

Christiana Care Health Services, Inc.

**Consolidated Financial Statements
June 30, 2019 and 2018**

Christiana Care Health Services, Inc.

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June 30, 2019 and 2018

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Report of Independent Auditors

To the Board of Directors
of Christiana Care Health Services, Inc.

We have audited the accompanying consolidated financial statements of Christiana Care Health Services, Inc. ("Health Services"), which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations and changes in net assets, and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the 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 our 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, we consider internal control relevant to Health Services' 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 Health Services' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Christiana Care Health Services, Inc. as of June 30, 2019 and 2018, and the results of its operations, its 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.

PricewaterhouseCoopers LLP

August 22, 2019

Christiana Care Health Services, Inc.
Consolidated Balance Sheets
June 30, 2019 and 2018

	2019	2018
Assets		
Current assets		
Cash and cash equivalents	\$ 102,516,275	\$ 109,239,932
Short-term investments	188,510,758	184,648,494
Patient accounts receivable, net	304,981,613	284,783,184
Other current assets	<u>77,610,325</u>	<u>65,797,001</u>
Total current assets	673,618,971	644,468,611
Assets limited as to use		
Long-term investments	30,023,062	31,431,438
Property and equipment, net	1,726,015,688	1,625,497,705
Other assets	<u>1,102,948,508</u>	<u>902,263,865</u>
Total assets	<u>\$ 3,566,564,836</u>	<u>\$ 3,232,865,915</u>
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	\$ 164,735,000	\$ 170,670,000
Accounts payable	79,811,766	69,035,430
Accrued salaries and professional fees	149,999,608	127,167,574
Other accrued expenses and current liabilities	<u>73,964,127</u>	<u>65,794,496</u>
Total current liabilities	468,510,501	432,667,500
Long-term debt, net of current portion		
Pension and postretirement benefits	75,717,898	77,887,244
Self insurance liabilities	86,467,144	77,321,618
Other liabilities	<u>37,827,073</u>	<u>33,323,924</u>
Total liabilities	<u>821,312,250</u>	<u>654,876,121</u>
Net assets		
Without donor restrictions	2,683,951,067	2,519,198,396
With donor restrictions		
Purpose restricted	30,659,164	29,596,700
Perpetual in nature	<u>30,642,355</u>	<u>29,194,698</u>
Total net assets with donor restrictions	61,301,519	58,791,398
Total net assets	<u>2,745,252,586</u>	<u>2,577,989,794</u>
Total liabilities and net assets	<u>\$ 3,566,564,836</u>	<u>\$ 3,232,865,915</u>

The accompanying notes are an integral part of these consolidated financial statements.

Christiana Care Health Services, Inc.
Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2019 and 2018

	2019	2018
Operating revenues and other support		
Net patient service revenue	\$ 1,973,908,782	\$ 1,878,902,576
Other revenue	64,352,591	61,696,620
Net assets released from donor restrictions used for operations	2,125,515	3,242,083
Total operating revenues and other support	<u>2,040,386,888</u>	<u>1,943,841,279</u>
Operating expenses		
Salaries and employee benefits	1,207,870,374	1,132,391,117
Supplies and other expenses	608,875,670	600,528,185
Interest expense	3,621,366	3,634,393
Depreciation expense	102,060,631	98,411,493
Total operating expenses	<u>1,922,428,041</u>	<u>1,834,965,188</u>
Operating income	<u>117,958,847</u>	<u>108,876,091</u>
Nonoperating revenues, gains, and losses		
Investment return, net	99,524,924	142,653,187
Other nonoperating (losses), revenues, and gains	(3,154,865)	889,396
Total nonoperating revenues, gains, and losses	<u>96,370,059</u>	<u>143,542,583</u>
Excess of revenues over expenses	<u>\$ 214,328,906</u>	<u>\$ 252,418,674</u>

(continued on next page)

The accompanying notes are an integral part of these consolidated financial statements.

Christiana Care Health Services, Inc.
Consolidated Statements of Operations and Changes in Net Assets
Years Ended June 30, 2019 and 2018

	2019	2018
Change in net assets without donor restrictions		
Excess of revenues over expenses	\$ 214,328,906	\$ 252,418,674
Net assets released from donor restrictions used for purchase of property and equipment	6,594,666	829,394
Other changes in pension and postretirement liabilities	<u>(56,170,901)</u>	<u>(8,631,474)</u>
Increase in net assets without donor restrictions	<u>164,752,671</u>	<u>244,616,594</u>
Change in net assets with donor restrictions		
Contributions	7,631,539	3,236,805
Investment return, net	1,551,791	3,148,677
Change in interest in net assets of the System	2,083,747	(8,887)
Net assets released from donor restrictions	(8,720,181)	(4,071,477)
Change in value of assets	<u>(36,775)</u>	<u>253,357</u>
Increase in net assets with donor restrictions	<u>2,510,121</u>	<u>2,558,475</u>
Increase in net assets	167,262,792	247,175,069
Net assets		
Beginning of year	<u>2,577,989,794</u>	<u>2,330,814,725</u>
End of year	<u>\$ 2,745,252,586</u>	<u>\$ 2,577,989,794</u>

The accompanying notes are an integral part of these consolidated financial statements.

