

Mercy Health Services, Inc. and Subsidiaries

**Consolidated Financial Statements and
Other Financial Information**

Years Ended June 30, 2019 and 2018

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Independent Auditors' Report

Board of Trustees
Mercy Health Services, Inc. and Subsidiaries
Baltimore, Maryland

We have audited the accompanying consolidated financial statements of Mercy Health Services, Inc. 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 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 did not audit the financial statements of Greenleaf Insurance Company, Ltd., a wholly owned subsidiary, which statements reflect total assets constituting 10% and 9% of consolidated total assets at June 30, 2019 and 2018, respectively. 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 Greenleaf 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 of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

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

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

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Mercy Health Services, Inc. and Subsidiaries, as of June 30, 2019 and 2018 and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in United States of America.



Change in Accounting Principles

As described in Note 2 to the consolidated financial statements, Mercy Health Services, Inc. and Subsidiaries adopted Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which provides guidance on revenue recognition and related disclosure using the modified retrospective method in 2019. Our opinion is not modified with respect to this matter.

Report on Supplementary Financial Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 47 to 54 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the 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 consolidating 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, which insofar as it related to Greenleaf Insurance Company, Ltd., is based on the report of other auditors, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Dixon Hughes Goodman LLP

**Charleston, West Virginia
September 11, 2019**

Mercy Health Services, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 120,125	\$ 107,701
Short-term investments	37,306	45,651
Current portion of funds held by trustee or authority -- <i>Note 6</i>	25,895	8,829
Resident prepayment deposits	565	684
Patient accounts receivable, net -- <i>Note 3</i>	68,828	66,988
Other amounts receivable, net	11,756	3,666
Current pledges receivable, net -- <i>Note 4</i>	2,733	3,505
Supplies inventory	8,739	9,233
Other current assets	<u>3,308</u>	<u>4,689</u>
Total current assets	279,255	250,946
Property and equipment, net -- <i>Note 5</i>	539,651	535,316
Investments and other assets:		
Funds held by trustee or authority, less current portion -- <i>Note 6</i>	10,378	10,241
Board designated and donor restricted investments -- <i>Note 7</i>	197,819	188,255
Restricted cash and investments	84,241	79,896
Long-term investments	7,528	7,091
Long-term pledges receivable, net -- <i>Note 4</i>	2,083	2,849
Investments in and advances to affiliates -- <i>Note 8</i>	4,717	4,720
Reinsurance receivable -- <i>Note 10</i>	9,925	5,256
Other assets -- <i>Note 9</i>	<u>7,365</u>	<u>8,816</u>
Total assets	<u>\$ 1,142,962</u>	<u>\$ 1,093,386</u>

(Continued)

	<u>2019</u>	<u>2018</u> (As Adjusted)
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current maturities of long-term debt -- <i>Note 11</i>	\$ 8,855	\$ 8,937
Accounts payable and accrued expenses	101,463	100,101
Advances from third-party payers	22,021	23,140
Resident prepayment deposits	565	684
Construction retainage	682	132
	<hr/>	<hr/>
Total current liabilities	133,586	132,994
Long-term debt, net -- <i>Note 11</i>	398,651	391,773
Provision for outstanding losses -- <i>Note 10</i>	87,952	77,823
Post-retirement obligation -- <i>Note 14</i>	7,573	7,124
Interest rate swap liabilities -- <i>Note 11</i>	19,781	13,184
Other long-term liabilities -- <i>Note 25</i>	13,190	13,641
	<hr/>	<hr/>
Total liabilities	660,733	636,539
Net assets:		
Without donor restrictions	456,306	425,429
With donor restrictions -- <i>Notes 17</i>	25,923	31,418
	<hr/>	<hr/>
Total net assets	482,229	456,847
Total liabilities and net assets	<u>\$ 1,142,962</u>	<u>\$ 1,093,386</u>

See notes to the consolidated financial statements.

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Operations
Years Ended June 30, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
Revenue:		(As Adjusted)
Patient service revenue (net of allowances and concessions) -- <i>Note 19</i>		\$ 718,826
Provision for bad debts		(15,770)
Net patient service revenue	\$ 734,345	703,056
Other operating revenue	28,816	28,717
Net assets released from restriction used for operations	3,754	5,675
Total revenue	766,915	737,448
Expenses -- <i>Note 21</i> :		
Salaries and benefits	412,490	395,735
Medical and surgical supplies	69,002	67,288
Pharmacy supplies	60,831	51,292
Other expendable supplies	31,868	29,216
Professional fees	18,549	18,219
Insurance	29,723	31,640
Other purchased services	51,339	51,856
Interest expense	16,434	16,466
Repairs	18,041	17,863
Depreciation and amortization	40,904	40,343
Total expenses	749,181	719,918
Operating income	17,734	17,530
Other income (losses):		
Investment income -- <i>Note 7</i>	7,607	8,403
Net unrealized gains on trading securities -- <i>Note 7</i>	4,245	3,411
Unrealized (loss) gain on interest rate swaps	(6,597)	4,792
Equity earnings in joint ventures -- <i>Note 8</i>	606	589
Loss on disposal of assets and other	(866)	(3,294)
Net other income	4,995	13,901
Excess of revenue over expenses	22,729	31,431
Changes to pension and post retirement plan obligations -- Notes 14 and 15	(14)	(775)
Net assets released from restrictions for the purchase of property and equipment	8,162	642
Increase in net assets without donor restrictions	\$ 30,877	\$ 31,298

See notes to the consolidated financial statements.

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2019 and 2018
(in thousands)

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Net assets, June 30, 2017 as adjusted	\$ 394,131	\$ 31,782	\$ 425,913
Excess of expenses over revenue	31,431	-	31,431
Net assets released from restrictions for the purchase of property and equipment	642	(642)	-
Restricted gifts, bequests and contributions	-	5,952	5,952
Changes to post retirement plans obligations	(775)	-	(775)
Net assets released from restrictions used for operations	<u>-</u>	<u>(5,674)</u>	<u>(5,674)</u>
Change in net assets	<u>31,298</u>	<u>(364)</u>	<u>30,934</u>
Net assets, June 30, 2018 as adjusted	<u>\$ 425,429</u>	<u>\$ 31,418</u>	<u>\$ 456,847</u>
Excess of revenue over expenses	\$ 22,729	\$ -	\$ 22,729
Net assets released from restrictions for the purchase of property and equipment	8,162	(8,162)	-
Restricted gifts, bequests and contributions	-	6,421	6,421
Changes to post retirement plans obligations	(14)	-	(14)
Net assets released from restrictions used for operations	<u>-</u>	<u>(3,754)</u>	<u>(3,754)</u>
Change in net assets	<u>30,877</u>	<u>(5,495)</u>	<u>25,382</u>
Net assets, June 30, 2019	<u>\$ 456,306</u>	<u>\$ 25,923</u>	<u>\$ 482,229</u>

See notes to the consolidated financial statements.

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
Operating activities:		
Change in net assets	\$ 25,382	\$ 30,934
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	40,904	40,343
Amortization of debt issuance cost, premiums and discounts	(155)	983
Loss (gain) on interest rate swaps	6,597	(4,792)
(Gain) loss on asset disposal	(3)	2,478
Realized and unrealized gain on investments	(8,797)	(9,078)
Restricted gifts, bequests, and contributions and restricted investment income	(6,421)	(5,952)
Provision for bad debts	-	15,770
(Increase) decrease in:		
Patient accounts receivable, net	(1,840)	(19,476)
Other amounts receivable, net	(12,759)	(1,157)
Inventory	494	(43)
Supplies	817	3,293
Restricted cash and investments	(4,345)	(10,892)
Trading portfolio	(10,063)	(19,229)
Increase (decrease) in:		
Accounts payable and accrued expenses	263	12,684
Provision for outstanding losses	10,129	11,557
Post-retirement obligation	435	1,534
Other long-term liabilities	(451)	(141)
Net cash and cash equivalents provided by operating activities	<u>40,187</u>	<u>48,816</u>
Investing activities:		
Purchases of property and equipment	(42,673)	(52,147)
Investment in joint venture	-	(1,623)
Net cash and cash equivalents used in investing activities	<u>(42,673)</u>	<u>(53,770)</u>

(Continued)

	<u>2019</u>	<u>2018</u>
Financing activities:		
Proceeds from restricted gifts, bequests, contributions and restricted investment income	\$ 7,959	\$ 7,644
Payment of financing costs	(446)	-
Proceeds from long term debt	21,000	-
Repayment of long term debt	<u>(13,603)</u>	<u>(9,433)</u>
Net cash and cash equivalents provided by (used in) financing activities	<u>14,910</u>	<u>(1,789)</u>
Net increase (decrease) in cash and cash equivalents	12,424	(6,743)
Cash and cash equivalents at beginning of year	<u>107,701</u>	114,444
Cash and cash equivalents at end of year	<u>\$ 120,125</u>	<u>\$ 107,701</u>

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

1. Organization and Summary of Significant Accounting Policies

Organization, basis of presentation and principles of consolidation

Mercy Health Services, Inc. (MHS) was formed for the purpose of supporting, benefiting, or carrying out some or all of the purposes of Mercy Medical Center, Inc. (Medical Center or MMC), Stella Maris, Inc. (SMI), the physician practice groups comprising the Physician Enterprise (as further described below) and Mercy Health Foundation (MHF). MHS is the sole member of the Medical Center, SMI, the Physician Enterprise and MHF. MHS prepares its consolidated financial statements on the accrual basis of accounting. The accompanying consolidated financial statements include MMC, SMI, the Physician Enterprise and MHF. All material intercompany balances and transactions have been eliminated.

Mercy Medical Center, Inc.

The Medical Center, a subsidiary of MHS, provides inpatient, outpatient and emergency care services primarily for the citizens of the Baltimore metropolitan area. In addition, the following entities are wholly owned subsidiaries of the Medical Center:

<u>Name of Subsidiary</u>	<u>Tax Status</u>
Mercy Transitional Care Services, Inc. (MTC) <i>Provider of subacute services</i>	Tax Exempt
Greenleaf Insurance Company, Ltd. (GIC) <i>Provider of self-insured general and malpractice coverage to MHS</i>	Foreign Subsidiary

Stella Maris, Inc.

SMI, a subsidiary of MHS, is the sole member of the Stella Maris Operating Corporation, as well as the Cardinal Sheehan Center, Incorporated (CSC). SMI provides sub-acute, hospice, long-term care, skilled homecare, personal care and adult day care to patients in the central Maryland service area within its 412-bed facility. CSC is engaged in maintaining and providing care and housing of aged and infirmed persons. CSC owns St. Elizabeth Hall, a 200-unit apartment complex for the elderly.

Physician Enterprise

The Physician Enterprise includes Maryland Family Care, Inc. (MFC), St. Paul Place Specialists, Inc. (SPPS) and Maryland Specialty Services, LLC (MSS). MSS is the sole member of Lutherville Hematology and Oncology, LLC and North Calvert Anesthesiology Services, LLC, and is the sole stockholder of Vascular Specialty Services, Inc. These entities provide primary care and specialty services within the Baltimore area. MFC, SPPS and MSS are wholly owned/controlled subsidiaries of MHS.

Mercy Health Foundation, Inc.

MHF, a subsidiary of MHS, was formed to coordinate and strengthen the fundraising function on behalf of MHS.

Income taxes

MHS, MMC, SMI, MFC, SPPS, MHF, and MSS are not-for-profit organizations exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, and are, therefore, not subject to federal income tax under current income tax regulations. MHS subsidiaries otherwise exempt from federal and state taxation are nonetheless subject to taxation at corporate tax rates at both the federal and state level on their unrelated business income.

Current accounting standards define the threshold for recognizing uncertain income tax return positions in the consolidated financial statements as “more likely than not” that the position is sustainable, based on its technical

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

merits, and also provide guidance on the measurement, classification and disclosure of tax return positions in the consolidated financial statements. Management believes there is no impact on MHS' accompanying consolidated financial statements related to uncertain income tax positions.

Basis of presentation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Revenues are reported as increases in net assets without donor restrictions unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Gains and losses are reported as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulation or by law. Contributions, including unconditional promises to give, with no donor-imposed restrictions are recognized in the period received as increases in net assets without donor restrictions. Contributions with donor-imposed restrictions are reported as increases in net assets with donor restrictions. Expirations of restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Income and realized net gains (losses) on investments are reported as follows:

- Increases (decreases) in net assets with donor restrictions if the terms of the gift or the MHS' interpretation of relevant state law require that they be added to the principal of a permanent net asset with donor restriction;
- Increases (decreases) in net assets with donor restrictions if the terms of the gift impose restrictions on the use of the income;
- Increases (decreases) in net assets without donor in all other cases.

