

Baxter Regional Health System

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2019 and 2018

Baxter Regional Health System
December 31, 2019 and 2018

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Independent Auditor's Report

Board of Directors
Baxter Regional Health System
Mountain Home, Arkansas

We have audited the accompanying consolidated financial statements of Baxter Regional Health System (the System) and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Baxter Regional Health System and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in *Note 1* to the consolidated financial statements, in 2019, the System adopted new accounting guidance regarding leases (Topic 842); Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*; and ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*. Our opinion is not modified with respect to these matters.

BKD, LLP

Little Rock, Arkansas
April 15, 2020

Baxter Regional Health System
Consolidated Balance Sheets
December 31, 2019 and 2018

Assets

	<u>2019</u>	<u>2018</u>
Current Assets		
Cash	\$ 16,233,505	\$ 23,165,495
Short-term investments	10,926,906	9,978,874
Assets limited as to use – current	1,822,701	1,725,346
Patient accounts receivable	23,476,378	21,041,918
Supplies	8,169,328	7,966,406
Prepaid expenses and other	1,550,629	2,152,328
Contributions receivable – current	157,374	238,409
	<u>62,336,821</u>	<u>66,268,776</u>
Assets Limited as to Use		
Internally designated for capital improvements	45,183,932	38,075,935
Externally restricted by donors	13,827,104	12,399,083
Held by trustee under indenture agreement	7,023,472	6,800,100
Other	200,000	200,000
	<u>66,234,508</u>	<u>57,475,118</u>
Less amount required to meet current obligations	1,822,701	1,725,346
	<u>64,411,807</u>	<u>55,749,772</u>
	→	
Investments in and Advances to Equity Investees	<u>200,363</u>	<u>147,363</u>
Property and Equipment, at Cost		
Land and land improvements	9,259,321	7,891,788
Buildings and leasehold improvements	90,890,329	81,833,572
Equipment	144,054,004	131,566,012
Construction in progress	2,686,937	2,677,006
	<u>246,890,591</u>	<u>223,968,378</u>
Less accumulated depreciation and amortization	163,833,601	156,643,620
	<u>83,056,990</u>	<u>67,324,758</u>
Other Assets		
Long-term investments	→ 249,321	273,667
Contributions receivable	-	449,306
Right-of-use assets – operating leases	2,821,305	-
Other	220,600	133,399
	<u>3,291,226</u>	<u>856,372</u>
	→	
Total assets	<u>\$ 213,297,207</u>	<u>\$ 190,347,041</u>

Liabilities and Net Assets

	<u>2019</u>	<u>2018</u>
Current Liabilities		
Current maturities of long-term debt	\$ 5,075,024	\$ 3,815,287
Current portion of operating lease liabilities	733,663	-
Accounts payable	11,151,109	12,461,355
Accrued expenses	12,798,851	11,822,675
Accrued interest	621,612	664,373
Estimated amounts due to third-party payors	<u>3,238,720</u>	<u>4,181,738</u>
Total current liabilities	<u>33,618,979</u>	<u>32,945,428</u>
Other Liabilities		
Long-term debt	59,832,273	55,271,994
Operating lease liabilities	<u>2,087,642</u>	<u>-</u>
Total other liabilities	<u>61,919,915</u>	<u>55,271,994</u>
Total liabilities	<u>95,538,894</u>	<u>88,217,422</u>
Net Assets		
Without donor restrictions		
Baxter Regional Health System	104,095,441	89,954,446
Noncontrolling interest	<u>420,654</u>	<u>282,815</u>
Total net assets without donor restrictions	104,516,095	90,237,261
With donor restrictions	<u>13,242,218</u>	<u>11,892,358</u>
Total net assets	<u>117,758,313</u>	<u>102,129,619</u>
Total liabilities and net assets	<u>\$ 213,297,207</u>	<u>\$ 190,347,041</u>

Baxter Regional Health System
Consolidated Statements of Operations
Years Ended December 31, 2019 and 2018

	2019	2018
Revenues, Gains and Other Support Without Donor Restrictions		
Patient service revenue	\$ 241,023,841	\$ 226,646,740
Other	2,621,404	2,173,983
Contributions received	1,422,752	2,038,340
Net assets released from restrictions used for operations	559,752	436,384
Total revenues, gains and other support without donor restrictions	245,627,749	231,295,447
Expenses and Losses		
Salaries and wages	96,978,770	90,868,967
Employee benefits	22,814,863	24,230,408
Professional fees	17,353,694	15,685,948
Supplies and other	92,951,912	86,020,773
Depreciation and amortization	10,581,074	9,534,326
Interest	1,989,770	1,713,830
Total expenses and losses	242,670,083	228,054,252
Operating Income	2,957,666	3,241,195
Other Income (Expenses)		
Investment return, net	9,093,057	(5,191,823)
Other, net	(165,466)	(102,344)
Total other income (expense)	8,927,591	(5,294,167)
Excess (Deficiency) of Revenues over Expenses	11,885,257	(2,052,972)
Investment return – Change in unrealized gains and losses on other-than-trading securities	968,565	819,942
Net assets released from restriction for purchase of property and equipment	191,988	876,026
Contributions of or for purchase of property and equipment	1,143,024	366,290
Sale of member units	90,000	-
Increase in Net Assets Without Donor Restrictions	\$ 14,278,834	\$ 9,286

Baxter Regional Health System
Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Net Assets Without Donor Restrictions		
Excess (deficiency) of revenues over expenses	\$ 11,885,257	\$ (2,052,972)
Investment return – change in unrealized gains and losses on other-than-trading securities	968,565	819,942
Net assets released from restriction for purchase of property and equipment	191,988	876,026
Contributions of or for purchase of property and equipment	1,143,024	366,290
Sale of member units	<u>90,000</u>	<u>-</u>
Increase in net assets without donor restrictions	<u>14,278,834</u>	<u>9,286</u>
Net Assets with Donor Restrictions		
Contributions received	335,664	87,146
Investment return, net	1,765,936	(945,114)
Net assets released from restriction	<u>(751,740)</u>	<u>(1,312,410)</u>
Increase (decrease) in net assets with donor restrictions	<u>1,349,860</u>	<u>(2,170,378)</u>
Change in Net Assets	15,628,694	(2,161,092)
Net Assets, Beginning of Year	<u>102,129,619</u>	<u>104,290,711</u>
Net Assets, End of Year	<u><u>\$ 117,758,313</u></u>	<u><u>\$ 102,129,619</u></u>

Baxter Regional Health System
Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Operating Activities		
Change in net assets	\$ 15,628,694	\$ (2,161,092)
Items not requiring (providing) operating cash flows		
Depreciation and amortization	10,035,859	9,037,432
Net realized and unrealized (gains) losses on investments	(9,965,447)	7,329,894
Contributions of or for purchase of property and equipment	(1,143,024)	(366,290)
(Gain) loss on disposal of property and equipment	36,014	43,086
Sale of member units	(90,000)	-
Changes in		
Patient accounts receivable	(2,434,460)	1,902,667
Estimated amounts due to/from third-party payors	(943,018)	(678,105)
Accounts payable and accrued expenses	895,619	3,687,850
Other current assets and liabilities	841,917	(1,948,413)
	<u>12,862,154</u>	<u>16,847,029</u>
Investing Activities		
Purchase of investments	(5,592,551)	(9,396,957)
Proceeds from disposition of investments	9,143,247	12,688,704
Purchase of property and equipment	(24,968,452)	(12,331,406)
Advances to equity investees	(53,000)	(86,113)
Proceeds from sale of property and equipment	196,730	20,136
	<u>(21,274,026)</u>	<u>(9,105,636)</u>
Financing Activities		
Proceeds from contributions for purchase of property and equipment	568,024	366,290
Proceeds from issuance of long-term debt	7,084,265	6,638,445
Proceeds from sale of member units	90,000	-
Principal payments on long-term debt	(3,569,082)	(4,280,350)
	<u>4,173,207</u>	<u>2,724,385</u>
Increase (Decrease) in Cash, Restricted Cash and Restricted Cash Equivalents	(4,238,665)	10,465,778
Cash, Restricted Cash and Restricted Cash Equivalents, Beginning of Year	<u>26,386,895</u>	<u>15,921,117</u>
Cash, Restricted Cash and Restricted Cash Equivalents, End of Year	<u>\$ 22,148,230</u>	<u>\$ 26,386,895</u>
Supplemental Cash Flows Information		
Interest paid	\$ 2,632,093	\$ 2,373,971
ROU assets obtained in exchange for new operating lease liabilities	\$ 2,230,058	\$ -
ROU assets obtained in exchange for new finance lease liabilities	\$ 1,813,995	\$ -
Seller financed purchase of equipment	\$ 1,145,940	\$ -
Donations of land	\$ 575,000	\$ -
Capital additions included in accounts payable and accrued expenses	\$ 239,833	\$ 1,512,283