Christiana Care Health Services, Inc.
Consolidated Statements of Cash Flows
Years Ended June 30, 2019 and 2018

	2019	2018
Cash flows from operating activities		
Change in net assets	\$ 167,262,792	\$ 247,175,069
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Net realized and unrealized gains on investments	(68,899,939)	(118,182,100)
Depreciation and amortization	102,106,285	98,345,757
Change in interest in net assets of the System	(2,083,747)	8,887
Restricted contributions and investment income received	(772,923)	(3,795,127)
Other changes in pension and postretirement benefits	56,170,901	8,631,474
(Increase) decrease in		
Patient accounts receivable	(20,198,428)	(45,747,311)
Other current assets	(11,813,325)	(597,113)
Other assets	(2,670,565)	955,631
Increase (decrease) in		
Accounts payable, accrued salaries, and other accrued expenses	23,366,912	12,027,582
Pension and postretirement benefits	(46,372,118)	(4,123,967)
Self insurance liabilities	4,503,149	8,743,619
Other liabilities	3,410,108	7,964,268
Net cash provided by operating activities	<u>204,009,102</u>	<u>211,406,669</u>
Cash flows from investing activities		
Purchase of property and equipment	(170,461,266)	(143,540,949)
Proceeds from sale of investments and assets limited as to use	822,519,348	848,500,359
Purchase of investments and assets limited as to use	<u>(856,393,861)</u>	<u>(878,669,572)</u>
Net cash used in investing activities	<u>(204,335,779)</u>	<u>(173,710,162)</u>
Cash flows from financing activities		
Repayment of long-term debt	(8,150,000)	(7,945,000)
Securities lending	980,097	120,937
Restricted contributions and investment income received	<u>772,923</u>	<u>3,795,127</u>
Net cash (used in) financing activities	<u>(6,396,980)</u>	<u>(4,028,936)</u>
Net (decrease) increase in cash and cash equivalents	(6,723,657)	33,667,571
Cash and cash equivalents		
Beginning of year	<u>109,239,932</u>	<u>75,572,361</u>
End of year	<u>\$ 102,516,275</u>	<u>\$ 109,239,932</u>
Supplemental disclosure of cash flow information		
Cash paid for interest, net of amounts capitalized	\$ 2,665,961	\$ 3,777,861
Accrued property and equipment acquisitions	13,227,518	11,680,145
Assets acquired under capital leases	119,056,489	-

The accompanying notes are an integral part of these consolidated financial statements.

Christiana Care Health Services, Inc.

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

1. Description of the Organization

Christiana Care Health Services, Inc. (“Health Services”), a Delaware not-for-profit corporation, owns and operates: Christiana Hospital, Wilmington Hospital, a free-standing emergency department, a physician network, residency training programs, and numerous ambulatory and physician office locations. Health Services’ primary activity is to provide healthcare services to the residents of Delaware and the surrounding counties in Maryland, Pennsylvania, and New Jersey.

On May 1, 2019, Health Services created a wholly owned subsidiary, Christiana Care Insurance Company, Ltd (“Captive”), which is incorporated under the laws of the Cayman Islands. The primary purpose of the Captive is to direct issue primary medical professional liability and primary general liability insurance coverage to Health Services. The Captive also reinsures excess umbrella liability coverage to Health Services. The activities of the Captive are more fully described in Note 13.

Health Services is an affiliate of Christiana Care Health System, Inc. (the “System”). The System is the parent organization of Health Services, Christiana Care Health Initiatives (“Health Initiatives”), Christiana Care Home Health and Community Services, Inc. (“CCHHCS”) and Christiana Care Health Plans, Inc. (“Health Plans”).

2. Summary of Significant Accounting Policies

Basis of Presentation

Health Services’ consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the assets, liabilities, net assets, revenues, and expenses of Health Services and all wholly owned subsidiaries after the elimination of all significant intercompany transactions and balances.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Future events and their effects cannot be predicted with certainty; accordingly, the accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of Health Services’ consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as the operating environment changes. Health Services evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluation, as considered necessary. Actual results could differ from those estimates.

Significant estimates include, but are not limited to, net realizable value of patient accounts receivables, useful lives of property and equipment, the valuation of certain investments, actuarially determined pension and postretirement benefits, and medical and professional liability and other self-insurance reserves.

Christiana Care Health Services, Inc.

Notes to Consolidated Financial Statements

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Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less. At June 30, 2019 and 2018, Health Services had cash balances in financial institutions which exceed federal depository insurance limits and therefore, bears a risk of loss. However, management believes that the credit risk related to these deposits is minimal, as it has not experienced such losses on these funds.

Patient Accounts Receivable

Patient accounts receivable are reported at the amounts that reflect the consideration to which Health Services expects to be entitled in exchange for providing patient care, as further described in Note 3. Patient accounts receivable consists of amounts owed by various governmental agencies, insurance companies, and patients. Health Services manages these receivables by regularly reviewing the accounts and contracts and by recording appropriate price concessions. Amounts that Health Services receives for the treatment of patients covered by governmental programs and third-party payors, as well as directly from patients, are subject to both explicit and implicit price concessions. Health Services estimates these price concessions using contractual agreements, discount policies, and historical experience. Health Services writes off amounts that have been deemed uncollectible because of circumstances that affect the ability of payors to make payments as they occur.

Inventories

Inventories primarily consist of medical and surgical supplies and pharmaceuticals. Inventories are valued at the lower of cost (determined by the first-in, first-out method) or market (defined as net realizable value).