Net assets

In fiscal year 2019, MHS adopted ASU 2016-14, Not-for-Profit Entities (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. The primary impact of adopting ASU 2016-14 for MHS is the presentation of net assets with and without donor restrictions and expanded disclosures related to functional expenses and liquidity and availability, as disclosed in notes 21 and 22, respectively. MHS has retrospectively adopted the guidance in ASU 2016-14 to the 2018 financial statement information and disclosures, except for the disclosures around liquidity and availability of resources and analysis of expenses by nature and function. These disclosures have only been presented for 2019, as permitted under the standard. The impact on net assets as of June 30, 2018 upon adoption of this standard was as follows:

<u>Net Asset Classifications</u>	<u>ASU 2016-14 Classifications</u>		
	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total Net Assets</u>
As previously presented:			
Unrestricted	\$ 425,429	\$ -	\$ 425,429
Temporarily restricted	-	29,240	29,240
Permanently restricted	-	2,178	2,178
Net assets as reclassified	<u>\$ 425,429</u>	<u>\$ 31,418</u>	<u>\$ 456,847</u>

Cash equivalents and short-term investments

MHS and certain of its subsidiaries invest in money market funds and U.S. Treasury Bills, which are highly liquid and have an original maturity of ninety days or less. These financial instruments are considered cash and cash equivalents and are recorded at cost, which approximates fair value. Short-term investments are highly liquid assets that have an original maturity between three months and one year.

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – net assets available for use in general operations and not subject to donor restrictions. All revenue not restricted by donors and donor restricted contributions whose restrictions are met in the same period in which they are received are accounted for in net assets without donor restrictions.

Net Assets With Donor Restrictions – net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. 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 to net assets without donor restrictions.

Restricted cash, cash equivalents and investments

Restricted cash, cash equivalents and investments represent funds that have been set aside to cover a portion of GIC's estimated outstanding claims, and donor restricted funds from net assets with donor restrictions. At June 30, 2019 and 2018, respectively, restricted cash and investments of \$84,241 and \$79,896 were set aside to cover estimated outstanding claims and donor restricted funds.

Investments

Investments include marketable securities with readily determinable fair values based on quoted market prices. Investment income or losses are reported in the consolidated statements of operations as part of excess of revenue over expenses unless the income is restricted by donor or law. Investments received by gift or bequest are reported at fair value at the date of the donation. Investment income and changes in the fair value of investments with donor restrictions are recorded as increases or decreases in net assets with or without donor restrictions in accordance with the terms of the donor's original gift or bequest.

Investments also include investments in limited partnerships and other alternative investments, which are made in accordance with the investment policies of MHS and are monitored through quarterly performance reviews. The limited partnerships acquire, hold, invest, manage, dispose of and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities are valued using generally accepted pricing services selected by the fund managers of the limited partnerships. Securities not valued by such pricing services are valued upon bid quotations obtained from independent dealers in the securities. In the absence of any independent quotations, securities are valued by the fund managers on the basis of data obtained from the best available sources.

Although the various fund managers use their best judgment at estimating the fair value of the alternative investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of the fair value could be material.

Donor-restricted gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as support with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the accompanying statements of operations as net assets released from restrictions.

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

Supplies inventories

Supplies inventories are stated at the lower of cost, determined by the first-in, first-out method, or net realizable value.

Advance from third-party payers

The Medical Center receives advances from third-party payers to provide working capital for services rendered to the beneficiaries of such services. These advances are subject to periodic adjustment, and are principally determined based on the timing difference between the provision of care and the anticipated payment date of the claim for service.

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. MMC 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 19). SMI and Physician Enterprise 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 MHS's uninsured patients will be unable or unwilling to pay for services provided. Thus, MHS 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, MHS used similar information to estimate a provision for bad debts. MHS 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 appropriate MHS entities for final write-off.

Medicare reimburses MTC and SMI under a prospective payment system (PPS) for skilled nursing facility services, under which facilities are paid a fixed fee for virtually all covered services. Under PPS, each patient's clinical status is evaluated and placed into a payment category. The patient's payment category dictates the amount that the provider will receive to care for the patient on a daily basis. The per diem rate covers (i) all routine inpatient costs currently paid under Medicare Part A; (ii) certain ancillary and other items and services previously covered separately under Medicare Part B on a "pass-through" basis; and (iii) certain capital costs.

Charity care

The Medical Center provides medically necessary services without charge or at amounts less than its established rates to patients who qualify for charity care under its financial assistance policy. Because the Medical Center does not pursue collection of those amounts determined to qualify as charity care, they are not reported as net patient service revenue and are not included in patient accounts receivable (see Note 2).

The criteria for qualifying for charity care applied by the Medical Center includes family income, net assets and the size of the patient's bill relative to the patient's ability to pay. Discounts are provided to patients who are unable to pay based on a sliding scale that is applied for family incomes up to approximately 400% above the U.S. Department of Health and Human Services (HHS) Poverty Guidelines. Free care is provided to patients with family incomes up to approximately 200% above the HHS Poverty Guidelines.

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

Charity care is provided to patients who qualify under the Medical Center's financial assistance policy at any time. Once the Medical Center determines that the patient qualifies for charity care, the Medical Center makes no further attempt to collect on the amount qualifying for charity care.

Certain other controlled subsidiaries of MHS also provide services without charge or at amounts less than their established rates to patients who qualify for charity care under their respective financial assistance policies.

Impairment of long-lived assets

MHS accounts for impairment or disposal of long-lived assets in accordance with applicable guidance. Such guidance requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Management believes that no asset impairment existed at June 30, 2019 and 2018.

Property and equipment

Property and equipment are recorded at cost. Donated property and equipment are recorded at fair value at the date of the donation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, which is forty years for buildings and the parking center and ranges from three to ten years for machinery and equipment.

The cost of new implemented software is capitalized. Costs include payment to vendors for the purchase and assistance in its installation, payroll costs of employees directly involved in the software installation and interest costs of the software project if financed by debt. Preliminary costs to document system requirements, vendor selection and any costs before software purchases are expensed. Capitalization of costs will generally end when the project is completed and the software is ready to be used. Where implementation of the project is in phases, only those costs incurred that further the development of the project will be capitalized. Costs incurred to maintain the applications are expensed.

Resident prepayment deposits

SMI's private pay residents are required to make a non-interest-bearing prepayment of two months' room and board at the time of admission. St. Elizabeth Hall obtains an interest-bearing security deposit, which is the lesser of one month rent or the resident responsibility. At the time of discharge or acceptance by Medical Assistance or similar government assistance programs, any prepayment remaining after application to the resident's outstanding bill will be refunded. At June 30, 2019 and 2018, resident prepayment deposits approximated \$565 and \$684, respectively, and have been recorded as a current asset liability within the consolidated balance sheets.

Accounting estimates

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

Derivative instruments

Current accounting standards require that an entity recognize all derivative instruments as either assets or liabilities in the statement of financial position and measure those instruments at fair value. MHS has entered into interest rate swap agreements to manage its interest rate risk (see Notes 11 and 12). The interest rate swaps do not qualify for hedge accounting under current accounting standards; therefore, management accounts for the

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(in thousands)

derivative instruments as speculative derivative instruments with the change in the fair value reflected in the accompanying consolidated statements of operations as a component of other non-operating income. Net settlement payments are reported as a component of interest cost, with the exception of the payments associated with construction activities that are capitalized. Entering into interest rate swap agreements involves varying degrees and elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the consolidated balance sheets. Such risks involve the possibility that there will be no liquid market for these agreements, the counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates.

Meaningful use incentives

Under certain provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), federal incentive payments are available to hospitals, physicians and certain other professionals when they adopt, implement or upgrade certified electronic health record (EHR) technology or become “meaningful users,” as defined under ARRA, of EHR technology in ways that demonstrate improved quality, safety and effectiveness of care. Incentive payments have been made over varying transitional schedules depending on the type of incentive (Medicare and Medicaid) and recipient (hospital or eligible provider). Eligible hospitals can attest for both Medicare and Medicaid incentives, while physicians must select to attest for either Medicare or Medicaid incentives. For Medicare incentives, eligible hospitals receive payments over four years while eligible physicians receive payments over five years. For Medicaid incentives, eligible hospitals receive payments based on the relevant State adopted payment structure and physicians receive payments over six years.

MHS recognized EHR incentives since it was reasonably assured that the Medical Center and PE successfully demonstrated compliance with established meaningful use criteria., MHS recognized \$91 and \$38 of EHR incentives during fiscal year 2019 and 2018, respectively, in other operating revenue.

Excess of revenue over expenses

The consolidated statements of operations include excess of revenue over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Activities that result in gains or losses unrelated to the primary operations of MHS are considered to be nonoperating.

Reclassifications

Certain 2018 amounts have been reclassified to conform to the 2019 presentation in the accompanying consolidated financial statements. Such reclassifications did not impact the 2018 consolidated change in net assets without donor restrictions.

New accounting pronouncements

In November 2015, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 23): Restricted Cash*. The ASU requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and 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. The ASU is effective for MHS for its fiscal year ending June 30, 2020. The ASU should be applied retrospectively to all periods presented.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in this ASU revise the accounting related to lessee accounting. Under the new guidance, lessees will be required to recognize a lease

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liability and a right-of-use asset for all leases. The amendments in this ASU are effective for MHS for its fiscal year ending June 30, 2021, 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 consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation-Retirement Benefits (Subtopic 715); Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in this update require the service cost component of net benefit cost be reported in the same line item or items as other compensation costs arising from service rendered by the pertinent employees during the period. The other components of net periodic pension cost are required to be presented in the statement of operations separately from the service cost component and outside the subtotal operating income. The ASU is effective for MHS for its fiscal year ending June 30, 2020. The ASU should be applied retrospectively to all periods presented.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU requires equity investments, excluding investments recorded under the equity method of accounting, to be measured at fair value with changes reported within the performance indicator. Not-for-profit entities are no longer required to disclose fair value of financial instruments not recognized at fair value on the balance sheet. The ASU is effective for MHS for its fiscal year ending June 30, 2020.

Management has not yet determined the impact, if any, of adoption of these changes in accounting standards on the consolidated financial statements of MHS.

2. Net Patient Service Revenue

During fiscal year 2019, MHS 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 modified retrospective method (ASC 606). The information in the prior year comparative period has not been restated and continues to be reported under the accounting standards in effect for that period. 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, therefore, included in net patient service revenue in 2019. Such implicit price concessions reflected in net patient service revenue in the accompanying consolidated financial statements for the year ended June 30, 2019 were \$17,030. 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 allowance for doubtful accounts and contractual adjustments of \$78,757 at June 30, 2018, was 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 MHS 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 MHS's facilities at the balance sheet date. Accordingly, MHS 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 MHS does not have any amounts that should be reflected separately as contract assets.

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As part of the adoption of ASC 606, MHS elected certain available practical expedients under the standard. First, MHS 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 MHS'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, MHS 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, MHS 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 MHS 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 MHS 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, MHS 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 MHS. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. MHS 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 Medical Center or SMI. MHS 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, or resident 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 MHS 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, MHS 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 19, MMC charges are based on rates established by the Commission, which is subsequently reduced by contractual discounts provided to third-party payers and discounts provided to uninsured patients in accordance with MHS policy. SMI and Physician Enterprise determine 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. MHS determines its estimate of implicit price concessions based on historical collection experience with this 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 MHS with these laws and regulations, and it is not possible to determine the impact (if any) such

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claims or penalties would have upon MHS. The results of such governmental review could include fines, penalties and exclusion from participation in the Medicare and Medicaid programs. In addition, the contracts MHS 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. MHS also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. MHS 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 MHS, care is provided to patients regardless of their ability to pay. Therefore, MHS has determined it has provided 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 MHS expects to collect based on its collection history with those patients.

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:

	2019				
	Medicare	Medicaid	Commercial	Other	Total
Hospital IP	\$ 89,721	\$ 33,824	\$ 72,794	\$ 2,123	\$ 198,462
Hospital OP	75,026	58,516	125,933	5,473	264,948
Hospital ER	10,362	2,615	5,627	786	19,390
Stella SNF	5,968	22,608	567	7,790	36,933
Stella Home Health	11,933	1,199	1,897	3,671	18,700
Physician Enterprise FFS	42,571	18,852	77,681	11,128	150,232
Physician Enterprise Ancillary	18,578	2,772	24,143	187	45,680
Revenues	<u>\$ 254,159</u>	<u>\$ 140,386</u>	<u>\$ 308,642</u>	<u>\$ 31,158</u>	<u>\$ 734,345</u>

	2018				
	Medicare	Medicaid	Commercial	Other	Total
Hospital IP	\$ 121,018	\$ 9,517	\$ 70,943	\$ 2,169	\$ 203,647
Hospital OP	108,194	8,511	121,439	5,438	243,582
Hospital ER	16,801	1,322	5,369	1,278	24,770
Stella SNF	6,083	22,343	369	8,197	36,992
Stella Home Health	10,489	1,415	1,673	5,178	18,755
Physician Enterprise FFS	38,530	15,936	76,835	11,821	143,122
Physician Enterprise Ancillary	13,414	1,519	17,090	165	32,188
Revenues	<u>\$ 314,529</u>	<u>\$ 60,563</u>	<u>\$ 293,718</u>	<u>\$ 34,246</u>	<u>\$ 703,056</u>

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

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3. Patient Accounts Receivable and Charity Care

Patient accounts receivable consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Patient accounts receivable	\$ 67,339	\$ 145,465
Less:		
Allowance for doubtful accounts and contractual adjustments	-	(78,757)
Medicare Periodic Interim Payment	<u>1,489</u>	<u>280</u>
	<u>\$ 68,828</u>	<u>\$ 66,988</u>

Approximately 45% and 43% of gross patient accounts receivable were due from Medicare and Medicaid at June 30, 2019 and 2018, respectively.