Baxter Regional Health System
Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2019 and 2018

	2019	2018
Reconciliation of Cash and Cash Equivalents to the Consolidated Balance Sheets		
Cash	\$ 16,233,505	\$ 23,165,495
Cash and cash equivalents in assets limited as to use:		
Internally designated for capital improvements	4,829,911	2,888,858
Externally restricted by donors	1,084,814	332,542
Total cash, cash equivalents and restricted cash shown in the consolidated statements of cash flows	\$ 22,148,230	\$ 26,386,895

Baxter Regional Health System
Notes to Consolidated Financial Statements
December 31, 2019 and 2018

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

Baxter Regional Health System (the System) is an Arkansas not-for-profit charitable corporation as described in Section 501(c)(3) of the Internal Revenue Code. The System primarily earns revenue by providing health care services, including acute, psychiatric, clinical, hospice and home health services to patients in Baxter and Marion Counties, located in Arkansas, as well as its secondary service area of Ozark County, Missouri, and Izard and Fulton Counties, located in Arkansas.

Organization	Primary Business Activity	Tax Status
Baxter Regional Health System (the System)	Parent holding company	Not-for-profit 501(c)(3)
Baxter County Regional Hospital, Inc. d/b/a Baxter Regional Medical Center (the Medical Center)	Acute-care hospital	Not-for-profit 501(c)(3); the System is sole member
Hospital Development Foundation, Inc. d/b/a Baxter Regional Hospital Foundation (the Foundation)	Solicit contributions for the benefit of the System and its nonprofit subsidiaries	Not-for-profit 501(c)(3); the System is sole member
Hospice of the Ozarks, Inc. (Hospice)	Hospice services	Not-for-profit 501(c)(3); the Medical Center is sole member
The BRMC Hometown Clinics, LLC (the Clinics)	Operation of physician clinics	Taxable LLC; 100% owned by the System
BRMC Pain Center, LLC (the Pain Center)	Real estate holding company	Taxable LLC; 51% owned by the System
Baxter Physician Partners, LLC (BPP)	Integrated network of providers to improve the quality of health for patients in the network's service area	Taxable LLC; 100% owned by the System

Baxter Regional Health System
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Organization	Primary Business Activity	Tax Status
BRMC Cancer Diagnostic Center, LLC (the Cancer Diagnostic Center)	Real estate holding company	Taxable LLC; 51% owned by the System
Baxter Regional Outpatient Surgery Center, LLC (the Outpatient Surgery Center)	Outpatient surgery center	Taxable LLC; 51% owned by the System

Use of Estimates

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

Noncontrolling Interest

Noncontrolling interest represents the 49% interest in the Pain Center, the Cancer Diagnostic Center, and the Outpatient Surgery Center owned by outside investors. Losses attributable to the noncontrolling interest are allocated to the noncontrolling interest even if the carrying amount of the noncontrolling interest is reduced below zero.

Baxter Regional Health System
Notes to Consolidated Financial Statements
December 31, 2019 and 2018

Changes in consolidated net assets attributable to the controlling financial interest of the System and the noncontrolling interest are:

	<u>Total</u>	<u>Controlling Interest</u>	<u>Noncontrolling Interest</u>
Balance, January 1, 2018	\$ 104,290,711	\$ 104,098,194	\$ 192,517
Excess (deficiency) of revenues over expenses	(2,052,972)	(2,143,270)	90,298
Investment return – change in unrealized gains and losses on other-than-trading securities	819,942	819,942	-
Net assets released from restriction for purchase of property and equipment	876,026	876,026	-
Contributions of or for purchase of property and equipment	366,290	366,290	-
Change in net assets with donor restriction	<u>(2,170,378)</u>	<u>(2,170,378)</u>	<u>-</u>
Change in net assets	<u>(2,161,092)</u>	<u>(2,251,390)</u>	<u>90,298</u>
Balance, December 31, 2018	<u>102,129,619</u>	<u>101,846,804</u>	<u>282,815</u>
Excess of revenues over expenses	11,885,257	11,837,418	47,839
Investment return – change in unrealized gains and losses on other-than-trading securities	968,565	968,565	-
Net assets released from restriction for purchase of property and equipment	191,988	191,988	-
Contributions of or for purchase of property and equipment	1,143,024	1,143,024	-
Sale of member units	90,000	-	90,000
Change in net assets with donor restriction	<u>1,349,860</u>	<u>1,349,860</u>	<u>-</u>
Change in net assets	<u>15,628,694</u>	<u>15,490,855</u>	<u>137,839</u>
Balance, December 31, 2019	<u>\$ 117,758,313</u>	<u>\$ 117,337,659</u>	<u>\$ 420,654</u>

Cash and Cash Equivalents

The System considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2019 and 2018, cash equivalents in investments consisted primarily of sweep accounts with brokers.

Uninvested cash and equivalents included in investment accounts, including endowment accounts and assets limited as to use, are considered to be cash and cash equivalents.

Deposit accounts restricted internally by the board and/or externally by regulators are considered to be cash and cash equivalents.

Baxter Regional Health System
Notes to Consolidated Financial Statements
December 31, 2019 and 2018

At December 31, 2019, the System’s cash accounts exceeded federally insured limits by approximately \$12,870,000.

Assets Limited as to Use

Assets limited as to use primarily include (1) assets set aside by the board of directors (the Board) for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes; (2) assets restricted by donors; and (3) assets held by trustees. Amounts required to meet current liabilities of the System are included in current assets.

Patient Accounts Receivable

Patient accounts receivable reflect the outstanding amount of consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs) and others. As a service to the patient, the System bills third-party payors directly and bills the patient when the patient’s responsibility for co-pays, coinsurance and deductibles is determined. Patient accounts receivable are due in full when billed.

Supplies

The System states supply inventories at the lower of cost, determined using the first-in, first-out method, or net realizable value.

Debt Investments

Debt securities held by the System generally are classified and recorded in the consolidated financial statements as follows:

Classified as	Description	Recorded at
Trading	Securities that are bought and held principally for the purpose of selling in the near term and, therefore, held for only a short period of time	Fair value, with changes in fair value included in excess (deficiency) revenues over expenses
Other than trading	Securities not classified as trading	Fair value, with unrealized gains and losses recorded below excess (deficiency) revenues over expenses

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Baxter Regional Health System
Notes to Consolidated Financial Statements
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When the fair value of securities is below the amortized cost, the System’s accounting treatment for an other-than-temporary impairment (OTTI) is as follows:

Circumstances of Impairment Considerations	Accounting Treatment for OTTI Components	
	Credit Component	Remaining Portion
Not intended for sale and more likely than not that the System will not have to sell before recovery of cost basis	Recognized in excess (deficiency) revenues over expenses	Recognized below excess (deficiency) revenues over expenses
Intended for sale or more likely than not that the System will be required to sell before recovery of cost basis	Recognized in excess (deficiency) revenues over expenses	

When a credit loss component is separately recognized in earnings, the amount is identified as the total of principal cash flows not expected to be received over the remaining term of the security, as projected based on cash flow projections.

Equity Investments

The System measures equity securities at fair value with changes recognized in excess (deficiency) revenues over expenses. The investment in equity investees is reported on the equity method of accounting. Other investments including real estate held by the Medical Center are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Real estate held by the Foundation is carried at fair value.

