



Financial Statements and Report of
Independent Certified Public Accountants

Bayhealth Medical Center, Inc.

June 30, 2019 and 2018



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Bayhealth Medical Center, Inc.

We have audited the accompanying financial statements of Bayhealth Medical Center, Inc. (the Medical Center), which comprise the balance sheets as of June 30, 2019 and 2018, and the related statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bayhealth Medical Center, Inc. as of June 30, 2019 and 2018, and the results of its operations and changes in net assets and its 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 B to the financial statements, during the year ended June 30, 2019 the Medical Center adopted the following Accounting Standards Updates: 2014-09, *Revenue from Contracts with Customers*; 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*; and 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to these matters.



Philadelphia, Pennsylvania
October 15, 2019

Bayhealth Medical Center, Inc.

BALANCE SHEETS

June 30,

ASSETS	2019	2018
CURRENT ASSETS		
Cash and cash equivalents	\$ 28,222,666	\$ 29,188,522
Assets limited as to use	11,132,283	15,270,214
Patient accounts receivable	65,762,253	66,719,865
Supplies	15,777,274	14,044,771
Prepaid expenses and other assets	10,140,749	10,160,797
 Total current assets	 131,035,225	 135,384,169
 Assets limited as to use		
Internally designated	126,565,320	176,474,734
Held by trustees	14,233,771	14,876,782
	140,799,091	191,351,516
 Other investments	 392,122,451	 353,144,569
Prepaid expenses and other assets	14,214,127	10,181,064
Property and equipment, net	576,923,081	504,999,884
Beneficial interest in net assets of Bayhealth Foundation	9,987,116	12,887,636
Beneficial interest in perpetual trusts	6,559,209	6,562,833
 TOTAL	 \$ 1,271,640,300	 \$ 1,214,511,671
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and other accrued expenses	\$ 41,799,287	\$ 42,108,928
Construction and retainage payable	7,251,845	10,936,939
Accrued salaries, wages and benefits	51,876,136	46,702,757
Current portion of long-term debt	4,900,000	5,360,000
Accrued interest payable	2,377,232	2,672,160
Estimated settlements due to third-party payors	15,564,051	14,390,481
 Total current liabilities	 123,768,551	 122,171,265
 Interest rate swap	 594,965	 609,526
Accrued postretirement benefit costs	46,621,759	44,342,107
Estimated professional liability costs	10,141,592	9,532,706
Estimated workers' compensation costs	2,354,292	3,020,213
Long-term debt, net of current portion	183,852,858	189,468,981
 Total liabilities	 367,334,017	 369,144,798
NET ASSETS		
Without donor restrictions	887,889,161	825,067,567
With donor restrictions	16,417,122	20,299,306
 Total net assets	 904,306,283	 845,366,873
 TOTAL	 \$ 1,271,640,300	 \$ 1,214,511,671

The accompanying notes are an integral part of these statements.

Bayhealth Medical Center, Inc.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

For the year ended June 30,

	2019	2018
NET ASSETS WITHOUT DONOR RESTRICTIONS		
Revenues		
Patient service revenue	\$ 662,580,167	\$ 599,865,136
Other revenue	<u>15,268,552</u>	<u>15,907,538</u>
Total revenues	677,848,719	615,772,674
Expenses		
Salaries and benefits	374,179,594	339,216,107
Supplies and other expenses	217,411,188	195,759,508
Interest	4,722,727	4,429,683
Depreciation and amortization	<u>37,456,084</u>	<u>32,524,050</u>
Total expenses	<u>633,769,593</u>	<u>571,929,348</u>
Operating income before other items	44,079,126	43,843,326
Other items:		
Loss on early extinguishment of debt	-	(8,755,755)
Curtailement of benefit obligations	-	6,619,796
Investment return, net	27,976,286	27,176,710
Change in fair value of interest rate swap	14,561	540,440
Change in beneficial interest in net assets of Bayhealth Foundation	(266,593)	(249,812)
Other, net	<u>(1,590,474)</u>	<u>42,051</u>
Total other items	<u>26,133,780</u>	<u>25,373,430</u>
Excess of revenues over expenses	70,212,906	69,216,756
OTHER CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS		
Net assets released from restrictions for property and equipment purchases	4,240,660	-
Other changes in benefit obligations	<u>(11,631,972)</u>	<u>17,450,396</u>
Increase in net assets without donor restrictions	<u>62,821,594</u>	<u>86,667,152</u>
NET ASSETS WITH DONOR RESTRICTIONS		
Other	(4,565)	(603)
Change in beneficial interest in perpetual trusts	(3,624)	155,668
Change in beneficial interest in net assets of Bayhealth Foundation	366,665	637,779
Net assets released from restrictions for property and equipment purchases	<u>(4,240,660)</u>	<u>-</u>
(Decrease) increase in net assets with donor restrictions	<u>(3,882,184)</u>	<u>792,844</u>
INCREASE IN NET ASSETS	58,939,410	87,459,996
NET ASSETS, beginning of year	<u>845,366,873</u>	<u>757,906,877</u>
NET ASSETS, end of year	<u>\$ 904,306,283</u>	<u>\$ 845,366,873</u>

The accompanying notes are an integral part of these statements.

Bayhealth Medical Center, Inc.

