% international equity, 16% large cap domestic stocks, and 19% small cap domestic stocks.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

The following table presents the fair value hierarchy of assets of the defined benefit pension plan of DCMC.

	June 30, 2020			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Mutual funds:				
Equity	\$ 15,571,000	\$ 15,571,000	\$ —	\$ —
Alternative investments:				
Common/collective trust	953,000	—	953,000	—
	<u>\$ 16,524,000</u>	<u>\$ 15,571,000</u>	<u>\$ 953,000</u>	<u>\$ —</u>

DCMC currently intends to make voluntary contributions to the defined benefit pension plan of \$1,232,000 in fiscal year 2021.

The following benefit payments for DCMC are expected to be paid:

2021	\$ 2,428,000
2022	1,292,000
2023	1,235,000
2024	1,257,000
2025	1,581,000
2026–2030	6,330,000

The combined pension liability of both entities is as follows:

AAMC	\$ 22,751,000
DCMC	6,525,000
Total	<u>\$ 29,276,000</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Retirement Plans (continued)

DCMC has a 403b defined contribution plan (the contribution plan) covering substantially all its employees. The contribution plan is employee and employer contributory. DCMC contributed a match of \$0.50 for every \$1.00 of elective deferrals for a plan year for eligible employees up to 4% of base compensation. Defined contribution plan expense amounted to \$1,266,000 for 2020.

DCMC has a deferred compensation plan that permits certain executives to defer receiving a portion of their compensation. The deferred amounts are included in other assets in the accompanying consolidated balance sheets. The associated liability of an equal amount is included in other liabilities in the accompanying consolidated balance sheets. The liability recorded regarding the deferred compensation was \$3,832,000 as of June 30, 2020.

DCMC is the beneficiary of split dollar life insurance policies in place for certain executives. The amounts that could be realized by DCMC under the insurance contracts are approximately \$9,000,000 as of June 30, 2020, are included in other assets on the consolidated balance sheets.

8. Concentrations of Credit Risk

Certain members of Luminis grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows for AAMC:

	June 30	
	2020	2019
Medicare	25%	26%
Medicaid	4	5
Blue Cross	19	18
Commercial, HMO, PPO, and other	43	32
Patients	9	19
	<u>100%</u>	<u>100%</u>

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Concentrations of Credit Risk (continued)

The mix of receivables from patients and third-party payors was as follows for the DCMC as of June 30, 2020:

Medicare	28%
Medicaid	21
Blue Cross	10
Commercial, HMO, PPO, and other	29
Patients	12
	<u>100%</u>

9. Malpractice Insurance Costs and Self-Insured Professional Liability

Until August 1, 1998, AAMC and certain subsidiaries maintained insurance coverage for general and professional liability claims on a claims-made basis. The professional liability coverage included a per-case deductible of \$250,000, up to a maximum out-of-pocket amount of \$750,000 annually. Effective August 1, 1998, the Group changed its professional liability coverage to a full coverage claims-made policy with no annual deductibles. This policy included tail coverage for claims incurred prior to August 1, 1998, but reported subsequently. Effective August 1, 2002, AAMC changed its professional liability coverage back to a claims-made policy with a per-case deductible of \$250,000, up to a maximum out-of-pocket amount of \$750,000 annually. Also, AAMC did not purchase tail coverage for claims incurred prior to August 1, 2002, which were not yet reported.

Effective March 1, 2004, AAMC changed its professional liability coverage to a self-insurance trust with annual exposure limits of \$2,000,000 per claim and \$11,000,000 in the aggregate. AAMC carried an excess liability insurance policy for claims above these limits.

Effective July 1, 2005, Cottage was formed as a captive insurer to provide professional liability insurance for AAMC. Cottage is a wholly owned subsidiary of AAMC, which was formed in the Cayman Islands. The primary layer of professional and general liability insurance coverage is self-insured through Cottage and the secondary layer is fully reinsured through several highly rated commercial carriers.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Malpractice Insurance Costs and Self-Insured Professional Liability (continued)

For the period from July 1, 2005 to June 30, 2009, Cottage issued claims-made policies covering AAMC professional liability (including employed physicians) and on an occurrence basis, comprehensive general liability risks of AAMC and certain affiliates. Policy limits were \$2,000,000 per claim with a \$9,000,000 policy aggregate. Effective July 1, 2005, Cottage assumed existing liabilities from AAMC's self-insured trust discussed above on a claims-made basis. Effective July 1, 2009, Cottage issued a claims-made policy providing \$2,000,000 per claim for AAMC professional liability coverage and \$1,000,000 per claim for comprehensive general liability coverage, subject to a consolidated annual aggregate limit of \$10,000,000. Effective July 1, 2018, policy limits were increased to \$5,000,000 per claim with a \$25,000,000 policy aggregate.

For the period from July 1, 2005 to June 30, 2008, Cottage also issued an excess umbrella coverage policy (covering AAMC professional liability) with limits of \$20,000,000 per claim with a policy aggregate. For claims reported on and subsequent to July 1, 2008, the coverage limit provided is \$30,000,000 per claim with a policy aggregate. These excess limits are in excess of the primary policy, and the umbrella policies are 100% reinsured with highly rated third-party commercial reinsurers.

The provision for estimated professional liability claims, general liability claims, and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. As of June 30, 2020, and 2019, the balance for outstanding claims reserves recorded at Cottage is \$32,444,000 and \$36,843,000 and reinsurance receivable is \$9,884,000 and \$17,286,000, respectively. The remaining tail liability for claims incurred but not reported is \$11,667,000 and \$10,607,000 as of June 30, 2020 and 2019, respectively, with \$10,163,000 of the 2020 liability and \$9,226,000 of the 2019 liability recorded at the AAMC. The remainder of the liability is recorded at PE. The Group has employed an independent actuary to estimate the ultimate settlement of such claims. In management's opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Malpractice Insurance Costs and Self-Insured Professional Liability (continued)

DCMC has coverage for professional and general liabilities on a claims-made basis from Freestate Healthcare Insurance Company, Ltd. (Freestate), a group captive formed by several Maryland hospitals. DCMC owns 20% interest in the captive and accounts for it using the cost method. The cost of \$15,000 is recorded in other noncurrent assets on the accompanying consolidated balance sheets as of June 30, 2020. Premiums are expensed as incurred and are established based on the DCMC historical experience supplemented as necessary with industry experience. The total premium is allocated to each of the shareholders based on their experience. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment of credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2020. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals. The captive is responsible for claims up to \$1,000,000 for each and every loss event. Additional coverage has been purchased by the captive for all claims in excess of \$1,000,000 to a limit of \$6,000,000 effective March 1, 2006, \$10,000,000 effective March 1, 2012, and \$15,000,000 effective March 1, 2019. The estimated unpaid loss liability reserved by the captive for DCMC was \$9,466,000 at June 30, 2020. These amounts are included in long-term liabilities and the related anticipated insurance recoveries were reported in noncurrent assets on the accompanying consolidated balance sheets. The liability for all claims incurred but not reported for DCMC was \$1,106,000 at June 30, 2020. The discount rate for unpaid losses is 3.5% for the year ended June 30, 2020. DCMC engages a consulting actuary to assist in the determination of all professional liability claims incurred but not reported.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies

Leases

The following table presents the components of the Luminis' right-of-use assets and liabilities related to ASC 842 leases and their classification in Luminis' consolidated balance sheets as of June 30, 2020:

<u>Component of Lease Balances</u>	<u>Classification in Consolidated Balance Sheet</u>	<u>June 30, 2020</u>
Assets		
Operating lease assets	Right of use asset long term	\$ 44,995,000
Total leased assets		<u>\$ 44,995,000</u>
Liabilities		
Operating lease liabilities:		
Current	Lease liability short term	\$ 8,753,000
Long term	Lease liability long term	<u>37,429,000</u>
Total operating lease liabilities		<u>\$ 46,182,000</u>

Luminis determines if an arrangement is a lease at inception of the contract. The right-of-use assets represent Luminis' right to use the underlying assets for the lease term and the lease liabilities represent Luminis' obligation to make lease payments arising from the leases. Right-of-use assets and lease liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. Luminis uses a risk-free discount rate that is determined using Treasury securities of a comparable term to that of its leases when acting as a lessee.

Luminis' operating leases are primarily for real estate and equipment. Real estate leases include leases of medical facilities and office spaces. Equipment leases mainly include lease of copiers and medical equipment. Luminis' real estate lease agreements typically have initial terms of 3 to 20 years, and equipment lease agreements typically have initial terms of 3 to 5 years.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

Real estate leases may include one or more options to renew that can extend the lease term from five to ten years. The exercise of lease renewal options is at Luminis' sole discretion. In general, Luminis does not consider renewal options to be reasonably likely to be exercised; therefore, renewal options are generally not recognized as part of Luminis' right-of-use assets and lease liabilities. Certain equipment leases also include options to purchase the leased equipment. The useful life of assets and leasehold improvements are limited by the expected lease term unless there is a transfer of title or purchase option reasonably certain of exercise. Luminis currently does not have any leases whereby there is a transfer of title or a purchase option that is reasonably certain to be exercised; hence, all of Luminis' leases are depreciated over the lease term.

Certain of the Luminis' lease agreements for real estate include payments based on actual common area maintenance expenses and other operating expenses. These variable lease payments are recognized in purchased services but are not included in the right of-use asset or liability balances. Luminis' lease agreements do not contain any material residual value guarantees, restrictions, or covenants.

Luminis elected the accounting policy practical expedients by class of underlying asset to: (i) exclude recording leases with an initial term of 12 months or less (short-term leases) as right-of-use assets and liabilities on the consolidated balance sheets; and (ii) combine associated lease and non-lease components into a single lease component. Non-lease components, which are not significant overall, are combined with lease components. Luminis' has elected these practical expedients for real estate, equipment, and all other asset classes when acting as a lessee.

Luminis' also elected the practical expedient package not to reassess at adoption (i) expired or existing contracts for whether they are or contain a lease, (ii) the lease classification of any existing leases, or (iii) initial indirect costs for existing leases.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

The following table presents the components of the Luminis' lease expense for the year ended June 30, 2020:

Operating lease expense	\$ 11,826,000
Finance lease expense:	
Amortization of leased assets	27,000
Interest on lease liabilities	2,000
Total finance lease expense	<u>11,855,000</u>
Variable lease expense	60,000
Short-term lease expense	5,000
Total lease expense	<u>\$ 11,920,000</u>

Total rent expense under operating leases was \$9,875,000 for the year ended June 30, 2019, and is included in purchased services on the accompanying consolidated statement of operations and changes in net assets.

The weighted average lease terms and discount rates for operating and finance leases are as follows as of June 30, 2020:

Weighted average remaining lease term (years):	
Operating leases	8.1
Finance leases	2.2
Weighted average discount rate:	
Operating leases	3.2%
Finance leases	1.8%

Cash flow and other information related to leases are included in the following table for the year ended June 30, 2020:

Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash outflows from operating leases	\$ 21,756,000
Operating cash outflows from finance leases	1,000
Financing cash outflows from finance leases	26,000
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	8,507,000
Finance leases	27,000

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

The following table summarizes the maturity lease obligations as of June 30, 2020:

	Operating Leases	Finance Leases	Total
2021	\$ 8,922,000	\$ 63,000	\$ 8,985,000
2022	7,706,000	28,000	7,734,000
2023	5,817,000	5,000	5,822,000
2024	4,544,000	—	4,544,000
2025	2,830,000	—	2,830,000
Thereafter	16,999,000	—	16,999,000
Total lease payments	46,818,000	96,000	46,914,000
Less: Imputed interest	729,000	3,000	732,000
Total lease liabilities	<u>\$ 46,089,000</u>	<u>\$ 93,000</u>	<u>\$ 46,182,000</u>

Contingencies

Members of Luminis have been named as defendants in various legal proceedings arising from the performance of their normal activities. In the opinion of management, after consultation with legal counsel and after consideration of applicable insurance, the amount of the Luminis' ultimate liability under all current legal proceedings will not have a material adverse effect on its consolidated financial position or results of operations.

Luminis' revenues may be subject to adjustment as a result of examination by government agencies or contractors, based upon differing interpretations of government regulations, medical diagnoses, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered. Section 302 of the Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare overpayments and underpayments made to providers. Management has established protocols to respond to RAC requests and payment denials. Payment recoveries resulting from RAC reviews are appealable through administrative and judicial processes, and management intends to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, management will incur additional costs to respond to requests for records and pursue the reversal of payment denials. As of June 30, 2020 and 2019, Luminis has recorded an

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

estimated reserve regarding the Medicare overpayments. In the opinion of the Luminis' management, the ultimate settlement of this matter will not have a material adverse effect on the consolidated financial position of Luminis.

During the year ended June 30, 2018, the System recorded a \$3,500,000 accrual related to an inquiry by the Department of Justice regarding a potential billing discrepancy. A final settlement was signed in June 2019 and the payment amount approximated the amount accrued at June 30, 2018. A corporate integrity agreement (CIA) was also signed in June 2019 with the Office of Inspector General of the Department of Health and Human Services. The CIA will be in place for five years and will require periodic reporting of various matters by an independent review organization and the System.

During the year ended June 30, 2020, DCMC recorded an accrual related to a billing error that it intends to self-report to the Department of Health and Human Services. DCMC expects to work with the Federal Government to come to a resolution on this matter. It is possible that other regulatory conditions may be part of the final resolution. Based on consultation with legal counsel, management believes the final resolution will not have a material adverse effect on the June 30, 2020 financial statements.

11. Functional Expenses

Members of Luminis provide general health care services to residents within their service area. Expenses related to providing these services are as follows:

	Health Care Services	General and Administrative	Total
Year ended June 30, 2020			
Salaries and wages	\$ 401,827,000	\$ 78,053,000	\$ 479,880,000
Employee benefits	63,580,000	12,350,000	75,930,000
Supplies	189,335,000	8,152,000	197,487,000
Purchases services	113,213,000	113,162,000	226,375,000
Depreciation and amortization	22,742,000	23,252,000	45,994,000
Interest	16,151,000	-	16,151,000
Total operating expenses	\$ 806,848,000	\$ 234,969,000	\$ 1,041,817,000

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Functional Expenses (continued)

	Health Care Services	General and Administrative	Total
Year ended June 30, 2019			
Salaries and wages	\$ 293,400,000	\$ 56,260,000	\$ 349,660,000
Employee benefits	45,157,000	11,199,000	56,356,000
Supplies	158,348,000	1,141,000	159,489,000
Purchases services	70,001,000	67,556,000	137,557,000
Depreciation and amortization	26,647,000	10,186,000	36,833,000
Interest	13,118,000	—	13,118,000
Transaction costs	—	3,279,000	3,279,000
Total operating expenses	<u>\$ 606,671,000</u>	<u>\$ 149,621,000</u>	<u>\$ 756,292,000</u>

12. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, patient receivables, prepaid expenses and other current assets, accounts payable, accrued salaries, wages and benefits, other accrued expenses, and advances from third-party payors approximate fair value, given the short-term nature of these financial instruments or their methods of valuation. The following methods and assumptions were used by Luminis in estimating the fair value of other financial instruments.

Investments and Assets Whose Use is Limited

Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Pledges Receivable

Luminis estimates that the carrying value of pledges receivable approximates fair value, given the discount rates applied.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Net Assets

Net assets with donor restrictions are restricted for use, as follows:

	June 30	
	2020	2019
Hospital capital additions	\$ 7,248,000	\$ 6,382,000
Hospital operating programs	<u>16,613,000</u>	<u>16,207,000</u>
	<u>\$ 23,861,000</u>	<u>\$ 22,589,000</u>

14. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date comprise the following as of June 30, 2020:

Assets

Current assets:

Cash and cash equivalent	\$ 178,795,000
Short-term investments	1,365,000
Current portion of assets whose use is limited	15,912,000
Patient receivables, net	118,882,000
Current portion of pledges receivable, net	945,000
Prepaid expenses and other current assets	19,857,000
Investments*	<u>338,985,000</u>
Total financial assets	<u>\$ 674,741,000</u>

*While these investments are long-term in nature, they are available for general expenditures within one year of the balance sheet date if necessary.

AAMC's bond covenant requires AAMC to maintain unrestricted cash and marketable securities on hand to meet 90 days of normal operating expenses. The AAMC obligated group was compliant with all financial covenants as of June 30, 2020 and 2019.

DCMC's bond covenant requires DCMC to maintain unrestricted cash and marketable securities on hand to meet 60 days of normal operating expenses. The DCMC obligated group was compliant with all financial covenants as of June 30, 2020.

Luminis Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Subsequent Events

Luminis has evaluated the impact of subsequent events through October 23, 2020, representing the date at which the accompanying consolidated financial statements were issued.

On July 20, 2020, Luminis received \$20,019,000 in provider relief funds authorized in the CARES Act from HHS. Luminis expects that these relief funds will be forgivable, but uncertainty exists as to the final outcome of the terms and conditions associated with the relief funds. Management will continue to monitor compliance with the terms and conditions of the Relief Fund and the impact of the pandemic on the System's revenues and expenses. If unable to attest to or comply with current or future terms and conditions, the System's ability to retain some or all of the distributions received may be impacted. Furthermore, the HSCRC is proposing to reduce Luminis' ability to recoup undercharges from its GBR reimbursement program in future years by an amount derived from these provider relief funds. The final outcome of the HSCRC's decisions on treatment of the undercharge resulting from the Global Budget Reimbursement Revenue program and application of CARES Act funding to GBR limits is still being evaluated.

On October 22, 2020, HHS released additional reporting requirements for health care entities that received distributions from the Provider Relief Fund. The Post-Payment Notice of Reporting Requirements (the Notice) supplements the previous notice issued on July 20, 2020, and amended on August 14, 2020 and September 19, 2020. The System considered the effects of the changes included in the Notice and concluded these changes represent non-recognized (i.e., Type II) subsequent events in accordance with ASC 855, *Subsequent Events*, since the reporting requirements included in the Notice provide evidence about conditions that did not exist at the balance sheet date, but instead are conditions that arose after that date but before financial statements were issued. Based on the expectations of the revenue to be recognized through December 31, 2020, the Company does not believe the new guidance will result in a material change to amounts recorded in the June 30, 2020, financial statements related to the Provider Relief Funds. The System will continue to monitor changes in reporting guidance or additional clarifications that may be issued by HHS, which would affect the accounting for distributions from the Provider Relief Fund. In addition, the System will continue to monitor guidance from the HSCRC related to how the HSCRC will interpret the new HHS guidance.

On October 1, 2020, a new law was signed that included modifications to the CMS Accelerated and Advance Payment Program. These modifications included an extension to the previous terms discussed within Note 2. The changes in payments terms are considered a non-recognized subsequent event in accordance with ASC 855.

Except for those events mentioned above, no events have occurred that require disclosure in or adjustments to the accompanying consolidated financial statements.

Supplementary Information

Luminis Health, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

June 30, 2020

	Luminis Health, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	AAHS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Doctors Community Medical Center and Subsidiaries	Eliminating Entries	Consolidated
Assets												
Current assets:												
Cash and cash equivalents	\$ (7,700,000)	\$ 80,540,000	\$ 423,000	\$ (19,000)	\$ 1,191,000	\$ 7,000	\$ 716,000	\$ 2,000	\$ 4,414,000	\$ 99,221,000	\$ -	\$ 178,795,000
Short-term investments	-	912,000	-	-	-	-	-	-	453,000	-	-	1,365,000
Current portion of assets whose use is limited	-	15,912,000	-	-	-	-	-	-	-	-	-	15,912,000
Patient receivables, net	-	69,769,000	2,448,000	-	-	677,000	10,519,000	-	-	35,469,000	-	118,882,000
Current portion of pledges receivable, net	-	-	-	-	-	-	-	-	945,000	-	-	945,000
Inventories	-	15,677,000	-	-	-	-	525,000	-	-	5,587,000	-	21,789,000
Prepaid expenses and other current assets	11,000	8,033,000	93,022,000	4,900,000	23,468,000	775,000	2,104,000	5,030,000	33,678,000	5,380,000	(156,544,000)	19,857,000
Total current assets	(7,689,000)	190,843,000	95,893,000	4,881,000	24,659,000	1,459,000	13,864,000	5,032,000	39,490,000	145,657,000	(156,544,000)	357,545,000
Property and equipment	123,000	772,018,000	28,349,000	3,732,000	138,279,000	77,000	27,376,000	-	2,013,000	124,878,000	-	1,096,845,000
Less accumulated depreciation and amortization	-	(418,394,000)	(26,372,000)	(1,905,000)	(66,552,000)	(77,000)	(14,741,000)	-	(146,000)	(10,166,000)	-	(538,353,000)
Net property and equipment	123,000	353,624,000	1,977,000	1,827,000	71,727,000	-	12,635,000	-	1,867,000	114,712,000	-	558,492,000
Other assets:												
Investments	-	317,410,000	-	-	-	-	-	-	1,552,000	20,023,000	-	338,985,000
Investments in joint ventures	-	-	-	254,000	7,575,000	-	-	-	-	6,195,000	-	14,024,000
Pledges receivable, net	-	-	-	-	-	-	-	-	3,192,000	-	-	3,192,000
Assets whose use is limited	-	-	-	-	-	-	-	-	15,482,000	-	-	15,482,000
Beneficial interest in net assets of AAMC Foundation, Inc.	-	-	-	-	-	-	-	-	-	-	(23,450,000)	-
Restricted collateral for interest rate swap contract	-	23,450,000	-	-	-	-	-	-	-	-	-	23,450,000
Right of use asset	-	110,002,000	-	-	-	-	-	-	-	-	-	110,002,000
Other assets	576,829,000	22,381,000	882,000	785,000	11,648,000	-	18,597,000	-	387,000	4,544,000	-	44,995,000
Total assets	\$ 569,263,000	\$ 1,051,987,000	\$ 98,752,000	\$ 7,747,000	\$ 116,947,000	\$ 1,459,000	\$ 46,488,000	\$ 5,032,000	\$ 61,970,000	\$ 320,451,000	\$ (738,230,000)	\$ 1,321,868,000

Luminis Health, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

June 30, 2020

	Luminis Health, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	AARHS Research Institute, Inc.	Physician Collaborative Care Network LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Doctors Community Medical Center and Subsidiaries	Eliminating Entries	Consolidated
Liabilities and net assets												
Current liabilities:												
Accounts payable	\$ 69,678,000	\$ 63,319,000	\$ 899,000	\$ 1,536,000	\$ 316,000	\$ 1,224,000	\$ 8,283,000	\$ 214,000	\$ 6,659,000	\$ 10,274,000	\$ (121,961,000)	\$ 40,441,000
Accrued salaries, wages, and benefits	12,901,000	19,112,000	312,000	1,056,000	—	149,000	5,177,000	—	77,000	14,654,000	—	53,438,000
Other accrued expenses	1,369,000	15,934,000	—	4,000	3,599,000	—	1,740,000	—	31,784,000	13,953,000	(35,970,000)	32,413,000
Current portion of long-term debt	—	7,498,000	—	—	4,033,000	—	—	—	—	4,979,000	—	16,440,000
Advances from third-party payors	—	120,479,000	—	—	661,000	—	7,977,000	—	—	51,905,000	—	182,697,000
Current portion of lease liability	—	2,862,000	—	450,000	1,283,000	—	2,850,000	—	—	1,184,000	—	8,753,000
Total current liabilities	83,948,000	229,134,000	1,335,000	3,046,000	9,892,000	1,373,000	26,027,000	1,889,000	38,520,000	96,949,000	(157,931,000)	334,182,000
Long-term debt, less current portion and unamortized original issue premium	—	290,254,000	—	—	57,288,000	—	—	—	—	122,766,000	—	470,308,000
Interest rate swap contract	—	117,037,000	—	—	—	—	—	—	—	—	—	117,037,000
Accrued pension liability	—	22,751,000	—	—	—	—	—	—	—	6,525,000	—	29,276,000
Lease liability, less current portion	—	5,759,000	767,000	335,000	10,511,000	—	15,982,000	—	—	4,075,000	—	37,429,000
Other long-term liabilities	—	32,444,000	—	—	—	—	167,000	—	—	14,421,000	—	47,032,000
Total liabilities	83,948,000	697,379,000	2,102,000	3,381,000	77,691,000	1,373,000	42,176,000	1,889,000	38,520,000	244,736,000	(157,931,000)	1,035,264,000
Net assets:												
Without donor restrictions	462,606,000	331,670,000	96,650,000	4,366,000	39,256,000	86,000	4,312,000	3,143,000	(608,000)	75,098,000	(553,987,000)	460,552,000
With donor restrictions	22,709,000	22,938,000	—	—	—	—	—	—	24,058,000	468,000	(46,312,000)	23,861,000
Non-controlling interest	—	—	—	—	—	—	—	—	—	2,191,000	—	2,191,000
Total net assets	485,315,000	354,608,000	96,650,000	4,366,000	39,256,000	86,000	4,312,000	3,143,000	23,450,000	75,717,000	(600,299,000)	486,604,000
Total liabilities and net assets	\$ 569,263,000	\$ 1,051,987,000	\$ 98,752,000	\$ 7,747,000	\$ 116,947,000	\$ 1,459,000	\$ 46,488,000	\$ 5,032,000	\$ 61,970,000	\$ 320,453,000	\$ (758,330,000)	\$ 1,521,868,000

Anne Arundel Medical Center, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

June 30, 2020

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Anne Arundel Mental Health Hospital, Inc.	Cottage Insurance Company Ltd.	Consolidating and Eliminating Entries	Consolidated
Assets						
Current assets:						
Cash and cash equivalents	\$ 80,459,000	\$ 19,000	\$ 62,000	\$ -	\$ -	\$ 80,540,000
Short-term investments	912,000	-	-	-	-	912,000
Current portion of assets whose use is limited	12,382,000	-	-	3,530,000	-	15,912,000
Patient receivables, net	68,164,000	210,000	1,395,000	-	-	69,769,000
Inventories	15,677,000	-	-	-	-	15,677,000
Due from affiliates, net	500,000	1,363,000	-	-	(1,514,000)	349,000
Prepaid expenses and other current assets	7,653,000	2,000	-	29,000	-	7,684,000
Total current assets	185,747,000	1,594,000	1,457,000	3,559,000	(1,514,000)	190,843,000
Property and equipment	735,814,000	9,057,000	27,147,000	-	-	772,018,000
Less accumulated depreciation and amortization	(413,435,000)	(4,744,000)	(215,000)	-	-	(418,394,000)
Net property and equipment	322,379,000	4,313,000	26,932,000	-	-	353,624,000
Other assets:						
Investments	317,410,000	-	-	-	-	317,410,000
Investments in joint ventures	-	-	-	-	-	-
Assets whose use is limited	7,000	-	-	25,531,000	-	25,538,000
Beneficial interest in net assets of Anne Arundel Medical Center Foundation, Inc.	23,450,000	-	-	-	-	23,450,000
Notes receivable from affiliate	1,559,000	-	-	-	-	1,559,000
Restricted collateral for interest rate swap contract	110,002,000	-	-	-	-	110,002,000
Right of use asset	8,539,000	-	-	-	-	8,539,000
Other assets	23,327,000	-	-	9,884,000	(12,189,000)	21,022,000
Total assets	\$ 992,420,000	\$ 5,907,000	\$ 28,389,000	\$ 38,974,000	\$ (13,703,000)	\$ 1,051,987,000

Anne Arundel Medical Center, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

June 30, 2020

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Anne Arundel Mental Health Hospital, Inc.	Cottage Insurance Company Ltd.	Consolidating and Eliminating Entries	Consolidated
Liabilities and net assets						
Current liabilities:						
Accounts payable	\$ 24,219,000	\$ 24,000	\$ 50,000	\$ 56,000	\$ -	\$ 24,349,000
Accrued salaries, wages, and benefits	18,831,000	167,000	114,000	-	-	19,112,000
Other accrued expenses	15,933,000	1,000	-	-	-	15,934,000
Current portion of long-term debt	7,428,000	-	-	-	-	7,428,000
Intercompany payables	12,280,000	-	28,225,000	-	(1,535,000)	38,970,000
Advances from third-party payors	120,479,000	-	-	-	-	120,479,000
Current portion of lease liability	2,862,000	-	-	-	-	2,862,000
Total current liabilities	202,032,000	192,000	28,389,000	56,000	(1,535,000)	229,134,000
Long-term debt, less current portion and unamortized original issue premium	290,254,000	-	-	-	-	290,254,000
Interest rate swap contract	117,037,000	-	-	-	-	117,037,000
Accrued pension liability	22,751,000	-	-	-	-	22,751,000
Lease liability, less current portion	5,759,000	-	-	-	-	5,759,000
Other long-term liabilities	-	-	-	32,444,000	-	32,444,000
Total liabilities	637,833,000	192,000	28,389,000	32,500,000	(1,535,000)	697,379,000
Net assets:						
Without donor restrictions	331,649,000	5,715,000	-	6,474,000	(12,168,000)	331,670,000
With donor restrictions	22,938,000	-	-	-	-	22,938,000
Total net assets	354,587,000	5,715,000	-	6,474,000	(12,168,000)	354,608,000
Total liabilities and net assets	\$ 992,420,000	\$ 5,907,000	\$ 28,389,000	\$ 38,974,000	\$ (13,703,000)	\$ 1,051,987,000

Anne Arundel Medical Center, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations

Year Ended June 30, 2020

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Anne Arundel Mental Health Hospital, Inc.	Cottage Insurance Company Ltd.	Consolidating and Eliminating Entries	Consolidated
Operating revenue:						
Net patient service revenue	\$ 557,943,000	\$ 4,810,000	\$ 1,456,000	\$ -	\$ -	\$ 564,209,000
Other operating revenue	36,221,000	489,000	839,000	8,121,000	(12,043,000)	33,627,000
Total operating revenue	594,164,000	5,299,000	2,295,000	8,121,000	(12,043,000)	597,836,000
Operating expenses:						
Salaries and wages	225,875,000	4,054,000	1,253,000	-	-	231,182,000
Employee benefits	41,222,000	583,000	301,000	-	-	42,106,000
Supplies	139,555,000	616,000	92,000	-	(234,000)	140,029,000
Purchased services	133,365,000	921,000	693,000	9,771,000	(8,296,000)	136,454,000
Foundation transfer to Anne Arundel Medical Center Foundation, Inc. and subsidiaries	-	-	-	-	(3,515,000)	(3,515,000)
Depreciation and amortization	28,378,000	329,000	212,000	-	-	28,919,000
Interest	10,136,000	-	-	-	-	10,136,000
Total operating expenses	578,531,000	6,503,000	2,551,000	9,771,000	(12,045,000)	585,311,000
Operating income (loss)	15,633,000	(1,204,000)	(256,000)	(1,650,000)	2,000	12,525,000
Other (loss) income:						
Investment loss, net	(12,645,000)	-	-	(348,000)	-	(12,993,000)
(Loss) income from joint venture and other, net	(3,657,000)	-	-	-	3,583,000	(74,000)
Pension credit	1,777,000	-	-	-	-	1,777,000
Change in unrealized losses on trading securities, net	(11,470,000)	-	-	(127,000)	-	(11,597,000)
Realized and unrealized losses on interest rate swap contracts, net	(43,149,000)	-	-	-	-	(43,149,000)
Total other (loss) income, net	(69,144,000)	-	-	(475,000)	3,583,000	(66,036,000)
(Deficit) excess of revenue over expenses	\$ (53,511,000)	\$ (1,204,000)	\$ (256,000)	\$ (2,125,000)	\$ 3,585,000	\$ (53,511,000)

Luminis Health, Inc. and Subsidiaries

Supplementary Description of Consolidating and Eliminating Entries

June 30, 2020

1. To eliminate intercompany payables and receivables
2. To eliminate investments in subsidiaries and related net asset accounts
3. To eliminate intercompany income and expense generated from management fees, staffing contracts, captive insurance premiums, and operating leases
4. To eliminate intercompany notes
5. To eliminate income of wholly owned subsidiaries
6. To eliminate intercompany revenue and expense for interest and other miscellaneous transactions
7. To eliminate the AAMC's beneficial interest in the Foundation

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Doctors Community Medical Center and Subsidiaries

**Consolidated Financial Statements and
Other Financial Information**

Years Ended June 30, 2020 and 2019

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Independent Auditors' Report

The Board of Directors
Doctors Community Medical Center and Subsidiaries
Lanham, Maryland

We have audited the accompanying consolidated financial statements of Doctors Community Medical Center and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of June 30, 2020 and 2019, and the related consolidated statements of operations and other changes in net assets without donor restrictions, 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.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Doctors Community Medical Center and Subsidiaries as of June 30, 2020 and 2019, and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Change in Accounting Principles

As discussed in Note 1 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2018-02, Leases (Topic 842) in 2020. Our opinion is not modified with respect to this matter.