Net Investment Return

Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments, less external and direct internal investment expense.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in net assets without donor restrictions. Other investment return is reflected in the consolidated statements of operations and changes in net assets as with or without donor restrictions based upon the existence and nature of any donor or legally imposed restrictions.

The System maintains pooled investment accounts for its endowments. Investment income and realized and unrealized gains and losses from securities in the pooled investment accounts are allocated monthly to the individual endowments based on the relationship of the fair value of the interest of each endowment to the total fair value of the pooled investments accounts, as adjusted for additions to or deductions from those accounts.

Baxter Regional Health System
Notes to Consolidated Financial Statements
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Property and Equipment

Property and equipment acquisitions over \$2,000 are recorded at cost, less accumulated depreciation and amortization. Depreciation and amortization is charged to expense on the straight-line basis over the estimated useful life of each asset. Assets under finance lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Land improvements	5–25 years
Buildings and leasehold improvements	15–40 years
Equipment	3–20 years

Donations of property and equipment are reported at fair value as an increase in net assets without donor restrictions unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in net assets without donor restrictions when the donated asset is placed in service.

Long-Lived Asset Impairment

The System evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended December 31, 2019 and 2018.

Debt Issuance Costs

Debt issuance costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt into interest expense using the effective interest method. Amounts amortized in 2019 and 2018 were approximately \$85,000 and \$92,000, respectively.

Refund Liabilities

The consideration the System has received from patients for which it does not expect to be entitled to is recorded as a refund liability.

Baxter Regional Health System
Notes to Consolidated Financial Statements
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Net Assets

Net assets revenues, gains, and losses are classified based on the existence or absence of donor restrictions.

Net assets without donor restrictions are available for use in general operations and not subject to donor restrictions. The governing board has designated, from net assets without donor restrictions, net assets for an operating reserve and board-designated endowment.

Net assets with donor restrictions are subject to donor restrictions. Some restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity.

Patient Service Revenue

Patient service revenue is recognized as the System satisfies performance obligations under its contracts with patients. Patient service revenue is reported at the estimated transaction price or amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. The System determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the System's policies and implicit price concessions provided to uninsured patients.

The System determines its estimates of explicit price concessions, which represent adjustments and discounts based on contractual agreements, its discount policies and historical experience by payor groups. The System determines its estimate of implicit price concessions based on its historical collection experience by classes of patients. The estimated amounts also include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations by third-party payors.

Charity Care

The System provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the System does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as patient service revenue. Charity care is discussed more fully in *Note 12*.

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Contributions

Contributions are provided to the System either with or without restrictions placed on the gift by the donor. Revenues and net assets are separately reported to reflect the nature of those gifts—with or without donor restrictions. The value recorded for each contribution is recognized as follows:

Nature of the Gift	Value Recognized
<i>Conditional gifts, with or without restriction</i>	
Gifts that depend on the System overcoming a donor-imposed barrier to be entitled to the funds	Not recognized until the gift becomes unconditional, <i>i.e.</i> , the donor-imposed barrier is met
<i>Unconditional gifts, with or without restriction</i>	
Received at date of gift – cash and other assets	Fair value
Received at date of gift – property, equipment and long-lived assets	Estimated fair value
Expected to be collected within one year	Net realizable value
Collected in future years	Initially reported at fair value determined using the discounted present value of estimated future cash flows technique

In addition to the amount initially recognized, revenue for unconditional gifts to be collected in future years is also recognized each year as the present-value discount is amortized using the level-yield method.

When a donor-stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statements of operations as net assets released from restrictions. Absent explicit donor stipulations for the period of time that long-lived assets must be held, expirations of restrictions for gifts of land, buildings, equipment and other long-lived assets are reported when those assets are placed in service.

Gifts and investment income having donor stipulations which are satisfied in the period the gift is received are recorded as revenue and net assets without donor restrictions.

Conditional contributions having donor stipulations which are satisfied in the period the gift is received are recorded as revenue and net assets without donor restrictions.

Baxter Regional Health System
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Professional Liability Claims

The System recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in *Note 7*.

Self-Insured Employee Health Claims

The System has elected to self-insure certain costs related to its employee health program. Costs resulting from noninsured losses are charged to income when incurred. An estimated accrual is made for claims incurred but not paid at year-end. Total expense for employee health insurance claims for the years ended December 31, 2019 and 2018, was \$12,385,983 and \$14,113,759, respectively. The System has purchased insurance that limits its exposure for individual claims above \$400,000.

Self-Insured Workers' Compensation Trust

The System has a self-insured workers' compensation trust for its employees. Claims against the trust are administered by an independent risk management firm. Claims are recorded as an expense as they are paid. An annual estimated provision is accrued for both reported claims and claims incurred but not reported. Funds maintained to pay future claims are included in the System's consolidated financial statements.

Income Taxes

The System, Medical Center, Foundation and Hospice have been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. As such, they are required to file IRS Form 990 on an annual basis. These entities are subject to federal income tax on any unrelated business taxable income.

The Pain Center, Cancer Diagnostic Center and Outpatient Surgery Center are organized as Arkansas limited liability companies and treated as partnerships for income tax purposes. Taxable income or losses are reported to the individual members for inclusion in their respective tax returns.

The Clinics and BPP are treated as disregarded entities and included in the parent Form 990 return. The System files tax returns in the U.S. federal jurisdiction.

No provision for federal or state income taxes is included in the System's consolidated financial statements.

Baxter Regional Health System
Notes to Consolidated Financial Statements
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Excess (Deficiency) of Revenues over Expenses

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

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period beginning date.

Subsequent Events

Subsequent events have been evaluated through April 15, 2020, which is the date the consolidated financial statements were issued.

Change in Accounting Principle

See *Note 15* for discussion of the System’s adoption of ASU 2016-02, *Leases (Topic 842)*.

In 2019, the System adopted ASU 2016-01, *Financial Instruments (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*. The new accounting guidance in ASU 2016-01 requires companies to recognize changes in fair value of equity investments through the performance indicator. The following financial statement line items for fiscal year 2018 were affected by the adoption of the standard:

	December 31, 2018		
	As Previously Reported	As Adjusted	Adoption Impact
Statement of Operation and Changes in Net Assets			
Investment return, net	\$ 5,085,044	\$ (5,191,823)	\$ (10,276,867)
Total other income (expense)	4,982,700	(5,294,167)	(10,276,867)
Excess (deficiency) of revenues over expenses	8,223,895	(2,052,972)	(10,276,867)
Investment return – Change in unrealized gains and losses on other-than-trading securities	(9,456,925)	819,942	10,276,867

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In 2019, the System changed its method of accounting for restricted cash and restricted cash equivalents by adopting the provisions of ASU 2016-18 (ASU 2016-18), *Statement of Cash Flows (Topic 230): Restricted Cash*. The new accounting guidance in ASU 2016-18 requires balances generally described as restricted cash or restricted cash equivalents to be included with cash and cash equivalents when reconciling beginning and end of the period balances on the statement of cash flows. This change was applied retrospectively to all periods presented which resulted in the following changes within the statement of cash flows:

	December 31, 2018		
	As Previously Reported	As Adjusted	Adoption Impact
Statement of Cash Flows			
Increase (Decrease) in Cash, Restricted Cash and Restricted Cash Equivalents	\$ 11,496,384	\$ 10,465,778	\$ (1,030,606)
Proceeds from disposition of investments	13,719,310	12,688,704	(1,030,606)
Cash, Restricted Cash and Restricted Cash Equivalents Beginning of Year	11,669,111	15,921,117	4,252,006
Cash, Restricted Cash and Restricted Cash Equivalents End of Year	23,165,495	26,386,895	3,221,400

Note 2: Patient Service Revenue

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the System bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility and patient accounts receivable are due in full when billed. Revenue is recognized as performance obligations are satisfied.

Performance Obligations

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on charges accumulated over the period of service. The System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the System receiving inpatient acute care services or patients receiving services in its outpatient centers or in their homes (home care).