STATEMENTS OF CASH FLOWS

For the year ended June 30,

	2019	2018
OPERATING ACTIVITIES		
Increase in net assets	\$ 58,939,410	\$ 87,459,996
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Other changes in benefit obligations	11,631,972	(17,450,396)
Curtailment of benefit obligations	-	(6,619,796)
Loss on early extinguishments of debt	-	8,755,755
Change in fair value of interest rate swap	(14,561)	(540,440)
Net realized and unrealized gains on investments	(16,786,732)	(16,788,295)
Depreciation and amortization	37,456,084	32,524,050
Loss on sale of property and equipment	1,951,505	-
Change in beneficial interest in perpetual trusts	3,624	(155,668)
Change in beneficial interest in net assets of Bayhealth Foundation	(99,480)	(387,967)
Changes in assets and liabilities		
Patient accounts receivable	957,612	(5,187,250)
Supplies	(1,732,503)	120,621
Prepaid expenses and other assets	(2,093,015)	(2,571,427)
Accounts payable and other accrued expenses	(1,217,970)	(53,419)
Accrued salaries, wages and benefits	5,643,379	3,628,801
Accrued interest payable	(294,928)	(511,542)
Estimated settlements due to third-party payors	1,173,570	4,091,654
Accrued postretirement benefit costs	(9,822,320)	(4,825,840)
Estimated professional liability costs	1,446,277	69,386
Estimated workers' compensation costs	(594,983)	(940,293)
	86,546,941	80,617,930
INVESTING ACTIVITIES		
Capital expenditures, net	(115,732,003)	(139,090,289)
Distribution from Bayhealth Foundation	3,000,000	4,000,000
Investment in unconsolidated joint venture	(1,920,000)	-
Change in investments	32,499,206	61,133,067
	(82,152,797)	(73,957,222)
FINANCING ACTIVITIES		
Proceeds from the issuance of long-term debt	-	196,726,666
Debt issuance costs incurred	-	(1,480,579)
Repayment of long-term debt	(5,360,000)	(198,985,303)
	(5,360,000)	(3,739,216)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(965,856)	2,921,492
CASH AND CASH EQUIVALENTS - beginning of year	29,188,522	26,267,030
CASH AND CASH EQUIVALENTS - end of year	\$ 28,222,666	\$ 29,188,522
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for interest, net of amounts capitalized	\$ 5,017,655	\$ 4,941,225
SUPPLEMENTAL NONCASH INVESTING ACTIVITIES		
Change in accrual for the purchase of property and equipment	\$ (3,685,094)	\$ 2,733,530

The accompanying notes are an integral part of these statements.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

NOTE A - DESCRIPTION OF ORGANIZATION

Organization

Bayhealth Medical Center, Inc. (the Medical Center) is a not-for-profit, tax-exempt corporation under the control of its parent, Bayhealth, Inc., a not-for-profit Delaware corporation whose primary activities are to provide development and planning support to the Medical Center's two acute care hospitals: Bayhealth Hospital - Kent Campus (Kent), Dover, Delaware, and Milford Memorial Hospital (Milford), Milford, Delaware, until February 5, 2019 when Milford was replaced with the new Bayhealth Hospital - Sussex Campus (Sussex), Milford, Delaware. Milford was subsequently sold. The Medical Center's primary service area includes Kent and portions of Sussex Counties in Delaware. Other entities affiliated with the Medical Center through common control by Bayhealth, Inc. are Bayhealth Foundation (the Foundation) and Bayhealth Development Corporation.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Recently Adopted Accounting Pronouncements

Effective July 1, 2018, the Medical Center adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers* (Topic 606) ("ASU 2014-09"), using the retrospective method of application to all contracts existing on July 1, 2017. The core principle of the standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of the standard had no impact on the Medical Center's current or historical financial position, results of operations or cash flows. Additionally, management does not anticipate that the standard will have an impact on the amount or timing of when the Medical Center recognizes revenue prospectively. However, in accordance with the standard, the Medical Center now recognizes its previously reported provision for bad debts, primarily related to its self-pay patient population, as a direct reduction to revenues as an implicit pricing concession, instead of separately as a discrete deduction to arrive at patient service revenue. The Medical Center's revenue recognition and accounts receivable policies are more fully described below.

Effective July 1, 2018, the Medical Center adopted retrospectively and applied the practical expedient for FASB ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard makes changes to the presentation of net periodic pension cost in the income statement for employers that sponsor defined benefit pension and/or other postretirement benefit plans. Employers are required to present the service cost component of net periodic benefit cost in the same statement of operations line item as other employee compensation costs arising from services rendered during the period. Employers are also required to present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating income. This change resulted in a reclassification of the other components of the net periodic benefit cost for its pension plan and other benefits for the year ended June 30, 2018. The other components of the net periodic benefit cost for the postretirement benefit plans, gains (losses) of \$197,618 and (\$301,245) for the years ended June 30, 2019 and 2018, respectively, are recorded within other items in the statements of operations and changes in net assets.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

For 2019, the Medical Center adopted FASB ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. This standard makes certain improvements to the previous reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the previously required three classes, as well as the annual change in each of the two classes; (2) information about liquidity and the availability of resources; and (3) addresses the lack of consistency with expenses and investment return. The Medical Center's consolidated financial statements have been adjusted to reflect the new requirements. The standard has been applied retrospectively to all years presented.

2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) 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 financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant management estimates and assumptions are used in recording patient accounts receivable and patient service revenue, estimated settlements with third-party payors, fair value of the interest rate swap, useful lives of property and equipment, actuarial estimates for the postretirement benefit plans, professional liability and workers' compensation costs, and the reported fair values of certain assets and liabilities. Actual results could differ from those estimates.

3. Fair Value of Financial Instruments

Financial instruments consist of cash equivalents, patient accounts receivable, investments and assets limited as to use, beneficial interest in perpetual trusts, accounts payable and accrued expenses, interest rate swap agreements and long-term debt. The carrying amounts reported in the balance sheets for cash equivalents, patient accounts receivable, investments and assets limited as to use, beneficial interest in perpetual trusts, accounts payable and accrued expenses and the interest rate swap agreement approximate fair value. Management's estimate of the fair value of other financial instruments is described elsewhere in the notes to the financial statements.