The net cost of charity care provided by MHS totaled \$15,663 and \$12,821 for the years ended June 30, 2019 and 2018, respectively. The cost of charity care was calculated by applying the cost-to-charge ratio to the total amount of charges foregone for each of the controlled subsidiaries of MHS that provide charity care. The cost of charity care was determined net of any patient-related revenue due to sliding scale payments or other patient-specific sources and includes both direct and indirect cost of rendering care. The net cost of charity care is excluded from the uncompensated care fund net receipts (see Note 19). Additionally, MHS and certain of its controlled subsidiaries provide structured repayment plans to patients without collateral.

4. Pledges Receivable, Net

At June 30, 2019 and 2018, pledges receivable were \$5,290 and \$6,894, respectively, less an allowance for uncollectible pledges of \$261 and \$324, respectively, and a discount of \$213 and \$216, respectively. The expected payment of the pledges receivable less the uncollectible pledges at June 30, 2019 are as follows:

2020	\$ 2,733
2021	726
2022	268
2023	146
Thereafter	<u>943</u>
	4,816
Less current portion	<u>(2,733)</u>
Long-term portion	<u>\$ 2,083</u>

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5. Property and Equipment

Property and equipment, at cost, consists of the following at June 30:

	<u>2019</u>	<u>2018</u>
Buildings and improvements	\$ 623,032	\$ 612,165
Machinery and equipment	250,293	223,281
Parking center	41,234	41,234
Construction-in-progress	13,083	26,800
Land	<u>18,976</u>	<u>18,976</u>
	946,618	922,456
Accumulated depreciation	<u>(406,967)</u>	<u>(387,140)</u>
	<u>\$ 539,651</u>	<u>\$ 535,316</u>

As of June 30, 2019, SMI has a \$14.7 million commitment remaining under a construction contract related to the addition of a four-level transitional care center that is scheduled to open in the fall of 2020.

6. Funds Held by Trustee or Authority

Funds held by trustee or authority, which consist primarily of cash and government obligations (at fair value), are limited as to use as follows at June 30:

	<u>2019</u>	<u>2018</u>
Debt service reserve	\$ 25,895	\$ 8,829
Debt service fund	9,140	9,093
Reserve for replacements and residual receipts	<u>1,238</u>	<u>1,148</u>
	36,273	19,070
Less current portion	<u>25,895</u>	<u>8,829</u>
Long-term portion	<u>\$ 10,378</u>	<u>\$ 10,241</u>

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7. Board Designated and Donor Restricted Investments

Board designated investments are set aside by the board of trustees for costs relating to replacement or improvement of existing assets, or to cover the cost of services rendered as charity care and other programs. All board-designated investments are without donor restrictions, as the board at its discretion may undesignate the use of such funds. Investments with donor restrictions have been limited by donors to a specific purpose.

Board designated and investments with donor restrictions consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Equity	\$ 117,847	\$ 112,392
Fixed maturity	58,885	47,707
Cash	7,324	8,362
Alternatives	1,207	1,826
Pooled investments	<u>12,556</u>	<u>17,968</u>
	<u>\$ 197,819</u>	<u>\$ 188,255</u>

The investments above have been allocated, by source, as follows at June 30:

	<u>2019</u>	<u>2018</u>
Board designated	\$ 178,890	\$ 165,369
With donor restrictions subject to passage of time or use	<u>18,929</u>	<u>22,886</u>
	<u>\$ 197,819</u>	<u>\$ 188,255</u>

Investments with perpetual donor restrictions at June 30, 2019 and 2018 of \$2,178 are reported as restricted cash and investments.

Earnings on investments are as follows for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Interest and dividends	\$ 3,055	\$ 2,736
Net realized gains	<u>4,552</u>	<u>5,667</u>
	7,607	8,403
Unrealized gains on trading securities	<u>4,245</u>	<u>3,411</u>
	<u>\$ 11,852</u>	<u>\$ 11,814</u>

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8. Investments In and Advances to Affiliates

Investments in and advances to affiliates include joint venture relationships in which MHS or its subsidiaries have an ownership interest of 50% or less. Investments in which the ownership interest is less than 20% are carried at cost, and investments in which the ownership interest is at least 20% and less than 51% are generally carried on the equity method.

MHS has investments totaling \$4,716 and \$4,720 at June 30, 2019 and 2018, respectively, in the following joint ventures:

Joint Venture	Business Purpose	Percentage of Ownership		Investment	
		2019	2018	2019	2018
Premier Purchasing Partners, Inc.	Capital balance in group purchasing organization	n/a	n/a	\$ 917	\$ 916
Johns Hopkins Medicare Advantage	Medicare Advantage plan	1.5%	6.0%	3,800	3,800
Mercy Ridge, Inc.	Continuing care retirement community	50.0%	50.0%	-	-
Other investments	-	-	-	-	4
				<u>\$ 4,717</u>	<u>\$ 4,720</u>

MHS recorded non-operating income of \$606 and \$589 related to the operations of these investments for the years ended June 30, 2019 and 2018, respectively. MHS receives rebates from Premier Purchasing Partners, Inc., which are netted with associated supplies expense in the accompanying consolidated financial statements.

In June 1997, MMC invested executed a joint venture agreement with the Archbishop of Baltimore to form Mercy Ridge, Inc. (MR) for the purpose of developing a continuing care retirement community located in Timonium, MD. MMC has a 50% ownership in the joint venture. Since the original contribution into the joint venture, MMC has received distributions greater than the original investment. As of June 30, 2019 and 2018, MR has operated at a net deficit. MMC has recorded the equity method in the investment at zero for the period ending June 30, 2019 and 2018 since MMC is not obligated to make additional contributions into MR.

In September 2016, MHS invested in the Maryland Health Advantage Medicare Advantage Plan (the MA Plan) as a minority owner acquiring a six percent ownership stake. The MA Plan is comprised of various Maryland healthcare providers to deliver comprehensive provider, physician, prescription medicine, wellness and other coverage to participating Medicare beneficiaries in Maryland through a health care network. MHS and the Physician Enterprise are also contracted as participating providers in the MA Plan.

MHS recognizes its ownership in the MA Plan using the cost basis of accounting. MHS' current committed capital is \$3,800 and the mandatory capital is limited to \$3,000. Any additional capital requirements are optional but electing not to contribute will dilute MHS' ownership percentage accordingly. MHS elected not to contribute during the period ending June 30, 2019 which diluted ownership share to 1.5%. All net revenue from providing services to MA Plan beneficiaries is recognized at expected reimbursable amounts in the accompanying consolidated statements of operations. Members are allocated a portion of profits or losses in accordance with their participation in the MA Plan based on the terms of the membership agreement. The amount of such allocated profits or losses cannot be estimated at the present time. Accordingly, they will be recognized in the period the amount of such allocations become known.

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9. Other Assets

Other assets consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Amortizable assets, net	\$ 903	\$ 2,241
Deferred compensation plan assets (see Note 13)	4,233	4,634
Health insurance prepayment	1,449	1,482
Other investments	779	437
Notes receivable	<u>1</u>	<u>22</u>
	<u>\$ 7,365</u>	<u>\$ 8,816</u>

Amortizable assets of \$10,526 and \$10,006 for the years ended June 30, 2019 and 2018, respectively, are amortized over the expected useful life of the asset on a straight-line basis. MHS has recorded accumulated amortization of \$9,623 and \$7,765 for the years ended June 30, 2019 and 2018, respectively. Amortization expense is included with depreciation and amortization on the consolidated statements of operations.

10. Reinsurance Receivable/Recoverable and Provision for Outstanding Losses

GIC management based the provision for losses at June 30, 2019 on a report dated July 2019 prepared by GIC's independent actuaries, Complete Actuarial Solutions Co. of Bethesda, Maryland. In their report, the actuaries estimate outstanding losses at an expected confidence level, on an undiscounted basis, to be \$78,027 and \$72,567, net of reinsurance as of June 30, 2019 and 2018, respectively. As of June 30, 2019 and 2018, GIC's provision for outstanding losses was \$87,952 and \$77,823, respectively, and the reinsurance receivable for such losses was \$9,925 and \$5,256, respectively, after factoring in actual losses paid to June 30. The estimates provided by the actuaries are based on the historical data of the program blended together with relevant insurance industry loss development statistics.

In the opinion of GIC management, the provision for outstanding losses relating to losses reported and losses incurred but not reported at the consolidated balance sheet dates is adequate to cover the expected ultimate liability of GIC. However, due to the nature of the insurance risks assumed, these provisions are necessarily estimates, and could vary from the amounts ultimately paid.

Consistent with most companies with similar insurance operations, GIC's provision for outstanding losses is ultimately based on management's reasonable expectations of future events. It is reasonably possible that the expectations associated with these amounts could change in the near term (i.e., within one year) and that the effect of such changes could be material to the consolidated financial statements.

GIC's long-term estimated provision for outstanding losses exceeds GIC's retention limits by \$9,925 and \$5,256 for the years ended June 30, 2019 and 2018, respectively and are recorded as reinsurance balances recoverable in the accompanying consolidated balance sheets. GIC's current reinsurance receivable is \$8,038 and \$46 for the years ending June 30, 2019 and 2018, respectively and are recorded as other amounts receivable, net in the accompanying consolidated balance sheets. These losses are reinsured as described in Note 18.

In the event that GIC's reinsurers are unable to meet their obligations under the reinsurance agreements, GIC would still be liable to pay all losses under the insurance policies it issues but would only receive reimbursement to the extent the reinsurers could meet their above-mentioned obligations. GIC believes that all amounts included in reinsurance balances receivable and recoverable in the accompanying consolidated balance sheets will be collected in full from the reinsurers.

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11. Long-Term Debt

Long-term debt consists of the following at June 30:

	<u>2019</u>	<u>2018</u>
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2006; interest rate 5.69%; due July 1, 2036	\$ 28,075	\$ 28,955
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2007 B and C (converted); interest rate 3.87%; due July 1, 2024	17,845	20,945
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2008 (converted); interest rate 4.85%; due July 1, 2022	12,040	14,890
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2011; interest rate ranging from 3.00% to 6.25%; due July 1, 2031	36,825	37,030
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2012; interest rate ranging from 4.00% to 5.00%; due July 1, 2031	49,995	49,995
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2016A; interest rate ranging from 3.50% to 5.00%; due July 1, 2042	135,250	135,250
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2016B; variable interest rate (2.62% at June 30, 2019); due July 1, 2037	35,055	35,055
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2016C; variable interest rate (2.83% June 30, 2019); due July 1, 2042	63,205	63,555
MHHEFA Revenue Bonds, Stella Maris Issue, Series 2018; variable interest rate (1.90% at June 30, 2019); due 2050	21,000	-
MHHEFA Revenue Bonds, Stella Maris Issue, Series 1997; variable interest rate (1.16% at June 30, 2018); due 2021	-	6,090
HUD mortgage loan; interest rate 2.64%; due 2046	4,526	4,626
Other	<u>22</u>	<u>22</u>
Total long-term debt	<u>403,838</u>	<u>396,413</u>
Add:		
Net unamortized discount	7,355	7,753
Less:		
Net unamortized debt issuance costs	(3,687)	(3,456)
Current portion	<u>(8,855)</u>	<u>(8,937)</u>
Long -term portion	<u>\$ 398,651</u>	<u>\$ 391,773</u>

Principal payments on long-term debt are as follows for the years ended June 30:

2020	\$ 8,855
2021	9,924
2022	10,157
2023	10,635
2024	11,183
Thereafter	<u>353,084</u>
	<u>\$ 403,838</u>

Pursuant to an amended and restated Master Loan Agreement, as supplemented (the Loan Agreement), the Obligated Group members have issued debt through Maryland Health and Higher Educational Facilities Authority (MHHEFA). Currently the Medical Center, MHS and MHF comprise the Obligated Group for Mercy Medical Center issues. Each Obligated Group member is jointly and severally liable for the repayments under the obligations of the Loan Agreement. As security for the performance of the obligations of the Obligated Group members under the Loan Agreement, the Obligated Group members have granted to MHHEFA a security interest in their receipts, subject to certain permitted encumbrances. In addition, the Medical Center has mortgaged to

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MHHEFA certain real and personal property of the Medical Center under a mortgage from the Medical Center to MHHEFA, as amended and supplemented. The Loan Agreement contains certain restrictive, financial and nonfinancial covenants. Under the terms of the Loan Agreement and other loan agreements, certain funds are required to be maintained on deposit with the trustee or MHHEFA to provide for repayment of the obligations of the Obligated Group (see Note 6).