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The System measures the performance obligation from inpatient admission, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to its patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the System does not believe it is required to provide additional goods related to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, the System has elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

Transaction Price

The System determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions which consist of contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the System's policy and implicit price concessions provided to uninsured patients.

The System determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. The System determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Third-Party Payors

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

Medicare—Inpatient acute care, hospice, psychiatric and rehabilitation services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare administrative contractor.

Medicaid—Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology subject to certain cost limitations. Outpatient services rendered to Medicaid beneficiaries are paid based on a fee schedule. The System is reimbursed for inpatient services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid administrative contractor.

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Based on its status as a private hospital, the System participates in the Arkansas Medicaid provider assessment program. This program assesses a fee of no more than 5.5% of patient service revenue of private hospitals and allocates the proceeds to supplement Medicaid payments.

The federal government matches the assessment amount at a rate of approximately 3-to-1, and these amounts are allocated to private hospitals in Arkansas based on each hospital's share of total Medicaid patients. Assessment fees under this program for the years ended December 31, 2019 and 2018, were approximately \$2.7 million and \$3.5 million, respectively. Amounts recorded for the provider assessment revenues under this program for the years ended December 31, 2019 and 2018, were approximately \$6.3 million and \$7.4 million, respectively.

Other—Payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements.

Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the System. In addition, the contracts the System has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the System's historical settlement activity, including an assessment to ensure that it is probable that 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 based on newly available information, or as years are settled or are no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price were not significant in 2019 or 2018.

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Patient and Uninsured Payors

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The System also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions.

The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the System's mission, care is provided to patients regardless of their ability to pay. Therefore, the System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances, such as co-pays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the System expects to collect based on its collection history with those patients.

Patients who meet the System's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Refund Liabilities

From time to time the System will receive overpayments of patient balances from third-party payors or patients resulting in amounts owed back to either the patients or third-party payors. These amounts are excluded from revenues and are recorded as liabilities until they are refunded. As of December 31, 2019 and 2018, the System has a liability for refunds to third-party payors and patients recorded of approximately \$371,290 and \$312,170, respectively.

Revenue Composition

The System has determined that the nature, amount, timing and uncertainty of revenue and cash flows are primarily affected by factors including payors and service lines. Tables providing details of these factors are presented below.

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The composition of patient service revenue by primary payor for years ended December 31, 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 109,978,375	\$ 115,112,076
Medicaid	11,910,910	12,817,173
Other third-party payors	116,087,457	96,459,391
Self-pay	<u>3,047,099</u>	<u>2,258,100</u>
Total	<u>\$ 241,023,841</u>	<u>\$ 226,646,740</u>

Revenue from patients' deductibles and coinsurance is included in the categories presented above based on the primary payor.

The composition of patient service revenue based on service lines for years ended December 31, 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
Service lines		
Acute care	\$ 206,830,258	\$ 194,530,623
Post-acute care	14,914,132	14,680,316
Physician clinics	<u>19,279,451</u>	<u>17,435,801</u>
Total	<u>\$ 241,023,841</u>	<u>\$ 226,646,740</u>

Revenue is recognized as health care services are transferred over time. Revenue recognized at a point in time, such as for retail pharmacy, is not material.

Financing Component

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 a third-party payor pays for that service will be one year or less.

However, the System does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

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Note 3: Concentration of Credit Risk

The System grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2019 and 2018, is:

	<u>2019</u>	<u>2018</u>
Medicare	39 %	44 %
Medicaid	2	3
Other third-party payors	49	43
Patients	<u>10</u>	<u>10</u>
	<u>100 %</u>	<u>100 %</u>

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Note 4: Investments and Investment Return

Investments are reported in the consolidated balance sheets in the following captions and consist of the following:

	<u>2019</u>	<u>2018</u>
Assets limited as to use:		
Internally designated for capital improvements		
Cash and cash equivalents	\$ 4,829,911	\$ 2,888,858
Equity securities	13,723,456	5,219,060
Equity exchange-traded funds	10,875,484	18,928,023
Corporate debt securities	14,134,579	9,938,357
Preferred stock	1,037,640	438,381
Real estate	250,000	250,000
Interest receivable	50,099	41,217
Other	282,763	372,039
	<u>45,183,932</u>	<u>38,075,935</u>
Externally restricted by donors ⁽¹⁾		
Cash and cash equivalents	1,084,814	332,542
Certificates of deposit	28,411	311,899
Equity mutual funds	153,258	119,723
Equity exchange-traded funds	1,463,231	7,813,168
Corporate debt securities	707,116	654,442
Real estate	3,338,387	2,388,388
Equity securities	6,281,340	279,591
Other	598,047	499,330
	<u>13,654,604</u>	<u>12,399,083</u>
Held by trustee under indenture agreement		
Mortgage-backed securities	5,145,414	5,048,112
U.S. Treasury obligations fund	1,822,701	1,725,346
Interest receivable	55,357	26,642
	<u>7,023,472</u>	<u>6,800,100</u>
Other		
Certificates of deposit	200,000	200,000

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	<u>2019</u>	<u>2018</u>
Other investments:		
Certificates of deposit	\$ 323,393	\$ 105,473
Equity securities	7,827,229	7,312,848
Corporate debt securities	2,376,035	1,890,715
Preferred stock	454,570	748,505
Real estate	195,000	195,000
	<u>11,176,227</u>	<u>10,252,541</u>
Less long-term investments	<u>249,321</u>	<u>273,667</u>
Short-term investments	<u>10,926,906</u>	<u>9,978,874</u>
Total System investments	<u>\$ 77,238,235</u>	<u>\$ 67,727,659</u>

⁽¹⁾ Excludes contributions receivable. See *Note 5*.

Total investment return is comprised of the following:

	<u>2019</u>	<u>2018</u>
Interest and dividend income	\$ 1,862,111	\$ 2,012,899
Realized and unrealized gains (losses)	<u>9,965,447</u>	<u>(7,329,894)</u>
	<u>\$ 11,827,558</u>	<u>\$ (5,316,995)</u>

Total investment return is reflected in the consolidated statements of operations and changes in net assets as follows:

	<u>2019</u>	<u>2018</u>
Net assets without donor restrictions		
Other nonoperating income (loss)	\$ 9,093,057	\$ (5,191,823)
Change in unrealized gains on debt securities	968,565	819,942
Net assets with donor restrictions	<u>1,765,936</u>	<u>(945,114)</u>
	<u>\$ 11,827,558</u>	<u>\$ (5,316,995)</u>

At December 31, 2019, and 2018, the System's real estate investments included real estate located in various locations in north central Arkansas and southern Missouri with a carrying value of \$3,783,387 and \$2,833,388, respectively. The System has a practice of periodically challenging the value of its holdings and updating these values when conditions arise that indicate the valuation could be materially affected.

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Certain investments in debt securities are reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2019 and 2018, was \$11,128,064 and \$11,557,437, respectively, which was approximately 14% and 17%, respectively, of the System’s investment portfolio. Management believes the declines in fair value for these debt securities are temporary.

The System routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment has occurred. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in excess of revenues over expenses in the period the other-than-temporary impairment is identified. At December 31, 2019, no amounts were recognized as other-than-temporary impairment losses.

The following table show the System’s debt investments’ gross unrealized losses and fair value, aggregated by length of time that individual securities have been in a continuous unrealized loss position at December 31, 2019 and 2018:

	2019		2018	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Less than 12 months	\$ 4,482,306	\$ 153,253	\$ 9,530,728	\$ 373,690
12 months or more	6,645,758	140,282	2,026,709	90,923
	<u>\$ 11,128,064</u>	<u>\$ 293,535</u>	<u>\$ 11,557,437</u>	<u>\$ 464,613</u>

Note 5: Contributions Receivable

As a result of the Foundation’s fundraising activities, the System has recognized contributions receivable, some of which have been restricted by donors. At December 31, 2019 and 2018, total contributions receivable were \$329,874 and \$687,715, respectively. Contributions with donor restrictions amounting to \$172,500 and \$0 at December 31, 2019 and 2018, respectively, are reflected on the accompanying consolidated balance sheets as assets limited as to use – externally restricted by donors. The balance at December 31, 2019, is reduced by an allowance for uncollectible pledges of approximately \$175,000. At December 31, 2019 and 2018, \$231,541 and \$238,409, respectively, of contributions receivable was due in one year. Management has assessed any discount as not material.