4. Cash and Cash Equivalents

Cash and cash equivalents include short-term investments purchased with original maturities of three months or less and are stated at fair value.

The Medical Center routinely invests its surplus funds in repurchase agreements and money market funds. These funds generally are collateralized by, or invested in, highly-liquid U.S. Government and agency obligations.

5. Patient Accounts Receivable

Patient accounts receivable for which the Medical Center receives payment under cost reimbursement, prospective payment formulas, or negotiated rates, which cover the majority of patient services, are stated at the estimated net amounts receivable from payers, which are generally less than the established billing rates of the Medical Center.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Under the provisions of ASU 2014-09, when there is an unconditional right to payment, subject only to the passage of time, the right is treated as a receivable. Patient accounts receivable, including billed accounts and unbilled accounts, which have the unconditional right to payment, and estimated amounts due from third-party payers for retroactive adjustments, are recorded as receivables since the right to consideration is unconditional and only the passage of time is required before payment of that consideration is due. The estimated uncollectible amounts are generally considered implicit price concessions that are recorded as a direct reduction to patient accounts receivable.

6. Supplies

Supplies are stated at the lower of cost or market. Cost is determined by using the first-in, first-out method of accounting.

7. Investments and Assets Limited as to Use

Investments in debt and equity securities are measured at fair value based on quoted market prices, if available, or estimated quoted market prices for similar securities.

Investment income includes dividend and interest income; realized gains and losses and unrealized gains and losses on trading securities are included in other income as a component of excess of revenues over expenses unless such earnings are subject to donor-imposed restrictions. Realized gains and losses for all investments are determined by the average cost method.

Assets limited as to use include internally designated 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, assets held by trustees under bond indenture agreements and assets held by a trustee under a malpractice funding arrangement. Amounts required to meet current liabilities have been classified as current assets in the accompanying balance sheets.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is 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 financial statements.

8. Beneficial Interest in Perpetual Trusts

The Medical Center is an irrevocable income beneficiary of certain perpetual trusts administered by independent trustees. Because the trusts are perpetual and the original corpus cannot be violated, these funds are reported at fair value based on the Medical Center's interest in the trusts, as net assets with donor restrictions.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

9. Property and Equipment

Property and equipment acquisitions are recorded at cost. Donated assets are recorded at their fair value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest in the amount of \$1,934,275 and \$2,440,276 was capitalized for the years ended June 30, 2019 and 2018, respectively.

Expenditures for renewals and improvements are charged to the property accounts. Replacements, maintenance and repairs that do not improve or extend the life of the respective assets are expensed when incurred. The Medical Center removes the cost and the related accumulated depreciation from the accounts for assets sold or retired, and resulting gains or losses are included in the accompanying statements of operations and changes in net assets.

Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted donations. Absent explicit donor stipulations about how long those assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long lived assets are placed in service.

10. Derivative Financial Instruments

The Medical Center recognizes all derivative financial instruments in the balance sheets at fair value. Management has determined that the interest rate swap agreement does not qualify as a hedge for financial reporting purposes. Consequently, the change in the fair value of the interest rate swap agreement is included in other items as a component of excess of revenues over expenses in the statements of operations and changes in net assets.

The interest rate swap agreement is used to manage interest rate exposures and to hedge the changes in cash flows on variable rate revenue bonds. Derivative financial instruments involve, to a varying degree, elements of market and credit risk. The market risk associated with these instruments resulting from interest rate movements is expected to offset the market risk of the liability being hedged.

11. Estimated Professional Liability Costs

The reserve for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

12. Net Assets with Donor Restrictions

Net assets with donor restrictions represent those net assets whose use has been limited by donors to a specific time period, purpose, or to be maintained in perpetuity. The income from net assets that are to be maintained in perpetuity is not restricted by the donor.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

13. Excess of Revenues over Expenses

The statements of operations and changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets that are excluded from the excess of revenues over expenses, consistent with industry practice, are other changes in benefit obligations.

14. Donor-Restricted Gifts

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

15. Liquidity and Availability of Resources

As of June 30, 2019 and 2018, the adjusted working capital was \$522,074,007 and \$538,498,932, respectively, and the adjusted average days of cash on hand was 339 and 386 days, respectively, both of which include internally designated assets limited as to use and other long-term investments.

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

	June 30	
	2019	2018
Cash and cash equivalents	\$ 28,222,666	\$ 29,188,522
Patient accounts receivable	65,762,253	66,719,865
Assets limited as to use – internally designated	133,817,165	187,411,673
Other investments	392,122,451	353,144,569
	<u>\$ 619,924,535</u>	<u>\$ 636,464,629</u>

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

16. Patient Service Revenue

In accordance with ASU 2014-09, patient service revenue is reported at the amounts that reflect the consideration to which the Medical Center is expected to be entitled to in exchange for providing patient care for both the Hospital and any employed physicians. These amounts are due from patients, third-party payors (including managed care organizations and government programs, i.e., Medicare and Medicaid), and others and they included variable consideration for retroactive adjustments due to settlement of future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Generally, patients and third-party payors are billed several days after the services are performed or shortly after discharge. Patient service revenue is recognized in the period in which the performance obligations are satisfied under contracts by transferring services to patients.

Performance obligations are determined based on the nature of the services provided. The Medical Center recognizes revenues for performance obligations satisfied over time based on actual charges incurred in relation to total expected charges. The Medical Center believes that this method provides an appropriate depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations. Generally, performance obligations are satisfied over time related to patients receiving inpatient acute care services. The Medical Center measures performance obligations from admission to the point when there are no further services required for the patient, which is generally the time of discharge. The Medical Center recognizes revenues for performance obligations satisfied at a point in time, which generally relate to patients receiving outpatient services, when: (1) services are provided; and (2) when it is believed the patient does not require additional services.