Investments and Assets Limited as to Use

Investments and assets limited as to use are measured at fair value in the balance sheets based on the methodology described in Note 5. Investment income or loss (consisting of realized and unrealized gains and losses on investments, interest, and dividends) are included in the excess of revenues over expenses unless the income or loss is restricted by donors.

Managed funds represent subscriptions in funds-of-funds and managed equity common funds utilized to diversify the portfolio of Health Services. As a practical expedient, Health Services estimates the fair value of managed funds using the reported net asset value (NAV). Health Services has assessed factors such as the managed funds' compliance with fair value reporting standards, price transparencies and valuation procedures, the ability to redeem at NAV at the measurement date, and existence of redemption restrictions at the measurement dates. Health Services is required to provide written notice of at least 90 calendar days prior to a calendar quarter-end to redeem managed funds-of-funds. Managed equity common funds are subject to redemption on a monthly basis. Requests accepted in the prior month, subject to terms, are redeemed on the first of the subsequent month. There are no lock-up provisions.

Health Services classifies investments as trading securities. Investment income or loss generated by trading securities is classified within nonoperating revenues, gains, and losses within the consolidated statement of operations and changes in net assets. Health Services considers the activity of the investment portfolio and the associated cash receipts and cash purchases resulting from purchases and sales of investments classified as trading securities as an investing activity and classifies this activity accordingly within the consolidated statements of cash flows.

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Notes to Consolidated Financial Statements

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Assets limited as to use include designated assets set aside by Health Services' Board of Directors ("Board"). During 2018, the Board designated \$5 million to support the Center for Translational Cancer Research (CTCR) at the Helen F. Graham Cancer Center, and these assets are classified as assets limited as to use in the June 30, 2019 and June 30, 2018 consolidated balance sheets.

Property, Equipment, and Depreciation

Property and equipment acquisitions are recorded at cost. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation is computed using the straight-line method based on the following estimated useful lives: Buildings and building improvements 5-40 years, equipment 3-20 years. Leasehold improvements are depreciated using the lesser of the lease term or the useful life of the improvement. Gains and losses from retirement or disposition of fixed assets are recognized in the consolidated statement of operations and changes in net assets as a nonoperating activity. There were no significant disposals of property and equipment for the years ended June 30, 2019 and 2018. 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.

Gifts of long-lived assets such as land, buildings, or equipment are reported as net assets without donor restrictions at fair value as of the date of the gift, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as net assets with donor restrictions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Leases

Lease agreements, which primarily include Health Services' rental of office facilities, are evaluated to determine whether they are capital or operating leases in accordance with Accounting Standards Codification 840, Leases ("ASC 840"). If substantially all of the risks and benefits of property ownership have been transferred to Health Services, as determined by the criteria in ASC 840, the lease then qualifies as a capital lease. Capital leases are capitalized at the lower of the net present value of the total amount of rent payments under the lease agreement or the fair market value of the leased asset. Capital lease assets are depreciated on a straight-line basis over a period consistent with Health Services' depreciation policy for property and equipment. Interest charges are expensed over the period of the lease in relation to the carrying value of the capital lease obligation.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. Health Services' policy is to record an impairment loss when it is determined that the carrying amount of the asset exceeds the sum of the expected undiscounted future cash flows resulting from use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell. No significant impairment charges were recorded in the years ended June 30, 2019 and June 30, 2018.

Christiana Care Health Services, Inc.

Notes to Consolidated Financial Statements

June 30, 2019 and 2018

Securities Lending

Health Services engages in securities lending whereby certain securities in its portfolio are loaned to other parties generally for a short period of time. Health Services receives collateral equal to 100% of the market value of securities borrowed. Health Services records the fair value of the collateral received as a component of both other current assets and other current liabilities as Health Services is obligated to return the collateral upon the return of the borrowed securities. Other current assets and liabilities include \$1,131,236 and \$151,139 of collateral investments at June 30, 2019 and 2018, respectively.

Bond Issuance Costs

Bond Issuance costs are recorded as a direct deduction from long-term debt and represent the cost of issuing long-term debt. Such costs are amortized over the life of the applicable indebtedness using the interest method.

Interest in the System

Health Services records an interest in certain net assets of the System resulting from donor restricted contributions that were solicited and held by the System for the ultimate benefit of Health Services. An interest in the net assets of the System is recorded within other assets in the balance sheet. The change in the value of the interest in the net assets of the System is recorded as a change in net assets with donor restrictions. The interest in the System was \$8,119,092 and \$6,035,345 as of June 30, 2019 and June 30, 2018, respectively.

Investments Held in Trust

Health Services is entitled to beneficial interests in perpetual trusts at various percentages, which are maintained by outside trustees. Health Services' share of the market value of the trusts is recorded in net assets with donor restrictions and is updated on an annual basis. The change in value of the assets is recorded within net assets with donor restrictions. The periodic income distributions received from the trustees are recorded as increases in either net assets without restrictions or net assets with donor restrictions, based on the donors' intentions.

Compensated Paid Leave

Health Services records a liability in accrued salaries and professional fees for amounts due to employees for future paid leave which are attributable to services performed in the current and prior periods.