Note 6: Investments in and Advances to Equity Investees

The investments in and advances to equity investees relate to a 25% ownership of Arkansas Community Hospital Network – Shared Services Organization, LLC and a 50% ownership of Baxter Regional PHO, LTD., which provides medical credentialing services to the System.

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Note 7: Professional Liability Claims

The System is self-insured for the first \$100,000 per occurrence and \$300,000 in aggregate for medical malpractice risks. The System purchases commercial insurance coverage above the self-insurance limits for the next \$1,000,000 per occurrence and \$3,000,000 in aggregate of medical malpractice risks.

This commercial coverage is provided under a claims-made policy. Under such a policy, only claims made and reported to the insurer during the policy term, regardless of when the incidents giving rise to the claims occurred, are covered.

Based on the System's claims experience, an accrual had been made for the System's estimated medical malpractice costs, including costs associated with litigating or settling claims under its malpractice insurance policy, amounting to \$300,000 as of December 31, 2019 and 2018. It is reasonably possible that this estimate could change materially in the near term.

Note 8: Long-term Debt

	<u>2019</u>	<u>2018</u>
Revenue refunding bonds (A)	\$ 40,500,000	\$ 43,710,000
Note payable (B)	12,059,320	5,888,797
Finance lease obligation (C)	2,385,862	690,293
Note payable (D)	1,991,515	2,090,658
Note payable (E)	1,598,908	701,258
Note payable (F)	1,568,894	1,623,601
Installment note payable (G)	1,145,936	-
Note payable (H)	957,947	1,003,900
Note payable (I)	117,662	203,154
Note payable (J)	24,943	49,021
	<u>62,350,987</u>	<u>55,960,682</u>
Less unamortized debt issuance costs	(385,803)	(470,960)
Less current maturities	(5,075,024)	(3,815,287)
Plus bond premium	<u>2,942,113</u>	<u>3,597,559</u>
	<u>\$ 59,832,273</u>	<u>\$ 55,271,994</u>

- (A) The 2016 Revenue Refunding Bonds (the 2016 Bonds) consist of Tax-exempt Hospital Revenue Bonds Series 2016A in the original amount of \$44,925,000 and Series 2016B in the original amount of \$4,785,000; issued for the purpose, together with funds in bond fund and debt service reserve funds, of refunding \$52,095,000 of existing revenue bonds and advance refunding \$5,095,000 of existing revenue bonds; and bearing interest at rates ranging from 2% to 5%.

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The 2016 Bonds are payable in annual installments including mandatory sinking fund redemption through September 1, 2032. Interest is due semiannually on March 1 and September 1. The System is required to make monthly deposits into the debt service funds of approximately \$430,000.

All of the 2016 Bonds still outstanding may be redeemed at the System's option on or after September 1, 2026, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the date of redemption. The 2016 Bonds are obligations of the Medical Center, but are guaranteed by the System. Unamortized debt issuance costs were \$385,803 and \$470,960 at December 31, 2019 and 2018, respectively. The effective interest rate was 3.33% for both of the years ended December 31, 2019 and 2018.

Baxter County (the County) issued the 2016 Bonds on behalf of the Medical Center. The 2016 Bonds are secured by a mortgage on the hospital facility, the gross receipts of the Hospital and the assets restricted under the trust agreement. The 2016 Bonds were not guaranteed by the County.

The trust agreement requires that certain funds be established with the trustee. Accordingly, these funds are included as assets limited as to use held by trustee in the consolidated balance sheets. The trust agreement also requires the Medical Center to comply with certain restrictive covenants including minimum insurance coverage, maintaining a debt-service coverage ratio of at least 115% and restrictions on incurrence of additional debt and transfers of assets.

- (B) Originally due May 9, 2019, a \$12,500,000 revolving line of credit, which provides for interest at 3.24%. Draws on this line are for the purpose of capital improvements. On April 15, 2019, the line was refinanced into a 15-year loan due April 9, 2034, with monthly payments of \$88,018 including interest of 3.24%; secured by certain property and equipment. Includes a subjective acceleration clause.
- (C) At varying rates of imputed interest from 1.12% to 7.85% due through December 2024.
- (D) Was due October 1, 2018; 59 monthly payments of \$14,532 including interest of 2.99% and one balloon payment of \$2,108,361; amended October 11, 2018, and is now due October 11, 2023; 60 monthly payments of \$16,657 including interest of 4.85% and one balloon payment of \$1,574,271; secured by the Pain Center building and land and guaranteed by the System. Includes a subjective acceleration clause.
- (E) Due on demand, but if no demand, one single payment was due on January 31, 2020, with maximum available draw of \$1,615,000 and interest at 4.25%. Amended August 31, 2019, and is now due August 31, 2024; 59 monthly payments of \$10,498 including interest of 4.75% and one balloon payment of \$1,348,113 due August 31, 2024. As of December 31, 2019, \$1,598,908 was outstanding; collateralized by certain property in Mountain View, Arkansas. The lender has formally acknowledged that the due-on-demand debt will not be called during the term of the note: as long as the regular monthly payments continue to be made on a timely basis. Therefore, at December 31, 2019 and 2018, the debt has been classified in accordance with its original stated maturity. Includes a subjective acceleration clause.

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- (F) Due on demand, but if no demand, monthly payments of \$10,219 through June 1, 2023, with a balloon payment of \$1,368,416 at maturity; includes interest of 4.25% collateralized by certain property in Melbourne, Arkansas. The lender has formally acknowledged that the due-on-demand debt will not be called during the term of the note: as long as the regular monthly payments continue to be made on a timely basis. Therefore, at December 31, 2019 and 2018, the debt has been classified in accordance with its original stated maturity.
- (G) Due June 2022; monthly payments of \$47,748 with interest at 3.24%; secured by certain specific capital equipment. Includes a subjective acceleration clause.
- (H) Due on demand, but if no demand, monthly payments of \$6,073 including interest of 2.75% are due through April 1, 2021; with a balloon payment of \$900,868 then due; secured by the Cancer Diagnostic Center building and land. The lender has formally acknowledged that the due-on-demand debt will not be called during the term of the note: as long as the regular monthly payments continue to be made on a timely basis. Therefore, at December 31, 2019 and 2018, the debt has been classified in accordance with its original stated maturity.
- (I) Due on demand, but if no demand, monthly payments of \$7,500 including interest of 2.75% are due through April 1, 2021; secured by the Cancer Diagnostic Center, equipment. The lender has formally acknowledged that the due-on-demand debt will not be called during the term of the note: as long as the regular monthly payments continue to be made on a timely basis. Therefore, at December 31, 2019 and 2018, the debt has been classified in accordance with its original stated maturity.
- (J) Due December 21, 2020; monthly payments are \$2,113 including interest of 2.99%; secured by certain Pain Center equipment. Includes a subjective acceleration clause.

On October 31, 2019, the Outpatient Surgery Center (OSC) entered into a contract for the construction of a new outpatient surgery facility. As of December 31, 2019, no amounts had been incurred under this contract which had a maximum guaranteed price of \$8,731,479. The Outpatient Surgery Center is financing this construction with a construction loan and security agreement dated December 9, 2019. The loan agreement is for a maximum of \$9,000,000 with an interest rate of 4.5% due six years after the initial 12-month construction term is complete. The loan agreement is guaranteed by the System up to 51% of the original principle and secured by the OSC property, building and equipment.