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare and Medicaid - Inpatient acute care services provided to Medicare and Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Medical Center is reimbursed for certain cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by Medicare. Medicare reimburses for most outpatient services on the Outpatient Prospective Payment System (OPPS). Medicaid outpatient services are paid based on a fee schedule. The Medical Center's Medicare cost reports have been audited and finalized by the Medicare fiscal intermediary through June 30, 2017, with the exception of the 2005, 2016, and 2017 reports for Kent and the 2007 and 2015 reports for Milford/Sussex.

Blue Cross of Delaware - Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed primarily on a discount from established charge basis.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenue from the Medicare and Medicaid programs accounted for approximately 35% and 24%, and 36% and 21%, respectively, of the Medical Center's patient service revenue for the years ended June 30, 2019 and 2018, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. For the years ended June 30, 2019 and 2018, patient service revenue reflects net decreases of approximately \$205,000 and \$2,421,000, respectively, due to final settlements or estimate changes.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to the Medical Center under these agreements is primarily on a discount from established charges but also includes prospectively determined daily rates and prospectively determined fee schedules.

Patient service revenue for both years ended June 30, 2019 and 2018, recognized in the period from these major payor sources based on primary insurance designation, is as follows:

	<u>Third-Party Payors</u>	<u>Self-Pay</u>	<u>Total All Payors</u>
Patient service revenue	<u>93%</u>	<u>7%</u>	<u>100%</u>

Deductibles and copayments under third-party payment programs within the third-party payor amount above are patients' responsibility, and the Medical Center considers these amounts in its determination of implicit price concessions.

17. Charity Care and Community Service

The Medical Center provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than its established rates. Criteria for charity care include the patient's family income and net worth. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Medical Center maintains records to identify and monitor the level of charity care and community service it provides. These records include the amount of charges foregone based on established rates for services and supplies furnished under its charity care and community service policies and the number of patients receiving services under these policies. The Medical Center provided approximately \$15,753,000 and \$12,863,000 for the years ended June 30, 2019 and 2018, respectively, of charity care at full cost including direct and indirect costs, based on the actual charity population using a cost accounting system.

Additionally, the Medical Center provides a wide range of community services to the general public. These include but are not limited to the following: free health screenings for breast cancer, prostate cancer, skin cancer, diabetes, high blood pressure, high blood cholesterol, hearing loss and glaucoma; free educational programs on a variety of health care topics; health fairs and demonstrations; and networking and coordination of services for the needy, elderly and disabled. These community services are offered at the Medical Center and at schools, businesses and other locations throughout the Medical Center's service area.

The Medical Center also participates in the Medicaid program, which makes payment for services provided to financially needy patients at rates which are less than the established charges for such services.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

18. Tax Status

The Medical Center is a Delaware nonprofit corporation and is exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Medical Center follows the accounting guidance for uncertainties in income tax positions, which requires that a tax position be recognized or derecognized based on a "more likely than not" threshold. This applies to positions taken or expected to be taken in a tax return. The Medical Center does not believe its financial statements include any material uncertain tax positions. At June 30, 2019, the Medical Center's tax years ended June 30, 2016 through 2019 for the federal tax jurisdiction remain open.

19. Pending Accounting Pronouncement

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires that most leased assets be recognized on the balance sheet as assets and liabilities for the rights and obligations created by these leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. An entity is required to apply the amendments in the standard under the modified retrospective transition approach. This approach includes a number of optional practical expedients, which are described in the final standard. Under these practical expedients, an organization will continue to account for leases that commence before the effective date in accordance with current U.S. GAAP, unless the lease is modified. However, lessees are required to recognize on the balance sheet leased assets and liabilities for operating leases at each reporting date. The Medical Center has not determined the impact of this standard at this time.

20. Reclassifications

Certain amounts in the prior year financial statements have been reclassified to be consistent with the current year presentation, primarily due to the recently adopted accounting pronouncements.

NOTE C - ASSETS LIMITED AS TO USE AND OTHER INVESTMENTS

Assets Limited as to Use

As of June 30, assets limited as to use consisted of:

	2019	2018
Internally designated		
Cash and cash equivalents	\$ 88,743,020	\$ 48,794,417
Government securities and corporate bonds	13,470,958	111,023,757
Equity securities	31,603,187	27,593,499
	133,817,165	187,411,673
Less amounts required for current liabilities	<u>(7,251,845)</u>	<u>(10,936,939)</u>
	<u>\$126,565,320</u>	<u>\$176,474,734</u>

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE C - ASSETS LIMITED AS TO USE AND OTHER INVESTMENTS - Continued

	2019	2018
Held by trustees		
Under bond indenture agreements		
Cash and cash equivalents	<u>\$ 3,888,227</u>	<u>\$ 6,143,865</u>
Under malpractice funding arrangement		
Cash and cash equivalents	1,305,502	845,880
Government securities and corporate bonds	5,670,172	5,154,442
Equity securities	<u>7,250,308</u>	<u>7,065,870</u>
	<u>14,225,982</u>	<u>13,066,192</u>
Total held by trustees	18,114,209	19,210,057
Less amounts required for current liabilities	<u>(3,880,438)</u>	<u>(4,333,275)</u>
	<u>\$ 14,233,771</u>	<u>\$ 14,876,782</u>

Other Investments

Other investments at June 30, consisted of:

	2019	2018
Cash and cash equivalents	\$ 17,846,186	\$ 24,201,229
Government securities and corporate bonds	91,331,458	51,555,740
Equity securities	<u>282,944,807</u>	<u>277,387,600</u>
	<u>\$392,122,451</u>	<u>\$353,144,569</u>