Mercy Medical Center issue, series 2006 bonds

In August 2006, MHHEFA authorized the issuance, sale and delivery of the \$35,000 Mercy Medical Center Series 2006 Revenue Bonds. The proceeds were loaned by MHHEFA to MMC in order to finance the construction of a new parking garage as well as the financing of certain routine capital expenditures.

Principal repayment of these bonds began on July 1, 2009 and is paid annually through July 1, 2036. Interest is paid semiannually on January 1 and July 1. Interest accrues at a fixed rate of 5.69%. The bonds are currently callable at par (100%).

Mercy Medical Center issue, series 2007B and C (converted)

In October 2007, MHHEFA authorized the issuance, sale and delivery of its \$100,000 Revenue Bonds, Mercy Medical Center Issue, Series 2007B and C, the proceeds of which were loaned by MHHEFA to MMC to finance the construction of a replacement hospital facility. On April 1, 2010, \$18,080 of the \$50,000 Series 2007B and \$11,920 of the \$50,000 Series 2007C Bonds were converted to Bank Qualified Revenue Bonds with a fixed interest rate, terminating July 1, 2024. On April 1, 2020, the bonds convert to a floating rate at which time the bonds will be remarketed. Principal repayment of the converted bonds began July 1, 2012 and is scheduled to be paid annually through July 1, 2024. Interest accrues at a fixed rate of 3.87%. The monthly interest payments on the Series 2007B and C Bonds are made directly to the bank.

The portion of the Series 2007B and C bonds that were not converted to Bank Qualified Bonds were refinanced with other MHHEFA Revenue bonds.

Mercy Medical Center issue, series 2008 (converted)

In July 2008, MHHEFA authorized the issuance, sale and delivery of its \$35,325 Revenue Bonds, Mercy Medical Center Issue, Series 2008, the proceeds of which were loaned by MHHEFA to MMC in order to refund the MMC Series 2003 Bonds. On December 16, 2009, \$30,000 of the Series 2008 Bonds was converted to Bank Qualified Revenue Bonds with a fixed interest rate period of approximately twelve years. On June 15, 2020, the bonds convert to a floating rate at which time the bonds will be remarketed. Principal repayment of the converted bonds began July 1, 2011 and is paid annually through July 1, 2022. Interest accrues at a fixed rate of 3.99%.

The monthly interest payments on the Series 2008 Bonds were made directly to the bank. Principal repayment of the Series 2008 Bonds began on July 1, 2009, and the portion of those bonds that were not converted to Bank Qualified Bonds were fully paid on July 1, 2011.

Mercy Medical Center issue, series 2011 bonds

In February 2011, MHHEFA authorized the issuance, sale and delivery of its \$40,770 Revenue Bonds, Mercy Medical Center Issue, Series 2011. The proceeds were loaned by MHHEFA to MMC to refund \$35,110 aggregate principal amount of the MMC Issue, Series 2007 B and C Bonds. The bonds were issued net of an original issue discount of \$881, which is being amortized over the life of the bonds using the straight-line method. The bonds require a debt service reserve fund. The balance of the debt service reserve fund at June 30, 2019 and 2018 was \$4,127 and \$4,035, respectively (see Note 5).

Principal repayment of the MMC Issue, Series 2011 Bonds began July 1, 2012 and is scheduled to be paid annually through July 1, 2031. Interest accrues at a rate varying from 3.00% to 6.25%. The interest is payable semi-annually on January 1 and July 1.

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Mercy Medical Center issue, series 2012 bonds

In April 2012, MHHEFA authorized the issuance, sale and delivery of its \$49,995 Revenue Bonds, Mercy Medical Center Issue, Series 2012. The proceeds were loaned by MHHEFA to MMC to refund the \$49,480 aggregate principal amount of the Mercy Medical Center Issue, Series 2001 Bonds. The bonds include an original issue premium of \$1,742, which is being amortized over the life of the bonds using the straight-line method. The bonds require a debt service reserve fund. The balance of the debt service reserve fund at June 30, 2019 and 2018 was \$5,012 and \$5,059, respectively (see Note 5).

Principal repayment of the MMC Issue, Series 2012 begins July 1, 2023 and is scheduled to be paid annually through July 1, 2031. Interest accrues at a rate varying from 4.0% to 5.0%. The interest is paid semi-annually on January 1 and July 1.

Mercy Medical Center issue, series 2016A

In March 2016, MHHEFA authorized the issuance, sale and delivery of its \$135,250 Revenue Bonds, Mercy Medical Center Issue, Series 2016A. The proceeds were loaned by MHHEFA to MMC to advance refund \$145,880 aggregate principal amount and \$11,452 aggregate interest due until July 1, 2017 of the MMC Issue, Series 2007A Bonds. As of June 30, 2016, the 2007A bonds were defeased and on July 1, 2017 the Series 2007A Bonds were fully refunded.

Principal repayment of the Series 2016A begins on July 1, 2032 and is scheduled to be paid annually through July 1, 2042. Interest accrues at a fixed rate ranging from 3.5% to 5.0%. The Series 2016A bonds were issued net of an original issue premium of \$9,327, which is being amortized over the life of the bonds using the straight-line method, which approximates the effective interest method.

Mercy Medical Center issue, series 2016B

In May 2016, MHHEFA authorized the issuance, sale and delivery of its \$35,055 Revenue Bonds, Mercy Medical Center, Series 2016B. The proceeds were loaned by MHHEFA to MMC to refund the \$34,890 Series 2011B bonds then outstanding. The Series 2016B bonds were issued as non-bank qualified revenue bonds and directly purchased by a commercial bank. The direct bank purchase terminates on May 19, 2021, at which time the Series 2016B bonds will be subject to a mandatory purchase at their par value by MMC unless the bank and MMC agree to an extension. Originally, the Series 2016B bonds bore interest at a variable rate equal to 70% of one-month LIBOR plus 0.70%. Effective January 1, 2018, as a result of the Tax Cuts and Jobs Act, and by function of the debt agreements for tax law changes, the effective interest rate changed to a variable rate equal to 85% of one-month LIBOR plus 0.85%. In December 2018, the bank agreed to modify the interest rate to 80% of one-month LIBOR plus 0.70%. Interest is paid monthly.

Annual principal repayment of Series 2016B bonds will begin on July 1, 2032 and the final payment will be on July 1, 2037.

Mercy Medical Center issue series 2016C

In May 2016, MHHEFA authorized the issuance, sale and delivery of its \$65,450 Revenue Bonds, Mercy Medical Center, Series 2016C. The proceeds were loaned by MHHEFA to MMC to refund the \$65,290 Series 2013 and Series 2013B bonds then outstanding. The Series 2016C bonds were issued as a non-bank qualified revenue bonds and directly purchased by a commercial bank. The direct bank purchase terminates on May 19, 2023, at which time the Series 2016C bonds will be subject to a mandatory purchase at their par value by MMC unless the bank and MMC agree to an extension. Originally, the Series 2016C bonds bore interest at a variable rate equal to 70% of one-month LIBOR plus 0.83%. Effective January 1, 2018, as a result of the Tax Cuts and Jobs Act, and by function of the debt agreements for tax law changes, the effective interest rate changed to a variable rate equal to 85% of one-month LIBOR plus 1.01%. In December 2018, the bank agreed to modify the interest rate to 70% of one-month LIBOR plus 1.15%. Interest is paid monthly.

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Annual principal repayment of Series 2016C bonds began on July 1, 2016 and the final payment will be on July 1, 2042.

Stella Maris issue, series 2018 bonds

In December 2018, the Series 2018 Bonds were issued to refund Series 1997 and to partially finance the construction of a Transitional Care Center in Stella Maris. Principal repayment of these bonds began on July 1, 2019 and are scheduled to be paid annually through July 1, 2050. All Series 2018 Bonds are subject to redemption prior to maturity. Interest accrues at a variable rate based on SIFMA. Interest on the bonds is payable monthly.

Under the provisions of the Series 2018 Bonds agreement, SMI has granted to MHHEFA a security interest in all of its real property and the assignment of its leases. In addition, payments on the Series 2018 Bonds are secured by an irrevocable letter of credit provided by a commercial bank. An annual letter of credit fee, equal to 0.73% of the letter of credit amount, is payable quarterly by SMI. The letter of credit expires December 19, 2028.

Under the terms of the bond indenture, SMI is required to maintain certain deposits with a trustee. The bond indenture agreement also requires SMI to satisfy certain measures of financial performance as long as the Series 2018 Bonds are outstanding. As of June 30, 2019, management believes SMI was in compliance with the financial covenant requirements of the bond indenture.

Stella Maris issue, series 1997 bonds

The Series 1997 Bonds were issued to finance the acquisition by SMI of Stella Maris Operating Corporation and CSC; to advance refund certain nursing home revenue bonds previously issued by MHHEFA, Stella Maris Issue, Series 1991; and to refinance certain outstanding indebtedness of the acquired corporations.

Principal repayment of these bonds began on July 1, 2001, to be paid annually through July 1, 2021. All Series 1997 Bonds were subject to redemption prior to maturity beginning March 1, 2001. Payments on the Series 1997 were secured by an irrevocable letter of credit provided by a commercial bank, with an annual fee equal to 1.29% of the letter of credit amount, payable quarterly. The bonds were refunded in December 2018 by the new Series 2018 bonds and the letter of credit was terminated.

Until the Series 1997 Bonds were refunded, interest accrued at a variable rate based on the prevailing interest rate in effect as determined by the Remarketing Agent on each Calculation Date. Interest on the Series 1997 bonds was payable monthly.

HUD mortgage loan

The mortgage loan from the U.S. Department of Housing and Urban Development (HUD) was used by CSC to construct St. Elizabeth Hall. This original note was refinanced during the year ended June 30, 2013. The original terms of the note reflected an interest rate of 6.86% per annum with monthly installments of \$43, including interest, with the final payment due November 1, 2020.

From July 1997 through December 2005, CSC received authorization from HUD to suspend its monthly principal and interest payments of \$43. The unpaid interest during this deferral period was accrued. On December 21, 2012, the original outstanding debt was refinanced with a new outstanding face amount of \$5,202 and the unpaid interest accrued during the deferral period was forgiven, resulting in a gain on extinguishment of debt of \$2,649. The current note reflects an interest rate of 2.64% per annum with monthly installments of \$20, including interest, with the final payment due January 1, 2046. The current note requires mortgage insurance of 0.45% of the average annual outstanding principal balance determined annually for the duration of the note. Concurrent with these monthly mortgage payments, St. Elizabeth Hall is required to make monthly payments of \$23 derived from the savings of the new note to a debt service savings reserve fund through May 2029 for purposes stipulated by a debt service savings agreement. In addition, concurrent with these monthly payments, St. Elizabeth Hall is required to make monthly payments of \$8 to a reserve fund for the replacement of property and equipment. These

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payments are required until the mortgage matures and are included in Board designated and donor restricted investments. All disbursements from this fund are contingent upon HUD's prior approval.

The liability of CSC under the mortgage note is limited to the underlying value of the real estate collateral plus other amounts deposited with the lender.

Lines of credit

The Medical Center has a \$10,000 operating line of credit with a commercial bank. At June 30, 2019 and 2018, the operating line of credit had \$0 outstanding. As of June 30, 2019 and 2018, the interest rate on the outstanding line of credit draw was 4.15% and 4.24%, respectively, and is based on one-month LIBOR plus 1.75%. This line of credit agreement is scheduled to remain in effect until all obligations, including other debt held by this bank, are paid in full or terminated by the bank.

Additionally, In June 2019, MMC secured a committed line of credit from a commercial bank in the amount of \$25,000 with a scheduled termination date of September 15, 2020. The line of credit also includes an option for an extension with bank approval. The purpose of the commitment is to provide bridge financing for the Series 2008 (converted) and Series 2007 B and C (converted) bonds, if necessary. Both issues are Bank Qualified Revenue Bonds held by commercial banks with a mandatory purchase or remarketing date during the year ending June 30, 2020. Management intends to extend, refund or replace the Bank Qualified Revenue Bonds prior to the line of credit termination. Accordingly, the portion of these Qualified Revenue Bonds remaining after June 30, 2019 are classified as long-term obligations in the accompanying consolidated balance sheets.

At June 30, 2019 this line of credit had \$0 outstanding, and the interest rate on the outstanding line of credit draw is 4.15% based on one-month LIBOR plus 1.75%.

Interest rate swaps

On December 1, 2004, the Medical Center entered into a fixed spread basis swap agreement in order to reduce the cost of capital with respect to the Series 2001 Bonds by removing the tax risk to bond holders and transferring the risk to the Medical Center. The fixed spread basis swap matures on December 1, 2024 and the exchanges of cash flows with the counter party began March 1, 2005. The notional amount of the swap is \$50,000. Pursuant to the swap agreement, the Medical Center pays the counter party a variable rate equal to the USD-SIFMA Municipal Swap Index and receives interest at a variable rate equal to the sum of 67% of USD-LIBOR-BBA and 0.60%.