Emphasis of Matter

As explained in Notes 1 and 18 to the consolidated financial statements, the Company executed an affiliation agreement and became a controlled affiliate of Anne Arundel Health System effective July 1, 2019. Beginning net assets on July 1, 2019 have been adjusted in connection with this transaction and change in control. Our opinion is not modified with respect to this matter.

Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The consolidating information presented in the supplemental schedules is presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual organizations, and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management, 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.

Dixon Hughes Goodman LLP

**Tysons, Virginia
October 23, 2020**

Doctors Community Medical Center and Subsidiaries
Consolidated Balance Sheets

	June 30	
	2020 Successor	2019 Predecessor
Assets		
Current assets:		
Cash and cash equivalents	\$ 99,221,421	\$ 34,168,164
Patient receivables, net	35,468,849	38,839,947
Inventories	5,587,114	4,243,356
Prepaid expenses and other current assets	5,379,423	9,600,901
Total current assets	<u>145,656,807</u>	<u>86,852,368</u>
Property and equipment	124,878,074	259,442,817
Less accumulated depreciation and amortization	<u>(10,165,956)</u>	<u>(157,091,894)</u>
Net property and equipment	<u>114,712,118</u>	<u>102,350,923</u>
Other assets:		
Investments	20,023,040	18,257,784
Lease right-of-use asset	4,543,771	-
Investments in joint ventures	6,195,831	5,019,926
Goodwill	-	3,070,898
Other assets	29,322,305	26,092,855
Total assets	<u>\$ 320,453,872</u>	<u>\$ 241,644,754</u>

Doctors Community Medical Center and Subsidiaries
Consolidated Balance Sheets (continued)

	June 30	
	2020 Successor	2019 Predecessor
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 10,273,880	\$ 13,146,010
Accrued salaries, wages, and benefits	14,653,755	16,046,116
Other accrued expenses	13,952,583	2,682,475
Advances from third-party payors	51,905,567	7,765,308
Current portion of lease liabilities	1,183,557	-
Current portion of long-term debt	4,978,798	4,448,457
Total current liabilities	<u>96,948,140</u>	<u>44,088,366</u>
Long-term debt, less current portion and unamortized original issue premium	122,765,997	122,394,065
Lease liabilities	4,074,861	-
Accrued pension liability	6,525,431	5,001,393
Other long-term liabilities	14,421,786	16,005,694
Total liabilities	<u>244,736,215</u>	<u>187,489,518</u>
Net assets:		
Without donor restrictions	73,058,778	51,403,040
Noncontrolling interest	2,191,257	2,265,386
With donor restrictions	467,622	486,810
Total net assets	<u>75,717,657</u>	<u>54,155,236</u>
Total liabilities and net assets	<u>\$ 320,453,872</u>	<u>\$ 241,644,754</u>

See the accompanying notes to the consolidated financial statements.

Doctors Community Medical Center and Subsidiaries
Consolidated Statements of Operations

	Year Ended June 30	
	2020 Successor	2019 Predecessor
Operating revenue:		
Net patient service revenue	\$ 239,122,825	\$ 243,509,189
Other operating revenue	21,884,197	6,466,016
Total operating revenue	<u>261,007,022</u>	<u>249,975,205</u>
Operating expenses:		
Salaries and wages	108,828,804	105,670,968
Employee benefits	17,005,912	17,058,725
Purchased services	80,683,895	69,729,474
Supplies	35,088,434	34,293,627
Depreciation and amortization	10,413,150	9,222,787
Interest	4,317,819	4,766,952
Total operating expenses	<u>256,338,014</u>	<u>240,742,533</u>
Operating income	<u>4,669,008</u>	<u>9,232,672</u>
Other (loss) income:		
Investment income, net	461,214	158,553
Gain from joint ventures and other, net	253,366	311,435
Loss on sale of property	—	(11,247)
Change in unrealized gains (losses) on trading securities, net	(262,337)	145,630
Pension expense	(660,906)	(1,533,516)
Total other loss, net	<u>(208,663)</u>	<u>(929,145)</u>
Excess of revenue over expenses	<u>\$ 4,460,345</u>	<u>\$ 8,303,527</u>

See the accompanying notes to the consolidated financial statements.

Doctors Community Medical Center and Subsidiaries
Consolidated Statements of Changes in Net Assets

Predecessor

	Without Donor Restrictions	With Donor Restrictions	Total
Net assets, June 30, 2018	\$ 44,983,697	\$ 838,920	\$ 45,822,617
Excess of revenues over expenses	8,303,527	-	8,303,527
Pension liability adjustment	42,563	-	42,563
Released from restrictions used for purchase of property and equipment	338,639	-	338,639
Restricted gifts, bequests, and contributions	-	980,092	980,092
Net assets released from restrictions	-	(1,332,202)	(1,332,202)
Changes in net assets	8,684,729	(352,110)	8,332,619
Net assets, June 30, 2019	53,668,426	486,810	54,155,236

Successor

Net assets, July 1, 2019	63,980,460	486,810	64,467,270
Excess of revenues over expenses	4,460,345	-	4,460,345
Pension liability adjustment	(1,527,044)	-	(1,527,044)
Released from restrictions used for purchase of property and equipment	35,476	-	35,476
Transfers and other, net	8,300,798	-	8,300,798
Restricted gifts, bequests, and contributions	-	533,153	533,153
Net assets released from restrictions	-	(552,341)	(552,341)
Changes in net assets	11,269,575	(19,188)	11,250,387
Net assets, June 30, 2020	\$ 75,250,035	\$ 467,622	\$ 75,717,657

See the accompanying notes to the consolidated financial statements.

Doctors Community Medical Center and Subsidiaries
Consolidated Statements of Cash Flows

	Year Ended June 30	
	2020 Successor	2019 Predecessor
OPERATING ACTIVITIES AND OTHER GAINS		
Increase in net assets	\$ 11,250,387	\$ 8,332,619
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities:		
Unrealized (gain) loss on investments	262,337	(145,630)
Pension liability adjustment	1,527,044	841,835
Equity in earnings of joint ventures and other	(408,621)	(311,435)
Distributions received from joint ventures	155,255	689,605
Restricted contributions received	(533,153)	(980,090)
Depreciation and amortization	10,413,150	8,979,516
Amortization on bond issue cost	59,621	186,921
Net sales of trading investments	(2,027,593)	(304,469)
Loss (gain) on sale of property	(3,000)	11,247
Transfer from parent	(8,300,798)	-
Net change in operating assets and liabilities	57,292,977	(8,871,224)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES AND OTHER GAINS	69,687,606	8,428,895
INVESTING ACTIVITIES		
Proceeds from sale on property	3,000	70,000
Purchase of property, plant and equipment	(8,585,345)	(4,338,290)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	(8,582,345)	(4,268,290)
FINANCING ACTIVITIES		
Principal payments on debt	\$ (4,885,955)	\$ (5,028,160)
Transfers from parent	8,300,798	-
Restricted contributions received	533,153	980,090
NET CASH AND CASH EQUIVALENTS PROVIDED BY (USED IN) FINANCING ACTIVITIES	3,947,996	(4,048,070)
NET INCREASE IN CASH AND CASH EQUIVALENTS	65,053,257	112,535
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	34,168,164	34,055,629
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 99,221,421	\$ 34,168,164

See the accompanying notes to the consolidated financial statements.

Doctors Community Medical Center and Subsidiaries
Consolidated Statements of Cash Flows

	Year Ended June 30	
	2020 Successor	2019 Predecessor
Changes in operating assets and liabilities		
(Decrease) increase in operating assets:		
Net patient accounts receivable	\$ 3,371,098	\$ (6,079,831)
Inventories	(1,343,758)	(356,148)
Prepaid expenses and other current assets	4,221,478	211,314
Other assets	1,485,197	(1,702,891)
	<u>7,734,015</u>	<u>(7,927,556)</u>
Increase (decrease) in operating liabilities:		
Accounts payable	(2,872,130)	(629,540)
Accrued salaries, wages and benefits	(1,392,361)	(122,887)
Accrued expenses	11,270,108	35,569
(Advances from) refunds to third party payers	44,140,259	(210,591)
Other liabilities	(1,586,914)	(16,219)
	<u>49,558,962</u>	<u>(943,668)</u>
	<u>\$ 57,292,977</u>	<u>\$ (8,871,224)</u>

See the accompanying notes to the consolidated financial statements.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Organization

Doctors' Hospital, Inc. (d/b/a Doctors Community Medical Center and Subsidiaries), (the Company) is a not-for-profit, non-stock corporation that operates an acute care general hospital facility licensed for 190 beds. The Company serves the health care needs of the residents of Prince George's County, the District of Columbia, and the greater Washington, D.C. metropolitan area. The Company has four wholly owned/controlled subsidiaries: Doctors Community Healthcare Programs (CHP), Doctors Community Hospital Foundation, Inc. (the Foundation), Doctors Community Health Ventures, Inc. (Health Ventures), and Doctors Community Sleep Center, LLC (the Sleep Center).

Doctors Community Healthcare Programs (CHP) consists of three wholly owned/controlled entities: Doctors Community Hospital Clinics (CLINICS), Doctors Community Practices, LLC (DCP), Capital Orthopedics Specialists, LLC (COS) and Care Transitional Organization (CTO). CLINICS is a limited liability company formed in Maryland for the purpose of providing outpatient medical care for the residents of Prince Georges County and surrounding areas. CLINICS includes a transitional outpatient program and mobile van that provides services throughout the Prince George's County. DCP is a limited liability company formed in Maryland for the purpose of providing medical primary care services for the residents of Prince Georges County and surrounding areas. COS is a limited liability company formed in Maryland for the purpose of providing surgical services for the residents of Prince Georges County and surrounding areas. CTO is a limited liability company formed in Maryland for the purpose of participating in certain Centers for Medicare and Medicaid (CMS) programs for primary care providers serving the residents of Prince Georges County and surrounding areas.

The Foundation was incorporated in Maryland in 1990 as a not-for-profit, non-stock corporation established to raise and invest funds to support or benefit the operations of the Company. The Foundation's bylaws provide that all funds raised, except those required for the operation of the Foundation, be distributed to or be held for the benefit of the Company. Under the Foundation's bylaws, a majority of its directors must be directors of the Company, appointed by its President. The Foundation's bylaws also provide the Company with the authority to direct its activities, management, and policies.

Health Ventures is incorporated under the laws of Maryland as a for-profit, stock corporation. The Company owns 100% of its stock. Health Ventures invests in for-profit businesses consistent with the mission and strategic plan of the Company. Health Ventures consolidates three LLCs: Metropolitan Medical Specialist, LLC (MMS), Doctors Community Management Services, LLC (MSO), and Doctors Community Ambulatory Surgical Center, LLC (ASC). Health Ventures also has investments in two other companies: Magnolia Gardens LLC (Magnolia Gardens) and Diagnostic Imaging Center, LLC (DI).

The Sleep Center is a limited liability company formed in Maryland for the purpose of providing diagnostic sleep services for residents of Prince Georges County and surrounding areas. The Sleep Center operates a 10-bed sleep lab located on the Company's campus and provides outpatient sleep studies.

The Company owns a 60% interest in Doctors Regional Cancer Center, LLC (DRCC). DRCC is a limited liability company formed in June 2007 by Maryland Regional Cancer Care, LLC (MRCC) for the purpose of providing outpatient cancer treatment services to the residents of central Maryland. The Company owns 100% of Spine Team Maryland (STM), for the purpose of providing medical primary care services for the residents of Prince Georges County and surrounding areas. STM ceased operations in fiscal year 2016. The Company owns a 61% interest in the Southern Maryland Integrated Healthcare, LLC (ACO). The ACO, which notified CMS that it ended participating in the program effective December 31, 2018, was a limited liability company formed in Maryland for the purpose of participating in a Medicare Shared Savings Program (MSSP) among primary care providers serving the residents of Prince Georges County and surrounding areas.

Doctors Community Medical Center and Subsidiaries

Notes to the Consolidated Financial Statements

Basis of presentation and periods presented

On July 1, 2019, the Company completed a transaction that resulted in the Company becoming a wholly-controlled subsidiary of Anne Arundel Health System (the "Acquisition"). Anne Arundel Health System then changed its name to Luminis Health ("Luminis"). The Acquisition resulted in a change of control and a new basis of accounting as of the opening of business on July 1, 2019 (see Note 18).

The Acquisition was recorded in accordance with ASC 805: *Business Combinations* and the fair values of the net assets acquired were pushed down from Luminis to the Company, which resulted in a new basis for the assets and liabilities of the Company. Under pushdown accounting, the acquiree uses the basis of the acquirer in the preparation of the acquiree's separate financial statements. Accordingly, the Company revised balance sheet amounts to estimated fair values as of July 1, 2019.

The consolidated balance sheet as of June 30, 2020, and the consolidated statements of operations, changes in net assets, and cash flows for the year then ended (the "Successor Period"), reflect the effects of the acquisition method of accounting. Financial statement amounts prior to July 1, 2019, and the results of operations and cash flows for the year ended June 30, 2019 (the "Predecessor Period"), reflect operations prior to the Acquisition.

Principles of consolidation

The consolidated financial statements include the accounts of the Company, CHP, the Foundation, Health Ventures, the Sleep Center, DRCC and ACO (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements include non-controlling interest held by third parties in less than wholly owned subsidiaries.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, amounts on deposit in banks, and highly liquid debt instruments with an original maturity of 90 days or less when purchased, excluding amounts whose use is limited. The Company has cash holdings in commercial banks routinely exceeding the Federal Deposit Insurance Corporation maximum insurance limit of \$250,000. Cash and cash equivalents are reported at cost which approximates market value.

Investments

Marketable securities consist of investments in equity and debt securities and are carried at fair value. All such investments are classified as trading.

Unrestricted investment income, including realized gains and losses on the sale of trading securities, is reported as other operating revenue. The cost of securities sold is based on the specific-identification method. Unrealized gains and losses on trading securities are included in non-operating gains (losses) in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions.

Inventories

Inventories consist of supplies and drugs and are carried at the lower of cost or market using the average-cost method.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

Land, buildings, and equipment

Land, buildings, and equipment are recorded at cost. Depreciation is recorded over the estimated useful lives of the assets using the straight-line method. Maintenance and repairs are charged to expense as incurred. The straight-line method is used to amortize the cost of equipment under financing leases over the estimated useful lives of the equipment or the term of the lease, whichever is appropriate.

Net assets with donor restrictions

Net assets with donor restrictions are those whose use by the Company and the Foundation have been limited by donors to a specific time period or purpose. Net assets with donor restrictions are available to fund various health care services and other community benefits provided by the Company. The Company's policy is to treat restricted contributions recorded and released in the same fiscal year as contributions without donor restrictions.

Excess of revenue over expenses (expenses over revenue)

The consolidated statements of operations and other changes in net assets without donor restrictions include the excess of revenue over expenses (expenses over revenue) (the "performance indicator"). Changes in net assets without donor restrictions, which are excluded from the excess of revenue over expenses (expenses over revenue), consistent with industry practice, include contributions received and used for additions of long-lived assets, distributions to non-controlling interest-holders, and changes in the pension obligation other than net periodic pension cost.

Net patient service revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered. The Company charges are based on rates established by the State of Maryland Health Services Cost Review Commission (the Commission); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (see Note 11). CHP and the Sleep Center are paid for services based on either negotiated contracts with commercial payers, fee schedules with Medicare and Medicaid or standardized pricing for self-pay patients.

Explicit price concessions represent the difference between amounts billed as patient service revenue and amounts allowed by third-party payers, and are accrued in the period in which the related services are rendered.

Based on historical experience, a significant portion of the Company's uninsured patients will be unable or unwilling to pay for services provided. Thus, the Company estimates an implicit price concession related to uninsured patients in the period the services are provided based upon management's assessment of historical and expected net collections. This estimate considers business and general economic conditions, trends in healthcare coverage and other collection indicators. Throughout the year, management assesses the adequacy of these implicit price concessions based upon its review of patient accounts receivable and collections to date. Other factors, such as account aging and payment cycles, are considered when estimating implicit price concessions. The Company follows established guidelines for placing its self-pay patient accounts with an outside collection agency. After collection efforts are exhausted, the uncollected balances are returned to the Company for final write-off.

Charity care

A patient is classified as a charity recipient by reference to certain established policies of the Company. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Company utilizes the generally recognized poverty income levels in the local community, but also includes certain cases where incurred charges are significant when compared to income.

Under current accounting standards, the Company is required to report the cost of providing charity care. The cost of charity care provided by the Company totaled \$9,528,010 and \$8,425,301 for the years ended June 30, 2020 and 2019, respectively. Rates charged by the Company for regulated services are determined based on assessment of direct and indirect cost calculated pursuant to the methodology established by the Commission (see Note 1), and therefore the cost of charity services noted above for the Company are equivalent to its established

Doctors Community Medical Center and Subsidiaries

Notes to the Consolidated Financial Statements

rates for those services. For any charity services rendered by the Company other than from the Company, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates. These charges are excluded from consolidated net patient service revenue.

The Company receives a payment from the Commission with respect to an Uncompensated Care Fund ("UCC") established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals. The Company received \$4,296,773 for 2020 and \$2,299,712 for 2019 in UCC payments. All hospitals contribute to the Health Care Coverage Fund ("HCCF") that supports the expansion of Medicaid eligibility and the Medicaid program. The Company contributed \$2,846,231 for 2020 and \$2,695,536 for 2019 to the HCCF.

Contributions and pledges

Unconditional promises to give cash and other assets to the Company and the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or when the conditions for receiving the donation have been satisfied. The gifts are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. Contributions restricted by donors for additions to the Company's operating property are transferred from net assets with donor restrictions to net assets without donor restrictions when the expenditure is made. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and statements of changes in net assets as net assets released from restriction.

The Company and Foundation write off any grants and pledges receivable that are considered uncollectible; accordingly, there is no allowance for doubtful accounts recorded for these grants and pledges. Grants and pledges receivable have not been discounted because management considers the effect to be immaterial. The balance of pledges receivable was \$191,332 and \$201,332 at June 30, 2020 and 2019, respectively, and is included in other amounts receivable in the accompanying consolidated balance sheets.

Other operating revenue

Other operating revenue is composed of contribution revenue, net assets released from restrictions for operating purposes and the CARES Act funding recognized.

Advertising costs

The Company expenses advertising costs as they are incurred. Advertising expense was \$1,444,374 and \$1,850,449 for the fiscal years June 30, 2020 and 2019, respectively, and is reported as other expense in the accompanying consolidated statements of operations.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

Functional expenses

The Company's consolidated operating expenses by functional classification for the years ended June 30, 2020 and 2019 are as follows:

	2020			
	Health care services	General and administrative	Fundraising	Total
Salaries and benefits	\$ 78,056,920	\$ 30,355,469	\$ 416,415	\$ 108,828,804
Employee benefits	12,244,257	4,761,655	-	17,005,912
Purchased services	58,808,056	21,547,578	328,261	80,683,895
Medical supplies	25,255,286	9,821,500	11,648	35,088,434
Depreciation and amortization	7,497,468	2,915,682	-	10,413,150
Interest	3,108,830	1,208,989	-	4,317,819
Total Operating Expenses	\$ 184,970,817	\$ 70,610,873	\$ 756,324	\$ 256,338,014

	2019			
	Health care services	General and administrative	Fundraising	Total
Salaries and benefits	\$ 75,769,916	\$ 29,466,079	\$ 434,973	\$ 105,670,968
Employee benefits	12,282,282	4,776,443	-	17,058,725
Purchased services	50,131,040	19,495,405	103,029	69,729,474
Medical supplies	24,685,767	9,600,021	7,839	34,293,627
Depreciation and amortization	6,640,407	2,582,380	-	9,222,787
Interest	3,432,205	1,334,747	-	4,766,952
Total Operating Expenses	\$ 172,941,617	\$ 67,255,075	\$ 545,841	\$ 240,742,533

Fair value of financial instruments

The following methods and assumptions were used by the Company to estimate the fair value of financial instruments:

- **Cash and cash equivalents, patient accounts receivable, other amounts receivable, notes receivable, and advances from third-party payers:** The carrying amount reported in the balance sheets for each of these assets and liabilities approximates their fair value.
- **Marketable securities:** Fair values are based on quoted market prices of individual securities or investments if available, or are estimated using quoted market prices for similar securities (see Note 2)
- **Long-term debt:** Fair values of the Company's fixed-rate debt are based on current traded values.

Doctors Community Medical Center and Subsidiaries

Notes to the Consolidated Financial Statements

Income taxes

The Company and the Foundation are exempt from federal income tax under section 501(c) (3) of the Internal Revenue Code as public charities. Both entities are entitled to rely on this determination as long as there are no substantial changes in their character, purposes, or methods of operation. Management has concluded that there have been no such changes, and therefore the status of the Company and Foundation as public charities exempt from federal income taxation remain in effect.

The state in which the Company and the Foundation operate also provides a general exemption from state income taxation for organizations that are exempt from federal income taxation. However, both entities are subject to federal and state income taxation at corporate tax rates on unrelated business income. Exemption from other state and local taxes, such as real and personal property taxes is separately determined. The Company and the Foundation had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which unrelated business income was recognized, a tax return was filed in order to report any unrelated business income as well as any taxes due.

DRCC and ACO are Maryland limited liability companies that have not elected to be taxed as corporations under current Treasury regulations. Both are owned by more than one member. DRCC and ACO are subject to the partnership tax rules under Subchapter K of the Internal Revenue Code of 1986 (IRC), as amended. Under these rules neither is subject to federal or state income tax, but must file annual information returns indicating their gross and taxable income to determine the tax results to their members.

The Sleep Center and CHP are Maryland limited liability companies that have not elected to be taxed as corporations under current treasury regulations. Sleep Center and CHP are wholly owned by the Company. As such, the Sleep Center and CHP are considered "disregarded entities" under current IRC regulations.

Goodwill

Goodwill represented the excess of cost over the fair value of assets acquired. Management evaluated goodwill for impairment on an annual basis. Due to the Acquisition on July 1, 2019, the goodwill was written off (see Note 13 and 18).

Other assets

Included in other assets is a certificate of need (see Note 18) with a balance of \$4 million. Management evaluates the carrying value reported for the certificate of need for impairment on an annual basis. As of June 30, 2020, there was no known impairment.

Reclassifications

To allow for improved transparency in the nature of revenue and expenses, in 2020 the Company moved several accounts in the revenue and expense categories to align with the line items of Luminis, the new Parent company. These reclassifications did not have any effect on the Company's total revenues or expenses, or consolidated excess of revenues over expenses for the year ended June 30, 2019.

Subsequent events

Subsequent events have been evaluated by management through October 23, 2020, which is the date the consolidated financial statements were available to be issued.

New accounting standard

On July 1, 2019, the Company adopted the requirements of Accounting Standards Update ("ASU") 2016-02, *Leases* (Topic 842). The objective of this ASU, along with several related ASUs issued subsequently, is to increase transparency and comparability between organizations that enter into lease agreements. For lessees, the key difference of the new standard from the previous guidance (Topic 840) is the recognition of a right-of-use (ROU) asset and lease liability on the balance sheet. The most significant change is the requirement to recognize ROU

Doctors Community Medical Center and Subsidiaries

Notes to the Consolidated Financial Statements

assets and lease liabilities for leases classified as operating leases. The accounting for finance leases remained substantially unchanged with the adoption of Topic 842. The standard requires disclosures to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

As part of the transition to the new standard, the Company was required to measure and recognize leases that existed at July 1, 2019 using a modified retrospective approach. For leases existing at the effective date, the Company elected the package of three transition practical expedients and therefore did not reassess whether an arrangement is or contains a lease, did not reassess lease classification, and did not reassess what qualifies as an initial direct cost. The adoption of Topic 842 resulted in the recognition of an operating right of use asset and corresponding lease liability of \$5,934,485 as of July 1, 2019.

2. Patient Revenue and Accounts Receivable

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

Performance obligations are determined based on the nature of the services provided by the Company. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Company believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligations. Generally, performance obligations satisfied over time relate to patients in the Company. The Company measures the performance obligation from admission to the facility to the point when the facility is no longer required to provide services to that patient, which is generally the time of discharge. Revenue for performance obligations satisfied at a point in time generally relate to patients receiving outpatient services or patients and customers in a retail setting and the Company does not believe it is required to provide additional goods or services.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Company has elected to apply the optional exemption provided in current applicable accounting standards and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. Any unsatisfied or partially unsatisfied performance obligations are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

As discussed in Note 11, the Company charges are based on rates established by the Commission, which are subsequently reduced by contractual discounts provided to third-party payers and discounts provided to uninsured patients (i.e., explicit price concessions) in accordance with the Company policy, as well as any applicable implicit price concessions that are estimated by management based on a number of factors including historical collection experience. For non-Hospital services provided by the Company, management generally determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concession in the form of contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with internal policy, and implicit price concessions provided to uninsured patients. The Company determines its estimate of implicit price concessions based on historical collection experience with each class of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. Management believes that the financial effects of using this practical expedient are not materially different from an individual contract approach.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

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

Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. The Company also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Company estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any discounts and price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

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

Net patient service revenue from third-party payers and others (including uninsured patients) for the years ended June 30, 2020 and 2019 are summarized in the following tables:

	2020		2019			
Medicare	\$	123,170,170	52%	\$	118,346,517	49%
Medicaid		16,145,516	7%		31,514,613	13%
Blue Cross Blue Shield		60,318,653	25%		55,852,375	23%
Other third-party payers		32,049,830	13%		32,975,064	13%
Self-pay patients		7,438,656	3%		4,820,620	2%
	\$	239,122,825		\$	243,509,189	

Revenue from deductibles and coinsurance are included in the categories presented above based on the primary payer.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The following table sets forth the detail of net patient service revenue:

	June 30	
	2020	2019
Gross patient service revenue	\$ 320,380,529	\$ 324,576,951
Price concessions:		
Charity care	9,528,010	8,425,301
Contractual and other allowances	71,729,694	72,642,461
Net patient service revenue	<u>\$ 239,122,825</u>	<u>\$ 243,509,189</u>

Patient accounts receivable were comprised of the following for the years ended June 30:

	2020	2019
Medicare	28%	24%
Medicaid	21%	27%
Blue Cross Blue Shield	10%	12%
Other third-party payers	29%	23%
Self-pay patients	12%	14%
	<u>100%</u>	<u>100%</u>

3. Investments

The following is a summary of investment securities held by the Company as of June 30:

	2020	2019
Marketable securities:		
Cash and cash equivalents		
Money market and CD funds	\$ 13,039,485	\$ 2,204,303
Equity		
Stock and mutual funds	6,983,555	16,053,481
	<u>\$ 20,023,040</u>	<u>\$ 18,257,784</u>

Investment return is summarized as follows for the years ended June 30:

	2020	2019
Interest and dividend income	\$ 508,405	\$ 406,889
Net realized loss	-	(214,952)
Net unrealized gain (loss)	(262,337)	145,630
Investment fees	(47,191)	(33,385)
	<u>\$ 198,877</u>	<u>\$ 304,183</u>

Doctors Community Medical Center and Subsidiaries Notes to the Consolidated Financial Statements

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 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. The three levels of inputs that may be used to measure fair value are as follows:

- Level 1:** Quoted prices in active markets for identical assets or liabilities.
- Level 2:** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3:** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following discussion describes the valuation methodologies used for the Company's financial assets and liabilities 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 the Company's business, its value, or financial position based on the fair value information of financial assets and liabilities presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset or liability, 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 or liability. 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 or liability. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's investments in mutual funds classified at Level 1 are based on quoted market prices. Fair values for the Company's fixed income securities (corporate debt and federal government obligations) are based on prices provided by its investment managers and its custodian bank. The investment managers and the custodian bank 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.

The Company's federal government obligations and government backed securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2020:

	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	\$ -	\$ 13,039,487	\$ -	\$ 13,039,487
Trading securities and other assets whose use is limited:				
Equity funds	8,151,817	-	-	\$ 8,151,817
Fixed income funds	-	3,031,760	-	3,031,760
Total assets	\$ 8,151,817	\$ 16,071,247	\$ -	\$ 24,223,064
Plus deposits in transit				-
Less investments included in other assets				4,200,024
Total investments per consolidated balance sheet				<u>\$ 20,023,040</u>

The above table includes financial instruments of \$4,200,024 included in other assets on the consolidated balance sheets for deferred compensation and other arrangements.