Investment Return

The following schedule summarizes the investment return on assets limited as to use and other investments in other items on the statements of operations and changes in net assets for the years ended June 30:

	2019	2018
Investment return, net		
Interest and dividend income	\$ 12,887,258	\$ 12,337,391
Net realized gains on sales of securities	5,117,428	28,834,683
Change in net unrealized gains and losses on trading securities	11,669,304	(12,046,388)
Investment fees	<u>(1,697,704)</u>	<u>(1,948,976)</u>
	<u>\$ 27,976,286</u>	<u>\$ 27,176,710</u>

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE D - PROPERTY AND EQUIPMENT

Property and equipment at June 30, consisted of:

	Estimated useful lives	2019	2018
Land		\$ 32,204,906	\$ 29,263,410
Land improvements	2 to 25 years	4,204,910	3,676,586
Buildings and improvements	5 to 40 years	419,622,921	278,047,803
Major movable and fixed equipment	3 to 20 years	469,442,441	340,865,155
		925,475,178	651,852,954
Construction in progress		26,431,428	217,429,159
		951,906,606	869,282,113
Less accumulated depreciation		(374,983,525)	(364,282,229)
		\$576,923,081	\$504,999,884

Depreciation expense for the years ended June 30, 2019 and 2018 totaled \$38,172,207 and \$32,882,871, respectively.

NOTE E - LONG-TERM DEBT

Long-term debt as of June 30, consisted of:

	2019	2018
Project Revenue Bonds, Series 2017A, net of unamortized premium of \$6,085,303 and \$6,887,913 at June 30, 2019 and 2018, respectively	\$114,650,303	\$119,007,913
Variable Rate Refunding Revenue Bonds, Series 2017B	75,445,000	77,250,000
	190,095,303	196,257,913
Less: Unamortized deferred financing costs, net	(1,342,445)	(1,428,932)
Current portion of long-term debt	(4,900,000)	(5,360,000)
	\$183,852,858	\$189,468,981

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE E - LONG-TERM DEBT - Continued

Fair Value

The Medical Center uses quoted market prices in estimating the fair value of the revenue bonds. The fair value of long-term debt was \$193,770,000 and \$193,491,000 at June 30, 2019 and 2018, respectively.

Bonds

Series 2017A Bonds

In December 2017, the Medical Center entered into a financing arrangement with the Delaware Health Facilities Authority (the Authority) to issue \$112,120,000 Revenue Bonds, Bayhealth Medical Center Project, Series 2017A (Series 2017A). The Series 2017A bonds proceeds were used to extinguish the Project Revenue Bonds, Series 2009A (Series 2009A). A bond premium and issuance costs relating to the Series 2017A bonds are being amortized over the life of the bonds. As a result of the extinguishment of the Series 2009A bonds, a loss on early extinguishment of \$8,755,755 was recognized. The loss was comprised of the write-off of the unamortized bond premium and deferred financing costs and future interest payments of the Series 2009A bonds.

The Series 2017A bonds include serial bonds bearing interest at rates ranging from 3.375% to 5.000%, with maturities annually through July 1, 2044, with principal payment ranging from \$1,780,000 to \$4,560,000. Term bonds, bearing interest at rates ranging from 3.000% to 4.000%, with maturities occurring on July 1, 2032 through July 1, 2043, are subject to mandatory sinking fund (principal) payments beginning July 1, 2032, ranging from \$7,500,000 to \$31,930,000 as set forth in the bond indenture agreements. The Series 2017A interest is payable semiannually on each January 1 and July 1.

Series 2017B Bonds

In December 2017, the Medical Center entered into a financing arrangement with the Authority and a national bank to issue privately placed \$77,250,000 Variable Rate Refunding Revenue Bonds, Bayhealth Medical Center Project, Series 2017B (Series 2017B). The Series 2017B bonds proceeds were used to extinguish the Variable Rate Refunding Revenue Bonds, Series 2012 (Series 2012) and to finance the Milford Memorial replacement hospital. Bond issuance costs relating to the Series 2017A bonds are being amortized over the life of the bonds.

The Series 2017B bonds have annual sinking fund (principal) payments through July 1, 2039 ranging from \$3,120,000 to \$4,110,000 and bear interest based on a daily LIBOR rate (as defined) which was 2.67% and 2.29% at June 30, 2019 and 2018, respectively.

As of June 30, 2019, the principal payments on long-term debt are as follows:

2020	\$ 4,900,000
2021	5,010,000
2022	5,150,000
2023	5,295,000
2024	5,445,000
Thereafter	<u>158,210,000</u>
	<u>\$184,010,000</u>

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE E - LONG-TERM DEBT - Continued

Interest Rate Swap

The Medical Center entered into an interest rate swap agreement in April 2003 to manage its exposure to fluctuations in interest rates relating to the Series 2003 bonds. The interest rate swap does not qualify for hedge accounting. The Series 2003 bonds were extinguished in October 2009; however, the interest rate swap agreement remains in place. The notional amount declines annually until the termination of the agreement on July 1, 2023. As of June 30, 2019 and 2018, the notional amount was \$11,555,000 and \$13,620,000, respectively. Under the agreement, the Medical Center receives a floating rate based on 68% of the 30-day U.S. dollar LIBOR rate and pays a fixed rate of 3.53% each month.

The Medical Center has established policies and procedures to limit the potential for counterparty credit risk, including establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. As a matter of practice, the Medical Center will enter into transactions only with counterparties whose obligations are rated "A-" or above as rated by Standard & Poor's, or "A3" or above as rated by Moody's.

The Medical Center's exposure to credit risk, associated with its derivative financial instruments, is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. As of October 15, 2019, the Medical Center was not exposed to any risk of loss.