Simultaneously, with the issuance of the Series 2006 bonds, MMC entered into an interest rate swap agreement, which was amended in November 2014, with a counter party with a notional amount of \$35,000 to convert the fixed rate structure to a variable rate. Under this amended agreement, MMC will receive a fixed interest rate of 5.69% and pay to the counter party the USD-SIFMA Municipal Swap Index plus 0.80%. On July 31, 2018, the interest rate swap agreement was extended from November 19, 2019 to April 1, 2023. Additionally, under this amended agreement, MMC will continue to receive a fixed interest rate of 5.69% and now pay to the counter party the USD-SIFMA Municipal Swap Index plus 0.836%. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles.

The value of this contract is based on two components: (i) the accrued but unpaid periodic cash flows and (ii) the termination value as defined in the agreement. By definition, the termination value is equal to the bond amount multiplied by the difference between highest price in the marketplace and the bonds base price (100%) and the call price would be the highest price in the marketplace on the valuation date. This is due to the fact that MHS would be economically inclined to call the bonds at par versus paying any termination payment on the swap and the bonds are carried on MHS' books at par. With MHS prepared to call the bonds at par, the market price should immediately converge on the call price. Additionally, MHS has the right to optionally terminate the contract. The counter party does not have the right to optionally terminate the agreement. The counter party can only terminate the agreement prior to its stated maturity if an event of default or an additional termination event exists.

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At June 30, 2019 and 2018, the fair value of the interest rate swap was \$1,434 and \$1,207, respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. An unrealized gain (loss) on interest rate swap totaling \$227 and \$28 is reflected in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2019 and 2018, respectively.

During October 2007, MMC entered into a fixed payer swap with a notional amount of \$65,000, which was amended in July 2014. Pursuant to the amended swap agreement, MMC pays the counter party a fixed rate of 3.459% and receives a variable rate equal to 70% of USD-LIBOR-BBA. The interest rate swap agreement terminates on July 1, 2042. At June 30, 2019 and 2018, the fair value of the interest rate swap was \$(21,215) and \$(14,391), respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. An unrealized gain/(loss) on interest rate swap totaling \$(6,824) and \$4,764 is reflected in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2019 and 2018, respectively.

12. Fair Value of Financial Instruments

The following methods and assumptions were used by MHS in estimating the fair value of its financial instruments:

Cash and cash equivalents, patient accounts receivable, other amounts receivable, accounts payable and accrued expenses due to third-party payers and construction retainage: The carrying amounts reported in the consolidated balance sheets approximate fair value.

Short-term investments, funds held by trustee or authority and board designated and donor restricted investments: Fair values, which are the amounts reported in the consolidated balance sheets, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Pooled separate accounts: NAV units, as determined by the custodian, are used to estimate fair value since quoted prices in active markets for identical assets are not available. These prices are determined using observable market information such as quotes from less active markets and/or quoted prices of securities with similar characteristics.

Long-term debt: Fair values of revenue bonds and other debt are based on current traded values. At June 30, 2019 and 2018, the fair value of long-term debt was approximately \$422,948 and \$404,288, respectively.

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:

Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities that are traded in an active exchange market, as well as U.S. Treasury securities.

Level 2: Observable input 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 2 assets and liabilities include debt securities with quoted market prices that are traded less frequently than exchange-traded instruments. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate-debt securities, and alternative investments.

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

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well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private debt and equity instruments and alternative investments.

The following discussion describes the valuation methodologies used for 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 business, value, or financial position of MHS 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.

MHS uses techniques consistent with the market approach for measuring fair value of its Level 2 and Level 3 assets and liabilities. The market approach is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Fair values of equity securities and fixed maturity securities have been determined by MHS from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes. Cash equivalents comprise short-term fixed maturity securities and carrying amounts approximate fair values, which have been determined from public quotations, when available. Money markets and certificates of deposit comprise short-term fixed maturity securities. The carrying amounts approximate fair values, which have been determined from public quotations, when available.

MHS holds alternative investments that are not traded on national exchanges or over-the-counter markets. MHS is provided information on net asset value per share as a practical expedient for these investments calculated by the funds of funds' managers (who are investment advisors registered with the Securities and Exchange Commission) based on information provided by the managers of underlying funds.

Fair value of the interest rate swaps represents, or are derived from, mid-market values. Mid-market prices and inputs may not be observable, and instead valuations may be derived from proprietary or other pricing models based on certain assumptions regarding past, present and future market conditions. Some inputs may be theoretical, not empirical, and require subjective assumptions and judgments. Valuations may be based on assumptions as to the volatility of the underlying security, basket or index, interest rates, exchange rates, dividend yields, correlations between these or other factors, the impact of these factors upon the value of the security (including any embedded options), as well as issuer funding rates and credit spreads (actual or approximated) or additional relevant factors.

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The following table presents the fair value hierarchy for financial instruments reported by MHS measured at fair value on a recurring basis as of June 30, 2019.

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
Board designated and donor restricted investments:				
Cash and cash equivalents:				
Cash	\$ 7,101	\$ -	\$ -	\$ 7,101
Equity securities:				
Mutual funds:				
International emerging markets	30,933	-	-	30,933
Domestic mutual fund-equity income	11,675	-	-	11,675
Common stocks:				
Consumer discretionary	7,547	-	-	7,547
Consumer staples	5,967	-	-	5,967
Energy	2,547	-	-	2,547
Financials	12,057	-	-	12,057
Real estate	2,885	-	-	2,885
Health care	9,152	-	-	9,152
Industrials	10,351	-	-	10,351
Information technology	17,366	-	-	17,366
Materials	1,900	-	-	1,900
Miscellaneous	990	-	-	990
Foreign stocks/American deposit receipt	-	4,477	-	4,477
Fixed maturity:				
U.S. government and agencies:				
U.S. treasury bonds	6,431	-	-	6,431
Government agency bonds	669	-	-	669
Corporate bonds:				
Asset backed securities	-	1,693	-	1,693
Financial	-	2,846	-	2,846
Industrial	-	7,246	-	7,246
Other	-	91	-	91
International (other global corp bonds)	-	2,012	-	2,012
Strip	-	585	-	585
Agency backed	-	1,557	-	1,557
Agency pooled	-	5,436	-	5,436
Equity funds	-	8,598	-	8,598
Mutual bond funds	21,659	-	-	21,659
Municipal bonds	-	285	-	285
Alternatives	-	-	1,207	1,207
Total assets in the fair value hierarchy	<u>\$ 149,230</u>	<u>\$ 34,826</u>	<u>\$ 1,207</u>	185,263
Investments measured at NAV ^(a)				<u>12,556</u>
Total board designated and donor restricted investments				<u>\$ 197,819</u>
Restricted cash and investments :				
Cash	\$ 2,178	\$ -	\$ -	\$ 2,178
Mutual funds	11,805	-	-	11,805
Corporate funds	25,656	13,678	-	39,334
Municipal bonds	-	4,465	-	4,465
Government and agencies	20,579	2,439	-	23,018
Asset backed securities	-	3,441	-	3,441
Total restricted cash and investments	<u>\$ 60,218</u>	<u>\$ 24,023</u>	<u>\$ -</u>	<u>\$ 84,241</u>

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<i>(continued)</i>	<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
Cash, cash equivalents and short-term investments:					
Cash	\$ 114,876	\$ -	\$ -	\$ -	\$ 114,876
Money market fund	-	34,555	-	-	34,555
U.S. Treasury notes	7,170	-	-	-	7,170
Certificate of deposit	-	830	-	-	830
Total cash, cash equivalents and short-term investments	<u>\$ 122,046</u>	<u>\$ 35,385</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 157,431</u>
Long-term investments:					
Cash	\$ 36	\$ -	\$ -	\$ -	\$ 36
Equity securities:					
Mutual funds	1,494	-	-	-	1,494
Fixed maturity:					
U.S. treasury notes	2,276	-	-	-	2,276
U.S. government and agencies:					
Government agency mortgage backed securities	-	820	-	-	820
Government agency pools	-	5	-	-	5
Corporate Bonds:					
Financial	-	831	-	-	831
Industrial	-	1,452	-	-	1,452
International (other global corp bonds)	-	70	-	-	70
Municipal bonds	-	544	-	-	544
Total long-term investments	<u>\$ 3,806</u>	<u>\$ 3,722</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,528</u>
Funds held by trustee (current):					
Money market	\$ -	\$ 4,544	\$ -	\$ -	\$ 4,544
Fixed maturity:					
Government agency notes	-	21,351	-	-	21,351
Total funds held by trustee (current)	-	25,895	-	-	25,895
Funds held by trustee (non-current):					
Cash	-	-	-	-	-
Money market	-	1,238	-	-	1,238
U.S. government and agencies	-	9,140	-	-	9,140
Funds held by trustee (non-current)	-	10,378	-	-	10,378
Total funds held by trustee	-	36,271	-	-	36,273
Total assets in the fair value hierarchy	<u>\$ 335,300</u>	<u>\$ 134,229</u>	<u>\$ 1,207</u>	<u>\$ -</u>	<u>470,736</u>
Investments measured at NAV ^(a)					<u>12,556</u>
Total investments at fair value					<u>\$ 495,848</u>
Liabilities:					
Interest rate swaps	\$ -	\$ 19,781	\$ -	\$ -	\$ 19,781
Total liabilities at fair value	<u>\$ -</u>	<u>\$ 19,781</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 19,781</u>

^(a) In accordance with current accounting standards, certain investments that were measured at NAV per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the consolidated balance sheets.

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The following table presents the fair value hierarchy for financial instruments reported by MHS measured at fair value on a recurring basis as of June 30, 2018.

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
Board designated and donor restricted investments:				
Cash and cash equivalents:				
Cash	\$ 8,362	\$ -	\$ -	\$ 8,362
Equity securities:				
Mutual funds:				
International emerging markets	31,002	-	-	31,002
Domestic mutual fund-equity income	21,799	-	-	21,799
Common stocks:				
Healthcare	6,846	-	-	6,846
Utilities	237	-	-	237
Telecommunications	195	-	-	195
Financials	12,940	-	-	12,940
Consumer staples	5,923	-	-	5,923
Consumer discretionary	7,108	-	-	7,108
Materials	961	-	-	961
Energy	2,947	-	-	2,947
Information technology	11,366	-	-	11,366
Industrials	6,552	-	-	6,552
Miscellaneous	811	-	-	811
Foreign stocks/American deposit receipt	-	3,705	-	3,705
Fixed maturity:				
U.S. government and agencies:				
U.S. Treasury bonds	7,626	-	-	7,626
Government agency bonds	5,820	-	-	5,820
Government zero coupon bonds	513	-	-	513
Corporate bonds:				
Financial	-	3,112	-	3,112
Industrial	-	5,728	-	5,728
International (other global corp bonds)	-	2,094	-	2,094
Asset backed securities	-	1,827	-	1,827
Bond fund	20,719	-	-	20,719
Municipal bonds	-	268	-	268
Alternatives	-	-	1,826	1,826
Total assets in the fair value hierarchy	<u>\$ 151,727</u>	<u>\$ 16,734</u>	<u>\$ 1,826</u>	170,287
Investments measured at NAV ^(a)				<u>17,968</u>
Total board designated and donor restricted investments				<u>\$ 188,255</u>
Restricted cash and investments:				
Cash	\$ 4,647	\$ -	\$ -	\$ 4,647
Mutual funds	12,641	-	-	12,641
Bond funds	24,050	-	-	24,050
Corporate funds	-	11,989	-	11,989
Municipal bonds	-	4,364	-	4,364
Government and agencies	19,968	-	-	19,968
Mortgage backed securities	-	2,236	-	2,236
Total restricted cash and investments	<u>\$ 61,306</u>	<u>\$ 18,590</u>	<u>\$ -</u>	<u>\$ 79,896</u>

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<i>(continued)</i>	<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
Cash, cash equivalents and short-term investments:					
	Cash	\$ 104,319	\$ -	\$ -	\$ 104,319
	Money market fund	-	6,000	-	6,000
	U.S. treasury notes	4,763	-	-	4,763
	Certificate of deposit	-	38,270	-	38,270
	Total cash, cash equivalents and short-term investments	<u>\$ 109,082</u>	<u>\$ 44,270</u>	<u>\$ -</u>	<u>\$ 153,352</u>
Long-term investments:					
	Money market fund	\$ 39	\$ -	\$ -	\$ 39
Equity securities:					
	Mutual funds	1,439	-	-	1,439
Fixed maturity:					
	U.S. Treasury notes	2,027	-	-	2,027
U.S. government and agencies:					
	Government agency mortgage backed securities	-	504	-	504
	Government agency pools	-	15	-	15
Corporate Bonds:					
	Financial	-	725	-	725
	Industrial	-	1,459	-	1,459
	International (other global corp bonds)	-	250	-	250
	Municipal bonds	-	633	-	633
	Total long-term investments	<u>\$ 3,505</u>	<u>\$ 3,586</u>	<u>\$ -</u>	<u>\$ 7,091</u>
Funds held by trustee (current):					
	Cash	\$ 5	\$ -	\$ -	\$ 5
	Money market	-	7,324	-	7,324
	Government agency notes	-	1,500	-	1,500
	Total funds held by trustee (current)	5	8,824	-	8,829
Funds held by trustee (non-current):					
	Cash	112	-	-	112
	Money market	-	8,953	-	8,953
	U.S. government and agencies	-	1,176	-	1,176
	Funds held by trustee (non-current)	<u>113</u>	<u>10,129</u>	<u>-</u>	<u>10,241</u>
	Total assets in the fair value hierarchy	<u>\$ 325,738</u>	<u>\$ 102,133</u>	<u>\$ 1,826</u>	429,697
	Investments measured at NAV ^(a)				<u>17,968</u>
	Total investments at fair value				<u>\$ 447,665</u>
Liabilities:					
	Interest rate swaps	\$ -	\$ 13,184	\$ -	\$ 13,184
	Total liabilities at fair value	<u>\$ -</u>	<u>\$ 13,184</u>	<u>\$ -</u>	<u>\$ 13,184</u>

^(a) In accordance with current accounting standards, certain investments that were measured at NAV per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the consolidated balance sheets.