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2019:

	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Cash and cash equivalents	\$ -	\$ 2,204,303	\$ -	\$ 2,204,303
Trading securities and other assets whose use is limited:				
Equity funds	8,889,254	-	-	8,889,254
Fixed income funds	-	11,747,496	-	11,747,496
Total assets	\$ 8,889,254	\$ 13,951,799	\$ -	\$ 22,841,053
Plus deposits in transit				38,327
Less investments included in other assets				4,621,596
Total investments per consolidated balance sheet				<u>\$ 18,257,784</u>

The total investment of \$22,879,380 includes deposits in transit of \$38,327 plus financial instruments of \$22,841,053. The above table includes financial instruments of \$4,621,596 included in other assets on the consolidated balance sheets for deferred compensation and other arrangements

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2020 and 2019.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

4. Joint Ventures and Equity Investments

Health Ventures and ASC invest in businesses consistent with the mission and strategic plan of the Company. Unconsolidated investments are carried at cost or at equity depending on the percentage of ownership and control. Investment in Magnolia Gardens LLC represents a 51% interest and is not consolidated with the financial statements of the Company because Health Ventures and ASC do not control the investees. The investment income of these joint ventures and equity investments is reported in other (loss) income in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions.

These investments, which are reported as noncurrent assets in the accompanying consolidated financial statements, are summarized as follows as of June 30:

Name	2020	2019
Magnolia Gardens LLC	\$ 5,387,968	\$ 5,210,175
University Center for Ambulatory Surgery	-	(922,539)
Diagnostic Imaging, LLC	<u>807,863</u>	<u>732,290</u>
	<u>\$ 6,195,831</u>	<u>\$ 5,019,926</u>

5. Related Party Transactions

The Company has income guarantee agreements with certain physicians. These advances are held as promissory notes and are often forgiven based on the established terms of these notes, such as maintaining an active practice in the Company's community.

The Company advanced funds to Health Ventures in its establishment of MMS. Since MMS is wholly owned by Health Ventures, the amounts loaned to MMS have been eliminated in consolidation.

The Medical Director of Radiology for the Company is an investor in DI, which is an unconsolidated subsidiary of Health Ventures. The Medical Director of DCP, who is also a Foundation board member, leases property to the Company and CHP.

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Notes to the Consolidated Financial Statements

6. Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows:

Name	Useful Life	June 30	
		2020	2019
Land improvements	2-40 Years	\$ 743,583	\$ 4,525,777
Buildings	4-40 Years	66,378,759	137,331,411
Leasehold improvements	4-40 Years	4,087,700	6,090,018
Furniture and equipment	2-20 Years	43,609,709	104,436,820
Equipment under finance lease obligations	2-20 Years	190,000	190,000
		115,009,751	252,574,026
Less accumulated depreciation		(10,165,956)	(157,091,894)
		104,843,795	95,482,132
Construction in progress		1,946,447	730,289
Land		7,921,876	6,138,502
		<u>\$ 114,712,118</u>	<u>\$ 102,350,923</u>

Doctors Community Medical Center and Subsidiaries
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7. Long-Term Debt

Long-term indebtedness as of June 30 consisted of the following:

	2020	2019
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2017B Bond 2.180% term bonds due October 1, 2024	\$ 24,165,000	\$ 28,570,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2016 Bond Series 2016A Tax Exempt Private Placement 2007 Refunding 2.567% term bonds due July 1, 2030	16,795,000	16,795,000
Series 2016A Tax Exempt Private Placement 2010 Partial Refunding 2.567% term bonds due July 1, 2030	15,150,000	15,150,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2017A: 5.00% term bonds due July 1, 2031	6,720,000	6,720,000
5.00% term bonds due July 1, 2032	7,055,000	7,055,000
5.00% term bonds due July 1, 2033	7,410,000	7,410,000
5.00% term bonds due July 1, 2034	7,780,000	7,780,000
5.00% term bonds due July 1, 2038	35,200,000	35,200,000
Finance leases	33,798	77,255
	<u>\$ 120,308,798</u>	<u>\$ 124,757,255</u>
Current portion of long-term debt	(4,978,798)	(4,448,457)
Financing costs, net of accumulated amortization	(1,340,361)	(1,514,133)
Premium, net of accumulated amortization	8,776,358	3,599,400
	<u>\$ 122,765,997</u>	<u>\$ 122,394,065</u>

The fair value of the Company's Series 2018A bonds, based on quoted market prices, was \$72,024,163 and \$72,482,555 for fiscal year 2020 and 2019, respectively. Remaining bonds are private placement bonds. Fair value of the private placement bonds approximate carrying value.

Financing costs incurred in issuing the Maryland Health and Higher Education Facilities Authority (MHHEFA) Revenue Bonds have been capitalized by the Company. These costs are being amortized over the life of the related bond issue using the bonds-outstanding method, which approximates the interest method. Deferred financing costs are presented as a direct deduction of long-term debt and are amortized using the straight-line method over the term of the related financing.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The aggregate maturities of long-term debt, including sinking fund principal requirements during the next five fiscal years, are as follows:

2021	\$	4,978,798
2022		5,070,000
2023		5,195,000
2024		5,265,000
2025		5,965,000
2026 and after		93,835,000
	\$	<u>120,308,798</u>

Total interest paid for the years ended June 30, 2020 and 2019 was \$4,317,000 and \$4,767,000, respectively.

Revenue bonds

On February 8, 2017 MHHEFA issued \$64,165,000 principal amount of Revenue Bonds, Series 2017A. The proceeds of this issue were used to retire the remainder of the Series 2010 Bonds in order to take advantage of lower interest rates with an estimated net present value savings of \$3.7 million.

On June 28, 2016 MHHEFA issued \$73,445,000 principal amount of Revenue Bonds, Series 2016A (\$31,945,000) and Series 2016B (\$41,500,000). The proceeds of this issue were used to retire the Series 2007A Bonds and Series 2010 Bonds (partial) in order to take advantage of lower interest rates with an estimated net present value savings of \$7.3 million. In 2017, the Series 2016B taxable note was converted as planned to Series 2017B. On March 23, 2017 the Series 2016 were converted to Series 2017B bonds as planned when the 2016B bonds were issued in June 2016.

The Obligated Group for MHHEFA bond issuances includes the Company, CHP, Foundation, Sleep Center, Doctors Community Medical Group and Doctors Integrated Healthcare Network and Health Ventures excluding the MAUI, Magnolia Gardens, DI LLC, ACO, and STM. The Series 2017A, Series 2017B, and Series 2016 Bonds are secured by the revenue and accounts receivable of the Obligated Group, and certain other property secured by a Deed of Trust. The Obligated Group is required to maintain certain compliance ratios and covenants as defined under the bond documents. In the opinion of the management, the Company has complied with the required covenants for 2017 and 2016 series bonds.

Other debt

During 2008, DRCC obtained a \$4,000,000 revolving line of credit from a commercial lender to finance the acquisition of certain medical equipment. The line of credit was converted to a financing lease during 2009. Beginning in October 2009, monthly payments of principal and interest at 6.8% per annum become due. In July 2012, DRCC modified the capital equipment lease to obtain an interest rate of 3.6%. This lease ended January 2019.

8. Professional and General Liabilities, Workers Compensation, and Employee Health Coverages

The Company has coverage for professional and general liabilities on a claims-made basis from Freestate Healthcare Insurance Company, Ltd., a group captive formed by several Maryland hospitals. The Company owns 20% interest in the captive and accounts for its investment in the captive using the cost method. The cost of \$15,000 is recorded in other noncurrent assets in the accompanying consolidated balance sheets as of June 30, 2020 and 2019. Premiums are expensed as incurred and are established by the captive based on the Company's historical experience supplemented as necessary with industry experience. The total premium is allocated to each of the shareholders based on their experience. Retrospective premium assessments and credits are calculated based on

Doctors Community Medical Center and Subsidiaries
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the aggregate experience of all named insureds under the policy. Each named insured's assessment of credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. Each named insured will not be charged or entitled to any retrospective premium assessments or credits until the policy period has been closed and no further claim obligations are expected. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2020. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

The captive is responsible for claims up to \$1,000,000 for each and every loss event. Additional coverage has been purchased by the captive for all claims in excess of \$1,000,000 to a limit of \$6,000,000 effective March 1, 2006, \$10,000,000 effective March 1, 2012, and \$15,000,000 March 1, 2019. The estimated unpaid loss liability reserved by the captive for the Company was \$9,466,094 and \$10,656,429 at June 30, 2020 and 2019, respectively. These amounts are included in long term liabilities and the related anticipated insurance recoveries were reported in noncurrent assets in the accompanying consolidated balance sheets. The liability for all claims incurred but not reported for the Company was \$1,106,000 and \$1,066,000 at June 30, 2020 and 2019, respectively. The discount rate for unpaid losses is 3.5% for years ending June 30, 2020 and 2019. The Company engages a consulting actuary to assist in the determination of all professional liability claims incurred but not reported.

The Company is self-insured against workers' compensation claims up to a per-claim limit of \$500,000 with an annual limitation of approximately \$1,000,000. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of \$1,204,270 and \$1,080,971 at June 30, 2020 and 2019, respectively. These amounts are included in accrued expense line item in the accompanying consolidated balance sheets.

The Company is self-insured against employee health medical claims up to a per-claim limit of \$200,000 and no maximum aggregate benefit. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of \$507,000 and \$621,000 at June 30, 2020 and 2019, respectively. These amounts are included in the accrued expenses line item in the accompanying consolidated balance sheets.

9. Leases

The following table presents the components of the Company's right-of-use assets and liabilities related to leases and their classification in the accompanying consolidated balance sheet as of June 30, 2020:

Component of Lease Balances	Classification in Consolidated Balance Sheet	June 30, 2020
Assets:		
Operating lease assets	Right of use asset	\$ 4,543,771
Finance lease assets	Property and equipment	155,672
Total leased assets		<u>\$ 4,699,443</u>
Liabilities:		
Operating lease liabilities:		
Current	Lease liabilities short term	\$ 1,183,557
Long-term	Lease liabilities long term	4,074,861
Total operating lease liabilities		<u>\$ 5,258,418</u>
Finance lease liabilities:		
Current	Current portion of long-term debt	\$ 33,798
Long-term	Long-term debt	-
Total finance lease liabilities		<u>33,798</u>
Total lease liabilities		<u>\$ 5,292,216</u>

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The Company determines if an arrangement is a lease at inception of the contract. The right-of-use assets represent the Company's right to use the underlying assets for the lease term and the lease liabilities represent the Company's obligation to make lease payments arising from the leases. Right-of-use assets and lease liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. The Company uses an incremental borrowing rate as the discount rate.

The Company's operating leases are primarily for real estate and equipment. Real estate leases include leases of medical facilities and office spaces. Equipment leases mainly include lease of copiers and medical equipment. The Company's real estate lease agreements typically have initial terms of three to ten years, and equipment lease agreements typically have initial terms of three to five years.

Real estate leases may include one or more options to renew that can extend the lease term from five to ten years. The exercise of lease renewal options is at the Company's sole discretion. In general, the Company does not consider renewal options to be reasonably likely to be exercised; therefore, renewal options are generally not recognized as part of the Company's right-of-use assets and lease liabilities. Certain equipment leases also include options to purchase the leased equipment. The useful life of assets and leasehold improvements are limited by the expected lease term unless there is a transfer of title or purchase option reasonably certain of exercise. The Company currently does not have any leases whereby there is a transfer of title or a purchase option that is reasonably certain to be exercised; hence, all of the Company's leases are depreciated over the lease term.

Certain of the Company's lease agreements for real estate include payments based on actual common area maintenance expenses and other operating expenses. These variable lease payments are recognized in other operating expenses, net but are not included in the right of-use asset or liability balances. The Company's lease agreements do not contain any material residual value guarantees, restrictions, or covenants.

The Company elected the accounting policy practical expedients by class of underlying asset to: (i) exclude recording leases with an initial term of twelve months or less ("short-term leases") as right-of-use assets and liabilities on the consolidated balance sheets; and (ii) combine associated lease and non-lease components into a single lease component. Non-lease components, which are not significant overall, are combined with lease components. The Company has elected these practical expedients for real estate, equipment, and all other asset classes when acting as a lessee.

The following table presents the components of the Company's lease expense for the year ended June 30, 2020:

	Year ended June 30, 2020
Components of Lease Expense	
Operating lease expense	\$ 1,653,919
Finance lease expense:	
Amortization of leased assets	2,391
Interest on lease liabilities	42,455
Total finance lease expense	44,846
Variable lease expense	59,713
Short-term lease expense	4,976
Total lease expense	\$ 1,763,454

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The weighted-average lease terms and discount rates for operating and finance leases are as follows:

	June 30, 2020
Weighted-average remaining lease term (years)	
Operating leases	7.44
Finance leases	.67
Weighted-average discount rate	
Operating leases	4.55%
Finance leases	4.16%

Cash flow and other information related to leases are included in the following table:

	Year ended June 30, 2020
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash outflows from operating leases	\$ 3,001,328
Operating cash outflows from finance leases	2,391
Financing cash outflows from finance leases	43,457
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	\$ 5,934,485

Future minimum lease payments as of June 30, 2020 are as follows:

	<u>Finance Leases</u>	<u>Operating Leases</u>	<u>Total</u>
2021	\$ 33,798	\$ 1,183,557	\$ 1,217,355
2022	-	756,519	756,519
2023	-	448,616	448,616
2024	-	434,938	434,938
2025	-	406,176	406,176
Thereafter	-	2,028,612	2,028,612
Total minimum lease payments	<u>\$ 33,798</u>	<u>\$ 5,258,418</u>	<u>\$ 5,292,216</u>

10. Retirement Plans

The Company has a 403b defined contribution plan (the "contribution plan") covering substantially all its employees. The contribution plan is employee and employer contributory. The Company contributed a match of \$0.50 for every \$1.00 of elective deferrals for a plan year for eligible employees up to 4% of base compensation. Defined contribution plan expense amounted to \$1,265,842 and \$1,422,542 for 2020 and 2019, respectively.

The Company froze the defined benefit pension plan that it sponsors (the Plan) in 2011, which covered substantially all employees. The decision to terminate the Plan has not been made by the board of directors. The benefits are based on years of service and employee compensation during years of employment. The Company's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Company expects to contribute \$1,232,021 to the Plan during 2021 to keep the funding levels at the ERISA requirements. The measurement date of the Plan is June 30.

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The following table provides a reconciliation of the benefit obligation, Plan assets, and funded status of the Plan in the Company's consolidated financial statements based on actuarial valuations for the years ended June 30:

	For the Year Ended	
	2020	2019
Accumulated Benefit Obligation		
Change in Benefit Obligation		
Benefit Obligation at beginning of year	\$ 21,661,466	\$ 22,871,105
Interest cost	636,293	796,893
Settlement loss/(gain)	(36,964)	(14,800)
Actuarial loss/(gain)	1,882,541	1,234,497
Settlement payments	(982,194)	(3,136,449)
Benefits paid	(111,500)	(89,780)
Benefit Obligation at End of Year	\$ 23,049,642	\$ 21,661,466
Change in Plan Assets		
Fair value of plan assets at beginning of year	\$ 16,660,073	\$ 18,711,547
Actual return on plan assets	293,921	525,639
Employer contributions	663,912	649,116
Settlement payments	(982,194)	(3,136,449)
Benefits paid	(111,500)	(89,780)
Fair Value of Plan Assets at End of Year	\$ 16,524,212	\$ 16,660,073
Funded Status (Pension Obligation)	\$ (6,525,430)	\$ (5,001,393)
Components of Net Periodic Benefit Costs		
Interest cost	\$ 636,293	\$ 796,893
Expected return on plan assets	(955,530)	(942,470)
Settlement	410,534	1,181,733
Recognition of loss from change in measurement date	569,608	497,360
Net Period Pension Costs	\$ 660,905	\$ 1,533,516

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The total amount recognized in net assets without donor restrictions in the accompanying consolidated financial statements for the years ended June 30:

	<u>2020</u>	<u>2019</u>
Net actuarial loss	\$ 9,634,202	\$ 8,107,158

Lump sum distributions exceeded the Plan's interest cost triggering a settlement event. As a result, a settlement loss of \$410,534 and \$1,181,733 was recognized for 2020 and 2019, respectively.

Plan assets are invested to ensure that the Plan has the ability to pay all benefit and expense obligations when due, to maximize return within prudent levels of risk for pension assets, and to maintain a funding cushion for unexpected developments. The target weighted-average asset allocation of pension investments was 38% equities and 62% fixed maturity securities and cash as of June 30, 2020.

The Plan's estimated future benefit payments are as follows:

2021	\$ 2,428,434
2022	1,291,976
2023	1,235,496
2024	1,257,026
2025	1,580,928
2026 - 2030	6,329,519
Total	<u>\$ 14,123,379</u>

The weighted-average assumptions used to determine net periodic benefit cost and the projected benefit obligation for the years ended June 30 were as follows:

	<u>2020</u>	<u>2019</u>
Discount rate	2.05%	3.10%
Expected return on Plan assets	6.00%	6.00%

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2020:

	<u>June 30, 2020</u>		
	<u>Quoted Prices in Active Markets for Identical Assets</u>	<u>Significant Other Observable Inputs</u>	<u>Significant Unobservable Inputs</u>
Total	Level 1	Level 2	Level 3
Assets			
Mutual funds:			
Equity	\$ 15,570,848	\$ 15,570,848	\$ -
Alternative investments:			
Common/collective trust	953,364	-	953,364
	<u>\$ 16,524,212</u>	<u>\$ 15,570,848</u>	<u>\$ -</u>

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2019:

	June 30, 2019		
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
Total	Level 1	Level 2	Level 3
Assets			
Mutual funds:			
Equity	\$ 16,660,073	\$ 16,660,073	\$ -
	\$ 16,660,073	\$ 16,660,073	\$ -

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2020 and 2019.

The Company has a deferred compensation plan that permits certain executives to defer receiving a portion of their compensation. The deferred amounts are included in other assets in the accompanying consolidated balance sheets. The associated liability of an equal amount is included in other liabilities in the accompanying consolidated balance sheets. The liability recorded regarding the deferred compensation was \$3,831,692 and \$4,253,265 as of June 30, 2020 and 2019, respectively.

The Company is the beneficiary of split dollar life insurance policies in place for certain executives. The amounts that could be realized by the Company under the insurance contracts are approximately \$9,000,000 as of both June 30, 2020 and 2019 and are included in other assets in the consolidated balance sheets.

11. Maryland Health Services Cost Review Commission

Certain of the Company's charges are subject to review and approval by the Commission. Company management has filed the required forms with the Commission and believes the Company is in compliance with Commission requirements.

The current rate of reimbursement for principally all hospital inpatient and outpatient services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare reimbursement principles under Section 1814(b) of the Social Security Act and will continue as long as all third-party payers elect to be reimbursed under this program, the rate of increase for costs per hospital services is below the national average, and certain specific quality indicators are met. In January 2014, the State of Maryland and CMS agreed to implement a revised waiver focused on population health, and the previous waiver was terminated.

This was a new global budget arrangement which set a fixed revenue amount for the upcoming year, without fluctuation due to utilization or case mix. This was a five-year demonstration where Maryland successfully made significant progress toward reducing costs inside and outside of the hospital as well as improving patient care. Beginning January 2019 the new "Total Cost of Care Model" (the "Model") was approved and builds upon the successes of the All-Payer Model. The Model encourages continued clinical redesign and provides tools to providers to treat complex and chronic conditions and is built on the same global budget arrangement mechanics for revenue setting as the predecessor model. This is approved for a 10-year term provided Maryland meets the Model performance requirements.

Doctors Community Medical Center and Subsidiaries Notes to the Consolidated Financial Statements

The Commission's rate-setting methodology for service centers that provide both inpatient and outpatient services or only outpatient services consists of establishing an acceptable unit rate for these centers within the applicable facility. The actual average unit charge for each service center is compared to the approved rate on a monthly basis. The rate variances, plus penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis. The timing of the Commission's rate adjustments for the Company could result in an increase or reduction due to the variances and penalties described above in a year subsequent to the year in which such items occur. The Company's policy is to accrue revenue based on actual charges for services to patients in the year in which the services are performed and billed. For 2020, hospitals that are in an undercharge position due to the current pandemic (see Note 17) may not be able to recoup more than their undercharge net of any applicable CARES Act funding (see Note 16).

12. Contingencies

Litigation

There are several lawsuits pending in which the Company has been named as defendant. In the opinion of Company management, after consultation with legal counsel, the potential liability, in the event of adverse settlement, will not have a material impact on the Company's consolidated financial position.

Risk factors

The Company's ability to maintain and/or increase future revenues could be adversely affected by:

- The growth of managed care organizations promoting alternative methods for health care delivery and payment of services such as discounted fee for service networks and capitated fee arrangements (the rate setting process in the State of Maryland prohibits hospitals from entering into discounted fee arrangements; however, managed care contracts may provide for exclusive service arrangements);
- Proposed and/or future changes in the laws, rules, regulations, and policies relating to the definition, activities, and/or taxation of not-for-profit tax-exempt entities;
- The enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology and/or further reductions in payments to hospitals and other health care providers;
- The future of Maryland's certificate of need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate the Company's ability to expand new services; and
- The ultimate impact of, and any changes to, the federal Patient Protection and Affordable Care Act and the Health Care Education Affordability Reconciliation Act of 2010.

The Joint Commission, a non-governmental privately owned entity, provides accreditation status to hospitals and other health care 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 payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the 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/payers would have a materially negative impact on the future financial position, operating results and cash flows of the Company. In February 2019, the Company was surveyed by Joint Commission and received a full three-year Joint Commission accreditation through February 2022.

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

Other contingency

During the year ended June 30, 2020, the Company recorded an accrual related to a billing error that it intends to self-report to the Department of Health and Human Services. The Company expects to work with the Federal Government to come to a resolution on this matter. It is possible that other regulatory conditions may be part of the final resolution. Based on consultation with legal counsel, management believes the final resolution will not have a material adverse effect on the June 30, 2020 financial statements.

13. Goodwill

The Company used the acquisition method of accounting to record goodwill when purchasing physician practices and other similar entities. Goodwill is not considered an identifiable asset and as such, was not included in the acquired assets during the acquisition with the entire balance being written off as of July 1, 2019. The table below presents goodwill that had been recorded as of June 30, 2019 prior to the Acquisition.

	2019
Cancer center, DRCC	\$ 1,062,531
Orthopedic practice	376,316
Nursing home	767,285
Surgery center	20,416
Cancer center, MRCC	646,975
Physician practices	197,375
	<u>\$ 3,070,898</u>

14. Liquidity and Availability

Financial assets available for general expenditure within one year of the consolidated balance sheet date, consist the following at June 30:

	2020	2019
Cash and cash equivalents	\$ 99,221,421	\$ 34,168,164
Patient accounts receivable, net	35,468,849	38,839,947
Pledges receivable, net	191,332	201,332
Other current assets	3,302,953	5,418,525
Investments with daily and weekly liquidity	18,179,843	17,436,369
Total	<u>\$ 156,364,398</u>	<u>\$ 96,064,337</u>

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15. Net Assets With Donor Restrictions

Net assets with donor restrictions are available as of June 30 for the following programs and projects:

	2020	2019
Hospital capital additions	\$ 35,476	\$ 48,108
Hospital operating programs	432,146	438,702
	<u>\$ 467,622</u>	<u>\$ 486,810</u>

16. CARES Act Funding

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law on March 27, 2020. One provision of the CARES Act was the establishment of the Provider Relief Funds administered by the U.S. Department of Health and Human Services (HHS). The Provider Relief Funds are being distributed to healthcare providers throughout the country to support the battle against the COVID-19 outbreak. During the year ended June 30, 2020, the Company has received \$15,553,859 in general distributions from this fund. These funds are intended to reimburse qualifying expenses and lost revenues attributable to COVID-19 and are subject to the terms, conditions, and regulatory requirements set forth by HHS. If the total distributions received by the Company exceed the cumulative amount of qualifying expenses and lost revenues attributable to COVID-19 through July 31, 2021, any excess funding may be subject recoupment. For the year ended June 30, 2020 the Company recognized \$15,553,859 as other operating revenues in the accompanying consolidated statements of operations. In July 2020, the Company received targeted distributions of \$16,505,004 from the Provider Relief Funds.

On October 22, 2020, HHS released additional reporting requirements for health care entities that received distributions from the Provider Relief Fund. The Post-Payment Notice of Reporting Requirements (the Notice) supplements the previous notice issued on July 20, 2020, and amended on August 14, 2020 and September 19, 2020. The Company considered the effects of the changes included in the Notice and concluded these changes represent non-recognized (i.e., Type II) subsequent events in accordance with ASC 855, Subsequent Events, since the reporting requirements included in the Notice provide evidence about conditions that did not exist at the balance sheet date, but instead are conditions that arose after that date but before financial statements were issued. Based on the expectations of the revenue to be recognized through December 31, 2020, the Company does not believe the new guidance will result in a material change to amounts recorded in the June 30, 2020, financial statements related to the Provider Relief Funds. The Company will continue to monitor changes in reporting guidance or additional clarifications that may be issued by HHS, which would affect the accounting for distributions from the Provider Relief Fund. In addition, the Company will continue to monitor guidance from the Commission related to how the Commission will interpret the new HHS guidance.

Also under the CARES Act, the Company received \$43,234,231 working capital financing from the Medicare Accelerated and Advance Payment Program in May 2020, which will need to be repaid beginning 120 days after the date of issuance of the payments as new claims are submitted to CMS. As of June 30, 2020, the remaining balance of \$43,101,714 is included in advances from third party payors in the accompanying consolidated balance sheets.

17. COVID-19

In March 2020, the World Health Organization declared the outbreak of COVID-19, a novel strain of Coronavirus, a pandemic. The coronavirus outbreak is disrupting supply chains and affecting production and sales across a range of industries. The extent of the impact of the outbreak on the Company's operational and financial

Doctors Community Medical Center and Subsidiaries
Notes to the Consolidated Financial Statements

performance will depend on certain developments, including the duration and spread of the outbreak, impact on employees and vendors, and governmental, regulatory and private sector responses. The accompanying consolidated financial statements do not reflect any adjustments as a result of the increase in economic uncertainty which continues through the issuance date.

18. Business Combination

On July 1, 2019, Luminis became the sole member and parent of the Company. No consideration was transferred by Luminis as part of the transaction. However, as part of the terms of the agreement, Luminis has committed to invest \$138,000,000 into the Company over the next five years, with \$8.3 million invested in 2020.

The Company elected to apply pushdown accounting whereby individual assets and liabilities were adjusted to the new basis of accounting established by Luminis as of the acquisition date. Luminis is required to reassess whether it has identified all of the assets acquired and all of the liabilities assumed from the transaction, and there is at least a reasonable possibility that recorded amounts will change.

The following information summarizes the recorded values of the assets acquired and liabilities assumed as of the date of the change-in-control:

Cash	\$ 34,168,164
Patient accounts receivable, net	38,839,947
Other receivables	5,619,857
Inventories	4,243,356
Prepaid expenses	3,981,044
Marketable securities	18,257,784
Joint ventures and equity investments	5,942,465
Property and equipment	116,539,923
Other non-current assets	<u>30,092,855</u>
 Total assets acquired	 <u>257,685,395</u>
 Accounts payable and accrued expenses	 31,874,601
Advances from third party payers	7,765,308
Long-term debt	132,571,129
Net pension liability	5,001,393
Deferred compensation/claims incurred but not reported	<u>16,005,694</u>
 Total liabilities assumed	 <u>193,218,125</u>
 Net assets acquired over liabilities assumed	 <u><u>\$ 64,467,270</u></u>

Supplementary Information

**Doctors Community Medical Center and Subsidiaries
Consolidating Balance Sheet
June 30, 2020**

ASSETS	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	Magnolia Gardens, MAUI, DI, UCAS	STM, ACO	Eliminations	Total
CURRENT ASSETS												
Cash and cash equivalents	\$ 91,769,627	\$ 2,930,306	\$ 376,096	\$ 640,220	\$ 1,644	\$ -	\$ 95,717,893	\$ 3,460,484	\$ -	\$ 43,044	\$ -	\$ 99,221,421
Patient accounts receivable, net	30,471,456	4,592,046	-	79,049	4,903	-	35,147,454	297,366	-	24,029	-	35,468,849
Inventories	5,587,731	-	-	-	19,383	-	5,587,114	0	-	-	-	5,587,114
Prepaid expenses and other current assets	3,878,080	184,636	484,053	464,093	12,521	-	5,023,383	271,924	-	84,116	-	5,379,423
TOTAL CURRENT ASSETS	131,686,894	7,706,988	860,149	1,183,362	38,451	-	141,475,844	4,023,774	-	151,189	-	145,656,807
Property and equipment	120,970,859	1,249,176	-	105,853	488,920	-	122,812,608	2,065,466	-	-	-	124,876,074
Accumulated depreciation	(9,484,367)	(230,004)	-	(20,772)	23,346	-	(9,711,797)	(464,159)	-	-	-	(10,195,956)
Net property and equipment	111,486,292	1,019,172	-	85,081	510,266	-	113,100,811	1,601,307	-	-	-	114,712,118
Other assets												
Investments	18,179,843	-	-	-	-	-	18,179,843	1,843,197	-	-	-	20,023,040
Investment in DRCC	4,241,920	-	-	-	-	(4,241,920)	-	-	-	-	-	-
Right of use asset	4,543,771	-	-	-	-	-	4,543,771	-	-	-	-	4,543,771
Other assets	31,791,201	12,271	-	-	-	(2,485,069)	29,316,403	-	-	3,902	-	29,322,305
Joint ventures and equity investments	-	-	-	6,195,831	-	(6,195,831)	-	-	6,195,831	-	-	6,195,831
DUE TO DCH	56,786,735	12,271	-	6,195,831	-	(12,922,820)	52,042,017	1,843,197	6,195,831	3,902	-	60,084,947
	97,091,847	-	-	-	9,172,239	(86,318,283)	9,945,803	-	-	-	(9,945,803)	-
TOTAL ASSETS	\$ 399,021,768	\$ 8,738,431	\$ 860,149	\$ 7,464,274	\$ 9,720,956	\$ (109,241,103)	\$ 316,564,475	\$ 7,484,278	\$ 6,195,831	\$ 155,091	\$ (9,945,803)	\$ 320,453,872

See independent auditors' report.