Aggregate annual maturities and sinking fund requirements of long-term debt, excluding finance leases, see *Note 15*, at December 31, 2019, are:

2020	\$ 4,788,118
2021	5,287,561
2022	4,963,916
2023	8,052,621
2024	6,559,377
Thereafter	<u>30,313,532</u>
	<u>\$ 59,965,125</u>

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Note 9: Net Assets with Donor Restrictions

Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes or periods:

	<u>2019</u>	<u>2018</u>
Subject to expenditure for specified purpose		
Purchase of property and equipment	\$ 200,000	\$ 189,292
Scholarships	<u>679,719</u>	<u>544,515</u>
	<u>879,719</u>	<u>733,807</u>
Subject to passage of time		
For periods after December 31, 2019 and 2018	<u>2,613,411</u>	<u>2,016,512</u>
Endowments		
Subject to spending policy and appropriations		
Investments to be held in perpetuity, the		
income is expendable to support:		
Scholarships	7,149,678	6,750,724
Indigent care	275,260	217,342
Community health needs	<u>2,324,150</u>	<u>2,173,973</u>
	<u>9,749,088</u>	<u>9,142,039</u>
	<u>\$ 13,242,218</u>	<u>\$ 11,892,358</u>

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Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of the passage of time or other events specified by donors.

	2019	2018
Purposed restrictions accomplished		
Scholarships	\$ 483,819	\$ 395,480
Purchase of property and equipment	191,988	876,026
Community health needs	71,501	40,613
Indigent care	4,432	291
	\$ 751,740	\$ 1,312,410

Note 10: Net Assets Without Donor Restrictions

The System's governing board has designated \$45,183,932 and \$38,075,935 at December 31, 2019 and 2018, respectively, from net assets without donor restrictions for future capital improvements, as well as \$206,554 and \$170,211 in 2019 and 2018, respectively, for endowment funds for the Hospital's Women's Health Education Center.

Note 11: Endowment

The System's endowment consists of approximately eight individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the governing body to function as endowments (board-designated endowment funds). As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The System is subject to State of Arkansas Prudent Management of Institutional Funds Act (SPMIFA) and, thus, classifies amounts in its donor-restricted endowment funds as net assets with donor restrictions because those net assets are time restricted until the board appropriates such amounts for expenditure. Most of those net assets are also subject to purpose restrictions that must be met before reclassifying those net assets to net assets without donor restrictions.

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The System's governing body has interpreted SPMIFA as not requiring the maintenance of purchasing power of the original gift amount contributed to an endowment fund, unless a donor stipulates to the contrary. As a result of this interpretation, when reviewing its donor-restricted endowment funds, the System considers a fund to be underwater if the fair value of the fund is less than the sum of (a) the original value of initial and subsequent gift and subsequent gift amounts donated to the fund and (b) any accumulations to the fund that are required to be maintained in perpetuity in accordance with the direction of the applicable donor gift instrument. The System has interpreted SPMIFA to permit spending from underwater funds in accordance with the prudent measures required under the law.

In addition, in accordance with SPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. Duration and preservation of the fund
2. Purposes of the System and the fund
3. General economic conditions
4. Possible effect of inflation and deflation
5. Expected total return from investment income and appreciation or depreciation of investments
6. Other resources of the System
7. Investment policies of the System

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The composition of net assets by type of endowment fund at December 31, 2019 and 2018, was:

	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	\$ 206,554	\$ -	\$ 206,554
Donor-restricted endowment funds			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	7,357,165	7,357,165
Accumulated investment gains	-	2,391,923	2,391,923
Total endowment funds	<u>\$ 206,554</u>	<u>\$ 9,749,088</u>	<u>\$ 9,955,642</u>
	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	\$ 170,211	\$ -	\$ 170,211
Donor-restricted endowment funds			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	7,357,165	7,357,165
Accumulated investment gains	-	1,784,874	1,784,874
Total endowment funds	<u>\$ 170,211</u>	<u>\$ 9,142,039</u>	<u>\$ 9,312,250</u>

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	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 170,211	\$ 9,142,039	\$ 9,312,250
Investment return, net	15,481	1,097,781	1,113,262
Contributions	20,862	10,664	31,526
Appropriation of endowment assets for expenditure	-	(501,396)	(501,396)
Endowment net assets, end of year	<u>\$ 206,554</u>	<u>\$ 9,749,088</u>	<u>\$ 9,955,642</u>
	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	\$ 185,089	\$ 10,155,729	\$ 10,340,818
Investment return, net	(14,878)	(482,658)	(497,536)
Contributions	-	20,000	20,000
Appropriation of endowment assets for expenditure	-	(551,032)	(551,032)
Endowment net assets, end of year	<u>\$ 170,211</u>	<u>\$ 9,142,039</u>	<u>\$ 9,312,250</u>

From time to time, fair value of assets associated with individual donor-restricted endowment funds may fall below the level the System is required to retain as a fund of perpetual duration pursuant to donor stipulation or SPMIFA (underwater endowments). There were no underwater endowments at December 31, 2019 and 2018.

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and other items supported by its endowment while seeking to maintain the purchasing power of the endowment. Endowment assets include those assets of donor-restricted endowment funds the System must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds. The System expects its endowment funds to provide an average rate of return of approximately 8% annually over time. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, the System relies on a total return strategy in which investment returns are achieved through both current yield (investment income such as dividends and interest) and capital appreciation (both realized and unrealized).

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The System targets a diversified asset allocation that places a greater emphasis on certificates of deposit and mutual fund investments to achieve its long-term return objectives within prudent risk constraints.

The System has various spending policies that govern expenditures of investment returns on endowment funds. Spending policies for donor-restricted endowments are based on the purpose restrictions placed on any proceeds from endowment funds and generally specify a fixed amount of spending each year. Spending policies related to board-designated endowment funds vary based on the goals set for each endowment fund, but are generally designed to support the endowment's short-term goals while allowing sufficient reinvestment to appreciate each fund.

Note 12: Charity Care

In support of its mission, the System voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported in patient service revenue. In addition, the System provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts that are less than established charges for the services provided to the recipients, and many times the payments are less than the cost of rendering the services provided. Management estimates that cost relating to these services was approximately \$870,000 and \$980,000 for the years ended December 31, 2019 and 2018, respectively, using a Medicare-based reasonable cost methodology.

In addition to uncompensated charges, the System also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, prenatal education and care, community educational services and various support groups.

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Note 13: Functional Expenses

The System provides health care services primarily to residents within its geographic area. Certain costs attributable to more than one function have been allocated among the health care services, general and administrative and fundraising functional expense classifications based on the cost report breakout of depreciation expense to overhead departments and health care services. The following tables present the natural classification of expenses by function as follows:

	2019			
	Health Care Services	General and Administrative	Fundraising	Total
Salaries and wages	\$ 91,558,879	\$ 5,302,601	\$ 117,290	\$ 96,978,770
Employee benefits	21,591,724	1,223,139	-	22,814,863
Professional fees	13,388,834	3,964,860	-	17,353,694
Supplies and other	86,631,470	6,226,767	93,675	92,951,912
Depreciation	10,581,074	-	-	10,581,074
Interest	1,514,509	475,261	-	1,989,770
Total expenses	<u>\$ 225,266,490</u>	<u>\$ 17,192,628</u>	<u>\$ 210,965</u>	<u>\$ 242,670,083</u>

	2018			
	Health Care Services	General and Administrative	Fundraising	Total
Salaries and wages	\$ 85,505,656	\$ 5,245,468	\$ 117,842	\$ 90,868,966
Employee benefits	22,824,147	1,406,262	-	24,230,409
Professional fees	13,741,982	1,943,966	-	15,685,948
Supplies and other	79,769,075	6,155,339	96,359	86,020,773
Depreciation	9,534,326	-	-	9,534,326
Interest	1,283,019	430,811	-	1,713,830
Total expenses	<u>\$ 212,658,205</u>	<u>\$ 15,181,846</u>	<u>\$ 214,201</u>	<u>\$ 228,054,252</u>

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Note 14: Liquidity and Availability

The System's financial assets available within one year of the balance sheet date for general expenditure are:

	<u>2019</u>	<u>2018</u>
Financial assets at year-end		
Cash	\$ 16,233,505	\$ 23,165,495
Short-term investments	10,926,906	9,978,874
Patient accounts receivable	23,476,378	21,041,918
Contributions receivable – current	157,374	238,409
Assets limited as to use	66,234,508	57,475,118
Long-term investments	249,321	273,667
Contributions receivable	-	449,306
	<u>117,277,992</u>	<u>112,622,787</u>
Less amounts not available to meet general expenditures within one year		
Board designated with liquidity horizons greater than one year	45,183,932	38,075,935
Donor restricted	13,827,104	12,399,083
Funds held by trustees	7,023,472	6,800,100
Long-term investments	249,321	273,667
Contributions receivable	-	449,306
Other restricted funds	200,000	200,000
	<u>66,483,829</u>	<u>58,198,091</u>
Financial assets not available to meet general expenditures within one year		
	<u>66,483,829</u>	<u>58,198,091</u>
Financial assets available to meet general expenditures within one year	<u>\$ 50,794,163</u>	<u>\$ 54,424,696</u>

The System has certain board-designated assets limited to use which are available for general expenditures within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above for financial assets to meet general expenditures within one year. The System has other assets limited to use for debt services. In addition, certain other board-designated assets are designated for future capital expenditures and an operating reserve. These assets limited to use, which are more fully described in *Notes 1, 4 and 14*, are not available for general expenditure within the next year. However, the board-designated amounts could be made available, if necessary.