Net Assets

Health Services reports its net assets as either net assets without donor restrictions or net assets with donor restrictions. Net assets without donor restrictions include undesignated amounts as well as amounts designated by the Board for a specific purpose. Net assets with donor restrictions are those assets whose use has been limited by donors to a specific purpose or maintained by Health Services in perpetuity.

Net assets that are perpetual in nature include gifts, trusts, income, and gains that are required by donor imposed restrictions to be maintained in perpetuity. Investment return derived from net assets that are perpetual in nature may be spent for general or specific purposes in accordance with donor imposed restrictions, based on the amounts appropriated for expenditure annually by Health Services' endowment spending policy.

Christiana Care Health Services, Inc.

Notes to Consolidated Financial Statements

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Net assets that are donor restricted for a purpose include gifts, income, and gains for which donor imposed restrictions have not yet been met. Such restrictions are purpose restrictions imposed by donors, which are normally released upon the incurrence of expenditures that fulfill those donor specified purposes.

Donor Restricted Contributions

Unconditional promises to give cash and other assets to Health Services are reported at fair value at the date the promise is received. Contributions 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 purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statement of operations and changes in net assets as net assets released from donor restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reported as net assets without donor restrictions in the accompanying consolidated financial statements.

Excess of Revenues Over Expenses

The consolidated statement of operations and changes in net assets includes excess of revenues over expenses. Changes in net assets without donor restrictions which are excluded from excess of revenues over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and other changes in pension and postretirement liabilities.

Tax Status

Health Services is a Delaware not-for-profit corporation and has been recognized as tax-exempt pursuant to Section 501(c) (3) of the Internal Revenue Code.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2016-02 on *Leases*, which amends the accounting for leases, requiring lessees to recognize most leases on their balance sheet with a right-of-use asset and corresponding lease liability. The liability will be equal to the present value of future minimum lease payments, and the asset will be based on the liability, subject to adjustment for certain costs. Leases will be classified as either finance or operating leases, which will impact the manner and timing of expense recognition of such leases over the lease term. Leases will be classified based on criteria similar to those applied in current lease accounting. The accounting by lessors remains largely unchanged. This standard is effective for Health Services beginning in fiscal year 2020. Health Services expects this standard to impact its balance sheet as it will have to recognize a right-of-use asset and corresponding lease liability for each operating lease. Health Services does not expect the standard to significantly impact its consolidated statement of operations and changes in net assets, its liquidity, or debt covenants.

Christiana Care Health Services, Inc.

Notes to Consolidated Financial Statements

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Recently Adopted Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. The new guidance requires improved presentation and disclosures to help not-for-profit entities provide more relevant information about their resources to donors, grantors, creditors, and other users of the consolidated financial statements. Health Services adopted this new standard in fiscal year 2019. The primary changes affecting Health Services include: presentation of two classes of net assets versus the previously required three; liquidity and availability; and disclosure of expenses by both their natural and functional classification in a matrix format. These changes have been reflected within the consolidated financial statements and notes herein.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Previously, net benefit cost was reported as an employee cost within excess of revenues over expenses from operations (or capitalized into assets when appropriate). This standard requires the bifurcation of net benefit cost, as follows: service cost will continue to be reported in employee benefits, while the remaining components of net benefit cost will be reported in nonoperating revenue, gains, and losses. Although this standard is not effective until fiscal year 2020, Health Services elected to early adopt the new guidance beginning in fiscal year 2019. As a result of implementing this standard, \$1,241,150 was reclassified from salaries and employee benefits within operating expenses to non-operating revenues, gains, and losses on the consolidated statement of operations and changes in net assets for the year ended June 30, 2018.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. The new standard applies to all entities that receive or make contributions. The new guidance shifts the accounting for revenue recognition for most federal and state grants from an exchange model to the contribution accounting model. Thus, grants are referred to as “contributions” and granting agencies are referred to as “donors.” Further, the guidance provides criteria for evaluating whether contributions are unconditional or conditional. Conditional contributions must specify a barrier that the recipient must overcome and a right of return that releases the donor from its obligation if the barrier is not achieved, otherwise the contribution is unconditional. Health Services adopted this new accounting standard in fiscal year 2019. There was no significant impact to the consolidated financial statements.

Health Services receives grants from various agencies, including Federal and State Governments, for the purpose of furthering its mission. The grants are carried out for research and other activities that benefit the general public and not for the sole purpose of the awarding agencies. The majority of grants are cost reimbursable, meaning that research and grant revenue is recognized when the related costs are incurred. Thus, at any point in time, Health Services has government grants that are considered conditional under the new standard. These grants are considered conditional due to the need to first spend the awarded funds on qualifying expenses and a right of return exists for unexpended awards. As of June 30, 2019, Health Services had \$8,741,013 of conditional contributions for which the conditions have not been met.

Christiana Care Health Services, Inc.
Notes to Consolidated Financial Statements
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3. Revenue Recognition and Accounts Receivable

In May 2014, the FASB issued several ASUs which established Topic 606, *Revenue from Contracts with Customers*. This standard supersedes existing revenue recognition guidance and creates a single framework for revenue recognition. The core principle of the new guidance 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 and services. Qualitative and quantitative disclosures are required to enable users of consolidated financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The applicable disclosures are described in this note.