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The following table summarizes investments for which fair value is measured using the NAV per share practical expedient as of June 30, 2019 and 2018.

	<u>Fair Value at June 30, 2019</u>	<u>Fair Value at June 30, 2018</u>	<u>Unfunded Commitments</u>	<u>Other Redemption Restrictions</u>	<u>Redemption Notice Period</u>
Multi-Strategy Fund ⁽¹⁾	\$ 6,997	\$ 6,714	None	None	65 days
Emerging Markets Equity Fund ⁽²⁾	-	8,797	None	None	3 days
Other	5,559	2,457	5,759	-	-

⁽¹⁾ The multi-strategy fund is event-driven with a focus on opportunities to exploit situations in which announced or anticipated events create opportunities to invest in securities and other financial instruments at a discount to their exit values. The fund also invests in a long/short equities portfolio of securities that can be readily valued and trade at a discount or premium to the fair value of the underlying assets. The fund permits semiannual redemption subject to 65 days advance written notice.

⁽²⁾ The fund's objective is to seek long-term capital appreciation by investing primarily in common stocks of emerging market issuers. The fund's performance benchmark is the Morgan Stanley Capital International Emerging Markets Index. The fund permits monthly redemption subject to 3 days advance written notice.

Included in alternative investments as of June 30, 2019 and 2018 are two classes of hedge funds with fair values of \$8 and \$456, respectively (Fund A), and \$1,199 and \$1,370, respectively, (Fund B). Fund A is in liquidation and redemptions are suspended until the fund can liquidate its underlying holding. Fund B is redeemable calendar quarterly with 65 days advance notice. There are no unfunded commitments for any of the hedge fund of funds for either 2019 or 2018.

The following table is a rollforward of the consolidated statements of financial position amounts for financial instruments classified by MHS within level 3 of the valuation hierarchy defined above:

	<u>Investments</u>
Fair value June 30, 2017	\$ 1,661
Unrealized gains, net	272
Purchases	602
Redemptions	<u>(709)</u>
Fair value June 30, 2018	1,826
Unrealized gain, net	40
Purchases	104
Redemptions	<u>(763)</u>
Fair value June 30, 2019	<u>\$ 1,207</u>

13. Pension and Profit-Sharing Plans

MHS had a qualified 401(k) plan covering substantially all employees of the Medical Center and SMI who have completed at least one year of service and are at least twenty-one years of age. MHS made an annual contribution on behalf of all eligible employees based on either the employee's contributions to the 401(k) plan or their annual compensation. MHS had matched, on a dollar for dollar basis (based on age and years of service thresholds) the amount contributed by the employee, not to exceed 6% of the employee's salary. MHS' contributions to the 401(k) plan for all participants employed prior to April 1, 1997 for Medical Center employees or July 1, 1997 for SMI employees, vested at a rate of 25% annually and completely vested on April 1, 2001 for Medical Center employees and July 1, 2001 for SMI employees. MHS' contributions for all participants employed on or after April 1, 1997 for Medical Center employees or July 1, 1997 for SMI employees vested after four years of service, with no vesting prior to four years of service. Effective January 1, 2018, Mercy made the following changes to the 401(k) plan: The age and service requirement used to calculate Mercy's match will be made at

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the beginning of each calendar quarter (as opposed to January 1). Additionally, the vesting schedule was changed to a 3-year cliff as described below. There is no age limit for participation in the plans which occurred retroactive to January 1, 2016.

Effective January 1, 2019, the plan was frozen and all contributions for MHS subsequent to this date are being directed to the 403(b) Plan. MHS has a qualified 403(b) plan covering substantially all employees of Mercy Medical Center and SMI. Eligibility for the employer match will begin after the completion of one year of service. MHS makes a quarterly contribution on behalf of all eligible employees based on the employee's contributions into the 403(b). MHS will match, up to 50% of an employee's contribution not to exceed 6% of the employee's salary. The MHS match increases based on age and years of services threshold up to 100% of the amount contributed by the employee not to exceed 6% of the employee's salary. MHS' contributions into the 403(b) for all participants are vested after three years of service, with no vesting prior to three years of service.

Contributions under these plans totaled approximately \$5,790 and \$5,376 for the years ended June 30, 2019 and 2018, respectively.

The Medical Center has a nonqualified deferred compensation plan for certain executives and physicians. The deferred compensation plan provides for severance and supplemental retirement benefits as defined in the plan. Compensation expense related to the deferred compensation plan was \$1,800 and \$1,947 for the years ended June 30, 2019 and 2018, respectively. Total deferred compensation obligations of \$4,233 and \$4,634 are included in other long-term liabilities in the accompanying consolidated balance sheets at June 30, 2019 and 2018, respectively (see Note 23).

The fair values of deferred compensation plan assets fair value on a recurring basis as of June 30, 2019 by asset category are as follows (see Notes 9 and 12):

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total Fair Value</u>
Equity:			
Mutual funds:			
International large cap core	\$ 149	\$ -	\$ 149
Emerging markets	53	-	53
Domestic mutual fund-equity income	3,012	-	3,012
Fixed maturity:			
Bond fund	-	1,019	1,019
Total assets fair value	<u>\$ 3,214</u>	<u>\$ 1,019</u>	<u>\$ 4,233</u>

The fair values of deferred compensation plan assets on a recurring basis as of June 30, 2018 by asset category are as follows (see Notes 8 and 11):

<u>Assets</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total Fair Value</u>
Equity:			
Mutual funds:			
International large cap core	\$ 219	\$ -	\$ 219
Emerging markets	97	-	97
Domestic mutual fund-equity income	3,281	-	3,281
Fixed maturity:			
Bond fund	-	1,037	1,037
Total assets fair value	<u>\$ 3,597</u>	<u>\$ 1,037</u>	<u>\$ 4,634</u>

There were no significant transfers between level 1 and level 2 fair value investments for the years ended June 30, 2019 and 2018.

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14. Post-Retirement Benefit Plan

MHS has an unfunded contributory health and medical post-retirement benefit plan available to all eligible employees who meet certain age and length of service requirements as defined by the plan. The plan provides for health and medical benefits including primary care physician and specialist visits, hospitalization and emergency care, prescription drugs, vision care and Medicare supplemental coverage.

The following table sets forth the components of the MHS obligation at June 30:

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 7,477	\$ 5,885
Service cost	55	63
Interest cost	297	301
Actuarial gain and assumption changes	401	1,604
Employer portion of benefits paid	<u>(307)</u>	<u>(376)</u>
Benefit obligation at end of year	7,923	7,477
Change in plan assets:		
Employer contribution	308	376
Plan participants' contribution	-	314
Benefits paid	<u>(308)</u>	<u>(690)</u>
Fair value of plan assets at end of year	<u>-</u>	<u>-</u>
Unfunded status	<u>(7,923)</u>	<u>(7,477)</u>
Accrued post-retirement benefit cost	(7,923)	(7,477)
Less current portion, included in accounts payable and accrued expenses	<u>(350)</u>	<u>(353)</u>
Total accrued post-retirement benefit cost, long-term portion	<u>\$ (7,573)</u>	<u>\$ (7,124)</u>

Net periodic post-retirement benefit cost included the following for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Service cost - benefits attributed to service during the period	\$ 55	\$ 63
Interest cost on accumulated post-retirement benefit obligation	<u>297</u>	<u>301</u>
Net post-retirement benefit cost	<u>\$ 352</u>	<u>\$ 364</u>

Amounts not yet recognized as a component of net periodic pension cost include net actuarial (loss) / gain of (\$363) and \$39 as of June 30, 2019 and 2018, respectively.

The weighted average discount rate used in determining the accumulated post-retirement benefit obligation (APBO) for the plan was 3.50% and 4.25% for the years ended June 30, 2019 and 2018, respectively. For measurement purposes, the health care cost trend rates used in determining the APBO for the plan were 5.4% in 2019 and 2018. Increasing the health care cost trend rates by 1% would increase the APBO by \$788 and aggregate service and interest cost by \$45 at June 30, 2019.

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15. Retirement Annuity Plan

MHS had a pension plan that was terminated on April 1, 1997 and established a retirement annuity plan under which certain participants of the terminated plan were entitled to annuity payments. Participants in the plan include (a) the retirees and beneficiaries entitled to benefits from the terminated plan on April 1, 1997 and (b) other participants with benefits worth more than \$4 that elected an annuity. All benefits are vested and based on the frozen accrued benefits at April 1, 1997.

The measurement dates for fiscal years 2019 and 2018 were June 30, 2019 and June 30, 2018, respectively. The following table sets forth the funded status of the retirement annuity plan and amounts recognized in accompanying consolidated financial statements:

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 5,675	\$ 6,680
Interest cost	214	237
Actuarial gain	(101)	(462)
Benefits paid	<u>(702)</u>	<u>(780)</u>
Benefit obligation at end of year	5,086	5,675
Change in plan assets:		
Fair value of plan assets at beginning of year	341	1,119
Actuarial return on plan assets	9	1
Employer contribution	1,000	-
Benefits paid	<u>(702)</u>	<u>(779)</u>
Fair value of plan assets at end of year	<u>648</u>	<u>341</u>
Unfunded status/accrued benefit cost (Note 25)	<u>\$ (4,438)</u>	<u>\$ (5,334)</u>
Net periodic pension cost:		
Interest cost	\$ 214	\$ 237
Expected return on plan assets	(23)	(47)
Amortization net (gain) loss	<u>176</u>	<u>218</u>
Net periodic pension cost	<u>\$ 367</u>	<u>\$ 408</u>

Amounts not yet recognized as a component of net periodic pension cost include net actuarial loss of \$2,227 and \$2,534 as of June 30, 2019 and 2018, respectively.

The discount rate to estimate the benefit obligation as of June 30, 2019 and 2018 was 3.50% and 4.25%, respectively. The expected rate of return on plan assets was 6.50% for 2019 and 2018.

MHS' expected rate of return is evaluated annually and is based on the current interest rate environment, rate of inflation, allocation of the plan assets among various investment options and other market conditions.

The weighted-average asset allocations in the plan as of June 30, 2019 and 2018, by asset category were as follows:

	<u>June 30,</u>	
	<u>2019</u>	<u>2018</u>
Asset Category:		
Fixed income securities	0%	67%
Cash and cash equivalents	<u>100%</u>	<u>33%</u>
Total	<u>100%</u>	<u>100%</u>

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The fair values of plan assets on a recurring basis as of June 30, 2019 by asset category are as follows:

Assets	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents:				
Cash	\$ -	\$ 1	\$ -	\$ 1
Money market funds	-	647	-	647
Total assets fair value	<u>\$ -</u>	<u>\$ 648</u>	<u>\$ -</u>	<u>\$ 648</u>

The fair values of plan assets on a recurring basis as of June 30, 2018 by asset category are as follows:

Assets	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents:				
Cash	\$ -	\$ 1	\$ -	\$ 1
Money market funds	-	110	-	110
Fixed maturity:				
Bond fund	80	-	-	80
U.S. Treasury Obligations	150	-	-	150
Total assets fair value	<u>\$ 230</u>	<u>\$ 111</u>	<u>\$ -</u>	<u>\$ 341</u>

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

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	<u>Benefit Payments</u>
2020	\$ 620
2021	\$ 583
2022	\$ 544
2023	\$ 504
2024	\$ 464
Next 5 years	\$ 1,733

16. Supplemental Cash Flow Information

Cash payments for interest, net of amounts capitalized and interest rate swap payments, were \$16,640 in 2019 and \$15,489 in 2018. Capitalized interest related to construction activities includes interest payments to creditors on bonds, net payments/receipts to counterparties on interest rate swap arrangements, and income received on trustee-held funds.