Doctors Community Medical Center and Subsidiaries
 Consolidating Balance Sheet
 June 30, 2020

(Continued)

	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	Magnolia Gardens, MAUI, HI, UCAS	STM ACO	Eliminations	Total
LIABILITIES AND NET ASSETS												
CURRENT LIABILITIES												
Accounts payable	\$ 8,145,323	\$ 1,386,691	\$ -	\$ 525,479	\$ 44,984	\$ -	10,102,477	\$ 170,275	\$ -	\$ 1,128	\$ -	10,273,880
Due to DCH	9,172,239	50,920,569	369,270	2,624,864	1,581,126	(63,603,775)	1,253,093	154,137	-	8,636,593	(9,945,803)	-
Salaries, wages, and related items	14,558,876	80,535	-	14,244	-	-	14,653,755	-	-	-	-	14,653,755
Other accrued expenses	13,451,659	-	128,253	75,872	56,714	-	13,724,438	88,997	-	138,088	-	13,952,593
Advances from third party payers	50,394,224	1,016,505	-	494,838	-	-	51,905,567	-	-	-	-	51,905,567
Current portion of operating lease liabilities	1,183,557	-	-	-	-	-	1,183,557	-	-	-	-	1,183,557
Current portion of long-term obligations	4,978,798	-	-	-	-	-	4,978,798	-	-	-	-	4,978,798
TOTAL CURRENT LIABILITIES	101,894,776	53,404,300	486,523	3,895,087	1,884,824	(63,603,775)	87,801,735	414,409	-	8,677,799	(9,945,803)	96,948,140
NONCURRENT LIABILITIES												
Other long-term liabilities	14,421,786	-	-	-	-	-	14,421,786	-	-	-	-	14,421,786
Pension obligation	6,525,431	-	-	-	-	-	6,525,431	-	-	-	-	6,525,431
Operating lease liabilities	4,074,861	-	-	-	-	-	4,074,861	-	-	-	-	4,074,861
Long-term obligation, net of current portion	122,765,997	-	-	32,725,782	-	(32,725,782)	122,765,997	-	-	-	-	122,765,997
TOTAL LIABILITIES	249,682,851	53,404,300	486,523	36,660,869	1,884,824	(66,329,557)	245,589,910	414,409	-	8,677,799	(9,945,803)	244,736,215
NET ASSETS AND MEMBERS' EQUITY												
Without donor restrictions	149,244,921	(44,665,869)	-	-	8,036,132	(44,289,398)	68,315,786	-	-	(2,270,061)	7,013,053	73,058,778
Members' equity	-	-	-	(29,196,595)	-	29,196,595	7,069,869	-	6,195,831	(6,292,647)	(7,013,053)	-
With donor restrictions	63,996	-	373,628	-	-	-	467,622	-	-	-	-	467,622
Noncontrolling interest	-	-	-	-	-	-	2,191,257	-	-	-	-	2,191,257
TOTAL LIABILITIES AND NET ASSETS	\$ 399,021,768	\$ 8,738,431	\$ 860,149	\$ 7,464,274	\$ 9,720,956	\$ (109,241,103)	\$ 316,564,475	\$ 7,484,278	\$ 6,195,831	\$ 155,091	\$ (9,945,803)	\$ 320,633,872

See independent auditors' report.

Doctors Community Medical Center and Subsidiaries
 Consolidating Statement of Operations and Changes in Net Assets
 June 30, 2020

	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	Magnolia Gardens, MAUI, DJ, UCAS	STM, ACO	Total
OPERATING REVENUE											
Net patient service revenue	211,990,545	12,965,479	-	9,958,306	2,664,682	-	230,379,012	8,743,813	-	-	239,122,825
Other operating revenue	18,869,657	2,561,796	308,287	644,666	-	(66,422)	21,817,984	65,645	-	568	21,884,197
TOTAL OPERATING REVENUE	229,760,202	14,927,275	308,287	4,602,972	2,664,682	(66,422)	252,196,996	8,809,458	-	568	261,007,022
EXPENSES											
Salaries and wages	89,485,612	14,320,212	345,261	4,659,717	24,000	-	108,828,802	-	-	2	108,828,804
Employee benefits	13,710,079	2,330,795	71,154	895,884	-	-	17,005,912	-	-	-	17,005,912
Purchased services	64,296,869	5,656,856	399,909	1,313,140	1,158,425	-	7,785,193	7,788,354	-	160,348	80,683,895
Supplies	33,920,959	663,483	-	368,887	-	-	34,953,139	135,295	-	-	35,088,434
Depreciation and Amortization	9,681,806	279,759	-	20,772	(23,346)	-	9,958,991	454,159	-	-	10,413,150
Interest	4,317,819	-	-	-	-	-	4,317,819	-	-	-	4,317,819
TOTAL EXPENSES	215,419,138	23,251,115	756,324	7,250,200	1,159,079	-	247,829,856	8,347,808	-	160,350	256,338,014
INCOME (LOSS) FROM OPERATIONS	14,347,064	(8,323,840)	(448,037)	(2,647,228)	1,505,603	(66,422)	4,367,140	461,650	-	(159,782)	4,669,008
NONOPERATING GAINS (LOSSES)											
Investment income, net	457,595	3,366	253	-	-	-	461,214	-	-	-	461,214
Pension expense	(660,906)	-	-	-	-	-	(660,906)	-	-	-	(660,906)
Loss in trading securities	(262,337)	-	-	-	-	-	(262,337)	-	-	-	(262,337)
Equity in joint ventures	(111,195)	-	-	175,671	-	(64,476)	0	-	-	-	259,366
EXCESS OF REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	13,770,221	(8,320,474)	(447,784)	(2,471,557)	1,505,603	(130,898)	3,905,111	461,650	259,366	(159,782)	4,460,345
Net asset transfer	473,964	-	412,308	56,683	(942,955)	-	8,300,798	-	-	-	8,300,798
Equity transfer	8,500,798	-	-	-	-	-	-	-	-	-	-
Net assets released from restrictions for capital acquisitions	-	-	35,476	-	-	-	35,476	-	-	-	35,476
Contributions with donor restrictions	15,275	-	517,878	-	-	-	533,153	-	-	-	533,153
Net assets released from restrictions for use in operations	(85,028)	-	(433,837)	-	-	-	(518,865)	-	-	-	(518,865)
Net assets released from restrictions for capital acquisitions	-	-	(95,476)	-	-	-	(95,476)	-	-	-	(95,476)
Pension - related changes other than net periodic pension cost	(1,527,044)	-	-	-	-	-	(1,527,044)	-	-	-	(1,527,044)
Increase (decrease) in net assets	20,950,186	(8,320,474)	48,565	(2,414,874)	562,648	(130,898)	10,695,153	461,650	259,366	(159,782)	11,250,387
Net assets, beginning of year	128,388,731	(36,945,395)	325,081	(26,781,721)	7,473,484	(12,780,648)	60,279,512	6,608,219	5,942,465	(9,362,916)	64,467,270
Net assets, end of year	149,338,917	(44,665,869)	373,626	(29,196,595)	8,036,132	(12,911,546)	70,974,665	7,069,869	6,195,831	(8,522,708)	75,717,657

See independent auditors' report.

Doctors Community Hospital and Subsidiaries

**Consolidated Financial Statements
and Other Financial Information**

Years Ended June 30, 2019 and 2018



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Independent Auditors' Report

The Board of Directors
Doctors Community Hospital and Subsidiaries
Lanham, Maryland

We have audited the accompanying consolidated financial statements of Doctors Community Hospital and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations and other changes in net assets without donor restrictions, 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.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Doctors Community Hospital and Subsidiaries as of June 30, 2019 and 2018, and the results of its operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Change in Accounting Principles

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, and FASB ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, respectively, in 2019. Our opinion is not modified with respect to these matters.

Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The consolidating information presented in the supplemental schedules is presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual organizations, and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management, 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.

Dixon Hughes Goodman LLP

Gaithersburg, Maryland
October 15, 2019

Doctors Community Hospital and Subsidiaries
Consolidated Balance Sheets

		June 30	
		2019	2018
<i>ASSETS</i>			
CURRENT ASSETS			
Cash and cash equivalents		\$ 34,168,164	\$ 34,055,629
Patient accounts receivable		38,839,947	32,760,116
Other amounts receivable		5,619,857	3,916,966
Inventories		4,243,356	3,887,208
Prepaid expenses		<u>3,981,044</u>	<u>4,220,183</u>
	TOTAL CURRENT ASSETS	86,852,368	78,840,102
INVESTMENTS			
Marketable securities		18,257,784	17,807,685
Joint ventures and equity investments		<u>5,019,926</u>	<u>5,398,099</u>
		23,277,710	23,205,784
LAND, BUILDINGS, AND EQUIPMENT - NET		102,350,923	107,260,317
GOODWILL		3,070,898	3,070,898
OTHER ASSETS		<u>26,092,855</u>	<u>26,065,030</u>
	TOTAL ASSETS	\$ 241,644,754	\$ 238,442,131

See the accompanying notes to the consolidated financial statements.

**Doctors Community Hospital and Subsidiaries
Consolidated Balance Sheets**

(Continued)

	<u>2019</u>	<u>2018</u>
		(As Adjusted)
<i>LIABILITIES</i>		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 15,828,485	\$ 16,422,456
Salaries, wages, and related items	16,046,116	16,169,005
Advances from third-party payers	7,765,308	7,975,899
Current portion of long-term obligations	4,448,457	4,981,689
TOTAL CURRENT LIABILITIES	44,088,366	45,549,049
NONCURRENT LIABILITIES		
Deferred compensation and claims incurred but not reported	16,005,694	16,021,913
Pension obligation	5,001,393	4,159,558
Long-term obligations, net of current portions	<u>122,394,065</u>	<u>126,888,994</u>
TOTAL LIABILITIES	187,489,518	192,619,514
NET ASSETS		
Without donor restrictions	51,403,040	43,111,360
Noncontrolling interest	<u>2,265,386</u>	<u>1,872,337</u>
TOTAL NET ASSETS WITHOUT DONOR RESTRICTIONS AND NONCONTROLLING INTEREST	53,668,426	44,983,697
With donor restrictions	<u>486,810</u>	<u>838,920</u>
TOTAL NET ASSETS	<u>54,155,236</u>	<u>45,822,617</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 241,644,754</u>	<u>\$ 238,442,131</u>

See the accompanying notes to the consolidated financial statements.

**Doctors Community Hospital and Subsidiaries
Consolidated Statements of Operations and
Other Changes in Net Assets Without Donor Restrictions**

	Year Ended June 30	
	2019	2018 (As Adjusted)
REVENUE		
Net patient service revenue	\$ 243,357,081	\$ 239,516,769
Other operating revenue	5,587,586	5,710,933
Contributions	195,528	162,506
Net assets released from restrictions used for operations	993,563	637,502
TOTAL OPERATING REVENUE	250,133,758	246,027,710
EXPENSES		
Salaries and wages	106,447,619	109,234,448
Employee benefits	16,934,250	19,179,380
Purchased services	40,549,850	39,983,434
Supplies	36,744,307	37,129,223
Other expenses	26,050,823	22,355,890
Depreciation	8,979,516	9,226,529
Amortization	186,921	200,921
Fundraising	80,994	58,822
Interest	4,768,253	4,648,600
TOTAL EXPENSES	240,742,533	242,017,247
INCOME FROM OPERATIONS	9,391,225	4,010,463
NONOPERATING GAINS (LOSSES)		
Gain (loss) on sale of property	(11,247)	1,500
Pension costs	(1,533,516)	(634,727)
Unrealized gain on trading securities	145,630	11,927
Gain on joint ventures	311,435	208,549
EXCESS OF REVENUE OVER EXPENSES	8,303,527	3,597,712
Net assets released from restrictions for capital acquisitions	338,639	0
Pension - related changes other than net periodic pension cost	42,565	1,433,239
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS	\$ 8,684,731	\$ 5,030,951

See the accompanying notes to the consolidated financial statements.

**Doctors Community Hospital and Subsidiaries
Consolidated Statements of Changes in Net Assets**

	Year Ended June 30, 2019		Year Ended June 30, 2018 (As Adjusted)			
	Total	Controlling Interests	Noncontrolling Interests	Total	Controlling Interests	Noncontrolling Interests
NET ASSETS WITHOUT DONOR RESTRICTIONS						
Excess of revenue over expenses	\$ 8,303,527	\$ 7,910,478	\$ 393,049	\$ 3,597,711	\$ 3,443,776	\$ 153,935
Net assets released from restrictions for capital acquisitions	338,639	338,639	0	0	0	0
Pension - related changed other than net periodic pension cost	42,565	42,565	0	1,433,239	1,433,239	0
INCREASE IN NET ASSETS WITHOUT DONOR RESTRICTIONS AND NONCONTROLLING INTERESTS	8,684,731	8,291,682	393,049	5,030,950	4,877,015	153,935
NET ASSETS WITH DONOR RESTRICTIONS						
Restricted contributions	980,090	980,090	0	709,620	709,620	0
Net assets released from restrictions for operations	(993,563)	(993,563)	0	(637,502)	(637,502)	0
Net assets released from restrictions for capital acquisitions	(338,639)	(338,639)	0	0	0	0
INCREASE (DECREASE) IN NET ASSETS WITH DONOR RESTRICTIONS	(352,112)	(352,112)	0	72,118	72,118	0
INCREASE IN NET ASSETS	8,332,619	7,939,570	393,049	5,103,068	4,949,133	153,935
NET ASSETS, BEGINNING OF YEAR	45,822,617	43,950,280	1,872,337	40,719,549	39,001,147	1,718,402
NET ASSETS, END OF YEAR	\$ 54,155,236	\$ 51,889,850	\$ 2,265,386	\$ 45,822,617	\$ 43,950,280	\$ 1,872,337

See the accompanying notes to the consolidated financial statements.

Doctors Community Hospital and Subsidiaries
Consolidated Statements of Cash Flows

	Year Ended June 30	
	2019	2018 (As Adjusted)
OPERATING ACTIVITIES AND OTHER GAINS		
Increase in net assets	\$ 8,332,619	\$ 5,103,068
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities and other gains		
Restricted contributions received	(980,090)	(709,620)
Depreciation	8,979,516	9,226,529
Unrealized gain on investments	(145,630)	(11,927)
Loss (gain) on sale of property	11,247	(1,500)
Amortization on bond issue cost	186,921	200,921
Gain in joint ventures and equity investments	(311,435)	(208,549)
(Increase) decrease in:		
Accounts payable and accrued expenses	(593,971)	167,172
Accrued salaries, wages and related items	(122,887)	1,048,099
(Advances from) refunds to third party payers	(210,591)	666,013
Pension obligation	841,835	(1,606,286)
Other liabilities	(16,219)	985,506
Decrease (increase) in:		
Net patient accounts receivable	(6,079,831)	(4,974,102)
Other amounts receivable	(1,702,891)	3,256,595
Inventories	(356,148)	(371,270)
Prepaid expenses and other assets	211,314	(2,759,657)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES AND OTHER GAINS	8,043,759	10,010,992
INVESTING ACTIVITIES		
Net sales of trading investments	(304,469)	(2,088,373)
Increase in goodwill	-	(20,416)
Proceeds from sale on property	70,000	1,500
Distributions from joint ventures	689,605	1,986,082
Purchase of property, plant and equipment	(4,338,290)	(5,662,441)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	(3,883,154)	(5,783,648)

See the accompanying notes to the consolidated financial statements.

**Doctors Community Hospital and Subsidiaries
Consolidated Statements of Cash Flows**

(Continued)

	Year Ended June 30	
	2019	2018
FINANCING ACTIVITIES		
Principal payments on debt	\$ (5,028,160)	\$ (4,798,092)
Restricted contributions received	<u>980,090</u>	<u>709,620</u>
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	<u>(4,048,070)</u>	<u>(4,088,472)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	112,535	138,872
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>34,055,629</u>	<u>33,916,757</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 34,168,164</u>	<u>\$ 34,055,629</u>

See the accompanying notes to the consolidated financial statements.

Doctors Community Hospital and Subsidiaries Notes to Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Organization

Doctors Community Hospital (the Hospital) is a not-for-profit, non-stock corporation that operates an acute care general hospital facility licensed for 190 beds. The Hospital serves the health care needs of the residents of Prince George's County, the District of Columbia, and the greater Washington, D.C. metropolitan area. The Hospital has four wholly owned/controlled subsidiaries: Doctors Community Healthcare Programs (CHP), Doctors Community Hospital Foundation, Inc. (the Foundation), Doctors Community Health Ventures, Inc. (Health Ventures), and Doctors Community Sleep Center, LLC (the Sleep Center).

Doctors Community Healthcare Programs (CHP) consists of three wholly owned/controlled entities: Doctors Community Hospital Clinics (CLINICS), Doctors Community Practices, LLC (DCP), Capital Orthopedics Specialists, LLC (COS) and Care Transitional Organization (CTO). CLINICS is a limited liability company formed in Maryland for the purpose of providing outpatient medical care for the residents of Prince Georges County and surrounding areas. CLINICS includes a transitional outpatient program and mobile van that provides services throughout the Prince George's County. DCP is a limited liability company formed in Maryland for the purpose of providing medical primary care services for the residents of Prince Georges County and surrounding areas. COS is a limited liability company formed in Maryland for the purpose of providing surgical services for the residents of Prince Georges County and surrounding areas. CTO is a limited liability company formed in Maryland for the purpose of participating in certain Centers for Medicare and Medicaid (CMS) programs for primary care providers serving the residents of Prince Georges County and surrounding areas.

The Foundation was incorporated in Maryland in 1990 as a not-for-profit, non-stock corporation established to raise and invest funds to support or benefit the operations of the Hospital. The Foundation's bylaws provide that all funds raised, except those required for the operation of the Foundation, be distributed to or be held for the benefit of the Hospital. Under the Foundation's bylaws, a majority of its directors must be directors of the Hospital, appointed by its President. The Foundation's bylaws also provide the Hospital with the authority to direct its activities, management, and policies.

Health Ventures is incorporated under the laws of Maryland as a for-profit, stock corporation. The Hospital owns 100% of its stock. Health Ventures invests in for-profit businesses consistent with the mission and strategic plan of the Hospital. Health Ventures consolidates three LLCs: Metropolitan Medical Specialist, LLC (MMS), Doctors Community Management Services, LLC (MSO), and Doctors Community Ambulatory Surgical Center, LLC (ASC). ASC has an investment of 51% in University Center for Ambulatory Surgery. Health Ventures also has investments in two other companies: Magnolia Gardens LLC (Magnolia Gardens) and Diagnostic Imaging Center, LLC (DI).

The Sleep Center is a limited liability company formed in Maryland for the purpose of providing diagnostic sleep services for residents of Prince Georges County and surrounding areas. The Sleep Center operates a 10-bed sleep lab located on the Hospital's campus and provides outpatient sleep studies.

The Hospital owns a 60% interest in Doctors Regional Cancer Center, LLC (DRCC). DRCC is a limited liability company formed in June 2007 by Maryland Regional Cancer Care, LLC (MRCC) for the purpose of providing outpatient cancer treatment services to the residents of central Maryland. The Hospital owns 100% of Spine Team Maryland (STM), for the purpose of providing medical primary care services for the residents of Prince Georges County and surrounding areas. STM ceased operations in fiscal year 2016. The Hospital owns a 61% interest in the Southern Maryland Integrated Healthcare, LLC (ACO). The ACO, which notified CMS that it ended participating in the program effective December 31, 2018, was a limited liability company formed in Maryland for the purpose of participating in a Medicare Shared Savings Program (MSSP) among primary care providers serving the residents of Prince Georges County and surrounding areas.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

Principles of consolidation

The consolidated financial statements include the accounts of the Hospital, CHP, the Foundation, Health Ventures, the Sleep Center, DRCC and ACO (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements include non-controlling interest held by third parties in less than wholly owned subsidiaries.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, amounts on deposit in banks, and highly liquid debt instruments with an original maturity of 90 days or less when purchased, excluding amounts whose use is limited. The Company has cash holdings in commercial banks routinely exceeding the Federal Deposit Insurance Corporation maximum insurance limit of \$250,000. Cash and cash equivalents are reported at cost which approximates market value.

Investments

Marketable securities consist of investments in equity and debt securities and are carried at fair value. All such investments are classified as trading.

Unrestricted investment income, including realized gains and losses on the sale of trading securities, is reported as other operating revenue. The cost of securities sold is based on the specific-identification method. Unrealized gains and losses on trading securities are included in non-operating gains (losses) in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions.

Inventories

Inventories consist of supplies and drugs and are carried at the lower of cost or market using the average-cost method.

Land, buildings, and equipment

Land, buildings, and equipment are recorded at cost. Depreciation is recorded over the estimated useful lives of the assets using the straight-line method. Maintenance and repairs are charged to expense as incurred. The straight-line method is used to amortize the cost of equipment under capital leases over the estimated useful lives of the equipment or the term of the lease, whichever is appropriate.

Net assets with donor restrictions

Net assets with donor restrictions are those whose use by the Hospital and the Foundation have been limited by donors to a specific time period or purpose. Net assets with donor restrictions are available to fund various health care services and other community benefits provided by the Hospital. The Company's policy is to treat restricted contributions recorded and released in the same fiscal year as contributions without donor restrictions.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

Excess of revenue over expenses (expenses over revenue)

The consolidated statements of operations and other changes in net assets without donor restrictions include the excess of revenue over expenses (expenses over revenue) (the "performance indicator"). Changes in net assets without donor restrictions, which are excluded from the excess of revenue over expenses (expenses over revenue), consistent with industry practice, include contributions received and used for additions of long-lived assets, distributions to non-controlling interest-holders, and changes in the pension obligation other than net periodic pension cost.

Net patient service revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered. The Hospital charges are based on rates established by the State of Maryland Health Services Cost Review Commission (the Commission); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (see Note 11). CHP and the Sleep Center are paid for services based on either negotiated contracts with commercial payers, fee schedules with Medicare and Medicaid or standardized pricing for self-pay patients.

Explicit price concessions represent the difference between amounts billed as patient service revenue and amounts allowed by third-party payers, and are accrued in the period in which the related services are rendered. Prior to July 1, 2018, these explicit price concessions were reported as contractual discounts within patient service revenue.

Based on historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for services provided. Thus, the Hospital estimates an implicit price concession related to uninsured patients in the period the services are provided based upon management's assessment of historical and expected net collections. This estimate considers business and general economic conditions, trends in healthcare coverage and other collection indicators. Throughout the year, management assesses the adequacy of these implicit price concessions based upon its review of patient accounts receivable and collections to date. Other factors, such as account aging and payment cycles, are considered when estimating implicit price concessions. Prior to July 1, 2018, the Hospital used similar information to estimate a provision for bad debts. The Hospital follows established guidelines for placing its self-pay patient accounts with an outside collection agency. After collection efforts are exhausted, the uncollected balances are returned to the Hospital for final write-off.

Charity care

A patient is classified as a charity recipient by reference to certain established policies of the Company. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Company utilizes the generally recognized poverty income levels in the local community, but also includes certain cases where incurred charges are significant when compared to income.

Under current accounting standards, the Company is required to report the cost of providing charity care. The cost of charity care provided by the Company totaled \$8,425,301 and \$8,862,484 for the years ended June 30, 2019 and 2018, respectively. Rates charged by the Hospital for regulated services are determined based on assessment of direct and indirect cost calculated pursuant to the methodology established by the Commission (see Note 1), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services. For any charity services rendered by the Company other than from the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates. These charges are excluded from consolidated net patient service revenue.

Doctors Community Hospital and Subsidiaries

Notes to Consolidated Financial Statements

The Hospital receives a payment from the Commission with respect to an Uncompensated Care Fund ("UCC") established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals. The Hospital received \$2,299,712 for 2019 and \$4,671,024 for 2018 in UCC payments. All hospitals contribute to the Health Care Coverage Fund (HCCF) that supports the expansion of Medicaid eligibility and the Medicaid program. The Hospital contributed \$2,695,536 for 2019 and \$2,520,138 for 2018 to the HCCF.

Contributions and pledges

Unconditional promises to give cash and other assets to the Hospital and the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or when the conditions for receiving the donation have been satisfied. The gifts are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. Contributions restricted by donors for additions to the Hospital's operating property are transferred from net assets with donor restrictions to net assets without donor restrictions when the expenditure is made. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and statements of changes in net assets as net assets released from restriction.

The Hospital and Foundation write off any grants and pledges receivable that are considered uncollectible; accordingly, there is no allowance for doubtful accounts recorded for these grants and pledges. Grants and pledges receivable have not been discounted because management considers the effect to be immaterial. The balance of pledges receivable was \$201,332 and \$220,008 at June 30, 2019 and 2018, respectively, and is included in other amounts receivable in the accompanying consolidated balance sheets.

Other operating revenue

The Hospital met compliance requirements to receive incentive payments for upgrading and implementing certified electronic health record systems and becoming a meaningful user under the provisions of the American Recovery and Reinvestment Act of 2009. The Hospital recognized and received a net \$17,605 and \$28,395 of meaningful use funds during the fiscal years June 30, 2019 and 2018, respectively, and reported the amounts as other operating revenue in the accompanying statements of operations and other changes in unrestricted net assets.

The ACO received notification that it will receive an incentive payment of \$1,800,049 for 2018 financial reconciliation and quality performance related to its ACO Medicare enrollees. ACO management anticipates that the CMS will issue payments in October 2019. The incentive payment will first be applied to the ACO operating costs and the remainder will be shared with providers who participated in the ACO during the performance period. This incentive payment is included in other operating revenues and other amounts receivable in the accompanying consolidated financial statements.

Advertising costs

The Hospital expenses advertising costs as they are incurred. Advertising expense was \$1,850,449 and \$1,691,853 for the fiscal years June 30, 2019 and 2018, respectively, and is reported as other expense in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

Functional expenses

The Company's consolidated operating expenses by functional classification for the years ended June 30, 2019 and 2018 are as follows:

	2019			
	Health care services	General and administrative	Fundraising	Total
Salaries and benefits	\$ 88,521,765	\$ 34,425,131	\$ 434,973	\$ 123,381,869
Other operating expenses	47,936,619	18,642,019	103,029	66,681,667
Medical supplies	26,450,257	10,286,211	7,839	36,744,307
Depreciation and amortization	6,599,835	2,566,602	0	9,166,437
Interest	3,433,142	1,335,111	0	4,768,253
Total Operating Expenses	\$ 172,941,618	\$ 67,255,074	\$ 545,841	\$ 240,742,533

	2018			
	Health care services	General and administrative	Fundraising	Total
Salaries and benefits	\$ 92,179,152	\$ 35,847,448	\$ 387,228	\$ 128,413,828
Other operating expenses	44,874,827	17,451,321	71,998	62,398,146
Medical supplies	26,727,698	10,394,105	7,420	37,129,223
Depreciation and amortization	6,787,764	2,639,686	0	9,427,450
Interest	3,346,992	1,301,608	0	4,648,600
Total Operating Expenses	\$ 173,916,433	\$ 67,634,168	\$ 466,646	\$ 242,017,247

Fair value of financial instruments

The following methods and assumptions were used by the Company to estimate the fair value of financial instruments:

- **Cash and cash equivalents, patient accounts receivable, other amounts receivable, notes receivable, and advances from third-party payers:** The carrying amount reported in the balance sheets for each of these assets and liabilities approximates their fair value.
- **Marketable securities:** Fair values are based on quoted market prices of individual securities or investments if available, or are estimated using quoted market prices for similar securities (see *Note 2*)
- **Long-term debt:** Fair values of the Hospital's fixed-rate debt are based on current traded values.

Income taxes

The Hospital and the Foundation are exempt from federal income tax under section 501(c) (3) of the Internal Revenue Code as public charities. Both entities are entitled to rely on this determination as long as there are no substantial changes in their character, purposes, or methods of operation. Management has concluded that there have been no such changes, and therefore the status of the Hospital and Foundation as public charities exempt from federal income taxation remain in effect.

Doctors Community Hospital and Subsidiaries

Notes to Consolidated Financial Statements

The state in which the Hospital and the Foundation operate also provides a general exemption from state income taxation for organizations that are exempt from federal income taxation. However, both entities are subject to federal and state income taxation at corporate tax rates on unrelated business income. Exemption from other state and local taxes, such as real and personal property taxes is separately determined. The Hospital and the Foundation had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which unrelated business income was recognized, a tax return was filed in order to report any unrelated business income as well as any taxes due.

DRCC and ACO are Maryland limited liability companies that have not elected to be taxed as corporations under current Treasury regulations. Both are owned by more than one member. DRCC and ACO are subject to the partnership tax rules under Subchapter K of the Internal Revenue Code of 1986 (IRC), as amended. Under these rules neither is subject to federal or state income tax, but must file annual information returns indicating their gross and taxable income to determine the tax results to their members.

The Sleep Center and CHP are Maryland limited liability companies that have not elected to be taxed as corporations under current treasury regulations. Sleep Center and CHP are wholly owned by the Hospital. As such, the Sleep Center and CHP are considered "disregarded entities" under current IRC regulations.

Goodwill

Goodwill represents the excess of cost over the fair value of assets acquired. Management evaluates goodwill for impairment on an annual basis. Management evaluated the carrying value reported for goodwill in the accompanying consolidated balance sheets for impairment and believes the carrying value reported for goodwill on the consolidated balances sheets as of June 30, 2019 and 2018 to be appropriately estimated (see Note 13).

Subsequent Events

Subsequent events have been evaluated by management through October 15, 2019, which is the date the consolidated financial statements were available to be issued.

Recent Accounting Pronouncements

Effective December 31, 2018, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changes certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduce reporting complexity. The Company adopted the ASU and has adjusted the presentation in these consolidated financial statements accordingly. The ASU has been applied retrospectively to all periods presented, except for the disclosure around liquidity and availability of resources. The Company has elected to apply the practical expedient available in this ASU with respect to disclosure for liquidity and availability of resources with respect to the year ended June 30, 2018.

In February 2018, the FASB issued ASU 2018-02, *Leases (Topic 842)*, which requires lessees to recognize a lease liability and a right-of-use asset for most leases. The amendments in this ASU are effective for the consolidated financial statements for fiscal year ending June 30, 2020, with early adoption permitted, and should be applied through a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Management is currently evaluating and has not yet determined the effects of adopting this ASU on the consolidated financial statements and disclosures.

During the year ended June 30, 2018, the Hospital adopted FASB ASU No. 2018-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which clarified where defined benefit pension cost components should be presented in an employer's income statement. This ASU requires service cost to be presented in the same line item as other compensation costs arising from services rendered by employees during the period, and other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations.

Doctors Community Hospital and Subsidiaries

Notes to Consolidated Financial Statements

The effect of the retroactive application of ASU 2018-07 on previously reported financial statement amounts resulted in \$415,117 of net periodic pension cost previously included in income from operations on the consolidated statements of operations and other changes in net assets without donor restrictions to be reclassified as a component of nonoperating gains (losses). The frozen defined benefit pension plan sponsored by the Hospital experienced no service cost in either 2019 or 2018.

2. Patient revenue and accounts receivable

During fiscal year 2019, the Company adopted FASB ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, using the full retrospective method (ASC 606). The information in the prior year comparative period has been restated. The overall impact of adoption was not material to the accompanying consolidated financial statements, with the primary changes related to presentation of certain information, as described below, and expanded disclosures related to revenue recognition principles, disaggregation of revenues and other matters.

As a result of the adoption of ASC 606, estimated uncollectible amounts from patients that were previously presented as the provision for bad debts in the consolidated statements of operations are now considered implicit price concessions (as defined in ASC 606), and are therefore, included in net patient service revenue. Such implicit price concessions reflected in net patient service revenue in the accompanying consolidated financial statements for the year ended June 30, 2019 and 2018 were \$11,071,017 and \$8,512,803, respectively. Prior to July 1, 2018, the provision for bad debts was presented consistent with the previous revenue recognition standards separately as a component of patient service revenue. Upon adoption of ASC 606, the allowances for doubtful accounts and contractual adjustments of \$15,467,115 and \$17,942,460 at June 30, 2019 and 2018, respectively, were reclassified as a direct reduction of patient accounts receivable. Such implicit price concessions continue to be presented as a direct reduction of patient accounts receivable.

