

CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

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

Ernst & Young LLP



Anne Arundel Health System, Inc. and Subsidiaries  
Consolidated Financial Statements and Supplementary Information  
Years Ended June 30, 2019 and 2018

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## Report of Independent Auditors

The Board of Trustees  
Anne Arundel Health System, Inc.

We have audited the accompanying consolidated financial statements of Anne Arundel Health System, Inc. (a Maryland not-for-profit corporation) and subsidiaries, which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Cottage Insurance Company, Ltd., a wholly owned subsidiary, which statements reflect total assets of \$39,535,000 and \$51,647,000 as of June 30, 2019 and 2018, respectively, and net loss after elimination of intercompany revenues of \$10,149,000 and \$7,137,000, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Cottage Insurance Company, Ltd., is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## **Opinion**

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

## **Adoption of New Accounting Pronouncements**

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

## **Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.



October 23, 2019

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

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

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Balance Sheets (continued)

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

*See accompanying notes.*

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

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

Anne Arundel Health System, Inc. and Subsidiaries

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

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

See accompanying notes.

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

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

Anne Arundel Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)

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

*See accompanying notes.*

# Anne Arundel Health System, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

June 30, 2019

### **1. Organization and Basis of Presentation**

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

### **2. Summary of Significant Accounting Policies**

#### **Cash and Cash Equivalents**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Derivative Instruments**

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

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

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

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Assets Whose Use is Limited and Investments**

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

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

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

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

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

#### **Patient Receivables**

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

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

#### **Inventories**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Property and Equipment**

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

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

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

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

**Investments in Joint Ventures**

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Deferred Debt Issuance Costs**

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

##### **Net Assets**

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

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

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

##### **Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. This includes regulatory discounts allowed to Blue Cross, Medicare, Medicaid, and other third-party payors and charity care.

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

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

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

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

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Charity Care**

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

##### **Other Operating Revenue**

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

##### **Transaction Costs**

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

##### **Donations and Bequests**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

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

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

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

**Excess of Revenues Over Expenses**

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

**Group Purchasing Organization Initial Public Offering**

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

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

#### **Income Tax Status**

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

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

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Use of Estimates**

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

##### **Recent Accounting Pronouncements**

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

## 2. Summary of Significant Accounting Policies (continued)

### New Accounting Standards Not Yet Adopted

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

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

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

## 3. Regulatory Environment

### Medicare and Medicaid

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Regulatory Environment (continued)**

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

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

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

#### **Maryland Health Services Cost Review Commission**

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **3. Regulatory Environment (continued)**

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**4. Investments**

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**4. Investments (continued)**

Amounts held by the trustee are broken down as follows:

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

The components of investment income, net are as follows:

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **5. Fair Value Measurements**

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

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Fair Value Measurements (continued)**

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Fair Value Measurements (continued)**

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Fair Value Measurements (continued)**

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**6. Long-Term Debt and Line of Credit**

Long-term debt consists of the following:

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

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

**Series 2017 Revenue Bonds**

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

**Series 2014 Revenue Bonds**

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

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

#### **Series 2012 Revenue Bonds**

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

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

#### **Series 2010 Revenue Bonds**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

**Series 2009 Revenue Bonds**

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

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Bank Line of Credit and Term Loan**

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

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

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

##### **2008 Construction Loan**

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

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

##### **Kent Island Term Loan**

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

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

#### **7. Pension Plan and Thrift Plan**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Pension Plan and Thrift Plan (continued)**

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Pension Plan and Thrift Plan (continued)**

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

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Pension Plan and Thrift Plan (continued)**

The net periodic pension benefit cost included the following components:

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Pension Plan and Thrift Plan (continued)**

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Pension Plan and Thrift Plan (continued)

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Pension Plan and Thrift Plan (continued)**

The following benefit payments are expected to be paid:

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

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

**8. Concentrations of Credit Risk**

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

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

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Malpractice Insurance Costs and Self-Insured Professional Liability**

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

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

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

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

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

The provision for estimated professional liability claims, general liability claims, and workers' compensation claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. As of June 30, 2019 and 2018, the balance for outstanding claims reserves recorded at Cottage is \$36,843,000 and \$45,662,000 and reinsurance receivable is \$17,286,000 and \$29,185,000, respectively. The remaining tail liability for claims incurred but not reported is \$10,607,000 and \$9,513,000 as of June 30, 2019 and 2018, respectively, with \$9,226,000 of the 2019 liability and \$8,061,000 of the 2018 liability recorded at the Hospital. The remainder of the liability is recorded at PE. The Group has employed an independent actuary to estimate the ultimate settlement of such claims. In management's opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