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17. Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following health care services and endowment funds at June 30:

	<u>2019</u>	<u>2018</u>
Capital improvements	\$ 8,101	\$ 13,844
Departmental expenses	6,832	6,887
Pastoral care	4,516	4,516
Research programs	1,371	1,220
Indigent care	991	1,015
SMI hospice endowment	1,055	1,055
Weinberg endowment	1,000	1,000
Dr. Goodman endowment	123	123
Education programs	688	632
Other	<u>1,246</u>	<u>1,126</u>
	<u>\$ 25,923</u>	<u>\$ 31,418</u>

18. Commitments and Contingent Liabilities

Litigation

MHS has outstanding litigation involving claims brought against it in the normal course of business. Litigation in the normal course of business, as well as responses to claims and investigations described below, can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings and government investigations are difficult to predict and in certain cases the likelihood of outcome is unknown. Like most healthcare organizations, MHS receives inquiries, request for information regarding clinical procedures, licensing, billing or medical record documentation matters from various State and Federal agencies. MHS responds to such requests and provides any detailed information requested. Attorneys for MHS are representing MHS in all of the above matters. Management is currently unable to estimate, with reasonable certainty, the possible loss, or range of loss, if any, for such lawsuits and investigations. MHS is also subject to asserted and unasserted claims (in addition to litigation) encountered in the ordinary course of business. As a result of the current level of governmental and public concerns with health care fraud and abuse, management recognizes that additional investigative activity could occur in the future. In the opinion of management and after consultation with legal counsel, management believes it has established adequate accrued reserves related to all known matters. The outcome of certain litigation, as well as any potential investigative, regulatory or prosecutorial activity that may occur in the future is unknown. Accordingly, any associated potential future losses resulting from such matters could have a material adverse effect on the future financial position, results of operations and liquidity of MHS.

Self-insurance programs

As discussed in Notes 1 and 10, GIC provides general and professional liability coverage to MHS and its subsidiaries. GIC's policies provide primary and certain excess liability coverage. GIC retains the risk related to the primary policy and reinsures the whole of the excess policies. While insurance policy limits vary by year, management believes the amounts are appropriate.

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GIC's primary coverage limits for the periods ending June 30 are:

	<u>2019</u>	<u>2018</u>
Healthcare Professional Liability (HPL) and Managed Care Organization Liability (MCO)	\$7,000 per related loss event \$30,000 aggregate	\$7,000 per related loss event \$30,000 aggregate
Commercial General Liability (CGL)	\$7,000 per occurrence \$30,000 aggregate	\$7,000 per occurrence \$30,000 aggregate

GIC's primary coverage for HPL is \$7,000 per loss event. GIC provides excess coverage for HPL and MCO in the aggregate amount of \$75,000 in excess of \$7,000 and \$7,000 for related loss events and in excess of \$30,000 and \$30,000 for fiscal years 2019 and 2018, respectively. GIC provides excess coverage for CGL in the aggregate amount of \$75,000 in excess of \$7,000 and \$7,000 per occurrence and in excess of \$30,000 and \$30,000 aggregate for fiscal years 2019 and 2018, respectively. All excess coverage is reinsured by commercial insurance companies.

In management's opinion, the assets of GIC are sufficient to meet its obligations as of June 30, 2019. If the financial condition of GIC were to materially deteriorate in the future, and GIC were unable to pay its claim obligations, the responsibility to pay those claims would return to MHS.

MHS and certain of its subsidiaries are self-insured against employee medical claims. Plan expenses include claims incurred and provisions for unreported claims. However, the program has an annual aggregate stop loss provision per employee.

MHS and certain of its subsidiaries are self-insured in the State of Maryland for the use and benefit of all employees of MHS. The State of Maryland requires any self-insured employer to provide a workers' compensation surety bond issued by a corporate surety company that meets the State's financial rating under A.M. Best. MHS has had a surety bond in place since 1997 currently written by Fidelity and Deposit Company of Maryland in the amount of \$2,200. All past, present, existing and potential liability under this bond shall remain in effect and to the benefit of the State of Maryland.

MHS and certain of its subsidiaries are self-insured against unemployment claims and have surety bonds of \$2,028 for the Medical Center and \$425 for SMI. The amounts change each October 1 as dictated by the Maryland Department of Licensing and Regulation.

Lease commitments

The Medical Center and MFC have entered into separate long-term leases for commercial space. The leases contain escalation clauses and charges for other costs related to the leased space. Future minimum payments for these leases for each of the years ended June 30 are as follows:

2020	\$	3,508
2021		3,445
2022		3,266
2023		3,239
2024		3,217
Thereafter		<u>58,194</u>
	<u>\$</u>	<u>74,869</u>

MHS and certain of its subsidiaries have other office space leases. Rent expense for the years ended June 30, 2019 and 2018 was \$3,887 and \$3,793, respectively.

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The Medical Center and MFC have entered into separate long-term operating leases for equipment. The leases contain escalation clauses and charges for other costs related to the leased space. Future minimum payments for these leases for each of the years ended June 30 are as follows:

2020	\$	2,254
2021		1,321
2022		903
2023		389
2024		<u>388</u>
	\$	<u>5,255</u>

MHS and certain of its subsidiaries have other operating leases for equipment. Equipment lease expense for the years ended June 30, 2019 and 2018 was \$2,509 and \$2,519, respectively.

19. Maryland Health Services Cost Review Commission

The Medical Center's charges are subject to review and approval by the State of Maryland Health Services Cost Review Commission. Management has made the required filings with the Commission and believes the Medical Center to be in compliance with the Commission's requirements. The Commission has jurisdiction over hospital reimbursement in Maryland by agreement with the Centers for Medicare and Medicaid Services (CMS). This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814(b) of the Social Security Act. On January 1, 2014, Maryland's All-Payer Hospital System Modernization was approved by CMS. 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.

The Commission established an uncompensated care fund whereby all hospitals are required to contribute 0.75% of revenues to this fund to help provide for the cost associated with uncompensated care for certain Maryland hospitals above the State average. In December 2008, the Commission modified this mechanism to finance uncompensated care statewide. The policy implemented 100% pooling and all Maryland hospitals have the same percentage of uncompensated care in rates. High uncompensated care hospitals receive funds and low uncompensated care hospitals pay into the fund. The Medical Center had net receipts (payments) of \$ (476) and \$1,472 for 2019 and 2018, respectively, related to its participation in the uncompensated care fund mechanism.

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 Medical Center 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. MHS' policy is to accrue revenue based on actual charges for services to patients in the year in which the services are performed and billed.

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20. Housing Assistance Payment Contract

The U.S. Federal Housing Administration (FHA) has contracted with CSC under Section 8 of Title II of the Housing and Community Development Act of 1974 to make housing assistance payments to CSC on behalf of certified tenants. For fiscal year 2019 and 2018, the maximum contract commitment was \$1,268 and \$1,220 per year, respectively. During the years ended June 30, 2019 and 2018, CSC received housing assistance payments of \$803 and \$1,035, respectively, which are included in patient service revenue in the accompanying consolidated statements of operations. The contract automatically renews each year on April 1 with an expiration date of March 31, 2033 subject to renewal at that time.

21. Functional Expenses

MHS and its subsidiaries provide general health care services to patients within what they consider their geographic service areas. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows for the year ended June 30:

	2019			
	<u>Healthcare Services</u>	<u>General and Administrative</u>	<u>Fundraising</u>	<u>Total</u>
Salaries and benefits	\$ 351,672	\$ 59,623	\$ 1,195	\$ 412,490
Supplies	156,349	5,192	160	161,701
Other purchased services	32,448	18,380	511	51,339
Insurance	27,470	2,253	-	29,723
Professional fees	17,761	788	-	18,549
Depreciation and amortization	28,216	12,688	-	40,904
Interest	10,736	5,698	-	16,434
Other	13,820	4,184	37	18,041
Total	<u>\$ 638,472</u>	<u>\$ 108,806</u>	<u>\$ 1,903</u>	<u>\$ 749,181</u>

	<u>2018</u>
Health care services	\$ 565,318
Administrative and support services	<u>154,600</u>
	<u>\$ 719,918</u>

The accompanying consolidated financial statements report certain expense categories that are attributable to more than one health care service or support function. These expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation and amortization, interest, and other occupancy costs, are allocated to a function based on a square footage basis.

22. Liquidity and Availability

As of June 30, 2019, the MHS had working capital of approximately \$145,670, and average days (based on normal expenditures) cash on hand of 177.

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

	<u>2019</u>
Cash and cash equivalents	\$ 120,125
Patient accounts receivable, net	68,828
Other accounts receivables, net	11,756
Short-term investments	37,306
Current portion of funds held by trustee	<u>25,895</u>
Total	<u>\$ 263,910</u>

In addition to the assets described above, MHS has other assets whose use is limited for specified purposes, and because they are not available for general expenditure within one year such assets are not reflected in the amounts above. MHS does, however, have certain long-term assets including general investments whose use is limited by board designation that could be made available for general expenditure within one year, if necessary.

23. Certain Risks and Uncertainties

Regulation and reimbursement

MHS provides health care services primarily through an acute care hospital in Baltimore City and a long-term care facility in Baltimore County, Maryland.

MHS and other healthcare providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and State Medicaid programs;
- Regulation of hospital rates by the Commission;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims.

Such inherent risks require the use of certain management estimates in the preparation of the consolidated financial statements of MHS, and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of MHS' revenues and MHS' operations are subject to a variety of other federal, state and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on MHS. Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on MHS.

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self-referral laws. Recent federal initiatives have prompted a national review of federally funded health care programs. In addition, the federal government and many states have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs. MHS has implemented a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future governmental review and enforcement action exists. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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As a result of federal health care reform legislation, substantial changes are underway in the U.S. health care delivery system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers, and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over the next decade. The known impact of all currently applicable federal health care reform legislation has been accounted for in the consolidated financial statements for the year ended June 30, 2019.

Investments

MHS and certain of its subsidiaries have funds on deposit with financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation.

Certain alternative investments held in the MHS portfolio are exposed to potential risks in excess of the risks associated with the other investments in the MHS portfolio. These include, but are not limited to, the following potential risks:

- limited or no liquidity (including “side pocket” arrangements),
- derivative financial instruments that expose the investment funds to market risk (if the market value of the contract is higher or lower than the contract price at the maturity date) and credit risk (arising from the potential inability of counterparties to perform under the terms of the contracts),
- investment in non-marketable securities that are valued without the benefit of an active secondary market,
- substantially less regulation, and
- no current income production.

24. Endowment

Current accounting standards provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Act of 2006 (UPMIFA) and additional disclosures about an organization’s endowment funds. In 2008, the State of Maryland adopted UPMIFA.

The MHS endowments consist of three individual funds established for a variety of purposes. The endowments include both endowment funds with donor restrictions and funds designated by the board of trustees to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the board of trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The board of trustees of MHS has interpreted the Maryland State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, MHS classifies as net assets with donor restrictions (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts donated to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the endowment fund with donor restrictions is classified as net assets with donor restrictions until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, MHS considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the organization and the donor-restricted endowment fund

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3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the organization
7. The investment policies of the organization

MHS has adopted an investment policy for endowment assets that attempts to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of funds with donor restrictions that must be held in perpetuity.

To satisfy its long-term rate-of-return objectives, MHS relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). MHS targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

At June 30, 2019, the endowment net asset composition by type of fund consisted of the following:

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Donor-restricted funds	\$ <u> -</u>	\$ <u> 2,275</u>	\$ <u> 2,275</u>

At June 30, 2018, the endowment net asset composition by type of fund consisted of the following:

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Donor-restricted funds	\$ <u> -</u>	\$ <u> 2,173</u>	\$ <u> 2,173</u>

Changes in endowment net assets for the fiscal year ended June 30, 2019, consisted of the following:

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ <u> -</u>	\$ <u> 2,173</u>	\$ <u> 2,173</u>
Investment return:			
Investment gain	<u> -</u>	<u> 144</u>	<u> 144</u>
Appropriation of endowment asset for expenditure	<u> -</u>	<u> (42)</u>	<u> (42)</u>
Endowment net assets, end of year	\$ <u> -</u>	\$ <u> 2,275</u>	\$ <u> 2,275</u>

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Changes in endowment net assets for the fiscal year ended June 30, 2018, consisted of the following:

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ -	\$ 2,220	\$ 2,220
Investment return:			
Investment gain	-	157	157
Appropriation of endowment asset for expenditure	-	(204)	(204)
Endowment net assets, end of year	<u>\$ -</u>	<u>\$ 2,173</u>	<u>\$ 2,173</u>

25. Other Long-Term Liabilities

Other long-term liabilities consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Deferred compensation plan	\$ 4,233	\$ 4,634
Retirement annuity plan	4,438	5,334
GIC claims estimated tail	3,636	2,822
Other	<u>883</u>	<u>851</u>
	<u>\$ 13,190</u>	<u>\$ 13,641</u>

26. Subsequent Events

Management evaluated all events and transactions that occurred after June 30, 2019 and through September 11, 2019, the date the consolidated financial statements were issued.