Management has determined that the Company has an unconditional right to payment only subject to the passage of time for services provided to date based on just the need to either finalize billing for such services (i.e., charge lag) or to discharge the patient and bill for such services for patients who are still receiving inpatient care in the Company's facilities at the balance sheet date. Accordingly, the Company accrues revenues and the related accounts receivable for services performed but not yet billed at the balance sheet date for in-house patients. Thus, management has determined that the Company does not have any amounts that should be reflected separately as contract assets.

As part of the adoption of ASC 606, the Company elected certain available practical expedients under the standard. First, the Company elected the practical expedient that allows nonrecognition of the promised amount of consideration from patients and third-party payers for the effects of a significant financing component due to the Company's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payer pays for that service will be one year or less. However, the Company does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the respective contracts. Additionally, the Company has applied the practical expedient whereby all incremental customer contract acquisition costs are expensed as they are incurred, as the amortization period of the asset that the Company otherwise would have recognized is one year or less in duration.

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

Doctors Community Hospital and Subsidiaries

Notes to Consolidated Financial Statements

Performance obligations are determined based on the nature of the services provided by the Company. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Company believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligations. Generally, performance obligations satisfied over time relate to patients in the Hospital. The Company measures the performance obligation from admission to the facility to the point when the facility is no longer required to provide services to that patient, which is generally the time of discharge. Revenue for performance obligations satisfied at a point in time generally relate to patients receiving outpatient services or patients and customers in a retail setting and the Company does not believe it is required to provide additional goods or services.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Company has elected to apply the optional exemption provided in current applicable accounting standards and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. Any unsatisfied or partially unsatisfied performance obligations are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

As discussed in Note 11, the Hospital charges are based on rates established by the Commission, which are subsequently reduced by contractual discounts provided to third-party payers and discounts provided to uninsured patients (i.e., explicit price concessions) in accordance with the Company policy, as well as any applicable implicit price concessions that are estimated by management based on a number of factors including historical collection experience. For non-Hospital services provided by the Company, management generally determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concession in the form of contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with internal policy, and implicit price concessions provided to uninsured patients. The Company determines its estimate of implicit price concessions based on historical collection experience with each class of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. Management believes that the financial effects of using this practical expedient are not materially different from an individual contract approach.

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

Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. The Company also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Company estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any discounts and price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

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

Net patient service revenue from third-party payers and others (including uninsured patients) for the years ended June 30, 2019 and 2018 are summarized in the following tables:

	<u>2019</u>		<u>2018</u>	
Medicare	\$ 118,346,517	49%	\$ 123,310,433	51%
Medicaid	31,514,613	13%	32,318,698	13%
Blue Cross Blue Shield	55,852,375	23%	43,909,366	18%
Other third-party payers	32,822,956	13%	38,565,238	16%
Self-pay patients	4,820,620	2%	1,413,034	2%
	<u>\$ 243,357,081</u>		<u>\$ 239,516,769</u>	

Revenue from deductibles and coinsurance are included in the categories presented above based on the primary payer.

Gross patient accounts receivable were comprised of the following for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Medicare	24%	27%
Medicaid	27%	24%
Blue Cross Blue Shield	12%	9%
Other third-party payers	23%	24%
Self-pay patients	14%	16%
	<u>100%</u>	<u>100%</u>

3. Investments

The following is a summary of investment securities held by the Company as of June 30:

	<u>2019</u>	<u>2018</u>
Marketable securities:		
Cash and cash equivalents		
Money market and CD funds	\$ 2,204,303	\$ 4,115,593
Equity		
Stock and mutual funds	16,053,481	13,692,092
	<u>\$ 18,257,784</u>	<u>\$ 17,807,685</u>

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

Investment return is summarized as follows for the years ended June 30:

	2019		
	Other Operating Revenue	Nonoperating Gains	Total
Interest and dividend income	\$ 406,889	\$ 0	\$ 406,889
Net realized loss	(214,951)	0	(214,951)
Net unrealized gain	0	145,630	145,630
Investment fees	(33,385)	0	(33,385)
	<u>\$ 158,553</u>	<u>\$ 145,630</u>	<u>\$ 304,183</u>

	2018		
	Other Operating Revenue	Nonoperating Gains	Total
Interest and dividend income	\$ 387,319	\$ 0	\$ 387,319
Net realized gain	1,300	0	1,300
Net unrealized gain	0	11,927	11,927
Investment fees	(32,104)	0	(32,104)
	<u>\$ 356,515</u>	<u>\$ 11,927</u>	<u>\$ 368,442</u>

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 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. The three levels of inputs that may be used to measure fair value are as follows:

- Level 1:** Quoted prices in active markets for identical assets or liabilities.
- Level 2:** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3:** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following discussion describes the valuation methodologies used for the Company's financial assets and liabilities 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

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

should be exercised in deriving conclusions about the Company's business, its value, or financial position based on the fair value information of financial assets and liabilities presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset or liability, 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 or liability. 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 or liability. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's investments in mutual funds classified at Level 1 are based on quoted market prices. Fair values for the Company's fixed income securities (corporate debt and federal government obligations) are based on prices provided by its investment managers and its custodian bank. The investment managers and the custodian bank 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.

The Company's federal government obligations and government backed securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2019:

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Money market funds	\$ 0	\$ 2,204,303	\$ 0	\$ 2,204,303
Fixed income				
U.S. government agency bonds/notes	0	11,747,496	0	11,747,496
Equity securities				
Premier supply chain investment	654,710	0	0	654,710
Mutual funds				
Short-term bond	1,337,600	0	0	1,337,600
Intermediate government	0	0	0	0
Merger arbitrage	0	0	0	0
World bond	154,845	0	0	154,845
Floating rate bonds	780,355	0	0	780,355
High-yield bond	339,981	0	0	339,981
Intermediate-term bond	441,749	0	0	441,749
Equity large blend	819,463	0	0	819,463
Long/short equity	902,573	0	0	902,573
Moderate allocation	1,140,189	0	0	1,140,189
Mid-cap growth	376,140	0	0	376,140
Real estate	292,544	0	0	292,544
Foreign large blend	917,601	0	0	917,601
Large blend	187,824	0	0	187,824
Diversified emerging markets	342,357	0	0	342,357
Large growth	201,323	0	0	201,323
Small growth	-	0	0	0
Total assets	<u>\$ 8,889,254</u>	<u>\$ 13,951,799</u>	<u>\$ 0</u>	<u>\$ 22,841,053</u>
Plus deposits in transit				38,327
Total				<u>\$ 22,879,380</u>
Less investments included in other assets				4,621,596
Total investments per consolidated balance sheet				<u>\$ 18,257,784</u>

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

The total investment of \$22,879,380 includes deposits in transit of \$38,327 plus financial instruments of \$22,841,053. The above table includes financial instruments of \$4,621,596 included in other assets on the consolidated balance sheets for deferred compensation and other arrangements.

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2018:

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Money market funds	\$ 0	\$ 4,115,593	\$ 0	\$ 4,115,593
Fixed income				
U.S. government agency bonds/notes	0	4,442,024	0	4,442,024
Equity securities				
Premier supply chain investment	601,990	0	0	601,990
Mutual funds				
Short-term bond	470,395	0	0	470,395
Intermediate government	616,001	0	0	616,001
Merger arbitrage	5,322,279	0	0	5,322,279
World bond	339,533	0	0	339,533
Floating rate bonds	767,457	0	0	767,457
High-yield bond	303,759	0	0	303,759
Intermediate-term bond	303,147	0	0	303,147
Equity large blend	791,469	0	0	791,469
Long/short equity	299,806	0	0	299,806
Moderate allocation	613,638	0	0	613,638
Mid-cap growth	617,394	0	0	617,394
Real estate	169,480	0	0	169,480
Foreign large blend	1,226,034	0	0	1,226,034
Large blend	159,579	0	0	159,579
Diversified emerging markets	390,715	0	0	390,715
Large growth	180,163	0	0	180,163
Small growth	390,547	0	0	390,547
	Total assets	\$ 13,563,386	\$ 8,557,617	\$ 22,121,003
Plus deposits in transit				4,271
Total				\$ 22,125,274
Less investments included in other assets				4,317,589
Total investments per consolidated balance sheet				\$ 17,807,685

The total investment of \$22,125,274 includes deposits in transit of \$4,271 plus financial instruments of \$22,121,003. The above table includes financial instruments of \$4,317,589 included in other assets on the consolidated balance sheets for deferred compensation and other arrangements.

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2019 and 2018.

4. Joint Ventures and Equity Investments

Health Ventures and ASC invest in businesses consistent with the mission and strategic plan of the Company. Unconsolidated investments are carried at cost or at equity depending on the percentage of ownership and control. Investment in Magnolia Gardens LLC represents a 51% interest and is not consolidated with the financial statements of the Company because Health Ventures and ASC do not control the investees. The investment income of these joint ventures and equity investments is reported in non-operating gains/losses in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

These investments, which are reported as noncurrent assets in the accompanying consolidated financial statements, are summarized as follows as of June 30:

Name	2019	2018
Magnolia Gardens LLC	\$ 5,210,175	\$ 5,347,172
University Center for Ambulatory Surgery	(922,539)	(675,494)
Maui	0	34,562
Diagnostic Imaging, LLC	732,290	691,859
	<u>\$ 5,019,926</u>	<u>\$ 5,398,099</u>

5. Related Party Transactions

The Hospital has income guarantee agreements with certain physicians. These advances are held as promissory notes and are often forgiven based on the established terms of these notes, such as maintaining an active practice in the Hospital's community.

The Hospital advanced funds to Health Ventures in its establishment of MMS. Since MMS is wholly owned by Health Ventures, the amounts loaned to MMS have been eliminated in consolidation.

The Medical Director of Radiology for the Hospital is an investor in DI, which is an unconsolidated subsidiary of Health Ventures. The Medical Director of DCP, who is also a Foundation board member, leases property to the Hospital and CHP.

6. Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows:

Name	Useful Life	June 30	
		2019	2018
Land improvements	2-40 Years	\$ 4,525,777	\$ 4,525,777
Buildings	4-40 Years	137,331,411	137,331,414
Leasehold improvements	4-40 Years	5,130,560	5,130,560
Furniture and equipment	2-20 Years	105,396,278	99,559,406
Equipment under capital lease obligations	2-20 Years	190,000	190,000
		<u>252,574,026</u>	<u>246,737,157</u>
Less accumulated depreciation		<u>(157,091,894)</u>	<u>(148,156,738)</u>
		95,482,132	98,580,419
Construction in progress		730,289	2,541,396
Land		6,138,502	6,138,502
		<u>\$ 102,350,923</u>	<u>\$ 107,260,317</u>

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

Accumulated depreciation includes accumulated amortization of capital leased equipment in the amount of \$276,150 and \$207,017 as of June 30, 2019 and 2018, respectively. Depreciation expense related to capital leased equipment was \$69,133 and \$61,350 for fiscal year 2019 and 2018, respectively.

7. Long-Term Debt

Long-term indebtedness as of June 30 consisted of the following:

	2019	2018
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2017B Bond 2.180% term bonds due October 1, 2024	\$ 28,570,000	\$ 33,510,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2016 Bond Series 2016A Tax Exempt Private Placement 2007 Refunding 2.567% term bonds due July 1, 2030	16,795,000	16,795,000
Series 2016A Tax Exempt Private Placement 2010 Partial Refunding 2.567% term bonds due July 1, 2030	15,150,000	15,150,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2017A: 5.00% term bonds due July 1, 2031	6,720,000	6,720,000
5.00% term bonds due July 1, 2032	7,055,000	7,055,000
5.00% term bonds due July 1, 2033	7,410,000	7,410,000
5.00% term bonds due July 1, 2034	7,780,000	7,780,000
5.00% term bonds due July 1, 2038	35,200,000	35,200,000
Capital leases	77,255	118,945
	<u>\$ 124,757,255</u>	<u>\$ 129,738,945</u>
Current portion of long-term debt	(4,448,457)	(4,981,689)
Financing costs, net of accumulated amortization	(1,514,133)	(1,701,053)
Original issue premium, net of accumulated amortization	3,599,400	3,832,791
	<u>\$ 122,394,065</u>	<u>\$ 126,888,994</u>

The fair value of the Company's Series 2018A bonds, based on quoted market prices, was \$72,482,555 and \$70,428,072 for fiscal year 2019 and 2018, respectively. Remaining bonds are private placement bonds. Fair value of the private placement bonds approximate carrying value.

Financing costs incurred in issuing the Maryland Health and Higher Education Facilities Authority (MHHEFA) Revenue Bonds have been capitalized by the Hospital. These costs are being amortized over the life of the related bond issue using the bonds-outstanding method, which approximates the interest method. Deferred financing costs are presented as a direct deduction of long-term debt and are amortized using the straight-line method over the term of the related financing.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

The aggregate maturities of long-term debt, including sinking fund principal requirements during the next five fiscal years, are as follows:

2020	\$4,448,457
2021	4,978,798
2022	5,070,000
2023	5,195,000
2024	5,265,000
2025 and after	99,800,000
	<u>\$ 124,757,255</u>

Total interest paid for the years ended June 30, 2019 and 2018 was \$4,768,000 and \$4,648,000, respectively.

Revenue bonds

On February 8, 2017 MHHEFA issued \$64,165,000 principal amount of Revenue Bonds, Series 2017A. The proceeds of this issue were used to retire the remainder of the Series 2010 Bonds in order to take advantage of lower interest rates with an estimated net present value savings of \$3.7 million.

On June 28, 2016 MHHEFA issued \$73,445,000 principal amount of Revenue Bonds, Series 2016A (\$31,945,000) and Series 2016B (\$41,500,000). The proceeds of this issue were used to retire the Series 2007A Bonds and Series 2010 Bonds (partial) in order to take advantage of lower interest rates with an estimated net present value savings of \$7.3 million. In 2017, the Series 2016B taxable note was converted as planned to Series 2017B. On March 23, 2017 the Series 2016 were converted to Series 2017B bonds as planned when the 2016B bonds were issued in June 2016.

The Obligated Group for MHHEFA bond issuances includes the Hospital, CHP, Foundation, Sleep Center, Doctors Community Medical Group and Doctors Integrated Healthcare Network and Health Ventures excluding the MAUI, Magnolia Gardens, DI LLC, ACO, and STM. The Series 2017A, Series 2017B, and Series 2016 Bonds are secured by the revenue and accounts receivable of the Obligated Group, and certain other property secured by a Deed of Trust. The Obligated Group is required to maintain certain compliance ratios and covenants as defined under the bond documents. In the opinion of the management, the Hospital has complied with the required covenants for 2017 and 2016.

Other debt

During 2008, DRCC obtained a \$4,000,000 revolving line of credit from a commercial lender to finance the acquisition of certain medical equipment. The line of credit was converted to a capital lease during 2009. Beginning in October 2009, monthly payments of principal and interest at 6.8% per annum become due. In July 2012, DRCC modified the capital equipment lease to obtain an interest rate of 3.6%. This lease ended January 2019.

During 2018, the Hospital obtained a \$155,672 capital lease for surgical equipment. Beginning in August 2017, monthly payments of principal and interest at 4.16% per annum commenced. The outstanding principal balance is \$77,255 as of June 30, 2019.

8. Professional and General Liabilities, Workers Compensation, and Employee Health Coverages

The Hospital has coverage for professional and general liabilities on a claims-made basis from Freestate Healthcare Insurance Company, Ltd., a group captive formed by several Maryland hospitals. The Hospital owns 20% interest in the captive and accounts for it using the cost method. The cost of \$15,000 is recorded in other noncurrent assets in the accompanying consolidated balance sheets as of June 30, 2019 and 2018. Premiums

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

are expensed as incurred and are established based on the Hospital's historical experience supplemented as necessary with industry experience. The total premium is allocated to each of the shareholders based on their experience. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment of credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2019. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

The captive is responsible for claims up to \$1,000,000 for each and every loss event. Additional coverage has been purchased by the captive for all claims in excess of \$1,000,000 to a limit of \$6,000,000 effective March 1, 2006, \$10,000,000 effective March 1, 2012, and \$15,000,000 March 1, 2019. The estimated unpaid loss liability reserved by the captive for the Hospital was \$10,656,429 and \$10,679,655 at June 30, 2019 and 2018, respectively. These amounts are included in long term liabilities and the related anticipated insurance recoveries were reported in noncurrent assets in the accompanying consolidated balance sheets. The liability for all claims incurred but not reported for the Hospital was \$1,066,000 and \$1,351,000 at June 30, 2019 and 2018, respectively. The discount rate for unpaid losses is 3.5% for years ending June 30, 2019 and 2018. The Hospital engages a consulting actuary to assist in the determination of all professional liability claims incurred but not reported.

The Company is self-insured against workers' compensation claims up to a per-claim limit of \$500,000 with an annual limitation of approximately \$1,000,000. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of \$1,080,971 and \$1,138,752 at June 30, 2019 and 2018, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

The Company is self-insured against employee health medical claims up to a per-claim limit of \$200,000 and no maximum aggregate benefit. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of \$621,000 and \$590,000 at June 30, 2019 and 2018, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

9. Leases

The Company has operating leases covering various medical and other equipment and facilities. Generally, the leases carry renewal provisions and require the Company to pay maintenance costs.

Future minimum lease payments as of June 30, 2019 are as follows:

	Capital Leases	Operating Leases	Total
2020	\$ 43,457	\$ 3,730,681	\$ 3,774,138
2021	33,798	3,207,274	3,241,072
2022	0	1,122,836	1,122,836
2023	0	846,883	846,883
Total minimum lease payments	<u>77,255</u>	<u>\$ 8,907,674</u>	<u>\$ 8,984,929</u>
Current portion of capital leases	(43,457)		
Capital lease obligations, less current portion	<u>\$ 33,798</u>		

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

Total rental expense reported in the accompanying consolidated statements of operations and other changes in net assets without donor restrictions for the years ended June 30, 2019 and 2018 was \$4,520,459 and \$4,590,269, respectively.

10. Retirement Plans

The Company has a 403b defined contribution plan (the "contribution plan") covering substantially all its employees. The contribution plan is employee and employer contributory. The Company contributed a match of \$0.50 for every \$1.00 of elective deferrals for a plan year for eligible employees up to 4% of base compensation. Defined contribution plan expense amounted to \$1,422,542 and \$1,358,026 for 2019 and 2018, respectively.

The Company froze the defined benefit pension plan that it sponsors (the Plan) in 2011, which covered substantially all employees. The decision to terminate the Plan has not been made by the board of directors. The benefits are based on years of service and employee compensation during years of employment. The Company's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Company expects to contribute \$731,210 to the Plan during 2019 to keep the funding levels at the ERISA requirements. The measurement date of the Plan is June 30.

The following table provides a reconciliation of the benefit obligation, Plan assets, and funded status of the Plan in the Company's consolidated financial statements based on actuarial valuations for the years ended June 30:

	For the Year Ended	
	2019	2018
Accumulated Benefit Obligation		
Change in Benefit Obligation		
Benefit Obligation at beginning of year	\$ 22,871,105	\$ 23,860,808
Interest cost	796,893	767,879
Settlement loss/(gain)	(14,800)	59,434
Actuarial loss/(gain)	1,234,497	(848,735)
Settlement payments	(3,136,449)	(884,944)
Benefits paid	(89,780)	(83,337)
Benefit Obligation at End of Year	\$ 21,661,466	\$ 22,871,105
Change in Plan Assets		
Fair value of plan assets at beginning of year	\$ 18,711,547	\$ 18,094,964
Actual return on plan assets	525,639	777,090
Employer contributions	649,116	807,774
Settlement payments	(3,136,449)	(884,944)
Benefits paid	(89,780)	(83,337)
Fair Value of Plan Assets at End of Year	\$ 16,660,073	\$ 18,711,547
Funded Status (Pension Obligation)	\$ (5,001,393)	\$ (4,159,558)
Components of Net Periodic Benefit Costs		
Interest cost	796,893	767,879
Expected return on plan assets	(942,470)	(1,019,667)
Settlement	1,181,733	315,334
Recognition of loss from change in measurement date	497,360	571,181
Net Period Pension Costs	\$ 1,533,516	\$ 634,727

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

The total amount recognized in net assets without donor restrictions in the accompanying consolidated financial statements for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Net actuarial loss	\$ 8,107,158	\$ 8,149,723

During 2018, lump sum distributions exceeded the Plan's interest cost triggering a settlement event. As a result, a settlement loss of \$1,181,733 and \$315,334 was recognized for 2019 and 2018, respectively.

Plan assets are invested to ensure that the Plan has the ability to pay all benefit and expense obligations when due, to maximize return within prudent levels of risk for pension assets, and to maintain a funding cushion for unexpected developments. The target weighted-average asset allocation of pension investments was 35% equities and 65% fixed maturity securities and cash as of June 30, 2019.

The Plan's estimated future benefit payments are as follows:

2020	\$ 2,289,270
2021	1,404,901
2022	1,291,287
2023	1,270,877
2024	1,291,441
2025 - 2029	6,743,826
Total	<u><u>\$ 14,291,602</u></u>

The weighted-average assumptions used to determine net periodic benefit cost and the projected benefit obligation for the years ended June 30 were as follows:

	<u>2019</u>	<u>2018</u>
Discount rate	3.10%	3.90%
Expected return on Plan assets	6.00%	6.00%

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2019:

	Level 1	Level 2	Level 3	Total Fair Value
Equity Securities				
Mutual Funds				
Diversified Emerging Mkts	\$ 412,261	\$ 0	\$ 0	\$ 412,261
Foreign Large Blend	333,347	0	0	333,347
Foreign Small/Mid Growth	84,096	0	0	84,096
High Yield Bond	1,658,239	0	0	1,658,239
Inflation-Protected Bond	1,691,182	0	0	1,691,182
Intermediate Government	1,689,794	0	0	1,689,794
Intermediate-Term Bond	3,215,307	0	0	3,215,307
Large Growth	1,324,825	0	0	1,324,825
Large Value	1,175,464	0	0	1,175,464
Mid-Cap Growth	823,906	0	0	823,906
Mid-Cap Value	850,896	0	0	850,896
Multisector Bond	2,537,735	0	0	2,537,735
Small Growth	358,485	0	0	358,485
Small Value	504,536	0	0	504,536
Total assets	\$ 16,660,073	\$ 0	\$ 0	\$ 16,660,073

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2018:

	Level 1	Level 2	Level 3	Total Fair Value
Equity Securities				
Mutual Funds				
Diversified Emerging Mkts	\$ 446,394	\$ 0	\$ 0	\$ 446,394
Foreign Large Blend	360,471	0	0	360,471
Foreign Small/Mid Growth	96,427	0	0	96,427
High Yield Bond	1,892,665	0	0	1,892,665
Inflation-Protected Bond	1,903,459	0	0	1,903,459
Intermediate Government	1,889,478	0	0	1,889,478
Intermediate-Term Bond	3,591,148	0	0	3,591,148
Large Growth	1,532,237	0	0	1,532,237
Large Value	1,315,072	0	0	1,315,072
Mid-Cap Growth	959,130	0	0	959,130
Mid-Cap Value	934,540	0	0	934,540
Multisector Bond	2,792,597	0	0	2,792,597
Small Growth	419,080	0	0	419,080
Small Value	578,849	0	0	578,849
Total assets	\$ 18,711,547	\$ 0	\$ 0	\$ 18,711,547

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2019 and 2018.

The Hospital has a deferred compensation plan that permits certain executives to defer receiving a portion of their compensation. The deferred amounts are included in other assets in the accompanying consolidated balance sheets. The associated liability of an equal amount is included in other liabilities in the accompanying consolidated

Doctors Community Hospital and Subsidiaries
Notes to the Consolidated Financial Statements

balance sheets. The liability recorded regarding the deferred compensation was \$4,253,265 and \$3,949,258 as of June 30, 2019 and 2018, respectively. During 2019 and 2018, distributions of \$85,329 and \$30,870 were made to participants in the deferred compensation plan, respectively.

The Hospital is the beneficiary of split dollar life insurance policies in place for certain executives. The amounts that could be realized by the Hospital under the insurance contracts are approximately \$9,000,000 as of both June 30, 2019 and 2018 and are included in other assets in the consolidated balance sheets.

11. Maryland Health Services Cost Review Commission

Certain of the Hospital's charges are subject to review and approval by the Commission. Hospital management has filed the required forms with the Commission and believes the Hospital is in compliance with Commission requirements.

The current rate of reimbursement for principally all hospital inpatient and outpatient services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare reimbursement principles under Section 1814(b) of the Social Security Act and will continue as long as all third-party payers elect to be reimbursed under this program, the rate of increase for costs per hospital services is below the national average, and certain specific quality indicators are met. In January 2014, the State of Maryland and CMS agreed to implement a revised waiver focused on population health, and the previous waiver was terminated.

This was a new global budget arrangement which set a fixed revenue amount for the upcoming year, without fluctuation due to utilization or case mix. This was a five-year demonstration where Maryland successfully made significant progress toward reducing costs inside and outside of the hospital as well as improving patient care. Beginning January 2019 the new "Total Cost of Care Model" (the "Model") was approved and builds upon the successes of the All-Payer Model. The Model encourages continued clinical redesign and provides tools to providers to treat complex and chronic conditions and is built on the same global budget arrangement mechanics for revenue setting as the predecessor model. This is approved for a 10-year term provided Maryland meets the Model performance requirements.

Management believes that the waiver program will remain in effect at least through June 2020. The Hospital undercharged its revenue target by \$928,478 and \$1,747,735 as of June 30, 2019 and 2018, respectively. Overcharges and undercharges are recouped in succeeding years through the Commission's rate setting methodology.

The timing of the Commission's rate adjustments for the Hospital could result in an increase or reduction in rates due to the variances and penalties in a year subsequent to the year in which such items occur. The Hospital's policy is to accrue revenue based on actual charges for services to patients in the year in which the services to patients are performed and billed.

12. Contingencies

Litigation

There are several lawsuits pending in which the Hospital has been named as defendant. In the opinion of Hospital management, after consultation with legal counsel, the potential liability, in the event of adverse settlement, will not have a material impact on the Hospital's consolidated financial position.

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

Risk factors

The Company's ability to maintain and/or increase future revenues could be adversely affected by:

- The growth of managed care organizations promoting alternative methods for health care delivery and payment of services such as discounted fee for service networks and capitated fee arrangements (the rate setting process in the State of Maryland prohibits hospitals from entering into discounted fee arrangements; however, managed care contracts may provide for exclusive service arrangements);
- Proposed and/or future changes in the laws, rules, regulations, and policies relating to the definition, activities, and/or taxation of not-for-profit tax-exempt entities;
- The enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology and/or further reductions in payments to hospitals and other health care providers;
- The future of Maryland's certificate of need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate the Company's ability to expand new services; and
- The ultimate impact of, and any changes to, the federal Patient Protection and Affordable Care Act and the Health Care Education Affordability Reconciliation Act of 2010.

The Joint Commission, a non-governmental privately owned entity, provides accreditation status to hospitals and other health care 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 payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the 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/payers would have a materially negative impact on the future financial position, operating results and cash flows of the Hospital. In February 2019 the Hospital was surveyed by Joint Commission and received a full three-year Joint Commission accreditation through February 2022.

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

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

13. Goodwill

The Company uses the acquisition method of accounting to record goodwill when purchasing physician practices and other similar entities. The table below presents goodwill that has been recorded as of June 30 for the following acquisitions:

	2019	2018
Cancer center, DRCC	\$ 1,062,531	\$ 1,062,531
Orthopedic practice	376,316	376,316
Nursing home	767,285	767,285
Surgery center	20,416	20,416
Cancer center, MRCC	646,975	646,975
Physician practices	197,375	197,375
	<u>\$ 3,070,898</u>	<u>\$ 3,070,898</u>

14. Liquidity and Availability

Financial assets available for general expenditure within one year of the consolidated balance sheet date, consist the following at June 30, 2019:

	2019
Cash and cash equivalents	\$ 34,168,164
Patient accounts receivable, net	38,839,947
Pledges receivable, net	201,332
Other receivables	5,418,525
Investments with daily and weekly liquidity	17,436,369
Total	<u>\$ 96,064,337</u>

Doctors Community Hospital and Subsidiaries
Notes to Consolidated Financial Statements

15. Net Assets With Donor Restrictions

Net assets with donor restrictions are available as of June 30 for the following programs and projects:

	2019	2018
Nancy Heilman Scholarship Fund	\$ 1,479	\$ 1,479
Brian Erfan Memorial Fund	5,850	5,850
Jane Schafer Scholarship Fund	10,785	10,785
Rehabilitation Services	12,937	12,937
Cardiac Rehab Services	7,389	20,088
Pulmonary Rehab Scholarship Fund	38,832	13,685
Borden Breast Center	20,000	20,000
Women's Health	119,015	94,304
Koman Grant	50,000	307,471
Diabetes Center	0	31,895
Lymphedema Center	7,826	7,826
Smoking Grant	14,755	14,755
Community Outreach	38,045	56,977
Behavioral Health	22,572	22,572
MHA HPP Disaster Grant	2,196	20,954
Health fair Screening	2,891	2,891
So. Md. Transitional Care Partnership	104,979	138,420
DHMH Biosense Grant	4,575	4,575
Population Health: Mobile Clinic	20,282	15,000
Volunteers	403	3,099
Multi-Faith Worship Center	1,999	33,357
	<u>\$ 486,810</u>	<u>\$ 838,920</u>

16. Subsequent Event

On July 1, 2019, the Company completed a transaction that resulted in the Company becoming a wholly-controlled subsidiary of Anne Arundel Health System (AAHS). The new combined entity will change its name in the interim to Luminis Health, pending selection of an appropriate name for the new combined health system. This transaction will be accounted for as an acquisition under current accounting standards during the year ending June 30, 2020. No consideration was exchanged in the transaction; however, AAHS has committed to investing \$138 million into the Company over a period of 5 years.