**10. Commitments and Contingencies**

**Operating Leases**

Various members of the Group have operating leases for storage space, equipment, and offices. During 2019 and 2018, rent expense for these leases was approximately \$9,785,000 and \$10,971,000, respectively. Future minimum annual rental payments under noncancelable operating leases, which expire through 2024, are as follows:

2020	\$ 8,063,000
2021	5,802,000
2022	3,487,000
2023	2,224,000
2024	2,123,000
Thereafter	1,725,000
	<u>\$ 23,424,000</u>

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Commitments and Contingencies (continued)

##### Contingencies

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

The Group's revenues may be subject to adjustment as a result of examination by government agencies or contractors, based upon differing interpretations of government regulations, medical diagnoses, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered. Section 302 of the Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare overpayments and underpayments made to providers. Management has established protocols to respond to RAC requests and payment denials. Payment recoveries resulting from RAC reviews are appealable through administrative and judicial processes, and management intends to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, management will incur additional costs to respond to requests for records and pursue the reversal of payment denials. As of June 30, 2019 and 2018, the Group has recorded an estimated reserve regarding the Medicare overpayments. In the opinion of the Group's management, the ultimate settlement of this matter will not have a material adverse effect on the consolidated financial position of the Group.

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Functional Expenses**

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

	<b>Health Care Services</b>	<b>General and Administrative</b>	<b>Total</b>
<b>Year ended June 30, 2019</b>			
Salaries and wages	\$ 293,400,000	\$ 56,260,000	\$ 349,660,000
Employee benefits	45,157,000	11,199,000	56,356,000
Supplies	158,348,000	1,141,000	159,489,000
Purchases services	70,001,000	67,556,000	137,557,000
Depreciation and amortization	26,647,000	10,186,000	36,833,000
Interest	13,118,000	–	13,118,000
Transaction costs	–	3,279,000	3,279,000
Total operating expenses	<u>\$ 606,671,000</u>	<u>\$ 149,621,000</u>	<u>\$ 756,292,000</u>
<b>Year ended June 30, 2018</b>			
Salaries and wages	\$ 276,549,000	\$ 52,087,000	\$ 328,636,000
Employee benefits	44,416,000	8,365,000	52,781,000
Supplies	150,155,000	1,392,000	151,547,000
Purchases services	65,347,000	63,739,000	129,086,000
Depreciation and amortization	26,873,000	9,500,000	36,373,000
Interest	13,205,000	–	13,205,000
Total operating expenses	<u>\$ 576,545,000</u>	<u>\$ 135,083,000</u>	<u>\$ 711,628,000</u>

**12. Fair Value of Financial Instruments**

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

Anne Arundel Health System, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**12. Fair Value of Financial Instruments (continued)**

**Investments and Assets Whose Use is Limited**

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

**Pledges Receivable**

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

**Long-Term Debt**

Fair values of the Group's long-term fixed-rate debt are established using discounted cash flow analyses, based on the Group's current incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of the Group's long-term variable-rate debt approximates fair value. The estimated fair value of all long-term debt at June 30, 2019 and 2018, was \$381,061,000 and \$383,715,000, respectively.

**13. Net Assets**

Temporarily restricted net assets are restricted for use, as follows:

	<b>June 30</b>	
	<b>2019</b>	<b>2018</b>
Hospital capital additions	\$ 6,382,000	\$ 5,076,000
Hospital operating programs	<b>16,207,000</b>	10,770,000
	<b><u>\$ 22,589,000</u></b>	<u>\$ 15,846,000</u>

## Anne Arundel Health System, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 14. Liquidity and Availability

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

##### Assets

Current assets:

Cash and cash equivalent	\$ 15,100,000
Short-term investments	15,261,000
Current portion of assets whose use is limited:	15,190,000
Patient receivables, net	80,307,000
Current portion of pledges receivable, net	494,000
Other current assets	6,659,000
Investments*	<u>386,056,000</u>
Total financial assets	<u>\$ 519,067,000</u>

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

The System's bond covenant requires the Group to maintain unrestricted cash and marketable securities on hand to meet 90 days of normal operating expenses, which would be \$174,166,000 as of June 30, 2019.