Other Financial Information

Mercy Health Services, Inc. and Subsidiaries
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As of June 30, 2019
(in thousands)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
ASSETS							
Current assets:							
Cash and cash equivalents	\$ 832	\$ 4,447	\$ 105,632	\$ 8,353	\$ 861	\$ -	\$ 120,125
Short-term investments	12	-	34,554	2,740	-	-	37,306
Current portion of funds held by trustee or authority	-	-	7,610	18,285	-	-	25,895
Resident prepayment deposits	-	-	-	565	-	-	565
Patient accounts receivable, net	-	-	46,612	6,310	15,906	-	68,828
Other amounts receivable, net	573	-	10,288	728	1,063	(896)	11,756
Current pledges receivable, net	-	2,733	-	-	-	-	2,733
Supplies inventory	-	-	8,656	83	-	-	8,739
Other current assets	-	-	3,391	(11)	(72)	-	3,308
Total current assets	1,417	7,180	216,743	37,053	17,758	(896)	279,255
Property and equipment, net	-	-	492,721	29,643	17,287	-	539,651
Investments and other assets:							
Funds held by trustee or authority, less current portion	-	-	9,140	1,238	-	-	10,378
Board designated and donor restricted investments	14,154	16,748	145,102	21,815	-	-	197,819
Restricted cash and investments	-	2,055	82,186	-	-	-	84,241
Interest in net assets of MHF	-	-	13,027	11,320	-	(24,347)	-
Long-term investments	7,528	-	-	-	-	-	7,528
Long-term pledges receivable, net	-	2,083	-	-	-	-	2,083
Investments in and advances to affiliates	14,880	(2,738)	5,025	(6,768)	(2,682)	(3,000)	4,717
Reinsurance receivable	-	-	5,686	4,239	-	-	9,925
Other assets	138	-	6,539	178	510	-	7,365
Total assets	<u>\$ 38,117</u>	<u>\$ 25,328</u>	<u>\$ 976,169</u>	<u>\$ 98,718</u>	<u>\$ 32,873</u>	<u>\$ (28,243)</u>	<u>\$ 1,142,962</u>

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(Continued)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
LIABILITIES AND NET ASSETS							
Current liabilities:							
Current maturities of long-term debt	\$ 26	\$ -	\$ 7,885	\$ 944	\$ -	\$ -	\$ 8,855
Accounts payable and accrued expenses	191	-	79,009	4,883	18,390	(1,010)	101,463
Advances from third-party payers	-	-	22,021	-	-	-	22,021
Resident prepayment deposits	-	-	-	565	-	-	565
Construction retainage	-	-	167	515	-	-	682
Total current liabilities	217	-	109,082	6,907	18,390	(1,010)	133,586
Long-term debt	10	-	374,678	23,963	-	-	398,651
Provision for outstanding losses	-	-	83,713	4,239	-	-	87,952
Post-retirement obligation	-	-	7,573	-	-	-	7,573
Interest rate swap liabilities	-	-	19,781	-	-	-	19,781
Other long-term liabilities	-	-	12,485	5	700	-	13,190
Total liabilities	227	-	607,312	35,114	19,090	(1,010)	660,733
Net assets:							
Without donor restrictions	37,890	885	355,690	52,301	12,427	(2,887)	456,306
With donor restrictions	-	24,443	13,167	11,303	1,356	(24,346)	25,923
Total net assets	37,890	25,328	368,857	63,604	13,783	(27,233)	482,229
Total liabilities and net assets	<u>\$ 38,117</u>	<u>\$ 25,328</u>	<u>\$ 976,169</u>	<u>\$ 98,718</u>	<u>\$ 32,873</u>	<u>\$ (28,243)</u>	<u>\$ 1,142,962</u>

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Mercy Health Services, Inc. and Subsidiaries
Consolidating Balance Sheet Information
As of June 30, 2018
(in thousands)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
ASSETS							
Current assets:							
Cash and cash equivalents	\$ 845	\$ 2,905	\$ 95,704	\$ 7,464	\$ 783	\$ -	\$ 107,701
Short-term investments	84	6,052	35,987	3,528	-	-	45,651
Current portion of funds held by trustee or authority	-	-	7,410	1,419	-	-	8,829
Resident prepayment deposits	-	-	-	684	-	-	684
Patient accounts receivables, net	-	-	45,032	6,579	15,377	-	66,988
Other amounts receivables, net	573	-	2,469	513	1,009	(898)	3,666
Current pledges receivable, net	-	3,505	-	-	-	-	3,505
Supplies inventory	-	-	9,123	110	-	-	9,233
Other current assets	-	-	4,326	103	260	-	4,689
Total current assets	1,502	12,462	200,051	20,400	17,429	(898)	250,946
Property and equipment, net	-	-	497,992	22,939	14,385	-	535,316
Investments and other assets:							
Funds held by trustee or authority, less current portion	-	-	9,094	1,147	-	-	10,241
Board designated and donor restricted investments	13,435	15,795	137,730	21,295	-	-	188,255
Restricted cash and investments	-	2,054	77,842	-	-	-	79,896
Interest in net assets of MHF	-	-	12,457	13,562	-	(26,019)	-
Long-term investments	7,091	-	-	-	-	-	7,091
Long-term pledges receivable, net	-	2,849	-	-	-	-	2,849
Investments in and advances to affiliates	14,330	(6,258)	3,339	(1,398)	(2,293)	(3,000)	4,720
Reinsurance receivable	-	-	1,244	4,012	-	-	5,256
Other assets	139	-	6,868	172	1,637	-	8,816
Total assets	\$ 36,497	\$ 26,902	\$ 946,617	\$ 82,129	\$ 31,158	\$ (29,917)	\$ 1,093,386

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(Continued)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
LIABILITIES AND NET ASSETS							
Current liabilities:							
Current maturities of long-term debt	\$ 26	\$ -	\$ 7,385	\$ 1,526	\$ -	\$ -	\$ 8,937
Accounts payable and accrued expenses	190	-	79,425	5,728	15,771	(1,013)	100,101
Advances from third-party payers	-	-	23,140	-	-	-	23,140
Resident prepayment deposits	-	-	-	684	-	-	684
Construction retainage	-	-	132	-	-	-	132
Total current liabilities	216	-	110,082	7,938	15,771	(1,013)	132,994
Long-term debt	10	-	382,813	8,950	-	-	391,773
Provision for outstanding losses	-	-	73,811	4,012	-	-	77,823
Post-retirement obligation	-	-	7,124	-	-	-	7,124
Interest rate swap liabilities	-	-	13,184	-	-	-	13,184
Other long-term liabilities	-	-	12,964	6	671	-	13,641
Total liabilities	226	-	599,978	20,906	16,442	(1,013)	636,539
Net assets:							
Without donor restrictions	36,271	883	333,367	44,203	13,590	(2,885)	425,429
With donor restrictions	-	26,019	13,272	17,020	1,126	(26,019)	31,418
Total net assets	36,271	26,902	346,639	61,223	14,716	(28,904)	456,847
Total liabilities and net assets	\$ 36,497	\$ 26,902	\$ 946,617	\$ 82,129	\$ 31,158	\$ (29,917)	\$ 1,093,386

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Mercy Health Services, Inc. and Subsidiaries
Consolidating Statements of Operations Information
For the Year Ending June 30, 2019
(in thousands)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
Revenues:							
Net patient service revenues	\$ -	\$ -	\$ 482,697	\$ 55,736	\$ 195,912	\$ -	\$ 734,345
Other operating revenues	1,783	1,469	26,998	5,094	8,481	(15,009)	28,816
Net assets released from restrictions used for operations	-	-	2,163	1,312	279	-	3,754
Total revenues	1,783	1,469	511,858	62,142	204,672	(15,009)	766,915
Expenses:							
Salaries and benefits	1,504	1,195	227,948	42,442	146,512	(7,111)	412,490
Medical and surgical supplies	-	-	66,907	750	1,345	-	69,002
Pharmacy supplies	-	-	26,005	1,111	33,715	-	60,831
Other expendable supplies	-	147	25,768	4,110	1,843	-	31,868
Professional fees	-	-	9,386	3,055	7,237	(1,129)	18,549
Insurance	-	-	22,155	927	6,620	21	29,723
Other purchased services	54	294	48,859	4,445	4,681	(6,994)	51,339
Interest expense	-	-	15,867	567	-	-	16,434
Repairs	-	37	15,053	1,406	1,545	-	18,041
Depreciation and amortization	-	-	35,915	2,520	2,469	-	40,904
Total expenses	1,558	1,673	493,863	61,333	205,967	(15,213)	749,181
Operating income (loss)	225	(204)	17,995	809	(1,295)	204	17,734

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	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
Other income (expenses)							
Investment income	\$ 451	\$ 360	\$ 6,089	\$ 1,067	\$ -	\$ (360)	\$ 7,607
Net unrealized gain on trading securities	337	(156)	3,867	41	-	156	4,245
Unrealized gain on interest rate swap	-	-	(6,597)	-	-	-	(6,597)
Equity in joint ventures	606	-	-	-	-	-	606
Other	-	-	2	(868)	-	-	(866)
Net other income (expenses)	<u>1,394</u>	<u>204</u>	<u>3,361</u>	<u>240</u>	<u>-</u>	<u>(204)</u>	<u>4,995</u>
Excess (deficit) of revenues over expenses	1,619	-	21,356	1,049	(1,295)	-	22,729
Changes to post retirement plan obligations	-	-	(14)	-	-	-	(14)
Transfer of net assets	-	-	(74)	-	74	-	-
Net assets released from restrictions for the purchase of property and equipment	<u>-</u>	<u>-</u>	<u>1,024</u>	<u>7,082</u>	<u>56</u>	<u>-</u>	<u>8,162</u>
Increase in net assets without donor restriction	<u>\$ 1,619</u>	<u>\$ -</u>	<u>\$ 22,292</u>	<u>\$ 8,131</u>	<u>\$ (1,165)</u>	<u>\$ -</u>	<u>\$ 30,877</u>

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Mercy Health Services, Inc. and Subsidiaries
Consolidating Statements of Operations Information
For the Year Ending June 30, 2018
(in thousands)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
Revenues:							
Patient service revenues (net of allowances and discounts)	\$ -	\$ -	\$ 481,128	\$ 56,696	\$ 181,002	\$ -	\$ 718,826
Provisions for bad debt	-	-	(9,163)	(915)	(5,692)	-	(15,770)
Net patient service revenues	-	-	471,965	55,781	175,310	-	703,056
Other operating revenues	1,609	744	26,578	4,844	7,762	(12,820)	28,717
Net assets released from restrictions used for operations	-	-	4,098	1,294	283	-	5,675
Total revenues	1,609	744	502,641	61,919	183,355	(12,820)	737,448
Expenses:							
Salaries and benefits	1,426	1,093	218,689	41,997	138,475	(5,945)	395,735
Medical and surgical supplies	-	-	65,253	743	1,292	-	67,288
Pharmacy supplies	-	-	27,230	1,016	23,046	-	51,292
Other expendable supplies	-	146	23,713	3,950	1,407	-	29,216
Professional fees	-	-	9,089	2,956	7,642	(1,468)	18,219
Insurance	-	-	24,206	934	6,473	27	31,640
Other purchased services	14	177	49,085	4,539	4,187	(6,146)	51,856
Interest expense	-	-	15,802	664	-	-	16,466
Repairs	-	40	15,222	1,310	1,291	-	17,863
Depreciation and amortization	-	-	35,529	2,497	2,317	-	40,343
Total expenses	1,440	1,456	483,818	60,606	186,130	(13,532)	719,918
Operating income (loss)	169	(712)	18,823	1,313	(2,775)	712	17,530

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(Continued)

	<u>Mercy Health Services, Inc.</u>	<u>Mercy Health Foundation, Inc.</u>	<u>Mercy Medical Center, Inc.</u>	<u>Stella Maris, Inc.</u>	<u>Physician Enterprise</u>	<u>Eliminations</u>	<u>Consolidated</u>
Other income (expenses)							
Investment income	\$ 378	\$ 435	\$ 6,802	\$ 1,223	\$ -	\$ (435)	\$ 8,403
Net unrealized gain on trading securities	420	275	2,200	791	-	(275)	3,411
Unrealized gain on interest rate swap	-	-	4,792	-	-	-	4,792
Equity in joint ventures	589	-	-	-	-	-	589
Other	-	-	(3,286)	-	(8)	-	(3,294)
Net other income (expenses)	<u>1,387</u>	<u>710</u>	<u>10,508</u>	<u>2,014</u>	<u>(8)</u>	<u>(710)</u>	<u>13,901</u>
Excess (deficit) of revenues over expenses	1,556	(2)	29,331	3,327	(2,783)	2	31,431
Changes to post retirement plan obligations	-	-	(775)	-	-	-	(775)
Transfer of net assets	-	-	(3,850)	-	3,850	-	-
Net assets released from restrictions for the purchase of property and equipment	<u>-</u>	<u>-</u>	<u>691</u>	<u>(49)</u>	<u>-</u>	<u>-</u>	<u>642</u>
Increase in net assets without donor restriction	<u>\$ 1,556</u>	<u>\$ (2)</u>	<u>\$ 25,397</u>	<u>\$ 3,278</u>	<u>\$ 1,067</u>	<u>\$ 2</u>	<u>\$ 31,298</u>

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DHG