Health Services adopted the new standard on July 1, 2018, using the full retrospective transition method. Adoption of the standard impacted Health Services reported results as follows:

	Year Ended June 30, 2018			
	As Reported	Reclassifications	As Adjusted	Adoption Impact
Consolidated Statement of Operations and Changes in Net Assets				
Net patient service revenue	\$ 1,929,153,407	\$ (50,250,831)	\$ 1,878,902,576	\$ (50,250,831)
Provision for bad debts	(50,250,831)	50,250,831	-	50,250,831
Other revenue	61,696,620		61,696,620	
Net assets released from donors' restrictions used for operations	3,242,083		3,242,083	
Total operating revenues and other support	\$ 1,943,841,279	\$ -	\$ 1,943,841,279	\$ -
Consolidated Statement of Cash Flows				
Provision for bad debts	50,250,831	(50,250,831)	-	(50,250,831)
Change in patient accounts receivable	(95,998,142)	50,250,831	(45,747,311)	50,250,831

Adoption of the standard had no impact on Health Services' opening net assets.

Net Patient Service Revenue

Health Services' revenues generally relate to contracts with patients in which Health Services' performance obligations are to provide health care services to the patients. Net patient service revenue is reported at the amount that reflects the consideration to which Health Services expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including government programs and commercial insurance companies), and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, Health Services bills the patient and third-party payors several days after the services are performed and/or the patient is discharged from a facility. Revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by Health Services. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred. Health Services 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.

Christiana Care Health Services, Inc.
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Generally, performance obligations satisfied over time relate to patients in our hospitals or physician practices receiving health care services. Health Services measures the performance obligation from admission into the hospital, or the commencement of an outpatient service, to the point when there are no further services required for the 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 or services are provided to our patients and customers in a retail setting (for example, pharmaceuticals), and Health Services does not believe it is required to provide additional goods or services to the patient. Because all of its performance obligations relate to contracts with a duration of less than one year, Health Services has elected to apply the practical expedient provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amounts 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 satisfied 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.

Health Services determines the transaction price based on standard charges for the services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured or underinsured patients in accordance with Health Services' policies, and/or implicit price concessions provided to uninsured or underinsured patients. Health Services determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. Health Services determines its estimate of implicit price concessions based on its historical collection experience with these classes of patients using a portfolio approach as a practical expedient. The portfolio approach is being used as Health Services has a large volume of similar contracts with similar classes of patients. Management's judgement to group the contracts by portfolio is based on the payment behavior expected in each portfolio category. Health Services reasonably expects that the effect of applying a portfolio approach to a group of contracts would not differ materially from considering each contract separately.

Agreements with third-party payors typically provide for payments at amounts less than established charges. For services provided under Medicare, inpatient acute care services rendered to program beneficiaries are paid at prospectively determined rates per diagnosis. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Medicare outpatient services are paid at a prospectively determined rate. Medicare physician services are paid based upon established fee schedules. Additionally, Medicare provides reimbursement for direct graduate medical education, certain allied health professional training, and organ procurement on the basis of cost. This cost, and data influencing add-on payments for uncompensated care and indirect medical education, is determined based upon information contained in the annual Medicare cost report submission. Health Services is reimbursed for these cost related items and the applicable add-ons included in the Medicare cost report at a tentative rate. Final settlements are determined after audits of the cost report data by the fiscal intermediary. For services provided under Medicaid, inpatient acute services are paid prospectively based upon two primary case rates, with adjustment for outliers. Medicaid outpatient services are paid at a prospectively determined rate. Payment arrangements with commercial insurance carriers include prospectively determined rates per discharge and discounts from established charges.

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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. Cost report settlements under reimbursement agreements with Medicare that result in retroactive adjustments due to audits, reviews or investigations are considered variable 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 Health Services' historical experience. Estimated settlements are adjusted in future periods as final settlements are determined. The 2019 and 2018 net patient service revenue increased \$1,926,176 and \$1,346,964, respectively, because of tentative settlements, final settlements, and final appeals for years that are no longer subject to audits, reviews, and investigations, as well as other changes in estimates. In addition, the contracts Health Services has with commercial payors also provide for retroactive audit and review of claims.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. Health Services also provides services to uninsured and underinsured patients. The transaction price for both uninsured patients as well as insured patients with deductibles and coinsurance is estimated 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. 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 results of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense is reported in operating expenses in the statements of operations and changes in net assets and was not significant for the years ended June 30, 2019 and 2018.

The composition of net patient service revenues by payor for the years ended June 30, 2019 and June 30, 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 626,286,363	\$ 597,386,775
Medicaid	270,019,976	252,407,576
Commercial insurance	989,177,926	941,323,553
Self-pay and other	88,424,517	87,784,672
Total	<u>\$ 1,973,908,782</u>	<u>\$ 1,878,902,576</u>

Revenue from patients' deductibles and coinsurance is included in the preceding categories based on the primary payor and is transferred to self-pay after consideration is received from the primary payor. Self-pay and other, which includes auto insurance, worker's compensation, pending Medicaid, and other commercial insurance payers, are grouped together because they share similar historical collection patterns.