NOTE F - POSTRETIREMENT BENEFIT PLANS

The Medical Center sponsors a noncontributory defined benefit pension plan (Pension Plan), covering substantially all employees, which was frozen for all participants effective January 1, 2008, except those whose age and years of vesting service total 65 or more as of December 31, 2007. These grandfathered participants will continue to add to the Pension Plan benefits in the future based on current plan provisions. For all other employees, Pension Plan benefits will not increase after December 31, 2007. The Medical Center's policy is to fund benefit costs accrued subject to limitations under the Employee Retirement Income Security Act of 1974. The actuarial cost method used to compute funding levels is the Projected Unit Credit Method. The mortality table used for projecting the benefit obligations is the RP-2014 Generational Mortality Table with annual updates for projected improvements.

Prior to January 1, 2018, the Medical Center provided certain reimbursement for health care benefits for eligible retirees (Other benefits). Employees who retired at age 65, or at age 55 with 10 consecutive years of service, and who were insured under the Medical Center's health insurance plan while an active employee, were eligible for coverage. Effective January 1, 2018, the Other benefits plan was closed to new retirees over age 65. Post-65 coverage ended after December 31, 2017, except for a small select group of grandfathered retirees.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE F - POSTRETIREMENT BENEFIT PLANS - Continued

The following table summarizes information about the benefit plans:

	Pension benefits		Other benefits	
	2019	2018	2019	2018
Accumulated benefit obligation	\$215,835,051	\$204,662,697	\$ N/A	\$ N/A
Change in benefit obligation				
Benefit obligation at beginning of year	\$207,248,689	\$217,871,710	\$ 4,689,110	\$ 18,594,199
Service cost	1,376,487	1,669,268	31,231	271,515
Plan amendments	-	-	-	(1,025,857)
Interest cost	8,721,621	8,304,950	138,603	321,562
Actuarial loss (gain)	17,766,487	(12,453,318)	(317,832)	394,471
Gain due to curtailment	-	-	-	(12,797,748)
Benefits paid	(8,610,329)	(8,143,921)	(1,032,420)	(1,069,032)
Benefits paid due to retiree annuity purchases	(8,311,198)	-	-	-
Benefit obligation at end of year	218,191,757	207,248,689	3,508,692	4,689,110
Change in plan assets				
Fair value of the plan assets at beginning of year	166,165,692	161,796,606	-	-
Actual return on plan assets	14,874,525	6,513,007	-	-
Contributions by the Medical Center	10,000,000	6,000,000	1,032,420	1,069,032
Benefits paid	(8,610,329)	(8,143,921)	(1,032,420)	(1,069,032)
Benefits paid retiree annuity purchase	(8,311,198)	-	-	-
Fair value of the plan assets at end of year	174,118,690	166,165,692	-	-
Funded status at year end	\$ (44,073,067)	\$ (41,082,997)	\$ (3,508,692)	\$ (4,689,110)
Net amounts recognized in the balance sheets consist of				
Current liabilities, as accrued salaries, wages and benefits	\$ -	\$ -	\$ (960,000)	\$ (1,430,000)
Noncurrent liabilities	(44,073,067)	(41,082,997)	(2,548,692)	(3,259,110)
Accrued retirement benefits	\$ (44,073,067)	\$ (41,082,997)	\$ (3,508,692)	\$ (4,689,110)
Amounts recognized in net assets without donor restrictions but not yet recognized in net periodic benefit costs consist of				
Net actuarial loss (gain)	\$ 84,846,188	\$ 73,093,237	\$ (457,426)	\$ (150,412)
Prior service credit	-	-	(787,546)	(973,581)
	\$ 84,846,188	\$ 73,093,237	\$ (1,244,972)	\$ (1,123,993)

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE F - POSTRETIREMENT BENEFIT PLANS - Continued

	Pension benefits		Other benefits	
	June 30		June 30	
	2019	2018	2019	2018
Components of net periodic benefit cost recognized in salaries and benefits:				
Service cost	\$ 1,376,487	\$ 1,669,268	\$ 31,231	\$ 271,515
Components of net periodic benefit cost recognized in other items:				
Interest cost	8,721,621	8,304,950	138,603	321,562
Expected return on plan assets	(10,773,878)	(10,383,773)	-	-
Amortization of prior service credit	-	-	(186,035)	(153,760)
Amortization of actuarial loss (gain)	1,912,889	2,060,989	(10,818)	151,277
	(139,368)	(17,834)	(58,250)	319,079
Gain due to curtailment	-	-	-	(6,619,796)
Net periodic benefit cost (income)	1,237,119	1,651,434	(27,019)	(6,029,202)
Other changes in benefit obligations recognized in other changes in net assets without donor restrictions				
Prior service cost (credit)	-	-	186,035	(154,630)
Net actuarial loss (gain)	11,752,951	(10,643,541)	(307,014)	(6,652,225)
	11,752,951	(10,643,541)	(120,979)	(6,806,855)
Total recognized in net benefit cost and other changes in net assets without donor restrictions	\$ 12,990,070	\$ (8,992,107)	\$ (147,998)	\$ (12,836,057)

At June 30, 2019, the expected estimated amount reclassified from net assets without donor restrictions into net periodic benefit cost for the next year is:

	Pension benefits	Other benefits
Prior service credit	\$ -	\$ (190,000)
Net actuarial loss (gain)	2,400,000	(24,000)
	\$ 2,400,000	\$ (214,000)

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE F - POSTRETIREMENT BENEFIT PLANS - Continued

	Pension benefits		Other benefits	
	June 30		June 30	
	2019	2018	2019	2018
Weighted-average assumptions used to determine benefit obligations were				
Discount rate	3.60%	4.31%	2.52%	3.59%
Rate of compensation increase	3.00%	3.00%	N/A	N/A
Measurement date	June 30	June 30	June 30	June 30
Weighted-average assumptions used to determine net periodic benefit costs were				
Discount rate	4.31%	3.93%	3.59%	3.84%/2.62% ^(a)
Expected long-term return on plan assets	6.50%	6.50%	N/A	N/A
Rate of compensation increase	3.00%	3.00%	N/A	N/A

^(a) The discount rate was 3.84% from July 1, 2017 to October 31, 2017 and 2.62% from November 1, 2017 to June 30, 2018.