Supplementary Information

Doctors Community Hospital and Subsidiaries
Consolidating Balance Sheet
June 30, 2019

	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	UCAS	STW, ACO	Eliminations	Total
ASSETS												
CURRENT ASSETS												
Cash and cash equivalents	\$ 27,810,649	\$ 1,356,722	\$ 866,179	\$ 573,044	\$ 0	\$ 0	\$ 30,608,594	\$ 3,516,526	\$ 0	\$ 43,044	\$ 0	\$ 34,188,164
Gross patient accounts receivable	43,275,906	7,869,147	0	759,116	0	0	51,903,169	2,379,259	0	24,634	0	54,307,062
Less: allowances for implicit price concessions	(5,684,147)	(5,579)	0	(28,840)	0	0	(5,718,566)	(404,090)	0	0	0	(6,122,656)
Less: allowance for explicit price concessions	(4,282,270)	(3,136,320)	0	(543,550)	0	0	(7,962,140)	(1,382,487)	0	168	0	(9,344,459)
Patient accounts receivable, net	33,309,489	4,727,248	0	185,726	0	0	38,222,463	592,662	0	24,802	0	38,839,947
Other amounts receivable	2,867,703	(103,337)	434,893	271,571	0	0	3,470,920	268,000	0	1,890,937	0	5,619,857
Inventories	4,223,973	0	0	19,383	0	0	4,243,356	0	0	0	0	4,243,356
Prepaid expenses	3,361,481	233,476	0	169,699	0	0	3,764,656	213,161	0	3,227	0	3,981,044
TOTAL CURRENT ASSETS	71,573,285	6,216,109	1,301,162	1,219,423	0	0	80,309,989	4,590,369	0	1,952,010	0	86,852,368
INVESTMENTS												
Marketable securities	17,436,369	0	0	0	0	0	17,436,369	821,415	0	0	0	18,257,784
Investment in Doctors Regional Cancer Center	4,353,115	0	0	0	0	(4,353,115)	0	0	0	0	0	0
Joint ventures and equity investments	0	0	0	5,019,926	0	(5,019,926)	0	0	5,019,926	0	0	5,019,926
TOTAL INVESTMENTS	21,789,484	0	0	5,019,926	0	(9,373,041)	17,436,369	821,415	5,019,926	0	0	23,277,710
NET ASSETS	89,225,468	0	0	7,540,701	0	(65,372,301)	11,369,868	0	0	(11,369,868)	0	0
LAND, BUILDING AND EQUIPMENT												
Land and land improvements	10,664,279	0	0	0	0	0	10,664,279	0	0	0	0	10,664,279
Building and fixed equipment	129,239,762	2,362,564	0	0	0	0	131,602,326	0	0	0	0	131,602,326
Medical office building	8,091,651	0	0	0	0	0	8,091,651	0	0	0	0	8,091,651
Major movable equipment	96,578,450	0	0	1,495,709	0	0	98,075,159	10,279,113	0	0	0	108,354,272
Construction in progress	730,289	0	0	0	0	0	730,289	0	0	0	0	730,289
Accumulated depreciation	(146,702,849)	(1,113,389)	0	(915,267)	0	0	(148,731,505)	(8,360,389)	0	0	0	(157,091,894)
TOTAL LAND, BUILDING AND EQUIPMENT	98,601,582	1,249,175	0	581,442	0	0	100,432,199	1,918,724	0	0	0	102,350,923
GOODWILL	1,439,847	197,375	0	786,701	0	0	2,423,923	646,975	0	0	0	3,070,898
OTHER ASSETS	27,650,211	12,271	0	911,539	0	(2,485,069)	26,088,952	0	0	3,903	0	26,092,855
TOTAL ASSETS	\$310,279,887	\$ 7,674,930	\$ 1,301,162	\$ 8,519,031	\$ 7,540,701	\$ (97,230,411)	\$238,085,300	\$ 7,977,483	\$ 5,019,926	\$ 1,955,913	\$ (11,369,868)	\$241,644,754

See independent auditors' report.

Doctors Community Hospital and Subsidiaries
 Consolidating Balance Sheet
 June 30, 2019

(Continued)

	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	Magnolia Gardens, MAUI, DI, UCAS	STM ACO	Eliminations	Total
LIABILITIES AND NET ASSETS												
CURRENT LIABILITIES												
Accounts payable and accrued expenses	\$ 14,064,991	\$ 683,369	\$ 23,721	\$ 267,592	\$ 67,217	\$ 0	15,106,890	\$ 562,381	\$ 0	\$ 139,214	\$ 0	\$ 15,828,485
Due to DCH	7,540,701	42,808,018	952,380	2,922,460	0	(53,149,226)	1,074,333	139,910	0	10,179,625	(11,399,868)	0
Salaries, wages, and related items	15,711,508	331,562	0	3,046	0	0	16,046,116	0	0	0	0	16,046,116
Advances from third party payers	7,765,308	0	0	0	0	0	7,765,308	0	0	0	0	7,765,308
Current portion of long-term obligations	4,448,457	0	0	0	0	0	4,448,457	0	0	0	0	4,448,457
TOTAL CURRENT LIABILITIES	49,530,965	43,822,949	976,101	3,193,098	67,217	(53,149,226)	44,441,104	722,291	0	10,318,839	(11,399,868)	44,086,366
NONCURRENT LIABILITIES												
Deferred compensation and claims incurred but not reported	16,005,694	0	0	0	0	0	16,005,694	0	0	0	0	16,005,694
Pension obligation	5,001,393	0	0	0	0	0	5,001,393	0	0	0	0	5,001,393
Long-term obligation, net of current portion	122,394,065	0	0	32,223,076	0	(32,223,076)	122,394,065	0	0	0	0	122,394,065
TOTAL LIABILITIES	192,932,117	43,822,949	976,101	35,416,174	67,217	(65,372,302)	187,842,258	722,291	0	10,318,839	(11,399,868)	187,489,518
NET ASSETS AND MEMBERS' EQUITY												
Without donor restrictions	117,166,021	(36,148,019)	0	0	7,473,484	(41,020,637)	47,490,849	0	0	(2,110,280)	5,385,779	50,766,348
Members' equity	0	0	0	(26,897,143)	0	26,897,142	(1)	7,255,192	5,019,926	(6,252,646)	(5,365,779)	636,692
With donor restrictions	161,749	0	325,061	0	0	0	486,810	0	0	0	0	486,810
Noncontrolling interest	0	0	0	0	0	2,265,386	2,265,386	0	0	0	0	2,265,386
TOTAL LIABILITIES AND NET ASSETS	\$310,279,887	\$ 7,674,930	\$ 1,301,162	\$ 8,519,031	\$ 7,540,701	\$ (97,230,411)	\$238,085,300	\$ 7,977,483	\$ 5,019,926	\$ 1,955,913	\$ (11,399,868)	\$241,644,754

See independent auditors' report.

**Doctors Community Hospital and Subsidiaries
Consolidating Statement of Operations and Changes in Net Assets
June 30, 2019**

	Hospital	Healthcare Programs	Foundation	Health Ventures	Sleep Center	Eliminations	Obligated Group	DRCC	Magnolia Gardens, MAUI, DI, UCAS	STM, ACO	Total
UNRESTRICTED NET ASSETS											
OPERATING REVENUE											
Inpatient revenue	\$ 146,114,701	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 146,114,701	\$ 0	\$ 0	\$ 0	\$ 146,114,701
Outpatient revenue	108,258,073	44,607,426	0	10,461,290	2,958,798	0	166,285,587	23,576,899	(1,755)	0	189,860,725
Less: explicit price concessions	(32,809,444)	(28,605,627)	0	(5,289,022)	0	0	(66,704,093)	(14,843,235)	0	0	(81,547,328)
Patient service revenue, net of explicit price concessions	221,563,330	16,001,799	0	5,172,268	2,958,798	0	245,696,195	8,733,658	(1,755)	0	254,428,098
Less: implicit price concessions	(10,220,973)	(892,639)	0	0	0	0	(11,113,612)	42,595	0	0	(11,071,017)
Net patient service revenue	211,342,357	15,109,160	0	5,172,268	2,958,798	0	234,582,583	8,776,253	(1,755)	0	243,357,081
Other operating revenue	3,315,472	489,200	11,180	(28,315)	0	0	3,787,537	0	0	1,800,049	5,587,586
Contributions	0	0	195,528	0	0	0	195,528	0	0	0	195,528
Net assets released from restrictions	385,403	608,160	0	0	0	0	993,563	0	0	0	993,563
TOTAL OPERATING REVENUE	215,043,232	16,206,520	206,708	5,143,953	2,958,798	0	239,559,211	8,776,253	0	1,798,294	250,133,798
EXPENSES											
Salaries and wages	86,409,582	14,772,330	350,558	3,563,049	0	0	105,095,519	1,353,100	0	0	106,447,619
Employee benefits	13,775,855	2,240,008	84,415	686,073	0	0	16,786,351	147,899	0	0	16,934,250
Purchased services	30,963,044	2,588,968	14,355	448,215	936,384	0	34,950,966	4,603,350	0	995,594	40,549,850
Supplies	35,591,254	660,884	7,889	397,843	3,917	0	36,661,537	82,770	0	0	36,744,307
Other expenses	20,541,604	2,134,690	7,680	2,304,264	152,489	0	25,140,727	905,461	4,635	0	26,050,823
Depreciation	7,997,413	249,234	0	32,119	0	0	8,278,766	700,750	0	0	8,979,516
Amortization	186,921	0	0	0	0	0	186,921	0	0	0	186,921
Fundraising	0	0	80,994	0	0	0	80,994	0	0	0	80,994
Interest	4,766,953	0	0	0	0	0	4,766,953	1,300	0	0	4,768,253
TOTAL EXPENSES	200,232,626	22,646,114	545,841	7,431,363	1,092,790	0	231,948,734	7,793,630	0	1,000,169	240,742,533
INCOME (LOSS) FROM OPERATIONS	14,810,606	(6,439,594)	(339,133)	(2,287,410)	1,866,008	0	7,610,477	982,623	0	798,125	9,391,225
NONOPERATING GAINS (LOSSES)											
Gain from sale of property	(12,747)	0	0	1,500	0	0	(11,247)	0	0	0	(11,247)
Pension costs	(1,533,516)	0	0	0	0	0	(1,533,516)	0	0	0	(1,533,516)
Unrealized gain on trading securities	145,650	0	0	0	0	0	145,650	0	0	0	145,650
Equity in joint ventures	589,574	0	0	311,435	0	0	901,009	0	0	0	901,009
EXCESS OF REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	13,999,547	(6,439,594)	(339,133)	(1,974,475)	1,866,008	(901,009)	6,211,344	982,623	311,435	798,125	8,303,527
Net asset transfer	(339,134)	0	339,134	1,379,216	0	(689,608)	689,608	0	(689,608)	0	0
Contributions	379,987	0	600,103	0	0	0	980,090	0	0	0	980,090
Net assets released from restrictions for use in operations	(382,187)	0	(611,376)	0	0	0	(993,563)	0	0	0	(993,563)
Net assets released from restrictions for capital acquisitions	338,639	0	(338,639)	0	0	0	0	0	0	0	0
Pension - related changes other than net periodic pension cost	42,565	0	0	0	0	0	42,565	0	0	0	42,565
Increase (decrease) in net assets	14,039,417	(6,439,594)	(349,911)	(595,259)	1,866,008	(1,590,617)	6,930,044	982,623	(378,173)	798,125	8,332,619
Net assets, beginning of year	103,308,353	(29,708,425)	674,972	(30,320,767)	5,607,476	(6,248,609)	43,313,000	6,272,569	5,998,099	(9,161,051)	45,822,617
Net assets, end of year	\$ 117,347,770	\$ (36,148,019)	\$ 325,061	\$ (30,916,026)	\$ 7,473,484	\$ (7,839,226)	\$ 50,243,044	\$ 7,255,192	\$ 5,019,926	\$ (8,362,926)	\$ 54,155,236

See independent auditors' report.

CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Anne Arundel Health System, Inc. and Subsidiaries
Years Ended June 30, 2019 and 2018
With Report of Independent Auditors

Ernst & Young LLP



Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Financial Statements and Supplementary Information

Years Ended June 30, 2019 and 2018

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Report of Independent Auditors

The Board of Trustees
Anne Arundel Health System, Inc.

We have audited the accompanying consolidated financial statements of Anne Arundel Health System, Inc. (a Maryland not-for-profit corporation) and subsidiaries, which comprise the consolidated balance sheets as of June 30, 2019 and 2018, 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 Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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 did not audit the financial statements of Cottage Insurance Company, Ltd., a wholly owned subsidiary, which statements reflect total assets of \$39,535,000 and \$51,647,000 as of June 30, 2019 and 2018, respectively, and net loss after elimination of intercompany revenues of \$10,149,000 and \$7,137,000, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Cottage Insurance Company, Ltd., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used



and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Anne Arundel Health System, Inc. and subsidiaries at June 30, 2019 and 2018, and the consolidated results of their operations, changes in their net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Adoption of New Accounting Pronouncements

As discussed in Note 2 to the consolidated financial statements, the System changed its method for revenue recognition as a result of the adoption of the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*, effective July 1, 2018. The System also changed the presentation and related disclosures of net assets as a result of the adoption of the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, effective June 30, 2019. Our opinion is not modified with respect to these matters.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating information is presented for purposes of additional analysis 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst & Young LLP

October 23, 2019

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

	June 30	
	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 15,100,000	\$ 101,403,000
Short-term investments	15,261,000	11,771,000
Current portion of assets whose use is limited	15,190,000	14,521,000
Patient receivables, net	80,307,000	78,889,000
Current portion of pledges receivable, net	494,000	1,017,000
Inventories	8,650,000	7,976,000
Prepaid expenses and other current assets	14,125,000	11,391,000
Total current assets	<u>149,127,000</u>	<u>226,968,000</u>
Property and equipment	918,666,000	884,437,000
Less accumulated depreciation and amortization	<u>(493,004,000)</u>	<u>(456,606,000)</u>
Net property and equipment	<u>425,662,000</u>	<u>427,831,000</u>
Other assets:		
Investments	386,056,000	292,636,000
Investments in joint ventures	8,886,000	9,740,000
Pledges receivable, net	2,802,000	3,098,000
Assets whose use is limited	35,973,000	36,375,000
Restricted collateral for interest rate swap contract	67,404,000	44,893,000
Other assets	34,374,000	43,856,000
Total assets	<u>\$ 1,110,284,000</u>	<u>\$ 1,085,397,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Balance Sheets (continued)

	June 30	
	2019	2018
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 30,458,000	\$ 21,915,000
Accrued salaries, wages, and benefits	37,814,000	36,100,000
Other accrued expenses	18,389,000	21,478,000
Current portion of long-term debt	11,029,000	8,848,000
Advances from third-party payors	23,903,000	21,005,000
Total current liabilities	<u>121,593,000</u>	<u>109,346,000</u>
Long-term debt, less current portion and unamortized original issue premium	359,735,000	372,283,000
Interest rate swap contracts	78,479,000	59,303,000
Accrued pension liability	6,076,000	3,314,000
Other long-term liabilities	37,010,000	45,829,000
Total liabilities	<u>602,893,000</u>	<u>590,075,000</u>
Net assets:		
Without donor restrictions	482,661,000	469,018,000
With donor restrictions	24,730,000	26,304,000
Total net assets	<u>507,391,000</u>	<u>495,322,000</u>
Total liabilities and net assets	<u>\$ 1,110,284,000</u>	<u>\$ 1,085,397,000</u>

See accompanying notes.

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30	
	2019	2018
Operating revenue:		
Net patient service revenue (net of contractual allowances)	\$ 742,876,000	\$ 725,266,000
Provision for bad debts	—	(17,886,000)
Net patient service revenue	<u>742,876,000</u>	<u>707,380,000</u>
Other operating revenue	33,180,000	28,093,000
Total operating revenue	<u>776,056,000</u>	<u>735,473,000</u>
Operating expenses:		
Salaries and wages	349,660,000	328,636,000
Employee benefits	56,356,000	52,781,000
Supplies	159,489,000	151,547,000
Purchased services	137,557,000	129,086,000
Depreciation and amortization	36,833,000	36,373,000
Interest	13,118,000	13,205,000
Transaction costs	3,279,000	—
Total operating expenses	<u>756,292,000</u>	<u>711,628,000</u>
Operating income	<u>19,764,000</u>	<u>23,845,000</u>
Other (loss) income:		
Investment income, net	13,873,000	11,214,000
Loss on advance refunding of debt	—	(6,056,000)
Loss from joint ventures and other, net	(545,000)	(1,730,000)
Pension expense	(4,777,000)	(230,000)
Change in unrealized losses on trading securities, net	10,034,000	8,170,000
Realized and unrealized (losses) gains on interest rate swap contracts, net	<u>(23,361,000)</u>	<u>8,858,000</u>
Total other (loss) income, net	<u>(4,776,000)</u>	<u>20,226,000</u>
Excess of revenue over expenses	<u>\$ 14,988,000</u>	<u>\$ 44,071,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

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

	Without Donor Restrictions	With Donor Restrictions	Total
Net assets, June 30, 2017	\$ 420,857,000	\$ 25,313,000	\$ 446,170,000
Excess of revenues over expenses	44,071,000	—	44,071,000
Pension liability adjustment	1,944,000	—	1,944,000
Released from restrictions used for purchase of property and equipment	592,000	—	592,000
Transfers and other, net	1,554,000	—	1,554,000
Restricted gifts, bequests, and contributions	—	6,834,000	6,834,000
Unrealized losses on investments	—	(180,000)	(180,000)
Restricted investment income	—	89,000	89,000
Net assets released from restrictions	—	(5,550,000)	(5,550,000)
Other	—	(202,000)	(202,000)
Changes in net assets	48,161,000	991,000	49,152,000
Net assets, June 30, 2018	469,018,000	26,304,000	495,322,000
Excess of revenues over expenses	14,988,000	—	14,988,000
Pension liability adjustment	(2,784,000)	—	(2,784,000)
Released from restrictions used for purchase of property and equipment	163,000	—	163,000
Transfers and other, net	1,276,000	—	1,276,000
Restricted gifts, bequests, and contributions	—	5,451,000	5,451,000
Unrealized losses on investments	—	(18,000)	(18,000)
Restricted investment income	—	60,000	60,000
Net assets released from restrictions	—	(7,964,000)	(7,964,000)
Other	—	897,000	897,000
Changes in net assets	13,643,000	(1,574,000)	12,069,000
Net assets, June 30, 2019	<u>\$ 482,661,000</u>	<u>\$ 24,730,000</u>	<u>\$ 507,391,000</u>

See accompanying notes.

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2019	2018
Operating activities		
Increase in net assets	\$ 12,069,000	\$ 49,152,000
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Change in net unrealized gains on investments	(10,016,000)	(7,990,000)
Realized and unrealized losses (gains) on interest rate swap contracts, net	23,361,000	(8,858,000)
Pension liability adjustment	2,784,000	(1,944,000)
Equity in earnings of joint ventures and other	854,000	1,143,000
Loss on advance refunding of debt	—	6,056,000
Distributions received from joint ventures	—	123,000
Restricted contributions and pledges, net	(5,374,000)	(6,834,000)
Depreciation and amortization	36,833,000	36,373,000
Restricted investment income	(60,000)	(89,000)
Increase in investments – trading	(86,894,000)	(9,650,000)
(Increase) decrease in assets whose use is limited, net – trading	(267,000)	13,335,000
Net change in operating assets and liabilities	6,846,000	(1,750,000)
Net cash (used in) provided by operating activities	<u>(19,864,000)</u>	<u>69,067,000</u>
Investing activities		
Purchases of property and equipment	(34,686,000)	(32,732,000)
Decrease in assets whose use is limited – other-than-trading	—	2,068,000
Change in collateralization and payments on interest rate swaps	(26,696,000)	1,216,000
Cash used for investments in joint ventures	—	(2,480,000)
Net cash used in investing activities	<u>(61,382,000)</u>	<u>(31,928,000)</u>
Financing and fundraising activities		
Payoff amount for 2008 Term and Construction Loans	(61,920,000)	—
Proceeds received from Real Estate Loan	61,920,000	—
Net proceeds from issuance of Series 2017 Revenue Bonds	—	60,245,000
Repayments of long-term debt	(11,310,000)	(1,930,000)
Advance refunding of Series 2010 Revenue Bond	—	(72,279,000)
Payments for deferred financing costs	—	(998,000)
Restricted contributions received and other	6,193,000	7,633,000
Restricted income received	60,000	89,000
Net cash used in financing and fundraising activities	<u>(5,057,000)</u>	<u>(7,240,000)</u>
Net (decrease) increase in cash and cash equivalents	(86,303,000)	29,899,000
Cash and cash equivalents at beginning of year	101,403,000	71,504,000
Cash and cash equivalents at end of year	<u>\$ 15,100,000</u>	<u>\$ 101,403,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2019	2018
Changes in operating assets and liabilities		
(Decrease) increase in operating assets:		
Patient receivables, net	\$ (1,418,000)	\$ (7,089,000)
Inventories	(674,000)	415,000
Prepaid expenses and other	(2,734,000)	1,423,000
Other assets	10,425,000	(5,232,000)
	<u>5,599,000</u>	<u>(10,483,000)</u>
 Increase (decrease) in operating liabilities:		
Accounts payable	8,543,000	1,662,000
Accrued salaries, wages, and benefits	1,714,000	7,541,000
Other accrued expenses	(3,089,000)	7,689,000
Advances from third-party payors	2,898,000	2,225,000
Other long-term liabilities	(8,819,000)	(10,384,000)
	<u>1,247,000</u>	<u>8,733,000</u>
Net change in operating assets and liabilities	<u>\$ 6,846,000</u>	<u>\$ (1,750,000)</u>
 Supplemental disclosures of cash flow information		
Cash paid for interest	<u>\$ 13,118,000</u>	<u>\$ 13,496,000</u>

See accompanying notes.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2019

1. Organization and Basis of Presentation

Anne Arundel Health System, Inc. (the Parent or the System) is a Maryland not-for-profit corporation. The Parent has the following wholly owned subsidiaries: Anne Arundel Medical Center, Inc. (the Hospital) and its subsidiaries; Anne Arundel Health Care Services, Inc. (HCS); Cottage Insurance Company, Ltd. (Cottage); Anne Arundel General Treatment Services, Inc. (GTS); Anne Arundel Health System Research Institute, Inc. (RI); Anne Arundel Medical Center Foundation, Inc. (the Foundation); Anne Arundel Health Care Enterprises, Inc. (HCE); Physician Enterprise, LLC (PE) and its subsidiaries; Anne Arundel Physician Group, LLC; AAMG Physical Therapy, LLC; Community Clinics, LLC; Anne Arundel FastCare, LLC; Orthopedic Physicians of Annapolis; Anne Arundel Medical Center Collaborative Care Network, LLC; Anne Arundel Real Estate Holding Company, Inc. (the Real Estate Company) and its subsidiaries; Pavilion Park, Inc. (PPI); Annapolis Exchange Lot IV, LLC; Annapolis Exchange Lot V, LLC; and Blue Building, LLC. The accompanying consolidated financial statements include the accounts of the Parent and its wholly owned subsidiaries (collectively, the Group). All significant intercompany accounts and transactions have been eliminated in consolidation. The Real Estate Company and PPI own a 42.84% interest in Kent Island Medical Arts, LLC (KIMA), a limited liability company that owns and operates a medical office building. PPI is the managing member of KIMA and has substantive participation rights in KIMA. The financial statements of KIMA are consolidated in the accompanying consolidated financial statements. The non-controlling interest in KIMA was 57.16% as of June 30, 2019 and 2018. This interest was \$884,000 and \$871,000 at June 30, 2019 and 2018, respectively, and is included within net assets without donor restrictions on the accompanying consolidated balance sheets.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents include cash held in checking and savings accounts, money market accounts, and short-term certificates of deposit with original maturities of 90 days or less. Cash balances and collateral held by a counterparty are principally uninsured and are subject to normal credit risks. At June 30, 2019 and 2018, and at various times during the year, the System maintained cash-in-bank balances in excess of the \$250,000 federally insured limits.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Derivative Instruments

On May 10, 2006, the Hospital entered into a forward variable-to-fixed interest rate swap agreement with an effective date of November 1, 2008. This contract was entered into in an effort to reduce the risk of variable interest rate debt and has a term through July 1, 2048. Under Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, the Hospital has recognized its derivative instruments as either assets or liabilities on the accompanying consolidated balance sheets at fair value. As these derivative instruments are not designated as hedges, the unrealized gain or loss on these contracts has been recognized on the accompanying consolidated statements of operations and changes in net assets as realized and unrealized gains (losses) on interest rate swap contracts, net. The fair market values of the derivative instruments include a credit valuation adjustment (CVA) as required by ASC 820, *Fair Value Measurement*. When applying the CVA, the valuation of the variable-to-fixed interest rate swap contract was decreased by \$361,000 and \$43,000 as of June 30, 2019 and 2018, respectively.

On March 23, 2016, in an effort to reduce the amount of restricted cash pledged as collateral with the original counterparty, the Hospital entered into a Novation Agreement with a second counterparty. Immediately prior to the Novation Agreement, the System modified the existing swap to bifurcate the existing swap into a five-year swap with the remainder into a 2021 through 2048 swap. The terms of the bifurcated swap remain identical to the original swap. The Novation Agreement resulted in the return of \$29,164,000 as of June 30, 2016.

A summary of the Hospital's derivative instruments and related activity at June 30, 2019 and 2018, and for the years then ended, is as follows:

<u>Description of Derivative Instrument</u>	<u>Fair Value Liability</u>	
	<u>2019</u>	<u>2018</u>
Variable-to-fixed interest rate swap contract (maturity date March 2021)	\$ (8,126,000)	\$ (10,251,000)
Variable-to-fixed interest rate swap contract (maturity date July 2048)	(70,353,000)	(49,052,000)
	<u>\$ (78,479,000)</u>	<u>\$ (59,303,000)</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The change in unrealized losses recognized in excess of revenues over expenses for the years ended June 30, 2019 and 2018, were \$(19,176,000) and \$(13,955,000), respectively.

At June 30, 2019 and 2018, the net termination value (i.e., mark-to-market value) of the derivative instruments totaled \$78,840,000 and \$60,518,000, respectively. The Hospital may be exposed to credit loss in the event of nonperformance by the other party to the interest rate swap agreements, the risk of which is reflected in the fair value of the instruments under ASC 820. However, the Hospital does not anticipate nonperformance by the counterparty.

During fiscal year 2019 and 2018, the Hospital paid net payments under its interest rate swap program of \$4,185,000 and \$5,097,000, respectively. These amounts are included within realized and unrealized gains (losses) on interest rate swap contracts, net on the accompanying consolidated statements of operations and changes in net assets and within investing activities on the accompanying consolidated statements of cash flows.

Under the derivative contract for the 2021 through 2048 swap, the Hospital must transfer collateral for the benefit of the counterparty, to the extent that the termination values exceed certain limits. The Hospital's collateral requirement for the benefit of the counterparty was approximately \$67,404,000 and \$44,893,000 at June 30, 2019 and 2018, respectively. The ongoing mark-to-market values and resulting collateral requirements of the Hospital's interest rate swap contract are subject to variability based on market factors (primarily changes in interest rates). Collateral requirements under this interest rate swap contract are excluded from unrestricted cash and investments for purposes of determining the System's compliance with its liquidity covenants under its Maryland Health and Higher Educational Facilities Authority (MHHEFA or the Authority) revenue bond agreements and its derivative agreements. Collateral amounts are included in noncurrent assets on the accompanying consolidated balance sheets. Approximately \$2,795,000 and \$199,000 of collateral was due to the financial institution as of June 30, 2019 and 2018.

The amount due to the financial institution is included in other accrued expenses on the accompanying consolidated balance sheet as of June 30, 2019 and 2018, and is reflected within investing activities on the accompanying consolidated statement of cash flows.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Assets Whose Use is Limited and Investments

Assets whose use is limited are principally composed of certain funds established to be held and invested by a trustee. These funds are related to the issuance of the Hospital's revenue bonds, investments held at Cottage, and certain permanently restricted endowment assets.

	June 30	
	2019	2018
Current:		
Principal, interest and other – bonds	\$ 12,258,000	\$ 11,716,000
Investments held at Trustee	2,932,000	2,805,000
	<u>\$ 15,190,000</u>	<u>\$ 14,521,000</u>
Noncurrent:		
Endowment assets	\$ 16,641,000	\$ 16,753,000
Investments held at Trustee	19,332,000	19,622,000
	<u>\$ 35,973,000</u>	<u>\$ 36,375,000</u>

The fair values of publicly traded securities and mutual funds are based on quoted market prices of individual securities or investments or estimated amounts using quoted market prices of similar investments. Alternative investments, some of which are structured so that the System holds limited partnership interests, are stated at fair value as estimated in an unquoted market. Valuations of these investments, and therefore the System's holdings, may be determined by the investment manager or general partner and for fund-of-funds investments are primarily based on financial data supplied by the underlying investee funds. Values may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. Investment income or loss from all unrestricted investments is included on the accompanying consolidated statements of operations and changes in net assets as part of other income (loss).

Investment income or loss on investments of assets with donor restrictions is added to or deducted from the restricted fund balance if the income is restricted. The cost of securities sold is based on the specific-identification method.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

All investment balances are principally uninsured and subject to normal credit risk. Investments are classified as either current or noncurrent based on the maturity dates and the availability for current operations. Investments included in noncurrent assets consist of board-designated investment funds of \$386,056,000 and \$292,636,000 as of June 30, 2019 and 2018, respectively. Based on the System's investment policy, such amounts could be liquidated, at the discretion of the board, to satisfy short-term requirements.

Substantially all investments, other than borrowed funds required to be expended for capital projects, are classified as trading securities, with unrealized gains and losses included in excess of revenues over expenses.

Borrowed funds required to be expended for capital projects are classified as other-than-trading and are included in assets whose use is limited.

Patient Receivables

Patient receivable include charges for amounts due from all patients less price concessions relating to allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid and other insurers. The provision for price concessions is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the price concessions based upon historical experience of self-pay accounts receivable, including those balances after insurance payments and not covered by insurance.

Insurance coverage and credit information are obtained from patients, when available. No collateral is obtained for accounts receivable.

Inventories

Inventories, which primarily consist of medical supplies and drugs, are carried at the lower of cost or market. Cost is determined using the first-in, first-out method.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost. Included in computers and software are capitalized labor costs of \$11,594,000 and \$11,240,000 as of June 30, 2019 and 2018, respectively. Depreciation and amortization, including amortization of assets recorded under capital leases, are recorded on the straight-line method over the estimated useful lives of the assets.

The following is a summary of property and equipment, stated at cost:

	Estimated Useful Lives	June 30 2019	2018
Land		\$ 14,901,000	\$ 14,901,000
Land improvements	20 years	22,413,000	22,091,000
Buildings and improvements	20–40 years	491,022,000	487,454,000
Fixed equipment	5–20 years	10,824,000	10,650,000
Leasehold improvements	5–10 years	55,651,000	53,675,000
Movable equipment	7–10 years	203,404,000	198,872,000
Computers and software	3–5 years	88,528,000	86,311,000
Construction-in-progress	–	31,923,000	10,483,000
		<u>\$ 918,666,000</u>	<u>\$ 884,437,000</u>

Construction-in-progress consists of direct costs associated with hospital department renovations, certain leasehold improvements, and smaller capital projects. As these projects are completed, the related assets are transferred out of construction-in-progress and into the appropriate asset category and are depreciated over the applicable useful lives.