Health Services 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 Health Services' 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, Health Services 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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Other Revenue

Other revenue consists primarily of research and grant revenue, retail pharmacy revenue, revenue from services agreements, affiliate revenue, rental revenue, and cafeteria revenue. For the majority of its grants, Health Services has determined that there is not exchange back to the granting agency. Therefore, Health Services accounts for these grants under the contribution model of accounting in ASC Topic 958, *Not-for-Profit Entities*, which is outside the scope of ASC 606, and revenue is recognized as expenses for these grants are incurred. Health Services' retail pharmacies offer a full inventory of standard, specialty, and over-the-counter medications, and retail pharmacy revenue is recognized as prescriptions are filled. Revenue from service agreements with third parties is recognized when performance obligations under the terms of the respective contract are satisfied. Affiliate revenue is charged primarily for the usage of Health Services personnel and office facilities by non-consolidating affiliates. Health Services recognizes rental income on a straight-line basis over the lease term in accordance with ASC Topic 840, *Leases*. Health Services' cafeterias offer food and beverage products to our visitors and employees, and revenue is recognized when the goods are exchanged. The composition of other revenue for the years ended June 30, 2019 and June 30, 2018 are as follows:

	2019		2018	
Research and grant revenue	\$ 18,671,742	29.0%	\$ 20,004,000	32.4%
Retail pharmacy revenue	15,266,061	23.7%	14,556,629	23.6%
Service agreements	12,629,035	19.6%	13,744,498	22.3%
Affiliate revenue	8,595,865	13.4%	5,365,174	8.7%
Rental revenue	3,463,528	5.4%	3,772,248	6.1%
Cafeteria revenue	3,951,059	6.1%	3,760,543	6.1%
Other	1,775,301	2.8%	493,528	0.8%
Other Revenue	\$ 64,352,591	100.0%	\$ 61,696,620	100.0%

4. Charity Care and Community Benefit

In accordance with Health Services' mission to improve the health of Delaware and the surrounding counties of Maryland, Pennsylvania, and New Jersey, Health Services provides care to patients regardless of their ability to pay. Health Services provides care to these patients, who meet certain criteria under Health Services' charity care policy, without charge or at amounts less than its established rates. Criteria for charity care considers the patient's family income, net worth, and other factors. Because Health Services does not pursue collections of amounts determined to qualify as charity care, they are not reported as revenue.

Direct and indirect costs for charity care services amounted to \$15.7 million and \$22.6 million in 2019 and 2018, respectively. The costs of providing charity care services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients.

Health Services also offers discounts for uninsured patients who do not qualify for the charity care program and provides flexible, long-term payment plans for patients. In addition, Health Services also provides services to beneficiaries of public programs and various other community health services intended to improve the health of communities in which it operates.

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Health Services uses the following four categories to identify the resources utilized for the care of persons who are underserved and for providing community benefit programs to the needy:

- Traditional charity care, which includes the cost of services provided to persons who cannot afford health care because of inadequate resources and who are uninsured.
- Unpaid cost of Medicare, which represents the unpaid cost of services provided to persons through the government program for individuals age 65 and older as well as those that qualify for federal disability benefits.
- Unpaid cost of Medicaid, which represents the unpaid cost of services provided to persons covered by the government program for medically indigent patients.
- Community benefit programs consist of the unreimbursed costs of certain programs and services for the general community, mainly for indigent patients but also for people with chronic health risks. Examples of these programs include health promotion and education, free clinics and screenings, and other community services.

5. Investments, Assets Limited as to Use, and Investment Income

The composition of investments and assets limited as to use at June 30, 2019 and 2018 is set forth in the following table. Investments and assets limited as to use are stated at fair value.

	2019	2018
Short-term investments	<u>\$ 188,510,758</u>	<u>\$ 184,648,494</u>
Assets limited as to use		
Internally designated by Board of Directors		
Infant mortality	13,461,771	14,537,698
Harrington VIP/VICP fund	11,231,384	11,648,345
Translational Cancer Research	<u>5,329,907</u>	<u>5,245,395</u>
Total assets limited as to use	<u>30,023,062</u>	<u>31,431,438</u>
Long-term investments		
Without donor restrictions	1,672,829,039	1,572,828,480
Purpose restricted	23,373,295	23,755,578
Perpetual in nature	<u>29,813,354</u>	<u>28,913,647</u>
Total long-term investments	<u>1,726,015,688</u>	<u>1,625,497,705</u>
Total investments and assets limited as to use	<u>\$ 1,944,549,508</u>	<u>\$ 1,841,577,637</u>

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Within the consolidated statement of operations and changes in net assets, investment return without donor restrictions for June 30, 2019 and 2018 is comprised of the following:

	2019	2018
Interest and dividend income	\$ 31,726,178	\$ 27,467,614
Net realized gains	47,068,018	26,815,554
Net unrealized gains	<u>20,730,728</u>	<u>88,370,019</u>
	<u>\$ 99,524,924</u>	<u>\$ 142,653,187</u>

Similarly, investment return with donor restrictions for June 30, 2019 and 2018 is comprised of the following:

	2019	2018
Interest and dividend income	\$ 413,825	\$ 405,507
Net realized gains	853,354	574,680
Net unrealized gains	<u>284,612</u>	<u>2,168,490</u>
	<u>\$ 1,551,791</u>	<u>\$ 3,148,677</u>

Investment return is shown net of the related expenses on the consolidated statement of operations and changes in net assets.