#### 15. Subsequent Events

On July 1, 2019, Anne Arundel Health System completed a transaction that resulted in Doctors Community Health System becoming a wholly owned subsidiary of Anne Arundel Health System. The new consolidated entity changed its name to Luminis Health on September 26, 2019. This transaction will be accounted for as an acquisition under ASC 958-805 during the year ending June 30, 2020. No consideration was exchanged in the transaction however AAHS has committed to investing \$138,000,000 into the Doctors organization over a period of five years.

The Group has evaluated the impact of subsequent events through October 23, 2019, representing the date at which the accompanying consolidated financial statements were issued.

# Supplementary Information

Anne Arundel Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	Cottage Insurance Company, Ltd.	AAHS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Consolidating and Eliminating Entries		Consolidated
											Cottage Insurance Company, Ltd.	Other Subsidiaries	
<b>Assets</b>													
Current assets:													
Cash and cash equivalents	\$ (2,584,000)	\$ 9,735,000	\$ 661,000	\$ (66,000)	\$ 1,218,000	\$ -	\$ 49,000	\$ 1,028,000	\$ 2,000	\$ 5,057,000	\$ -	\$ -	\$ 15,100,000
Short-term investments	-	14,813,000	-	-	-	-	-	-	-	448,000	-	-	15,261,000
Current portion of assets whose use is limited	-	12,320,000	-	-	-	2,870,000	-	-	-	-	-	-	15,190,000
Patient receivables, net	-	66,809,000	2,734,000	-	-	-	-	10,764,000	-	-	-	-	80,307,000
Current portion of pledges receivable, net	-	-	-	-	-	-	-	-	-	494,000	-	-	494,000
Inventories	-	7,799,000	-	-	-	-	-	851,000	-	-	-	-	8,650,000
Prepaid expenses and other current assets	10,000	7,416,000	86,744,000	5,704,000	17,916,000	48,000	768,000	2,030,000	5,794,000	21,877,000	-	(134,182,000)	14,125,000
Total current assets	(2,574,000)	118,892,000	90,139,000	5,638,000	19,134,000	2,918,000	817,000	14,673,000	5,796,000	27,876,000	-	(134,182,000)	149,127,000
Property and equipment	-	725,720,000	27,725,000	2,532,000	137,962,000	-	77,000	22,622,000	15,000	2,013,000	-	-	918,666,000
Less accumulated depreciation and amortization	-	(389,880,000)	(25,464,000)	(1,879,000)	(62,898,000)	-	(75,000)	(12,688,000)	-	(120,000)	-	-	(493,004,000)
Net property and equipment	-	335,840,000	2,261,000	653,000	75,064,000	-	2,000	9,934,000	15,000	1,893,000	-	-	425,662,000
Other assets:													
Investments	-	384,397,000	-	-	-	-	-	-	-	1,659,000	-	-	386,056,000
Investments in joint ventures	-	-	-	1,644,000	7,242,000	-	-	-	-	-	-	-	8,886,000
Pledges receivable, net	-	-	-	-	-	-	-	-	-	2,802,000	-	-	2,802,000
Assets whose use is limited	-	8,000	-	-	-	19,331,000	-	-	-	16,634,000	-	-	35,973,000
Beneficial interest in net assets of AAMC Foundation, Inc.	-	27,933,000	-	-	-	-	-	-	-	-	-	(27,933,000)	-
Restricted collateral for interest rate swap contract	-	67,404,000	-	-	-	-	-	-	-	-	-	-	67,404,000
Other assets	565,457,000	15,909,000	-	-	1,413,000	17,286,000	-	1,392,000	-	378,000	-	(567,461,000)	34,374,000
Total assets	\$ 562,883,000	\$ 950,383,000	\$ 92,400,000	\$ 7,935,000	\$ 102,853,000	\$ 39,535,000	\$ 819,000	\$ 25,999,000	\$ 5,811,000	\$ 51,242,000	\$ -	\$ (729,576,000)	\$ 1,110,284,000

Anne Arundel Health System, Inc. and Subsidiaries  
Supplementary Consolidating Balance Sheet (continued)