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As part of the System's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, the System invests cash in excess of daily requirements in short-term investments.

Note 15: Leases

Change in Accounting Principle

In February 2016, FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to recognize a lease liability and a right-of-use (ROU) asset on a discounted basis, for substantially all leases, as well as additional disclosures regarding leasing arrangements. Disclosures are required to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. In July 2018, FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides an optional transition method of applying the new lease standard. Topic 842 can be applied using either a modified retrospective approach at the beginning of the earliest period presented or, as permitted by ASU 2018-11, at the beginning of the period in which it is adopted, *i.e.*, the comparatives under ASC 840 option.

The System adopted Topic 842 on January 1, 2019 (the effective date), using the comparatives under ASC 840 transition method, which applies Topic 842 at the beginning of the period in which it is adopted. Prior period amounts have not been adjusted in connection with the adoption of this standard. The System elected the package of practical expedients under the new standard, which permits entities to not reassess lease classification, lease identification or initial direct costs for existing or expired leases prior to the effective date. Also, the System elected to keep short-term leases with an initial term of 12 months or less off the balance sheet. The System did not elect the hindsight practical expedient in determining the lease term for existing leases as of January 1, 2019.

The most significant impact of adoption was the recognition of operating lease ROU assets and operating lease liabilities of \$1,181,395, while the accounting for existing capital leases (now referred to as finance leases) remained substantially unchanged. The standard did not significantly affect the consolidated statements of operations, change in net assets or cash flows.

Accounting Policies

The System determines if an arrangement is a lease or contains a lease at inception. Leases result in the recognition of ROU assets and lease liabilities on the consolidated balance sheets. ROU assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make lease payments arising from the lease, measured on a discounted basis. The System determines lease classification as operating or finance at the lease commencement date. Finance leases are included in property and equipment, current maturities of long-term debt and long-term debt in the consolidated balance sheets.

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At lease inception, the lease liability is measured at the present value of the lease payments over the lease term. The ROU asset equals the lease liability adjusted for any initial direct costs, prepaid or deferred rent, and lease incentives. The System uses the implicit rate when readily determinable. As most of the leases do not provide an implicit rate, the System uses its incremental borrowing rate based on information available at the lease commencement date to determine the present value of lease payments. Incremental borrowing rates used to determine the present value of lease payments were derived by reference to recent borrowings corresponding to the lease commencement date.

The lease term is the noncancelable period per the contract. Additionally, the lease term may include options to extend or to terminate the lease that the System is reasonably certain to exercise. Lease expense is generally recognized on a straight-line basis over the lease term.

The System has elected not to record leases with an initial term of 12 months or less on the consolidated balance sheets. Lease expense on such leases is recognized on a straight-line basis over the lease term.

Nature of Leases

The System has entered into the following lease arrangements:

Finance Leases

These leases mainly consist of equipment for the use of information systems, administration and the surgical department. Termination of the leases generally are prohibited unless there is a violation under the lease agreement.

Operating Leases

The System leases building space for clinics that expire in various years through 2024. Termination of the leases is generally prohibited unless there is a violation under the lease agreement.

The System leases equipment for various hospital departments that expire in various years through 2024. These leases generally contain renewal options for periods ranging from 3 to 5 years. Lease payments are stated in lease agreements and are set for the entire lease term. Termination of the leases generally are prohibited unless there is a violation under the lease agreement.

Short-Term Leases

The System leases certain equipment and space for terms shorter than 12 months. Total short-term lease expense included in operating expenses for the year ended December 31, 2019, was \$1,782,432. As of December 31, 2019, there were no future commitments related to these short-term leases.

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All Leases

The System has no material related party leases. The System has elected to not record inter-company leases that would be eliminated in consolidation. The System's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Quantitative Disclosures

Supplemental balance sheet information related to leases at December 31, 2019, is as follows:

	<u>Balance Sheet Classification</u>	<u>2019</u>
Finance leases:		
Finance lease ROU asset	Property and equipment	\$ 2,504,288
Accumulated amortization	Accumulated depreciation and amortization	118,270
Current finance lease liabilities	Current maturities of long-term debt	286,901
Long-term finance lease liabilities	Long-term debt	2,098,961

The lease cost and other required information for the year ended December 31, 2019, are as follows:

Lease cost	
Finance lease cost	
Amortization of ROU asset	\$ 118,270
Interest on lease liabilities	38,375
Operating lease cost	830,299
Short-term lease cost	<u>1,782,432</u>
 Total lease cost	 <u><u>\$ 2,769,376</u></u>

Other information

Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from finance leases	\$ 38,375
Financing cash flows from finance leases	118,270
Operating cash flows from operating leases	830,299
ROU assets obtained in exchange for new finance lease liabilities	1,813,995
ROU assets obtained in exchange for new operating lease liabilities	2,230,058
Weighted-average remaining lease term	
Finance leases	3.73 years
Operating leases	3.88 years
Weighted-average discount rate	
Finance leases	4.5%
Operating leases	3.2%

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Future minimum lease payments and reconciliation to the consolidated balance sheet at December 31, 2019, are as follows:

	<u>Finance Leases</u>	<u>Operating Leases</u>
2020	\$ 352,349	\$ 790,328
2021	611,201	780,111
2022	611,173	724,518
2023	611,139	604,407
2024	445,184	112,491
Total future undiscounted lease payments	2,631,046	3,011,855
Less interest	245,184	190,550
Lease liabilities	<u>\$ 2,385,862</u>	<u>\$ 2,821,305</u>

Note 16: Operating Leases

The System leases equipment under various lease agreements. Total rent and lease expense was \$1,058,792 for the year ended December 31, 2018.

Note 17: Pension Plan

The System has a defined contribution pension plan covering substantially all employees. An employee who chooses to participate in the plan will be eligible for matching contributions from the System when they have completed one year of service.

The System's matching contribution is 100% of the first 2% of the participant's salary and 50% of the next 4% of the participant's salary. Employees are 100% vested in the portion of their account accumulated from their contributions to the plan. Employees become fully vested in matching contributions after three years of service. Total pension expense, net of forfeitures utilized, for the years ended December 31, 2019 and 2018, was \$2,372,354 and \$2,201,138, respectively.

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Note 18: Split-Interest Agreements

The System has a remainder interest in several charitable remainder trusts, charitable gift annuities or charitable remainder annuity trusts. These agreements generally pay a designated beneficiary a predetermined amount per year based on a percentage of the trusts' assets or net income. Upon the death of the beneficiary, the System will receive its interest in the remaining trust assets. The System records the underlying assets of the trusts at fair market value.

The System's liability portion in these trusts has been discounted using rates ranging from 4.4% to 9.6% over the actuarially determined expected life of the beneficiary using Society of Actuaries tables and the fair market value of the trusts' assets.

The System is the trustee under these agreements. The assets under these agreements have been included in assets limited as to use and total \$2,417,938 and \$2,558,106 at December 31, 2019 and 2018, respectively. A liability of \$424,656 and \$506,740 has been recorded as accounts payable for the present value of the expected payments to the beneficiaries as of December 31, 2019 and 2018, respectively.