Health Services adheres to applicable accounting guidance for fair value measurements and defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Health Services applies the following fair value hierarchy:

- Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets include money market funds, debt and equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. Governments and agency securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2 Observable inputs other than Level 1 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 same term of the assets or liabilities. Level 2 assets include equity and debt securities with quoted prices that are traded less frequently than exchange-traded instruments whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

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Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets include investments held in trust by others whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Transfers between levelled assets are based on the actual date of the event which caused the transfer. As of June 30, 2019 and 2018 there were no transfers between Level 1, 2, and 3. The following table presents the financial instruments carried at fair value as of June 30, 2019 in accordance with the fair value hierarchy:

	Level 1	Level 2	Level 3	Total
Investments and assets limited as to use				
Money market funds	\$ 278,594,169	\$ -	\$ -	\$ 278,594,169
U.S. Government and agency securities	96,118,979	-	-	96,118,979
Corporate and other debt securities	-	466,556,509	-	466,556,509
Equity securities	633,909,952	185,579,875	-	819,489,827
Investments held in trust by others	-	-	8,460,320	8,460,320
Total investments and assets limited as to use	<u>1,008,623,100</u>	<u>652,136,384</u>	<u>8,460,320</u>	<u>1,669,219,804</u>
Total assets at fair value	<u>\$ 1,008,623,100</u>	<u>\$ 652,136,384</u>	<u>\$ 8,460,320</u>	<u>1,669,219,804</u>
Other investments measured at net asset value				275,329,704
Total assets at fair value				<u>\$ 1,944,549,508</u>

The following table illustrates the change in Level 3 assets:

	Investments Held by Others
Fair value June 30, 2018	\$ 8,497,095
Change in value of assets	<u>(36,775)</u>
Fair value June 30, 2019	<u>\$ 8,460,320</u>

The following table presents the financial instruments carried at fair value as of June 30, 2018 in accordance with the fair value hierarchy:

	Level 1	Level 2	Level 3	Total
Investments and assets limited as to use				
Money market funds	\$ 238,358,406	\$ -	\$ -	\$ 238,358,406
U.S. Government and agency securities	115,276,954	-	-	115,276,954
Corporate and other debt securities	-	436,582,422	-	436,582,422
Equity securities	606,428,857	175,752,414	-	782,181,271
Investments held in trust by others	-	-	8,497,095	8,497,095
Total investments and assets limited as to use	<u>960,064,217</u>	<u>612,334,836</u>	<u>8,497,095</u>	<u>1,580,896,148</u>
Total assets at fair value	<u>\$ 960,064,217</u>	<u>\$ 612,334,836</u>	<u>\$ 8,497,095</u>	<u>1,580,896,148</u>
Other investments measured at net asset value				260,681,489
Total assets at fair value				<u>\$ 1,841,577,637</u>

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The following table illustrates the change in Level 3 assets:

	Investments Held by Others
Fair value June 30, 2017	\$ 7,821,873
Contribution	421,865
Change in value of assets	<u>253,357</u>
Fair value June 30, 2018	<u>\$ 8,497,095</u>

6. Property and Equipment

A summary of property and equipment at June 30, 2019 and 2018 is as follows:

	2019	2018
Land and land improvements	\$ 69,965,646	\$ 69,016,752
Buildings and building improvements	1,376,556,992	1,191,321,509
Equipment	<u>739,636,536</u>	<u>689,498,716</u>
	2,186,159,174	1,949,836,977
Accumulated depreciation	<u>(1,285,542,568)</u>	<u>(1,183,800,072)</u>
	900,616,606	766,036,905
Construction-in-progress	<u>202,331,902</u>	<u>136,226,960</u>
	<u>\$ 1,102,948,508</u>	<u>\$ 902,263,865</u>

Depreciation expense amounted to \$102,060,631 and \$98,411,493 in 2019 and 2018, respectively. In 2019 and 2018, Health Services incurred total interest costs of \$6,152,000 and \$5,678,414, respectively, of which \$3,841,863 in 2019 and \$2,091,376 in 2018 has been capitalized. At June 30, 2019 construction contracts of \$265,284,827 exist primarily for various expansion and other facility improvements. The remaining commitment on these contracts was \$104,093,354.

Capital Leases

On March 1, 2019, Health Services entered into a lease agreement with an unrelated party for the lease of an office facility in Wilmington, Delaware. The lease term is 21 years, and the lease has been recorded as a capital lease. Health Services also leases an office facility in New Castle, Delaware, which was classified as a capital lease and is included in the table below. The total leased property of \$125,284,638 and \$7,473,779 is reflected in property and equipment as of June 30, 2019 and 2018, respectively. Accumulated depreciation on the leased assets was \$1,889,786 as of June 30, 2019. Depreciation expense on these leased assets is included within depreciation expense in the consolidated statements of operations and changes in net assets.

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Future minimum lease payments under capital leases are as follows:

2020	\$ 3,786,247
2021	8,582,726
2022	8,613,507
2023	8,644,928
2024	8,677,633
Thereafter	134,945,391

Less: Amount representing interest \$ 46,870,112

Present value of minimum lease payments \$ 126,380,320

The amount necessary to reduce minimum lease payments to present value is calculated at Health Services' incremental borrowing rate at lease inception. Health Services reflects a noncurrent lease liability in the consolidated balance sheet of \$120,920,674 and \$6,228,149 in 2019 and 2018, respectively.