June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	Cottage Insurance Company, Ltd.	AAHS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Consolidating and Eliminating Entries		Consolidated
											Cottage Insurance Company, Ltd.	Other Subsidiaries	
<b>Liabilities and net assets</b>													
Current liabilities:													
Accounts payable	\$ 43,465,000	\$ 74,431,000	\$ 1,461,000	\$ 1,360,000	\$ 658,000	\$ 91,000	\$ 638,000	\$ 13,292,000	\$ 190,000	\$ 5,875,000	\$ –	\$ (111,003,000)	\$ 30,458,000
Accrued salaries, wages, and benefits	11,182,000	17,986,000	394,000	1,039,000	–	–	95,000	6,172,000	900,000	46,000	–	–	37,814,000
Other accrued expenses	845,000	16,165,000	–	4,000	4,242,000	1,000	–	1,554,000	–	20,780,000	–	(25,202,000)	18,389,000
Current portion of long-term debt	–	7,161,000	–	–	3,868,000	–	–	–	–	–	–	–	11,029,000
Advances from third-party payors	–	21,720,000	–	–	578,000	–	–	501,000	1,104,000	–	–	–	23,903,000
Total current liabilities	55,492,000	137,463,000	1,855,000	2,403,000	9,346,000	92,000	733,000	21,519,000	2,194,000	26,701,000	–	(136,205,000)	121,593,000
Long-term debt, less current portion and unamortized original issue premium													
	–	298,384,000	–	–	61,351,000	–	–	–	–	–	–	–	359,735,000
Interest rate swap contract	–	78,479,000	–	–	–	–	–	–	–	–	–	–	78,479,000
Accrued pension liability	–	6,076,000	–	–	–	–	–	–	–	–	–	–	6,076,000
Other long-term liabilities	–	–	–	–	–	36,843,000	–	167,000	–	–	–	–	37,010,000
Total liabilities	55,492,000	520,402,000	1,855,000	2,403,000	70,697,000	36,935,000	733,000	21,686,000	2,194,000	26,701,000	–	(136,205,000)	602,893,000
Net assets:													
Without donor restrictions	484,159,000	402,830,000	90,545,000	5,532,000	32,156,000	2,600,000	86,000	4,313,000	3,617,000	(332,000)	–	(542,845,000)	482,661,000
With donor restrictions	23,232,000	27,151,000	–	–	–	–	–	–	–	24,873,000	–	(50,526,000)	24,730,000
Total net assets	507,391,000	429,981,000	90,545,000	5,532,000	32,156,000	2,600,000	86,000	4,313,000	3,617,000	24,541,000	–	(593,371,000)	507,391,000
Total liabilities and net assets	\$ 562,883,000	\$ 950,383,000	\$ 92,400,000	\$ 7,935,000	\$ 102,853,000	\$ 39,535,000	\$ 819,000	\$ 25,999,000	\$ 5,811,000	\$ 51,242,000	\$ –	\$ (729,576,000)	\$1,110,284,000

Anne Arundel Health System, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations

Year Ended June 30, 2019

	Anne Arundel Health System, Inc.	Anne Arundel Medical Center, Inc. and Subsidiaries	Anne Arundel Health Care Services, Inc.	Anne Arundel Health Care Enterprises, Inc.	Anne Arundel Real Estate Holding Company, Inc. and Subsidiaries	Cottage Insurance Company, Ltd.	AAHS Research Institute, Inc.	Physician Enterprise, LLC	Anne Arundel Medical Center Collaborative Care Network LLC	Anne Arundel Medical Center Foundation, Inc.	Consolidating and Eliminating Entries		Consolidated
											Cottage Insurance Company, Ltd.	Other Subsidiaries	
Operating revenue:													
Net patient service revenue	\$ -	\$ 570,176,000	\$ 31,498,000	\$ -	\$ -	\$ -	\$ -	\$ 141,202,000	\$ -	\$ -	\$ -	\$ -	\$ 742,876,000
Other operating revenue	1,588,000	9,213,000	2,000	17,668,000	22,412,000	6,821,000	1,407,000	31,956,000	3,348,000	7,720,000	(6,821,000)	(62,134,000)	33,180,000
Total operating revenue	1,588,000	579,389,000	31,500,000	17,668,000	22,412,000	6,821,000	1,407,000	173,158,000	3,348,000	7,720,000	(6,821,000)	(62,134,000)	776,056,000
Operating expenses:													
Salaries and wages	-	215,316,000	6,005,000	8,692,000	-	-	1,193,000	116,070,000	1,134,000	1,250,000	-	-	349,660,000
Employee benefits	-	40,930,000	1,175,000	1,545,000	-	-	206,000	12,261,000	36,000	203,000	-	-	56,356,000
Supplies	-	143,961,000	1,132,000	98,000	211,000	-	3,000	14,052,000	4,000	28,000	-	-	159,489,000
Purchased services	1,148,000	118,543,000	14,025,000	7,208,000	9,655,000	10,949,000	709,000	41,465,000	395,000	1,457,000	(6,821,000)	(61,176,000)	137,557,000
Foundation transfer to AAMC and subsidiaries	-	(4,790,000)	-	-	-	-	-	-	-	5,664,000	-	(874,000)	-
Depreciation and amortization	-	29,947,000	866,000	49,000	4,076,000	-	2,000	1,865,000	-	28,000	-	-	36,833,000
Interest	-	10,746,000	-	-	2,472,000	-	-	6,000	-	-	-	(106,000)	13,118,000
Transaction costs	-	3,279,000	-	-	-	-	-	-	-	-	-	-	3,279,000
Total operating expenses	1,148,000	557,932,000	23,203,000	17,592,000	16,414,000	10,949,000	2,113,000	185,719,000	1,569,000	8,630,000	(6,821,000)	(62,156,000)	756,292,000
Operating income (loss)	440,000	21,457,000	8,297,000	76,000	5,998,000	(4,128,000)	(706,000)	(12,561,000)	1,779,000	(910,000)	-	22,000	19,764,000
Other income (loss):													
Investment income, net	-	12,664,000	-	-	6,000	1,070,000	-	-	-	133,000	-	-	13,873,000
Income (loss) from joint ventures and other, net	12,761,000	(30,000)	-	(323,000)	532,000	-	-	-	-	-	-	(13,485,000)	(545,000)
Pension expense	-	(4,777,000)	-	-	-	-	-	-	-	-	-	-	(4,777,000)
Change in unrealized gains (losses) on trading securities, net	-	11,134,000	-	-	-	(270,000)	-	-	-	(830,000)	-	-	10,034,000
Realized and unrealized losses on interest rate swap contracts, net	-	(23,361,000)	-	-	-	-	-	-	-	-	-	-	(23,361,000)
Total other income (loss), net	12,761,000	(4,370,000)	-	(323,000)	538,000	800,000	-	-	-	(697,000)	-	(13,485,000)	(4,776,000)
Excess of revenue over expenses (deficit)	\$ 13,201,000	\$ 17,087,000	\$ 8,297,000	\$ (247,000)	\$ 6,536,000	\$ (3,328,000)	\$ (706,000)	\$ (12,561,000)	\$ 1,779,000	\$ (1,607,000)	\$ -	\$ (13,463,000)	\$ 14,988,000

# Anne Arundel Medical Center, Inc. and Subsidiaries

## Supplementary Consolidating Balance Sheet

June 30, 2019

	<b>Anne Arundel Medical Center, Inc.</b>	<b>Anne Arundel General Treatment Services, Inc.</b>	<b>Consolidating and Eliminating Entries</b>	<b>Consolidated</b>
<b>Assets</b>				
<b>Current assets:</b>				
Cash and cash equivalents	\$ 9,719,000	\$ 16,000	\$ –	\$ 9,735,000
Short-term investments	14,813,000	–	–	14,813,000
Current portion of assets whose use is limited	12,320,000	–	–	12,320,000
Patient receivables, net	66,184,000	625,000	–	66,809,000
Inventories	7,799,000	–	–	7,799,000
Due from affiliates, net	500,000	966,000	(973,000)	493,000
Prepaid expenses and other current assets	6,920,000	3,000	–	6,923,000
<b>Total current assets</b>	<b>118,255,000</b>	<b>1,610,000</b>	<b>(973,000)</b>	<b>118,892,000</b>
Property and equipment	717,030,000	8,690,000	–	725,720,000
Less accumulated depreciation and amortization	(385,526,000)	(4,354,000)	–	(389,880,000)
<b>Net property and equipment</b>	<b>331,504,000</b>	<b>4,336,000</b>	<b>–</b>	<b>335,840,000</b>
<b>Other assets:</b>				
Investments	384,397,000	–	–	384,397,000
Investments in joint ventures	–	–	–	–
Assets whose use is limited	8,000	–	–	8,000
Beneficial interest in net assets of Anne Arundel Medical Center Foundation, Inc.	24,540,000	–	3,393,000	27,933,000
Notes receivable from affiliate	2,078,000	–	–	2,078,000
Restricted collateral for interest rate swap contract	67,404,000	–	–	67,404,000
Other assets	19,545,000	–	(5,714,000)	13,831,000
<b>Total assets</b>	<b>\$ 947,731,000</b>	<b>\$ 5,946,000</b>	<b>\$ (3,294,000)</b>	<b>\$ 950,383,000</b>