Note 19: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

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Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2019 and 2018:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Equity mutual funds	\$ 153,258	\$ 153,258	\$ -	\$ -
Equity securities	27,832,025	27,832,025	-	-
Equity exchange-traded funds	12,338,715	12,338,715	-	-
Preferred stock	1,492,210	1,492,210	-	-
U.S. Treasury obligations	1,822,701	1,822,701	-	-
Mortgage-backed securities	5,145,414	-	5,145,414	-
Corporate debt securities	17,217,730	-	17,217,730	-
Other	880,810	282,763	-	598,047
Real estate held by the Foundation	3,533,387	-	-	3,533,387
Total	<u>\$ 70,416,250</u>	<u>\$ 43,921,672</u>	<u>\$ 22,363,144</u>	<u>\$ 4,131,434</u>
December 31, 2018				
Equity mutual funds	\$ 119,723	\$ 119,723	\$ -	\$ -
Equity securities	12,811,499	12,811,499	-	-
Equity exchange-traded funds	26,741,191	26,741,191	-	-
Preferred stocks	1,186,886	1,186,886	-	-
U.S. Treasury obligations	1,725,346	1,725,346	-	-
Mortgage-backed securities	5,048,112	-	5,048,112	-
Corporate debt securities	12,483,514	-	12,483,514	-
Other	871,369	372,039	-	499,330
Real estate held by the Foundation	2,583,388	-	-	2,583,388
Total	<u>\$ 63,571,028</u>	<u>\$ 42,956,684</u>	<u>\$ 17,531,626</u>	<u>\$ 3,082,718</u>

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The following is a reconciliation of investments carried at fair value and the System's total investments:

	2019	2018
Financial instruments carried at fair value	\$ 70,416,250	\$ 63,571,028
Financial instruments not carried at fair value:		
Cash and cash equivalents	5,914,725	3,221,400
Real estate held by the Medical Center	250,000	250,000
Certificates of deposit	551,804	617,372
Interest receivable	105,456	67,859
Total System investments	<u>\$ 77,238,235</u>	<u>\$ 67,727,659</u>

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2019. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3. See the table below for inputs and valuation techniques used for Level 3 securities.

Level 3 Valuation Process

Fair value determinations for Level 3 measurements of securities are the responsibility of the controller's office. The controller's office contracts with a pricing specialist to generate fair value estimates on a monthly or quarterly basis. The controller's office challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States.

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Fair value determinations for Level 3 measurements of real estate held by the Foundation and beneficial interests in charitable remainder trusts are the responsibility of the controller's office. The controller's office contracts with a certified appraiser to generate fair value estimates for real estate upon purchases or when conditions indicate that previous measurements may no longer be reasonable. Management evaluates these conditions no less frequently than annually. The controller's office challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States. The controller's office determines the fair value estimates of beneficial interests in charitable remainder trusts based on a discounted cash flow model.

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated balance sheets using significant unobservable (Level 3) inputs:

	2019	2018
Balance, beginning of year	\$ 3,082,718	\$ 3,022,310
Purchases	950,000	135,000
Total unrealized gains (losses) included in change in net assets	98,716	(74,592)
Balance, end of year	\$ 4,131,434	\$ 3,082,718

Unobservable (Level 3) Inputs

The following tables present quantitative information about unobservable inputs used in recurring (Level 3) fair value measurements:

	Fair Value at 12/31/2019	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Beneficial interest in charitable remainder trusts	\$ 598,047	Discounted cash flow	Life expectancy of the beneficiary Expected rate of return	1.0–3.9 years (2.45 years) 1.7–2.4% (2.05%)
Real estate	\$ 3,533,387	Estimated based on comparable real estate transactions	Comparable real estate transactions	Various

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	Fair Value at 12/31/2018	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Beneficial interest in charitable remainder trusts	\$ 499,330	Discounted cash flow	Life expectancy of the beneficiary Expected rate of return	1.0–4.9 years (3.9 years) 2.0–2.1% (2.05%)
Real estate	\$ 2,583,388	Estimated based on comparable real estate transactions	Comparable real estate transactions	Various

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Beneficial Interest in Charitable Remainder Trusts

The significant unobservable inputs used in the fair value measurement of the System’s beneficial interest in charitable remainder trusts are life expectancy of the beneficiaries and expected rates of return. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Those inputs are not interrelated.

Real Estate

The significant unobservable input used in the fair value measurement of the System’s real estate investment is comparable real estate transactions. Significant increases (decreases) in this input would result in a significantly higher (lower) fair value measurement.

Note 20: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Professional Liability Claims

Estimates related to the accrual for medical malpractice claims are described in *Notes 1* and *7*.

Admitting Physicians

The System is served by an admitting physician group whose patients comprise approximately 11% of the System’s inpatient admissions for both years ended December 31, 2019 and 2018.

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Litigation

In the normal course of business, the System is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the System's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The System evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters.

As of December 31, 2019 and 2018, the System did not record an estimated loss. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Investments

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

Variable Consideration

Estimates of variable consideration in determining the transaction price for patient service revenue are described in *Notes 1* and *2*.

Note 21: Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (PPACA) has and will continue to substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system including many provisions that change payments from Medicare, Medicaid and insurance companies. A significant component of PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, have been substantially decreased. Each state's participation in an expanded Medicaid program is optional. The state of Arkansas has enacted a form of Medicaid expansion which uses the expansion funding to purchase private insurance policies on the health care exchanges for qualifying beneficiaries beginning January 1, 2014, originally called the Arkansas Private Option and now termed Arkansas Works.

Arkansas Works has been subject to annual reauthorization. In April 2016, Arkansas legislature reauthorized the Medicaid expansion with certain modifications through December 31, 2021, subject to annual budgetary reappropriation. In April 2019, the legislature reauthorized the expansion for the year ending June 30, 2020.

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Note 22: Coronavirus (COVID-19)

As a result of the spread of the SARS-CoV-2 virus and the incidence of COVID-19, the State of Arkansas has issued guidance limiting public gatherings and business operations to slow the spread of the virus. As a result, the System has experienced significant business disruption through reduced patient revenue related to elective procedures and physician office visits. The increased demand for health care supplies and equipment nationwide has increased costs and caused potential shortages that could further impact the System's financial performance.

Additionally, there has been significant volatility in the investment markets both nationally and globally since December 31, 2019, resulting in an overall market decline in certain market segments, which has resulted in a substantial decline in the value of the System's investment portfolio.

The duration of these uncertainties and the ultimate financial effects cannot be reasonably estimated at this time.

On March 27, 2020, President Trump signed into law the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act). The CARES Act includes numerous provisions intended to mitigate the pandemic's financial and operational impact to health care providers. The CARES Act provides three financial measures that the System expects will have a significant impact.

- A \$100 billion fund was established to reimburse health care providers for COVID-19-related expenses not otherwise reimbursable. More importantly for the System, foregone revenue from canceled procedures is a qualified expense under this program. In early April, CMS announced that it would distribute \$30 billion from this fund to all health care providers based on their fee-for-service Medicare payments. On April 10, 2020, the System received approximately \$6.3 million from this distribution. Key information regarding the criteria for the remaining funds such as the specific qualifications, the nature of the application process and the distribution method has not been finalized.
- The existing Medicare Accelerated and Advance Payment Program was expanded to a broader group of providers. This program allows hospitals and other providers to request an advance of their Medicare reimbursement. Specifically, hospitals may request up to 100% of their Medicare reimbursement for a six-month period. After 120 days from the advance, Medicare will begin the recoupment by withholding 100% of new claims processed until the advance has been repaid. The interest-free repayment period for hospitals is one year from the date of advance. Soon after the passage of the CARES Act, the System requested and expects to receive an advance in the amount of approximately \$37 million.
- The System has elected to defer applicable payroll taxes from late April 2020 through December 31, 2020. Estimated to total approximately \$3.4 million, the deferred amount will be accrued when incurred and will be due in two equal installments on December 31, 2021, and December 31, 2022.