Investments in Joint Ventures

The System accounts for its investments in joint ventures using the equity method of accounting. During 2011, the Real Estate Company and another party formed West County, LLC, a joint venture that owns and operates a medical office building that opened in December 2012. The Real Estate Company has a 50% interest in this joint venture, with each owner's investment being \$7,242,000 and \$6,947,000 as of June 30, 2019 and 2018, respectively.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Deferred Debt Issuance Costs

Administrative, legal, financing, underwriting discount, and other miscellaneous expenses that were incurred in connection with debt financings were deferred and are being amortized over the lives of the bond issues using the straight-line method, which approximates the effective-interest method in all material respects. The amortization expense of the deferred debt issue costs was \$297,000 and \$267,000 for the years ended June 30, 2019 and 2018, respectively.

Net Assets

Net resources that are not restricted by donors are included in net assets without donor restrictions. Gifts of long-lived operating assets, such as property, plant or equipment, are reported as net assets without donor restrictions and excluded from income. Resources restricted by donors for a specified time or purpose are reported as net assets with donor restrictions.

When the specific purposes are met, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to other operating revenues in the statement of operations and changes in net assets. Resources restricted by donors for additions to property, plant and equipment are initially reported as net assets with donor restrictions and are transferred to net assets without donor restrictions when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as net assets with donor restrictions.

Investment income related to net assets with donor restrictions is classified as net assets without donor restrictions based on the intent of the donor.

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. This includes regulatory discounts allowed to Blue Cross, Medicare, Medicaid, and other third-party payors and charity care.

During 2019 and 2018, approximately 35% and 35%, respectively, of net patient service revenue was received under the Medicare program, 28% and 29% from Blue Cross, 30% and 29% from contracts with other third parties, and 7% and 7% from other sources.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The following table sets forth the detail of net patient service revenue:

	Year Ended June 30	
	2019	2018
Gross patient service revenue	\$ 955,469,000	\$ 923,086,000
Revenue deductions:		
Charity care	5,326,000	4,907,000
Contractual and other allowances	207,267,000	192,913,000
Net patient service revenue (net of contractual allowances)	742,876,000	725,266,000
Less provision for bad debts	-	17,886,000
Net patient service revenue	<u>\$ 742,876,000</u>	<u>\$ 707,380,000</u>

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard related to revenue recognition. The System adopted the new standard effective July 1, 2018, using the modified retrospective method of transition. The most significant change from the adoption of the new standard relates to the System's estimation for the allowance for doubtful accounts. Under the previous standards, the System's estimate for amounts not expected to be collected based upon historical experience, were reflected as provision for bad debts and deducted from net patient service revenue to arrive at net patient service revenue less provision for bad debts. Under the new standard, those amounts will continue to be recognized as a reduction to net patient service revenue, however, not reflected separately as provision for bad debts, and accordingly the caption net patient service revenue less provision for bad debts will no longer be presented on the consolidated statements of operations and changes in net assets. Subsequent changes in the estimate of collectability due to a change in the financial status of a payor, for example a bankruptcy, will be recognized as bad debt expense in operating expenses. This adoption of the new standard did not have a material impact on the consolidated financial statements.

Additionally, the System's revenues may be subject to adjustment as a result of examination by government agencies or contractors and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

the terms of the payment agreements with the payor, correspondence from the payor and the System's historical settlement activity, including an assessment to ensure it is probable a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled or are no longer subject to such audits, reviews and investigations.

The System has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the System's expectation that the period between the time the service is provided to a patient and the time that the patient or third-party payor pays for that service will be one year or less.

The estimates for implicit price concessions are based upon management's assessment of historical write-offs and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections at facilities that represent a majority of the System's revenues and patient receivable as a primary source of information in estimating the collectability of patient receivable.

The Group employs physicians in several hospital-based specialties (including, but not limited to, obstetrics, intensive care, and hospitalists). Net physician revenue is recognized when the services are provided and recorded at the estimated net realizable amount based on the contractual arrangements with third-party payors and the expected payments from the third-party payors and the patients. The difference between the billed charges and the estimated net realizable amounts are recorded as a reduction in physician revenue when the services are provided. The System recognized net physician revenue of \$141,202,000 and \$126,201,000 for the years ended June 30, 2019 and 2018, respectively. At June 30, 2019 and 2018, \$10,764,000 and \$9,904,000, respectively, of net physician accounts receivable are included in patient receivables on the accompanying consolidated balance sheets.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Charity Care

The Group provides charity care to patients who meet certain criteria established under its charity care guidelines. Because members of the Group do not pursue the collection of amounts determined to qualify as charity care, they are not reported as revenue on the accompanying consolidated statements of operations and changes in net assets. The direct and indirect costs associated with providing this care are \$4,493,000 and \$3,472,000 for the years ended June 30, 2019 and 2018, respectively. These costs are calculated by applying a ratio of operating expenses over gross patient charges to the charity care provided at established rates. The state of Maryland's rate system includes components within the rates to partially compensate hospitals for uncompensated care.

Other Operating Revenue

Other operating revenue is composed of grant revenue, cafeteria revenue, net assets released from restrictions for operating purposes, and other miscellaneous items.

Transaction Costs

During fiscal year 2019, the System incurred \$3,279,000 for administrative and marketing costs that resulted from the transaction for Doctors Community Health System becoming a wholly owned subsidiary of Anne Arundel Health System, Inc.

Donations and Bequests

Unconditional promises to give cash and other assets are reported at fair value on the date the promise is received. Conditional promises to give, and indications of intentions to give, are reported at fair value on the date the gift is received. The gifts are reported as donor restricted 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 a purpose restriction is accomplished, the asset is reclassified to without donor restrictions on the accompanying consolidated statements of operations and changes in net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements. Contributions that are unrestricted are reflected as other operating revenue on the accompanying consolidated statements of operations and changes in net assets.

Anne Arundel Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Scheduled payments for pledges receivable for the years ending June 30 are as follows:

2020	\$ 903,000
2021–2023	1,100,000
2024 and thereafter	2,077,000
Less:	
Impact of discounting pledges receivable to net present value	(414,000)
Allowance for uncollectible pledges	(370,000)
Net pledges receivable	<u>\$ 3,296,000</u>

Pledges receivable are discounted using rates between 1.2% and 2.5%.

Excess of Revenues Over Expenses

The accompanying consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in net assets without donor restrictions that are excluded from excess of revenues over expenses, consistent with industry practice, include contributions received and used for additions of long-lived assets and certain changes in pension liabilities.

Group Purchasing Organization Initial Public Offering

The Hospital has participated and owned equity in the Premier Limited Partnership (Premier), which has served as a group purchasing organization for many years. This participation provides purchasing contract rates and rebates the System would not be able to obtain on its own. The Hospital accounts for its investment in Premier using the equity method of accounting.

During the year ended June 30, 2014, Premier restructured from a privately held company to a public company in an initial public offering (IPO) and several financial transactions have occurred with those holding equity in Premier before the IPO, including the System. As a result, the System received a cash payment of approximately \$1,500,000 in exchange for 16% of its previous ownership in Premier. In addition, in exchange for the extension of the group purchasing contract, the System received partial ownership of the new public company (the Class B units).

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The System received 309,580 Class B units that are earned in seven separate tranches over an 85-month period ending October 31, 2020. At June 30, 2019 and 2018, this investment was \$13,094,000 and \$10,067,000, respectively, and is reflected in other assets on the consolidated balance sheets. The opportunity will exist in the future for these Class B units to be converted to the Premier public company stock. Prior to vesting, the Class B units may be transferred or sold with the approval of Premier. During the years ended June 30, 2019 and 2018, the System recognized approximately \$1,988,000 and \$1,373,000, respectively, of income related to Tranches 5 and 6 of the Class B units, which is included as a reduction of supplies expense on the consolidated statement of operations and changes in net assets. The value of the Class B units is tied to the Group purchasing contract and is considered a vendor incentive.

Income Tax Status

The Parent, the Hospital, the Foundation, HCS, GTS, PE, and RI have received determination letters from the Internal Revenue Service (IRS) stating that they are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Real Estate Company has received a determination letter from the IRS stating that it is exempt from federal income taxes under Section 501(c)(2) of the Internal Revenue Code.

HCE and PPI are subject to federal and state income taxes. These income taxes are immaterial to the consolidated financial statements.

Certain limited liability companies within the consolidated group are not subject to income taxes. Taxable income or loss is passed through to and reportable by the members individually.

Under the Cayman Islands Tax Concessions Law (Revised), the Governor-in-Cabinet issued an undertaking regarding Cottage on November 29, 2005, exempting it from all local income, profit, or capital gains taxes. The undertaking has been issued for a period of 20 years and, at the present time, no such taxes are levied in the Cayman Islands. Accordingly, no provision for taxes is made in these consolidated financial statements.

Under the requirements of ASC 740, *Income Taxes*, tax-exempt organizations could be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. The Group has determined that it does not have any uncertain tax positions through June 30, 2019.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

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

Recent Accounting Pronouncements

Effective July 1, 2018, the System adopted FASB Accounting Standard Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method of transition. This ASU converged and replaced existing revenue recognition guidance, including industry-specific guidance and requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled in an exchange of goods or services. The adoption of this ASU did not materially impact the consolidated financial statements.

Effective June 30, 2019, the System adopted FASB ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changes certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduce reporting complexity. The System adopted the ASU and has adjusted the presentation in these consolidated financial statements accordingly. The ASU has been applied retrospectively to all periods presented. The System has elected to apply the practical expedient and not disclose prior year liquidity and availability of resources.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, which changes the presentation of net periodic pension cost and net periodic postretirement benefit cost requiring that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented on the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The System adopted the ASU in these consolidated financial statements accordingly.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

New Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 892)*. This ASU amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. This guidance is effective for fiscal year 2020. The System is currently assessing the potential impact this ASU will have on the System's consolidated results of operations, financial position, and cash flows.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities – Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (Topic 958)*. This ASU provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. This ASU was adopted by the System July 1, 2019. The adoption of ASU 2018-08 is not expected to have a material impact on the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments help entities evaluate the accounting for implementation costs paid by a customer in a cloud computing arrangement by providing guidance for determining when the service contract includes a software license. The System is evaluating the impact of this guidance, which will be effective in 2021.

3. Regulatory Environment

Medicare and Medicaid

The Medicare and Medicaid reimbursement programs represent a substantial portion of the Group's revenues. The Group's operations are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Over the past several years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

for patient services previously billed. Compliance with fraud and abuse standards and other government regulations can be subject to future government review and interpretation. Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the Group.

In 1983, Congress approved a Medicare prospective payment plan for most inpatient services as part of the Social Security Amendment Act of 1983. Hospitals in Maryland were granted a waiver from the Medicare prospective payment system under Section 1814(b) of the Social Security Act. The waiver would remain in effect as long as the Maryland rate of increase in payments per admission remained below the national average rate of increase.

In January 2014, the Centers for Medicare and Medicaid Services approved a modernized waiver that includes both inpatient and outpatient revenue. The new waiver will be in place as long as Maryland hospitals achieve significant quality improvements and limit the per capita growth for all payors for Maryland residents.

Maryland Health Services Cost Review Commission

The Hospital's rate structure for all hospital-based services is subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC or the Commission). Under the HSCRC rate-setting system, the Hospital's inpatient and outpatient charges are the same for all patients, regardless of payor, including Medicare and Medicaid.

Beginning in fiscal year 2014, the Hospital entered into an agreement with the HSCRC to participate in the Global Budget Revenue (GBR) program. The GBR model is a revenue constraint and quality improvement system to provide hospitals with strong financial incentives to manage their resources efficiently and effectively in order to slow the rate of increase in health care costs and improve health care delivery processes and outcomes. Under the GBR, total revenue is capped at a predetermined fixed amount. The annual approved revenue is calculated using a permanent base revenue with positive or negative adjustments for inflation, assessments, performance in quality-based programs, infrastructure requirements, and population. Revenue may also be adjusted annually for market share levels and shifts of regulated services to unregulated settings.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Regulatory Environment (continued)

Starting in January 2019, Maryland's hospitals began operating under a new 10-year contract with the federal government entitled Maryland Performance Adjustment (MPA). The MPA is designed to test whether the improvements hospitals have made under the previous modernized waiver can be expanded to all health care providers. The GBR methodology will remain in place for hospital rate setting under the MPA. In addition, programs aimed to measure and reduce total health care spending for attributed Medicare patients, including pre- and post-acute care by all providers, are being introduced during this contract period.

The Commission's rate-setting methodology compares the approved rate with the actual average rate charged. Any overcharges or undercharges are settled in future revenue determinations on an annual basis. For the current fiscal year, the Hospital was within the allowed corridors for charging.

The Hospital's policy is to recognize revenue based on actual charges for services to patients in the year in which the services are performed. The Hospital's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnoses, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until a subsequent period than which the services were rendered.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments

Investments, including assets whose use is limited, are stated at fair value. Borrowed funds that are required to be expended on specified capital projects under MHHEFA revenue bond agreements are classified as available for sale. All other investments and assets whose use is limited are classified as trading securities.

	June 30	
	2019	2018
Assets whose use is limited:		
Endowment assets:		
Cash and cash equivalents	\$ 1,237,000	\$ 1,164,000
Equity mutual funds	9,661,000	9,797,000
Fixed income mutual funds	5,737,000	5,935,000
	<u>16,635,000</u>	<u>16,896,000</u>
Amounts held by trustee:		
Cash and cash equivalents	12,320,000	11,715,000
U.S. government obligations	7,000	7,000
	<u>12,327,000</u>	<u>11,722,000</u>
Amounts held by Cottage:		
Cash and cash equivalents	2,869,000	2,655,000
Equity mutual funds	6,581,000	5,190,000
Fixed income mutual funds	12,751,000	14,351,000
Alternative investments	—	82,000
	<u>22,201,000</u>	<u>22,278,000</u>
Total assets whose use is limited	<u>51,163,000</u>	<u>50,896,000</u>
Less current portion	<u>15,190,000</u>	<u>14,521,000</u>
	<u>\$ 35,973,000</u>	<u>\$ 36,375,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Investments (continued)

Amounts held by the trustee are broken down as follows:

	June 30	
	2019	2018
Bond indenture	<u>\$ 12,270,000</u>	<u>\$ 11,722,000</u>
Other investments:		
	June 30	
	2019	2018
Cash and cash equivalents	\$ 15,368,000	\$ 11,867,000
Equity mutual funds	178,576,000	170,294,000
Fixed income mutual funds	133,747,000	99,491,000
Alternative investments	<u>73,626,000</u>	<u>22,755,000</u>
	401,317,000	304,407,000
Less short-term investments	<u>15,261,000</u>	<u>11,771,000</u>
Investments	<u>\$ 386,056,000</u>	<u>\$ 292,636,000</u>

The components of investment income, net are as follows:

	June 30	
	2019	2018
Interest and dividend income, net	\$ 10,257,000	\$ 6,117,000
Realized gains, net	3,616,000	5,097,000
	<u>\$ 13,873,000</u>	<u>\$ 11,214,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements

ASC 820 defines fair value and establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles. ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 – Defined as observable inputs, such as quoted prices in active markets
- Level 2 – Defined as inputs other than quoted prices in active markets that are either directly or indirectly observable
- Level 3 – Defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

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

ASC 820 requires that the fair value of derivative contracts include adjustments related to the credit risks of both parties associated with the derivative transactions. The fair value of the Group's derivative contracts reflected in the accompanying consolidated financial statements includes adjustments related to the credit risks of the parties to the transactions.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

The following tables present the fair value hierarchy for the Group's financial assets and liabilities measured at fair value on a recurring basis.

	June 30, 2019			
	Total	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		Level 1	Level 2	Level 3
Assets				
Cash and cash equivalents	\$ 15,100,000	\$ 15,100,000	\$ -	\$ -
Trading securities and assets whose use is limited:				
Cash and cash equivalents	31,794,000	31,794,000	-	-
Equity securities	194,818,000	194,818,000	-	-
Fixed income securities	152,235,000	152,235,000	-	-
U.S. Government obligation securities	6,000	6,000	-	-
Alternative investments	73,627,000	37,997,000	-	35,630,000
Total	<u>452,480,000</u>	<u>416,850,000</u>	-	<u>35,630,000</u>
Collateral for interest rate swap:				
Cash and cash equivalents	67,404,000	67,404,000	-	-
Total assets	<u>\$ 534,984,000</u>	<u>\$ 499,354,000</u>	\$ -	<u>\$ 35,630,000</u>
Liabilities				
Derivative instruments	\$ (78,479,000)	\$ -	\$ (78,479,000)	\$ -
Total liabilities	<u>\$ (78,479,000)</u>	<u>\$ -</u>	<u>\$ (78,479,000)</u>	<u>\$ -</u>

Anne Arundel Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

	June 30, 2018			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets				
Cash and cash equivalents	\$ 101,403,000	\$ 101,403,000	\$ —	\$ —
Trading securities and assets whose use is limited:				
Cash and cash equivalents	27,402,000	11,715,000	15,687,000	—
Equity securities	185,130,000	179,940,000	5,190,000	—
Fixed income securities	119,927,000	105,576,000	14,351,000	—
U.S. Government obligation securities	7,000	—	7,000	—
Alternative investments	22,837,000	—	22,837,000	—
Total	355,303,000	297,231,000	58,072,000	—
Collateral for interest rate swap:				
Cash and cash equivalents	44,893,000	44,893,000	—	—
Total assets	\$ 501,599,000	\$ 443,527,000	\$ 58,072,000	\$ —
Liabilities				
Derivative instruments	\$ (59,303,000)	\$ —	\$ (59,303,000)	\$ —
Total liabilities	\$ (59,303,000)	\$ —	\$ (59,303,000)	\$ —

The Group's Level 1 securities primarily consist of U.S. Treasury securities, exchange-traded mutual funds, and cash. The Group determines the estimated fair value for its Level 1 securities using quoted (unadjusted) prices for identical assets or liabilities in active markets.

The Group's Level 2 securities primarily consist of alternative investments, fixed income securities and money market funds. The Group determines the estimated fair value for these Level 2 securities using the following methods: quoted prices for similar assets/liabilities in active markets, quoted prices for identical or similar assets in non-active markets (few transactions, limited information, noncurrent prices, high variability over time), inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates, yield curve volatilities, default rates.), and inputs that are derived principally from or corroborated by other observable market

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Fair Value Measurements (continued)

data. Part of the System's alternative investments, approximately \$35,800,000 and \$20,000,000 at June 30, 2019 and 2018, respectively, are invested in international equity funds and are considered Level 2 investments due to quoted price not being readily available. The majority of the remaining alternative investments \$29,653,000 million and \$0 million at June 30, 2019 and 2018, respectfully are invested in a fund focused on energy infrastructure and are considered Level 2 investments due to quoted price not being readily available. The underlying assets of the fund are publicly-traded energy-related master limited partnerships and equity securities. Certain alternative investments require written notification over a certain period prior to redemption.

The Group's Level 2 securities also consist of derivative instruments, which are reported using valuation models commonly used for derivatives. Valuation models require a variety of inputs, including contractual terms, market-fixed prices, inputs from forward price yield curves, notional quantities, measures of volatility, and correlations of such inputs.

The Group also has pledges receivable, which are measured at fair value on a nonrecurring basis and are discounted to the net present value upon receipt using an appropriate risk-free discount rate based on the term of the receivable. Since these inputs are not observable, pledges receivable would be considered Level 3 fair value measurements upon their initial recording. Pledges receivable are recorded net of an allowance for uncollectible pledges. The following table provides a reconciliation of the beginning and ending balances of pledges receivable that used significant unobservable inputs.

	Year Ended June 30	
	2019	2018
Pledges receivable:		
Balance at July 1	\$ 4,115,000	\$ 4,914,000
New pledges	2,542,000	2,263,000
Collections of pledges	(3,146,000)	(2,912,000)
Write-off of pledges	(168,000)	(462,000)
Change in reserves	(47,000)	312,000
Balance at June 30	<u>\$ 3,296,000</u>	<u>\$ 4,115,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit

Long-term debt consists of the following:

	Interest Rate	Maturity Dates	June 30	
			2019	2018
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2017	2.0%–5.0%	2018–2043	\$ 58,935,000	\$ 60,245,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2014	2.0%–5.0%	2015–2040	116,200,000	118,360,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2012	2.0%–5.0%	2013–2035	59,735,000	62,375,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds – Series 2009B	Variable	2041–2044	60,000,000	60,000,000
2008 term loan from a bank	Variable	2019	–	41,105,000
Kent Island term loan from a bank	Variable	2021	5,908,000	6,159,000
2008 construction loan from a bank	Variable	2019	–	21,596,000
Real Estate Loan	Variable	2028	59,492,000	–
			<u>360,270,000</u>	<u>369,840,000</u>
Less current portion of long-term debt			11,029,000	8,848,000
Less deferred debt issue costs			3,803,000	3,949,000
Unamortized original issue premium, net			14,297,000	15,240,000
Long-term debt			<u>\$ 359,735,000</u>	<u>\$ 372,283,000</u>

These debt instruments are secured by the receipts of the Hospital and substantially all of the property and equipment of the consolidated Group.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

Principal payments due under all debt instruments as of June 30, 2019, are as follows:

2020	\$ 11,029,000
2021	11,347,000
2022	11,651,000
2023	11,667,000
2024	11,987,000
Thereafter	<u>302,589,000</u>
	<u>\$ 360,270,000</u>

Series 2017 Revenue Bonds

In November 2017, the Hospital entered into a loan agreement with the MHHEFA for the issuance of Series 2017 Revenue Bonds (referred to as the 2017 Bonds). The proceeds of the 2017 Bonds were used to advance refund the Series 2010 Bonds previously provided by MHHEFA. The bonds being refunded were originally obtained to finance the expansion of the parking garage for the Hospital's acute care pavilion, and costs related to the issuance. The 2017 Bonds provide for annual principal payments each July 1 from 2018 through 2043. Interest is payable annually each July 1 starting in July 2018. The 2017 Bonds bear stated interest rates between 2.00% and 5.00% and were issued at a premium of \$4,590,000, which is amortized over the life of the bonds using the straight-line method, which approximates the effective interest method. The effective annual interest rate for the 2017 Bonds for the year ended June 30, 2019 and June 30, 2018, was 1.93% and 3.00%, respectively.

Series 2014 Revenue Bonds

In November 2014, the Hospital entered into a loan agreement with the MHHEFA for the issuance of Series 2014 Revenue Bonds (referred to as the 2014 Bonds). The proceeds of the 2014 Bonds were used to advance refund the Series 2009A Bonds previously provided by MHHEFA. The bonds being refunded were originally obtained to finance a portion of the costs of construction for an eight-story patient care building, two parking garages, and costs related to the issuance. The 2014 Bonds provide for annual principal payments each July 1 from 2015 through 2040. Interest is payable semiannually each July 1 and January 1, beginning in January 2015. The 2014 Bonds bear stated interest rates between 2.00% to 5.00% and were issued at a premium of \$7,520,000, which is amortized over the life of the bonds using the straight-line method, which approximates

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

the effective interest method. The effective annual interest rate for the 2014 Bonds for the years ended June 30, 2019 and 2018, was 2.24% and 4.35%, respectively.

Series 2012 Revenue Bonds

In October 2012, the Hospital entered into a loan agreement with MHHEFA for the issuance of \$73,625,000 of Series 2012 Revenue Bonds (referred to as the 2012 Bonds). The proceeds of the 2012 Bonds were used to repay the Series 2004A Bonds and the Series 1998 Bonds previously provided by the Authority. The bonds being refinanced were originally obtained to finance a new replacement hospital (Series 1998 Bonds) and to finance major renovations to the Hospital's Cancer Center and land acquisition (Series 2004A Bonds). The 2012 Bonds provide for annual principal payments each July 1 from 2013 through 2035. Interest is payable semiannually on each July 1 and January 1, beginning July 1, 2013. The 2012 Bonds bear stated interest at rates of 2.00% to 5.00% and were issued at a premium of \$6,746,000. The effective annual interest rates for the 2012 Bonds for the years ended June 30, 2019 and 2018, were 2.16% and 3.73%, respectively.

The provisions of the 2017, 2014, and 2012 Bonds, together with the Series 2009 Bonds, require the Parent and subsidiaries to comply with certain covenants on an annual basis, including a debt service coverage requirement, a debt-to-capitalization requirement, and a liquidity requirement. The Hospital, the Parent, and HCS are members of the obligated Group for all of the revenue bonds issued by MHHEFA.

Series 2010 Revenue Bonds

In February 2010, the Hospital entered into a loan agreement with MHHEFA for the issuance of \$85,410,000 of Series 2010 Revenue Bonds (referred to as the 2010 Bonds). The proceeds of the 2010 Bonds were used to repay the Series 2004B Bonds and dedicated financing previously provided by the MHHEFA and are also being used to finance the expansion of the parking garage for the Hospital's acute care pavilion. The 2010 Bonds provide for annual principal payments each July 1, from 2011 through 2040. Interest is payable semiannually on each July 1 and January 1, beginning July 1, 2010. The 2010 Bonds bear stated interest at rates of 4.00% to 5.00% and were issued at an original issue discount of \$1,507,000. The effective annual interest rate for the 2010 Bonds for the year ended June 30, 2018, was 3.35%.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

In November 2017, the Series 2010 Bonds were refinanced through an advance refunding using the proceeds from the Series 2017 Bonds. As a result of the refinancing of the Series 2010 Bonds, a one-time charge of \$6,056,000 was recorded as a loss on advance refunding of debt and is included in other nonoperating income.

Series 2009 Revenue Bonds

In January 2009, the Hospital entered into a loan agreement with the MHHEFA for the issuance of \$120,000,000 of Series 2009A Revenue Bonds (the 2009A Bonds) and in February 2009, \$60,000,000 of Series 2009B Revenue Bonds (the 2009B Bonds) (collectively referred to as the 2009 Bonds). The proceeds of the 2014 Bonds were used to advance refund the Series 2009A Bonds previously provided by the MHHEFA. The proceeds of the 2009 Bonds were used to finance a portion of the costs of construction of an eight-story patient care building, two new parking garages, and certain costs relating to the issuance. The 2009B Bonds provide for annual principal payments each July 1, from 2041 through 2044. Interest is payable semiannually on each July 1 and January 1, beginning July 1, 2009. The 2009B Bonds bear interest at variable rates, as set forth in the loan agreement. The maximum interest rate is 12% for the 2009B Bonds. The effective annual interest rates for the 2009B Bonds for the years ended June 30, 2019 and 2018, were 1.65% and 0.75%, respectively. The principal and interest payments on the Series 2009B Bonds are secured by a letter of credit equal to the original principal of the bonds plus an amount equal to 40 days' interest thereon, calculated at the maximum rate. The current letter of credit, which was extended on May 1, 2019, expires on July 1, 2024. Under certain circumstances, the Hospital would need to fully redeem the 2009B Bonds upon expiration of the letter of credit, unless a conforming replacement letter of credit was secured prior to such expiration.

The related balances are included in assets whose use is limited and consist of the following:

	June 30	
	2019	2018
Debt service funds	\$ 12,263,000	\$ 11,715,000
Construction fund and capitalized interest fund	7,000	7,000
	<u>\$ 12,270,000</u>	<u>\$ 11,722,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

Bank Line of Credit and Term Loan

The Hospital maintains a line of credit with a bank providing available credit of \$30,000,000. The agreement with the bank is reviewed for renewal on February 28 of each year. Interest on any borrowings accrues at the one-month London Interbank Offered Rate (LIBOR) plus 1.5%. At June 30, 2019 and 2018, the Group has no balance on the line of credit.

On October 23, 2008, the Real Estate Company secured a term loan in the amount of \$55,000,000 with a bank. The proceeds from the term loan were used to refinance line of credit proceeds and fund certain construction costs related to a medical office building. The loan bore interest at a variable rate, based on the LIBOR market index rate plus 1.25%. The term loan required monthly payments of \$235,000 with all remaining amounts due upon final maturity on November 5, 2018. The effective annual interest rates for the years ended June 30, 2019 and 2018, were 2.25% and 2.72%, respectively. This loan was subsequently refinanced on October 17, 2018.

On October 17, 2018, the Real Estate Company secured a Real Estate loan from the bank through a wholly owned subsidiary and the proceeds were used to pay off the 2008 Term Loan and 2008 Construction Loan previously provided by the bank. The loans being refinanced were originally obtained to finance certain medical office buildings owned by the Company. The new loan requires flat monthly principal payments (amortized over seventeen years) plus interest at one month Libor + 1.10% from 2018 through 2028 with a balloon payment due October 5, 2028, of \$25,800,000.

2008 Construction Loan

On October 23, 2008, the Real Estate Company entered into a construction loan in the amount of \$30,000,000 with a bank to fund the construction of a medical office building. The loan was issued under the same loan agreement as the term loan discussed in the preceding paragraph. The debt is secured by the medical office building. Interest only was due during the construction period at a rate equal to the LIBOR market index rate plus 1.25%. The loan converted to a term loan after the completion of the construction in July 2009. The term loan provided for monthly principal and interest payments and has a final maturity of November 5, 2018. The effective annual interest rates for the years ended June 30, 2019 and 2018, were 4.65% and 2.72%, respectively. This loan was subsequently refinanced on October 17, 2018. Refer to the 2008 term loan section above for more information regarding the refinancing.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Line of Credit (continued)

Kent Island Term Loan

In August 2007, KIMA entered into a construction loan agreement with a bank in the amount of \$9,000,000 that would convert to a term loan after the completion of the construction. The proceeds were used to construct a medical office building. The debt was secured by the medical office building. Interest only was due during the construction period at a rate of the 30-day LIBOR plus 1.0%. The construction was completed in June 2008.

On May 9, 2017, KIMA refinanced the term loan with a \$6,567,000 promissory note. The promissory note provides for monthly principal and interest payments and has a final maturity of December 2021. The promissory note bears interest at a variable rate, based on the 30-day LIBOR plus 1.2%. The effective annual interest rates for the years ended June 30, 2019 and 2018, were 3.58% and 2.76%, respectively.