Anne Arundel Medical Center, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

June 30, 2019

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Consolidating and Eliminating Entries	Consolidated
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 25,067,000	\$ 19,000	\$ –	\$ 25,086,000
Accrued salaries, wages, and benefits	17,775,000	211,000	–	17,986,000
Other accrued expenses	16,164,000	1,000	–	16,165,000
Current portion of long-term debt	7,161,000	–	–	7,161,000
Intercompany payables	50,309,000	–	(964,000)	49,345,000
Advances from third-party payors	21,720,000	–	–	21,720,000
Total current liabilities	138,196,000	231,000	(964,000)	137,463,000
Long-term debt, less current portion and unamortized original issue premium	298,384,000	–	–	298,384,000
Interest rate swap contract	78,479,000	–	–	78,479,000
Accrued pension liability	6,076,000	–	–	6,076,000
Total liabilities	521,135,000	231,000	(964,000)	520,402,000
Net assets:				
Without donor restrictions	402,674,000	5,715,000	(5,559,000)	402,830,000
With donor restrictions	23,922,000	–	3,229,000	27,151,000
Total net assets	426,596,000	5,715,000	(2,330,000)	429,981,000
Total liabilities and net assets	\$ 947,731,000	\$ 5,946,000	\$ (3,294,000)	\$ 950,383,000

Anne Arundel Medical Center, Inc. and Subsidiaries  
 Supplementary Consolidating Statement of Operations

Year Ended June 30, 2019

	Anne Arundel Medical Center, Inc.	Anne Arundel General Treatment Services, Inc.	Consolidating and Eliminating Entries	Consolidated
Operating revenue:				
Net patient service revenue	\$ 565,001,000	\$ 5,175,000	\$ –	\$ 570,176,000
Other operating revenue	13,421,000	751,000	(4,959,000)	9,213,000
Total operating revenue	<u>578,422,000</u>	<u>5,926,000</u>	<u>(4,959,000)</u>	<u>579,389,000</u>
Operating expenses:				
Salaries and wages	211,393,000	3,923,000	–	215,316,000
Employee benefits	40,282,000	648,000	–	40,930,000
Supplies	143,523,000	601,000	(163,000)	143,961,000
Purchased services	117,833,000	710,000	–	118,543,000
Foundation transfer to Anne Arundel Medical Center Foundation, Inc. and subsidiaries	(1,000)	–	(4,789,000)	(4,790,000)
Depreciation and amortization	29,613,000	334,000	–	29,947,000
Interest	10,746,000	–	–	10,746,000
Transaction costs	3,279,000	–	–	3,279,000
Total operating expenses	<u>556,668,000</u>	<u>6,216,000</u>	<u>(4,952,000)</u>	<u>557,932,000</u>
Operating income (loss)	<u>21,754,000</u>	<u>(290,000)</u>	<u>(7,000)</u>	<u>21,457,000</u>
Other income (loss):				
Investment income, net	12,664,000	–	–	12,664,000
Income from joint venture and other, net	(320,000)	–	290,000	(30,000)
Pension expense	(4,777,000)	–	–	(4,777,000)
Change in unrealized losses on trading securities, net	11,134,000	–	–	11,134,000
Realized and unrealized losses on interest rate swap contracts, net	(23,361,000)	–	–	(23,361,000)
Total other income (loss), net	<u>(4,660,000)</u>	<u>–</u>	<u>290,000</u>	<u>(4,370,000)</u>
Excess of revenue over expenses (deficit)	<u>\$ 17,094,000</u>	<u>\$ (290,000)</u>	<u>\$ 283,000</u>	<u>\$ 17,087,000</u>

## Anne Arundel Health System, Inc. and Subsidiaries

### Supplementary Description of Consolidating and Eliminating Entries

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

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