The expected long-term rate of return on the Pension benefits' total assets is developed based on applying historical average total returns by asset class to the Pension benefits' current asset allocation.

The current health care cost trend rates used to measure the future benefits under the postretirement health care plans are: (1) 8% for pre-65 year old retirees, decreasing to 5% by 2021 and remaining at that level thereafter; and (2) 7.6% for retirees age 65 and older, decreasing to 5% by 2019 and remaining at that level thereafter. A one percentage-point change in assumed health-care cost trend rates would have the following effects on the year ended June 30, 2019:

	1% increase	1% (decrease)
Incremental effect on total service and interest cost components of benefit cost	\$ 4,733	\$ (5,021)
Incremental effect on postretirement benefit obligation	\$ 142,770	\$ (151,396)

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE F - POSTRETIREMENT BENEFIT PLANS - Continued

The Pension benefits' weighted average asset allocation as of the measurement dates of June 30, 2019 and 2018, by asset category, follows:

Asset category	2018	2017
Cash and cash equivalents	5%	2%
Fixed income	43	45
Equity securities	52	53
Total	100%	100%

The target asset allocation is 40% in fixed income and 60% in equity securities.

Fair Value of the Plan Assets

The following fair value hierarchy table presents information about each major category of the Pension benefits' financial assets measured at fair value using the market approach on a recurring basis as of June 30, 2019 and 2018:

	Fair value measurement at report date using			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<u>2019</u>				
Cash and cash equivalents	\$ 9,708,353	\$ 9,708,353	\$ -	\$ -
Fixed income ^(a)	75,268,804	-	75,268,804	-
Equity securities ^(b)	89,141,533	89,141,533	-	-
	\$174,118,690	\$ 98,849,886	\$ 75,268,804	\$ -
<u>2018</u>				
Cash and cash equivalents	\$ 7,863,064	\$ 7,863,064	\$ -	\$ -
Fixed income ^(a)	70,730,298	-	70,730,298	-
Equity securities ^(b)	87,572,330	87,572,330	-	-
	\$166,165,692	\$ 95,435,394	\$ 70,730,298	\$ -

^(a) Comprised of investment-grade bonds of U.S. issuers from various industries and a commingled trust fund.

^(b) Comprised of mutual funds investing primarily in common stock of companies with large market capitalizations similar to companies in the Standard & Poor's (S&P) 500 Index.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE F - POSTRETIREMENT BENEFIT PLANS - Continued

Investment Strategies

The funding obligations of the Pension benefits are long-term in nature; consequently, the investment of the Pension benefits' assets should have a long-term focus. The Pension benefits' assets are invested in accordance with sound investment practices that emphasize long-term fundamentals. The investment objectives for the plan's assets are:

- To achieve a positive rate of return over the long term that significantly contributes to meeting the Pension benefits' obligations, including actuarial interest and benefit payment obligations;
- To earn long-term returns that keep pace with or exceed the long-run inflation rate;
- To diversify the Pension benefits' assets in order to reduce the risk of wide swings in market value from year to year, or of incurring large losses; and
- To achieve investment results over the long term that compare favorably with those of Other benefits plan and of appropriate market indices.

It is expected that these objectives can be obtained through a well-diversified portfolio structure in a manner consistent with this investment policy.

Cash Flows

The Medical Center expects to contribute \$8,000,000 to the Pension Plan and \$960,000 to the Other benefits plan for the year ending June 30, 2020. The following benefit payments, which reflect expected future service, as appropriate, are expected to be made in future years:

<u>Year ending June 30,</u>	<u>Pension</u> <u>benefits</u>	<u>Other</u> <u>benefits</u>
2020	\$ 11,051,000	\$ 960,000
2021	11,583,000	740,000
2022	12,060,000	570,000
2023	12,436,000	420,000
2024	12,765,000	300,000
2025-2029	65,988,000	320,000

The Medical Center also offers a defined contribution savings plan to all full-time and part-time employees of the Medical Center. The Medical Center matches participant contributions for active participants as of December 31, who have completed at least 1,000 hours of service during the calendar year. The match is 50% of the first 4% of compensation. Effective on January 1, 2008, grandfathered participants will continue to receive a match of 50% of the first 4% of compensation, and for non-grandfathered participants, 50% of the first 6% of compensation. Additionally, non-grandfathered participants also receive a 3% contribution of compensation. The Medical Center's expense for the defined contribution savings plan for the years ended June 30, 2019 and 2018 was \$10,477,957 and \$11,273,799, respectively.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE G - ESTIMATED INSURANCE LIABILITY COSTS

Medical Professional Liability Insurance

The Medical Center maintains medical malpractice insurance coverage under an annual claims-made policy with a deductible amount of \$3,000,000 on a per-claim basis and \$9,000,000 in the aggregate. The Medical Center provides for estimated losses which have been reported and losses which have been incurred but not reported. At June 30, 2019 and 2018, the malpractice claims liability totaled \$12,745,998 and \$11,299,721, respectively, including the estimated current portion of this liability, totaling \$2,604,406 and \$1,767,015, respectively, reported in accounts payable and other accrued expenses.