7. Pension Plan and Thrift Plan

The Hospital has a qualified noncontributory, defined benefit pension plan (the Plan) that covers substantially all employees. The Group's policy is to fund pension costs as determined by its actuary. Adopted by the Board of Trustees on June 11, 2009, and effective September 1, 2009, the Hospital amended the Plan to freeze future benefit accruals, and participants have not earned any additional benefits under the Plan since that date. However, subsequent to September 1, 2009, participants have continued to vest in benefits they have earned through September 1, 2009. The frozen benefit balance for the participants will only accrue interest credits until the participants' benefit commencement dates. FASB ASC 715, *Compensation – Retirement Benefits*, requires the Group to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plan on its consolidated balance sheet, with a corresponding adjustment to unrestricted net assets. The pension liability adjustment to net assets without donor restrictions represents the change in net unrecognized actuarial losses that have not yet been recognized as part of excess of revenues over expenses. These amounts are subsequently recognized as a net periodic benefit cost pursuant to the Group's historical accounting policy for amortizing such amounts.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

The reconciliation of the beginning and ending balances of the projected benefit obligation and the fair value of plan assets for the years ended June 30 and the accumulated benefit obligation at June 30 is as follows:

	<u>2019</u>	<u>2018</u>
Accumulated benefit obligation	<u>\$ 124,331,000</u>	<u>\$ 124,571,000</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 124,571,000	\$ 127,127,000
Service cost	—	—
Interest cost	4,758,000	4,583,000
Actuarial loss	8,705,000	40,000
Benefits paid	(2,332,000)	(2,413,000)
Settlements paid	(11,371,000)	(4,766,000)
Projected benefit obligation at end of year	<u>124,331,000</u>	<u>124,571,000</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	121,257,000	116,439,000
Actual return on plan assets	5,901,000	6,797,000
Employer contribution	4,800,000	5,200,000
Benefits paid	(2,332,000)	(2,413,000)
Settlements paid	(11,371,000)	(4,766,000)
Fair value of plan assets at end of year	<u>118,255,000</u>	<u>121,257,000</u>
Net liability recognized	<u>\$ (6,076,000)</u>	<u>\$ (3,314,000)</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

	June 30	
	2019	2018
Net amounts recognized on the consolidated balance sheets consist of:		
Accrued pension costs	<u>\$ (6,076,000)</u>	<u>\$ (3,314,000)</u>
Amounts recognized in unrestricted net assets that have not been recognized in net periodic benefit costs consist of:		
Net actuarial loss	<u>\$ 71,988,000</u>	<u>\$ 69,204,000</u>

The following table sets forth the weighted average assumptions used to determine the benefit obligations:

	June 30	
	2019	2018
Discount rate	3.35%	4.10%
Rate of compensation increase	N/A	N/A

The following table sets forth the weighted average assumptions used to determine the net periodic benefit cost:

	Year Ended June 30	
	2019	2018
Discount rate	4.13%	3.70%
Expected return on plan assets	7.00	7.50
Rate of compensation increase	N/A	N/A

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

The net periodic pension benefit cost included the following components:

	June 30	
	2019	2018
Service cost	\$ —	\$ —
Interest cost	4,758,000	4,583,000
Expected return on plan assets	(8,403,000)	(8,979,000)
Amortization of prior service cost	—	—
Recognized net actuarial loss	1,484,000	1,518,000
Loss recognized from partial settlement of projected benefit obligation	6,938,000	2,648,000
Net periodic cost (credit)	<u>\$ 4,777,000</u>	<u>\$ (230,000)</u>

The estimated net loss of the defined benefit pension plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year is \$1,777,000.

The Hospital's defined benefit plan invests in a diversified mix of traditional asset classes. Investments in certain types of U.S. equity securities and fixed-income securities are made to maximize long-term results while recognizing the need for adequate liquidity to meet ongoing benefit and administrative obligations. Risk tolerance of unexpected investment and actuarial outcomes is continually evaluated by understanding the pension plan's liability characteristics. Equity investments are used primarily to increase the overall plan returns. Debt securities provide diversification benefits and liability hedging attributes that are desirable, especially in falling interest rate environments.

The Hospital's target asset allocation percentages as of June 30, 2019, were as follows: 60% investment grade bonds, 16% international equity, 13% large cap domestic stocks, 4% small cap domestic stocks and 7% alternative investments and exchange-traded notes.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

The following tables present the fair value hierarchy of assets of the defined benefit pension plan.

	June 30, 2019			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets				
Cash and cash equivalents	\$ 4,025,000	\$ —	\$ 4,025,000	\$ —
Mutual funds:				
Equity	20,237,000	20,237,000	—	—
Corporate bonds	57,573,000	57,573,000	—	—
International equity	11,922,000	11,922,000	—	—
International bonds	9,382,000	9,382,000	—	—
Alternative investments:				
Common/collective trust	3,813,000	—	3,813,000	—
Partnership	3,248,000	—	3,248,000	—
Other	8,055,000	—	8,055,000	—
	<u>\$ 118,255,000</u>	<u>\$ 99,114,000</u>	<u>\$ 19,141,000</u>	<u>\$ —</u>

Anne Arundel Health System, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

	June 30, 2018			
	Total	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		Level 1	Level 2	Level 3
Assets				
Cash and cash equivalents	\$ 736,000	\$ —	\$ 736,000	\$ —
Mutual funds:				
Equity	31,735,000	31,735,000	—	—
Corporate bonds	48,792,000	48,792,000	—	—
International equity	13,594,000	13,594,000	—	—
International bonds	12,013,000	12,013,000	—	—
Equity closed-end funds	4,686,000	4,686,000	—	—
Collective funds:				
International equity	9,701,000	—	9,701,000	—
	<u>\$ 121,257,000</u>	<u>\$ 110,820,000</u>	<u>\$ 10,437,000</u>	<u>\$ —</u>

Level 1 securities primarily consist of exchange-traded mutual funds. Level 2 securities primarily consist of money market funds and alternative investments. Methods consistent with those discussed in Note 5 are used to estimate the fair values of these securities.

The overall expected rate of return on assets assumptions was based on historical returns, with adjustments made to reflect expectations of future returns. The extent to which the future expectations were recognized considered the target rates of returns for the future, which have historically not changed.

The Hospital currently intends to make voluntary contributions to the defined benefit pension plan of \$4,800,000 in fiscal year 2020.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

The following benefit payments are expected to be paid:

2020	\$ 7,132,000
2021	7,481,000
2022	7,175,000
2023	6,918,000
2024	7,018,000
2025–2029	37,292,000

In addition to the noncontributory defined benefit pension plan, the Hospital also offers an employee thrift plan. Participation in the plan is voluntary. Substantially all full-time employees of the Hospital are eligible to participate. Employees may elect to contribute a minimum of 1% of compensation, and a maximum amount as determined by Sections 403(b) and 415 of the Internal Revenue Code. Any employee making contributions to the plan is entitled to a Hospital contribution that will match the employee contribution at the rate of 50% to 75%, depending on the number of years of service, up to a maximum of 5% of qualified compensation. Matching contributions under this thrift plan were \$8,000,000 and \$6,365,000 in fiscal years 2019 and 2018, respectively.

8. Concentrations of Credit Risk

Certain members of the Group grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	June 30	
	2019	2018
Medicare	26%	24%
Medicaid	5	5
Blue Cross	18	20
Commercial, HMO, PPO, and other	32	34
Patients	19	17
	<u>100%</u>	<u>100%</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Malpractice Insurance Costs and Self-Insured Professional Liability

Until August 1, 1998, the Group maintained insurance coverage for general and professional liability claims on a claims-made basis. The professional liability coverage included a per-case deductible of \$250,000, up to a maximum out-of-pocket amount of \$750,000 annually. Effective August 1, 1998, the Group changed its professional liability coverage to a full coverage claims-made policy with no annual deductibles. This policy included tail coverage for claims incurred prior to August 1, 1998, but reported subsequently. Effective August 1, 2002, the Group changed its professional liability coverage back to a claims-made policy with a per-case deductible of \$250,000, up to a maximum out-of-pocket amount of \$750,000 annually. Also, the Group did not purchase tail coverage for claims incurred prior to August 1, 2002, that were not yet reported.

Effective March 1, 2004, the Group changed its professional liability coverage to a self-insurance trust with annual exposure limits of \$2,000,000 per claim and \$11,000,000 in the aggregate. The Group carried an excess liability insurance policy for claims above these limits.

Effective July 1, 2005, Cottage was formed as a captive insurer to provide professional liability insurance for the Group. Cottage is a wholly owned subsidiary of the System, which was formed in the Cayman Islands. The primary layer of professional and general liability insurance coverage is self-insured through Cottage and the secondary layer is fully reinsured through several highly rated commercial carriers.

For the period from July 1, 2005 to June 30, 2009, Cottage issued claims-made policies covering Hospital professional liability (including employed physicians) and on an occurrence basis, comprehensive general liability risks of the Parent and certain affiliates. Policy limits were \$2,000,000 per claim with a \$9,000,000 policy aggregate. Effective July 1, 2005, Cottage assumed existing liabilities from the System's self-insured trust discussed above on a claims-made basis. Effective July 1, 2009, Cottage issued a claims-made policy providing \$2,000,000 per claim for Hospital professional liability coverage and \$1,000,000 per claim for comprehensive general liability coverage, subject to a consolidated annual aggregate limit of \$10,000,000. Effective July 1, 2018, policy limits were increased to \$5,000,000 per claim with a \$25,000,000 policy aggregate.

For the period from July 1, 2005 to June 30, 2008, Cottage also issued an excess umbrella coverage policy (covering Hospital professional liability) with limits of \$20,000,000 per claim with a policy aggregate. For claims reported on and subsequent to July 1, 2008, the coverage limit provided is \$30,000,000 per claim with a policy aggregate. These excess limits are in excess of the primary policy, and the umbrella policies are 100% reinsured with highly rated third-party commercial reinsurers.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Malpractice Insurance Costs and Self-Insured Professional Liability (continued)

The provision for estimated professional liability claims, general liability claims, and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. As of June 30, 2019 and 2018, the balance for outstanding claims reserves recorded at Cottage is \$36,843,000 and \$45,662,000 and reinsurance receivable is \$17,286,000 and \$29,185,000, respectively. The remaining tail liability for claims incurred but not reported is \$10,607,000 and \$9,513,000 as of June 30, 2019 and 2018, respectively, with \$9,226,000 of the 2019 liability and \$8,061,000 of the 2018 liability recorded at the Hospital. The remainder of the liability is recorded at PE. The Group has employed an independent actuary to estimate the ultimate settlement of such claims. In management's opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

10. Commitments and Contingencies

Operating Leases

Various members of the Group have operating leases for storage space, equipment, and offices. During 2019 and 2018, rent expense for these leases was approximately \$9,785,000 and \$10,971,000, respectively. Future minimum annual rental payments under noncancelable operating leases, which expire through 2024, are as follows:

2020	\$ 8,063,000
2021	5,802,000
2022	3,487,000
2023	2,224,000
2024	2,123,000
Thereafter	1,725,000
	<u>\$ 23,424,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

Contingencies

Members of the Group have been named as defendants in various legal proceedings arising from the performance of their normal activities. In the opinion of management, after consultation with legal counsel and after consideration of applicable insurance, the amount of the Group's ultimate liability under all current legal proceedings will not have a material adverse effect on its consolidated financial position or results of operations.

The Group's revenues may be subject to adjustment as a result of examination by government agencies or contractors, based upon differing interpretations of government regulations, medical diagnoses, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered. Section 302 of the Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare overpayments and underpayments made to providers. Management has established protocols to respond to RAC requests and payment denials. Payment recoveries resulting from RAC reviews are appealable through administrative and judicial processes, and management intends to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, management will incur additional costs to respond to requests for records and pursue the reversal of payment denials. As of June 30, 2019 and 2018, the Group has recorded an estimated reserve regarding the Medicare overpayments. In the opinion of the Group's management, the ultimate settlement of this matter will not have a material adverse effect on the consolidated financial position of the Group.

During the year ended June 30, 2018, the System recorded a \$3,500,000 accrual related to an inquiry by the Department of Justice regarding a potential billing discrepancy. A final settlement was signed in June 2019 and the payment amount approximated the amount accrued at June 30, 2018. A corporate integrity agreement (CIA) was also signed in June 2019 with the Office of Inspector General of the Department of Health and Human Services. The CIA will be in place for five years and will require periodic reporting of various matters by an independent review organization and the System.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Functional Expenses

Members of the Group provide general health care services to residents within their service area. Expenses related to providing these services are as follows:

	Health Care Services	General and Administrative	Total
Year ended June 30, 2019			
Salaries and wages	\$ 293,400,000	\$ 56,260,000	\$ 349,660,000
Employee benefits	45,157,000	11,199,000	56,356,000
Supplies	158,348,000	1,141,000	159,489,000
Purchases services	70,001,000	67,556,000	137,557,000
Depreciation and amortization	26,647,000	10,186,000	36,833,000
Interest	13,118,000	-	13,118,000
Transaction costs	-	3,279,000	3,279,000
Total operating expenses	<u>\$ 606,671,000</u>	<u>\$ 149,621,000</u>	<u>\$ 756,292,000</u>
Year ended June 30, 2018			
Salaries and wages	\$ 276,549,000	\$ 52,087,000	\$ 328,636,000
Employee benefits	44,416,000	8,365,000	52,781,000
Supplies	150,155,000	1,392,000	151,547,000
Purchases services	65,347,000	63,739,000	129,086,000
Depreciation and amortization	26,873,000	9,500,000	36,373,000
Interest	13,205,000	-	13,205,000
Total operating expenses	<u>\$ 576,545,000</u>	<u>\$ 135,083,000</u>	<u>\$ 711,628,000</u>

12. Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, patient receivables, prepaid expenses and other current assets, accounts payable, accrued salaries, wages and benefits, other accrued expenses, and advances from third-party payors approximate fair value, given the short-term nature of these financial instruments or their methods of valuation. The following methods and assumptions were used by the Group in estimating the fair value of other financial instruments.

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Fair Value of Financial Instruments (continued)

Investments and Assets Whose Use is Limited

Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Pledges Receivable

The Group estimates that the carrying value of pledges receivable approximates fair value, given the discount rates applied.

Long-Term Debt

Fair values of the Group's long-term fixed-rate debt are established using discounted cash flow analyses, based on the Group's current incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of the Group's long-term variable-rate debt approximates fair value. The estimated fair value of all long-term debt at June 30, 2019 and 2018, was \$381,061,000 and \$383,715,000, respectively.

13. Net Assets

Temporarily restricted net assets are restricted for use, as follows:

	June 30	
	2019	2018
Hospital capital additions	\$ 6,382,000	\$ 5,076,000
Hospital operating programs	16,207,000	10,770,000
	<u>\$ 22,589,000</u>	<u>\$ 15,846,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date comprise the following as of June 30, 2019:

Assets

Current assets:

Cash and cash equivalent	\$ 15,100,000
Short-term investments	15,261,000
Current portion of assets whose use is limited:	15,190,000
Patient receivables, net	80,307,000
Current portion of pledges receivable, net	494,000
Other current assets	6,659,000
Investments*	386,056,000
Total financial assets	<u>\$ 519,067,000</u>

*While these investments are long-term in nature, they are available for general expenditures within one year of the balance sheet date if necessary.

The System's bond covenant requires the Group to maintain unrestricted cash and marketable securities on hand to meet 90 days of normal operating expenses, which would be \$174,166,000 as of June 30, 2019.

15. Subsequent Events

On July 1, 2019, Anne Arundel Health System completed a transaction that resulted in Doctors Community Health System becoming a wholly owned subsidiary of Anne Arundel Health System. The new consolidated entity changed its name to Luminis Health on September 26, 2019. This transaction will be accounted for as an acquisition under ASC 958-805 during the year ending June 30, 2020. No consideration was exchanged in the transaction however AAHS has committed to investing \$138,000,000 into the Doctors organization over a period of five years.

The Group has evaluated the impact of subsequent events through October 23, 2019, representing the date at which the accompanying consolidated financial statements were issued.

Supplementary Information

Anne Arundel Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Health Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Medical Center, Inc.	Anne Arundel Health Care Enterprises, Inc.	AABS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Consolidating and Eliminating Entries	Consolidated
Assets													
Current assets:													
Cash and cash equivalents	\$ (2,584,000)	\$ 9,735,000	\$ 661,000	\$ (66,000)	\$ 1,218,000	\$ -	\$ 49,000	\$ 1,028,000	\$ 2,000	\$ 5,057,000	\$ -	\$ -	\$ 15,100,000
Short-term investments	-	14,813,000	-	-	-	-	-	-	-	448,000	-	-	15,261,000
Current portion of assets whose use is limited	-	12,320,000	-	-	-	2,870,000	-	-	-	-	-	-	15,190,000
Patient receivables, net	-	66,809,000	2,734,000	-	-	-	-	10,764,000	-	-	-	-	80,307,000
Current portion of pledges receivable, net	-	-	-	-	-	-	-	-	-	494,000	-	-	494,000
Inventories	10,000	7,799,000	-	-	-	-	-	851,000	-	-	-	-	8,650,000
Prepaid expenses and other current assets	7,416,000	-	86,744,000	5,704,000	17,916,000	48,000	768,000	2,030,000	5,794,000	21,877,000	-	-	14,125,000
Total current assets	(2,574,000)	118,892,000	90,139,000	5,638,000	19,134,000	2,918,000	817,000	14,673,000	5,796,000	27,876,000	-	(134,182,000)	149,127,000
Property and equipment	-	725,720,000	27,725,000	2,532,000	137,962,000	-	77,000	22,622,000	15,000	2,013,000	-	-	918,666,000
Less accumulated depreciation and amortization	-	(389,880,000)	(25,464,000)	(1,879,000)	(62,898,000)	-	(75,000)	(12,688,000)	-	(120,000)	-	-	(493,004,000)
Net property and equipment	-	335,840,000	2,261,000	653,000	75,064,000	-	2,000	9,934,000	15,000	1,893,000	-	-	425,662,000
Other assets:													
Investments	-	384,397,000	-	-	-	-	-	-	-	1,659,000	-	-	386,056,000
Investments in joint ventures	-	-	-	1,644,000	7,242,000	-	-	-	-	-	-	-	8,886,000
Pledges receivable, net	-	-	-	-	-	-	-	-	-	2,802,000	-	-	2,802,000
Assets whose use is limited	-	8,000	-	-	-	19,331,000	-	-	-	16,634,000	-	-	35,973,000
Beneficial interest in net assets of AAMC Foundation, Inc.	-	27,933,000	-	-	-	-	-	-	-	-	-	(27,933,000)	-
Restricted collateral for interest rate swap contract	-	67,404,000	-	-	-	-	-	-	-	378,000	-	-	67,404,000
Other assets	565,457,000	15,909,000	-	-	1,413,000	17,286,000	-	1,392,000	-	-	-	(567,461,000)	34,374,000
Total assets	\$ 562,883,000	\$ 950,383,000	\$ 92,400,000	\$ 7,935,000	\$ 102,533,000	\$ 39,535,000	\$ 819,000	\$ 25,959,000	\$ 5,811,000	\$ 51,242,000	\$ -	\$ (729,576,000)	\$ 1,110,284,000

Anne Arundel Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	Cottage Insurance Company, Ltd.	AHFS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Cottage Insurance Company, Ltd.	Other Subsidiaries	Consolidated
Liabilities and net assets														
Current liabilities:														
Accounts payable	\$ 43,465,000	\$ 74,431,000	\$ 1,461,000	\$ 1,360,000	\$ 658,000	\$ 91,000	\$ 638,000	\$ 13,292,000	\$ 190,000	\$ 5,875,000	\$ -	\$ (111,003,000)	\$ -	\$ 30,458,000
Accrued salaries, wages, and benefits	11,182,000	17,986,000	394,000	1,039,000	-	-	95,000	6,172,000	900,000	46,000	-	-	-	37,814,000
Other accrued expenses	845,000	16,165,000	-	4,000	4,242,000	1,000	-	1,554,000	-	20,780,000	-	-	(25,202,000)	18,389,000
Current portion of long-term debt	-	7,161,000	-	-	3,868,000	-	-	-	-	-	-	-	-	11,029,000
Advances from third-party payors	-	21,720,000	-	-	578,000	-	-	501,000	-	1,104,000	-	-	-	23,903,000
Total current liabilities	55,492,000	137,463,000	1,855,000	2,403,000	9,346,000	92,000	733,000	21,519,000	2,194,000	26,701,000	-	-	(136,205,000)	121,593,000
Long-term debt, less current portion and unamortized original issue premium	-	298,384,000	-	-	61,351,000	-	-	-	-	-	-	-	-	359,735,000
Interest rate swap contract	-	78,479,000	-	-	-	-	-	-	-	-	-	-	-	78,479,000
Accrued pension liability	-	6,076,000	-	-	-	-	-	-	-	-	-	-	-	6,076,000
Other long-term liabilities	-	-	-	-	-	36,843,000	-	167,000	-	-	-	-	-	37,010,000
Total liabilities	55,492,000	520,402,000	1,855,000	2,403,000	70,697,000	36,935,000	733,000	21,686,000	2,194,000	26,701,000	-	-	(136,205,000)	602,893,000
Net assets:														
Without donor restrictions	484,159,000	402,830,000	90,545,000	5,532,000	32,156,000	2,600,000	86,000	4,313,000	3,617,000	(332,000)	-	-	(542,845,000)	482,661,000
With donor restrictions	29,232,000	27,151,000	-	-	-	-	-	-	-	24,873,000	-	-	(50,526,000)	24,730,000
Total net assets	507,391,000	429,981,000	90,545,000	5,532,000	32,156,000	2,600,000	86,000	4,313,000	3,617,000	24,541,000	-	-	(593,371,000)	507,391,000
Total liabilities and net assets	\$ 562,883,000	\$ 950,383,000	\$ 92,400,000	\$ 7,935,000	\$ 102,853,000	\$ 39,535,000	\$ 819,000	\$ 25,999,000	\$ 5,811,000	\$ 51,242,000	\$ -	\$ -	\$ (729,576,000)	\$ 1,110,284,000

Anne Arundel Health System, Inc. and Subsidiaries
Supplementary Consolidating Statement of Operations

Year Ended June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	Cottage Insurance Company, Ltd.	AABS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Consolidating and Eliminating Entries	Consolidated
Operating revenue:													
Net patient service revenue	\$ 570,176,000	\$ 31,498,000	\$ 2,000	\$ 17,668,000	\$ 22,412,000	\$ 6,821,000	\$ 141,202,000	\$ 3,348,000	\$ 7,720,000	\$ 7,720,000	\$ 6,821,000	\$ 742,876,000	
Other operating revenue	1,588,000	5,213,000	1,588,000	17,668,000	22,412,000	6,821,000	1,407,000	3,348,000	7,720,000	7,720,000	(62,134,000)	33,180,000	
Total operating revenue	\$ 1,588,000	\$ 579,389,000	\$ 31,500,000	\$ 17,668,000	\$ 22,412,000	\$ 6,821,000	\$ 142,609,000	\$ 3,348,000	\$ 7,720,000	\$ 7,720,000	\$ (62,134,000)	\$ 776,056,000	
Operating expenses:													
Salaries and wages	215,316,000	6,005,000	8,692,000	8,692,000	—	—	1,193,000	1,134,000	1,250,000	1,250,000	—	349,660,000	
Employee benefits	40,930,000	1,175,000	1,545,000	1,545,000	—	—	206,000	36,000	203,000	203,000	—	56,356,000	
Supplies	143,961,000	1,132,000	98,000	98,000	211,000	—	3,000	4,000	28,000	28,000	—	159,489,000	
Purchased services	118,543,000	14,025,000	7,208,000	7,208,000	9,655,000	10,949,000	709,000	395,000	1,457,000	1,457,000	(61,176,000)	137,557,000	
Foundation transfer to AAMC and subsidiaries	(4,790,000)	—	—	—	—	—	—	—	5,664,000	5,664,000	(874,000)	—	
Depreciation and amortization	29,947,000	866,000	49,000	49,000	4,076,000	—	2,000	1,865,000	28,000	28,000	—	36,833,000	
Interest	10,746,000	—	—	—	2,472,000	—	—	6,000	—	—	—	13,118,000	
Transaction costs	3,279,000	—	—	—	—	—	—	—	—	—	—	3,279,000	
Total operating expenses	1,148,000	557,932,000	23,203,000	17,592,000	16,414,000	10,949,000	2,113,000	1,569,000	8,630,000	8,630,000	(62,156,000)	756,293,000	
Operating income (loss)	440,000	21,457,000	8,297,000	76,000	5,998,000	(4,128,000)	(706,000)	1,779,000	(12,561,000)	1,779,000	22,000	19,764,000	
Other income (loss):													
Investment income, net	—	12,664,000	—	—	6,000	1,070,000	—	—	133,000	—	—	—	13,872,000
Income (loss) from joint ventures and other, net	12,761,000	(30,000)	(323,000)	(323,000)	532,000	—	—	—	—	—	(13,485,000)	(545,000)	
Pension expense	—	(4,777,000)	—	—	—	—	—	—	—	—	—	(4,777,000)	
Change in unrealized gains (losses) on trading securities, net	—	11,134,000	—	—	—	(270,000)	—	—	(830,000)	—	—	10,034,000	
Realized and unrealized losses on interest rate swap contracts, net	—	(23,361,000)	—	—	—	—	—	—	—	—	—	(23,361,000)	
Total other income (loss), net	12,761,000	(4,370,000)	(323,000)	(323,000)	532,000	800,000	(12,561,000)	1,779,000	(697,000)	1,779,000	(13,485,000)	(4,776,000)	
Excess of revenue over expenses (deficit)	\$ 13,201,000	\$ 17,087,000	\$ 8,297,000	\$ (323,000)	\$ 6,536,000	\$ (3,328,000)	\$ (706,000)	\$ 1,779,000	\$ (12,561,000)	\$ 1,779,000	\$ (13,485,000)	\$ 14,988,000	

Anne Arundel Medical Center, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

June 30, 2019

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Consolidating and Eliminating Entries	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	\$ 9,719,000	\$ 16,000	\$ —	\$ 9,735,000
Short-term investments	14,813,000	—	—	14,813,000
Current portion of assets whose use is limited	12,320,000	—	—	12,320,000
Patient receivables, net	66,184,000	625,000	—	66,809,000
Inventories	7,799,000	—	—	7,799,000
Due from affiliates, net	500,000	966,000	(973,000)	493,000
Prepaid expenses and other current assets	6,920,000	3,000	—	6,923,000
Total current assets	118,255,000	1,610,000	(973,000)	118,892,000
Property and equipment	717,030,000	8,690,000	—	725,720,000
Less accumulated depreciation and amortization	(385,526,000)	(4,354,000)	—	(389,880,000)
Net property and equipment	331,504,000	4,336,000	—	335,840,000
Other assets:				
Investments	384,397,000	—	—	384,397,000
Investments in joint ventures	—	—	—	—
Assets whose use is limited	8,000	—	—	8,000
Beneficial interest in net assets of Anne Arundel Medical Center Foundation, Inc.	24,540,000	—	3,393,000	27,933,000
Notes receivable from affiliate	2,078,000	—	—	2,078,000
Restricted collateral for interest rate swap contract	67,404,000	—	—	67,404,000
Other assets	19,545,000	—	(5,714,000)	13,831,000
Total assets	\$ 947,731,000	\$ 5,946,000	\$ (3,294,000)	\$ 950,383,000

Anne Arundel Medical Center, Inc. and Subsidiaries
 Supplementary Consolidating Balance Sheet (continued)

June 30, 2019

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Consolidating and Eliminating Entries	Consolidated
Liabilities and net assets				
Current liabilities:				
Accounts payable	\$ 25,067,000	\$ 19,000	\$ —	\$ 25,086,000
Accrued salaries, wages, and benefits	17,775,000	211,000	—	17,986,000
Other accrued expenses	16,164,000	1,000	—	16,165,000
Current portion of long-term debt	7,161,000	—	—	7,161,000
Intercompany payables	50,309,000	—	(964,000)	49,345,000
Advances from third-party payors	21,720,000	—	—	21,720,000
Total current liabilities	138,196,000	231,000	(964,000)	137,463,000
Long-term debt, less current portion and unamortized original issue premium				
Interest rate swap contract	298,384,000	—	—	298,384,000
Accrued pension liability	78,479,000	—	—	78,479,000
Total liabilities	521,135,000	231,000	(964,000)	520,402,000
Net assets:				
Without donor restrictions	402,674,000	5,715,000	(5,559,000)	402,830,000
With donor restrictions	23,922,000	—	3,229,000	27,151,000
Total net assets	426,596,000	5,715,000	(2,330,000)	429,981,000
Total liabilities and net assets	\$ 947,731,000	\$ 5,946,000	\$ (3,294,000)	\$ 950,383,000

Anne Arundel Medical Center, Inc. and Subsidiaries
 Supplementary Consolidating Statement of Operations

Year Ended June 30, 2019

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Consolidating and Eliminating Entries	Consolidated
Operating revenue:				
Net patient service revenue	\$ 565,001,000	\$ 5,175,000	\$ —	\$ 570,176,000
Other operating revenue	13,421,000	751,000	(4,959,000)	9,213,000
Total operating revenue	<u>578,422,000</u>	<u>5,926,000</u>	<u>(4,959,000)</u>	<u>579,389,000</u>
Operating expenses:				
Salaries and wages	211,393,000	3,923,000	—	215,316,000
Employee benefits	40,282,000	648,000	—	40,930,000
Supplies	143,523,000	601,000	(163,000)	143,961,000
Purchased services	117,833,000	710,000	—	118,543,000
Foundation transfer to Anne Arundel Medical Center Foundation, Inc. and subsidiaries	(1,000)	—	(4,789,000)	(4,790,000)
Depreciation and amortization	29,613,000	334,000	—	29,947,000
Interest	10,746,000	—	—	10,746,000
Transaction costs	3,279,000	—	—	3,279,000
Total operating expenses	<u>556,668,000</u>	<u>6,216,000</u>	<u>(4,952,000)</u>	<u>557,932,000</u>
Operating income (loss)	<u>21,754,000</u>	<u>(290,000)</u>	<u>(7,000)</u>	<u>21,457,000</u>
Other income (loss):				
Investment income, net	12,664,000	—	—	12,664,000
Income from joint venture and other, net	(320,000)	—	290,000	(30,000)
Pension expense	(4,777,000)	—	—	(4,777,000)
Change in unrealized losses on trading securities, net	11,134,000	—	—	11,134,000
Realized and unrealized losses on interest rate swap contracts, net	(23,361,000)	—	—	(23,361,000)
Total other income (loss), net	<u>(4,660,000)</u>	<u>—</u>	<u>290,000</u>	<u>(4,370,000)</u>
Excess of revenue over expenses (deficit)	<u>\$ 17,094,000</u>	<u>\$ (290,000)</u>	<u>\$ 283,000</u>	<u>\$ 17,087,000</u>

Anne Arundel Health System, Inc. and Subsidiaries

Supplementary Description of Consolidating and Eliminating Entries

1. To eliminate intercompany payables and receivables
2. To eliminate investments in subsidiaries and related net asset accounts
3. To eliminate intercompany income and expense generated from management fees, staffing contracts, captive insurance premiums, and operating leases
4. To eliminate intercompany notes
5. To eliminate income of wholly owned subsidiaries
6. To eliminate intercompany revenue and expense for interest and other miscellaneous transactions
7. To eliminate the Hospital's beneficial interest in the Foundation

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