Workers' Compensation Insurance

The Medical Center has a self-insured workers' compensation program subject to a self-insured retention of \$800,000 per claim for the years ended June 30, 2019 and 2018. Claims exceeding the self-insured retention are covered under an excess insurance policy, the maximum limit of indemnity is statutory and the employers' liability maximum limit of indemnity per occurrence and aggregate is \$1,000,000 for 2019 and 2018. At June 30, 2019 and 2018, the workers' compensation liability totaled \$3,993,934 and \$4,588,917, respectively, including the estimated current portion of this liability, totaling \$1,639,642 and \$1,568,704, respectively, reported in accounts payable and other accrued expenses.

NOTE H – NET ASSETS WITH DONOR RESTRICTIONS

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

	June 30	
	2019	2018
Subject to expenditure for specific purpose or time:		
Capital purposes	\$ 9,857,913	\$ 13,736,473
Investments to be held in perpetuity, the income from which is unrestricted	6,559,209	6,562,833
Total	<u>\$ 16,417,122</u>	<u>\$ 20,299,306</u>

NOTE I - COMMITMENTS AND CONTINGENCIES

Litigation

The Medical Center is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without a material adverse effect on the Medical Center's financial position or results of operations.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE I - COMMITMENTS AND CONTINGENCIES - Continued

Operating Leases

The Medical Center leases equipment through lease agreements expiring on various dates through June 2025. Certain of these leases contain options to extend the lease terms. Lease expense for the years ended June 30, 2019 and 2018 was \$3,510,346 and \$3,625,704 respectively. Future minimum lease payments are as follows for the years ending June 30:

2020	\$ 3,188,851
2021	2,540,481
2022	1,688,865
2023	1,581,004
2024	1,177,575
Thereafter	2,243,698
	\$ 12,420,474

NOTE J - CONCENTRATIONS OF CREDIT RISK

The Medical Center grants credit without collateral to patients, most of whom are local residents and are insured under third-party agreements. The mix of accounts receivable from patients and third-party payors at June 30, 2019 and 2018 was as follows:

	2019	2018
Medicare	32%	30%
Blue Cross	10	10
Medicaid	23	24
Self-pay	18	16
Workers' compensation	1	2
Commercial and other	16	18
Total	100%	100%

In addition, the Medical Center invests its cash and cash equivalents primarily with banks and financial institutions. These deposits may be in excess of federally insured limits. Management believes that the credit risk related to these deposits is minimal.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE K - FUNCTIONAL EXPENSES

The Medical Center provides general health-care services to residents within its geographic location. Expenses related to providing these services for the years ended June 30, 2019 and 2018 are as follows:

	Health Care Services	General and Administrative	Total
<u>Year ended June 30, 2019</u>			
Salaries and benefits	\$240,176,738	\$134,002,856	\$374,179,594
Supplies and other expenses	159,751,047	57,660,141	217,411,188
Interest	4,722,727	-	4,722,727
Depreciation and amortization	37,456,084	-	37,456,084
	<u>\$442,106,596</u>	<u>\$191,662,997</u>	<u>\$633,769,593</u>
<u>Year ended June 30, 2018</u>			
Salaries and benefits	\$215,104,881	\$124,111,226	\$339,216,107
Supplies and other expenses	146,961,688	48,797,820	195,759,508
Interest	4,429,683	-	4,429,683
Depreciation and amortization	32,524,050	-	32,524,050
	<u>\$399,020,302</u>	<u>\$172,909,046</u>	<u>\$571,929,348</u>

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

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Medical Center measures fair value as the price that would be received to sell an asset or paid to transfer a liability (the exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures.

The fair value hierarchy is broken down into three levels based on the source of inputs: Level 1 - defined as observable inputs such as quoted prices in active markets; Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3 - defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

In determining fair value, the Medical Center uses the market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

In determining fair value, the Medical Center uses quoted prices and observable inputs. Observable inputs are inputs that market participants would use in pricing the assets or liabilities based on market data obtained from sources independent of the Medical Center.

Financial assets and liabilities carried at fair value are classified in the table below:

	Level 1	Level 2	Level 3	Total
<u>June 30, 2019</u>				
Assets				
Cash and cash equivalents	\$140,005,601	\$ -	\$ -	\$140,005,601
Government securities and corporate bonds	-	110,472,588	-	110,472,588
Equity securities	321,798,302	-	-	321,798,302
Beneficial interest in perpetual trusts	-	-	6,559,209	6,559,209
Total assets	\$461,803,903	\$110,472,588	\$ 6,559,209	\$578,835,700
Liabilities				
Interest rate swap	\$ -	\$ 594,965	\$ -	\$ 594,965
Total liabilities	\$ -	\$ 594,965	\$ -	\$ 594,965
<u>June 30, 2018</u>				
Assets				
Cash and cash equivalents	\$109,173,913	\$ -	\$ -	\$109,173,913
Government securities and corporate bonds	-	167,733,939	-	167,733,939
Equity securities	312,046,969	-	-	312,046,969
Beneficial interest in perpetual trusts	-	-	6,562,833	6,562,833
Total assets	\$421,220,882	\$167,733,939	\$ 6,562,833	\$595,517,654
Liabilities				
Interest rate swap	\$ -	\$ 609,526	\$ -	\$ 609,526
Total liabilities	\$ -	\$ 609,526	\$ -	\$ 609,526

Net unrealized (losses) gains on the Level 3 assets were (\$3,624) and \$155,668 for the years ended June 30, 2019 and 2018, respectively.

Bayhealth Medical Center, Inc.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2019 and 2018

NOTE M - SUBSEQUENT EVENTS

The Medical Center evaluated its June 30, 2019 financial statements for subsequent events through October 15, 2019, the date the financial statements were available to be issued. The Medical Center is not aware of any subsequent events which would require recognition or disclosure in the financial statements.



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