7. Other Current Assets and Other Assets

Other Current Assets at June 30, 2019 and 2018 consist of the following:

	2019	2018
Inventories	\$ 32,314,006	\$ 27,443,400
Prepaid expenses	17,570,072	17,016,122
Other	27,726,247	21,337,479
	<u>\$ 77,610,325</u>	<u>\$ 65,797,001</u>

Other Assets at June 30, 2019 and 2018 consist of the following:

	2019	2018
Interest in the System	\$ 8,119,092	\$ 6,035,345
Goodwill	1,015,805	1,015,805
Other receivables	15,941,437	15,804,982
Other	8,882,273	6,348,164
	<u>\$ 33,958,607</u>	<u>\$ 29,204,296</u>

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8. Net Assets with Donor Restrictions

Net assets with donor restrictions are funds limited by donors to a specific purpose or maintained by Health Services in perpetuity.

Net assets with donor restrictions are available for the following purposes at June 30, 2019 and 2018:

	2019	2018
Health care services	\$ 3,388,317	\$ 3,378,955
Purchases of buildings and equipment	11,966,932	10,851,152
Education, research, and other operational needs	<u>15,303,915</u>	<u>15,366,593</u>
	<u>\$ 30,659,164</u>	<u>\$ 29,596,700</u>

Net assets with donor restrictions that are perpetual in nature consist of the following at June 30, 2019 and 2018:

	2019	2018
Investments held in perpetuity	\$ 22,182,035	\$ 20,697,603
Investments held in trust by others	<u>8,460,320</u>	<u>8,497,095</u>
	<u>\$ 30,642,355</u>	<u>\$ 29,194,698</u>

9. Endowments

Health Services' endowment consists of twenty-three individual donor restricted endowment funds and three board-designated endowment funds for a variety of purposes. The endowment includes both donor restricted endowment funds and funds designated by the Board to function as endowments. The net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions. In accordance with Health Services' endowment spending policy, annual distributions are 5% of the fiscal year-end value of the endowment pool calculated on a 36-month trailing average of the market value.

Health Services has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Health Services classifies as net assets that are perpetual in nature, (a) the original value of gifts donated to the endowment, (b) the original value of subsequent gifts to the endowment, and (c) accumulations to the endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified as net assets that are perpetual in nature is classified as net assets that are purpose restricted until those amounts are appropriated for expenditure on an annual basis by the Board in a manner consistent with the standard of prudence prescribed by UPMIFA.

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Endowment net asset composition by type of fund as of June 30, 2019 and 2018:

	Without Donor Restrictions	With Donor Restrictions	Total
	2019		
Endowment funds			
Donor restricted	\$ -	\$ 37,313,788	\$ 37,313,788
Board designated	30,023,062	-	30,023,062
Total endowment funds	<u>\$ 30,023,062</u>	<u>\$ 37,313,788</u>	<u>\$ 67,336,850</u>

	Without Donor Restrictions	With Donor Restrictions	Total
	2018		
Endowment funds			
Donor restricted	\$ -	\$ 37,700,697	\$ 37,700,697
Board designated	31,431,438	-	31,431,438
Total endowment funds	<u>\$ 31,431,438</u>	<u>\$ 37,700,697</u>	<u>\$ 69,132,135</u>

Changes in endowment net assets for the year ended June 30, 2019 and 2018:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, June 30, 2018	\$ 31,431,438	\$ 37,700,697	\$ 69,132,135
Investment return, net	293,770	1,551,791	1,845,561
Contributions	-	518,673	518,673
Appropriation of endowment assets for expenditure	<u>(1,702,146)</u>	<u>(2,457,373)</u>	<u>(4,159,519)</u>
Endowment net assets, June 30, 2019	<u>\$ 30,023,062</u>	<u>\$ 37,313,788</u>	<u>\$ 67,336,850</u>

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, June 30, 2017	\$ 67,490,424	\$ 35,246,606	\$ 102,737,030
Investment return, net	4,028,872	3,148,677	7,177,549
Contributions	-	1,197,900	1,197,900
Removal of board-designation	(39,129,436)	-	(39,129,436)
Appropriation of endowment assets for expenditure	<u>(958,422)</u>	<u>(1,892,486)</u>	<u>(2,850,908)</u>
Endowment net assets, June 30, 2018	<u>\$ 31,431,438</u>	<u>\$ 37,700,697</u>	<u>\$ 69,132,135</u>

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Description of amounts classified as net assets with donor restrictions (endowments only):

	2019	2018
Endowment funds restricted for specific purpose		
Restricted for health care services	\$ 3,219,851	\$ 3,206,507
Restricted for purchases of building and maintenance	6,140,868	7,223,183
Restricted for program support	6,600,034	6,763,404
Endowment funds held in perpetuity		
Restricted for salary support	11,524,173	11,197,414
Restricted for program support	<u>9,828,862</u>	<u>9,310,189</u>
Total endowment funds classified as net assets with donor restrictions	<u>\$ 37,313,788</u>	<u>\$ 37,700,697</u>

Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor restricted endowment deficits exist, they are classified as a reduction of net assets with donor restrictions. There were no deficits of this nature reported in net assets with donor restrictions as of June 30, 2019 and June 30, 2018.

Strategies Employed for Achieving Investment Objectives

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

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10. Debt

Health Services debt at June 30, 2019 and 2018 consisted of the following:

	Interest Rates	Final Maturity	2019	2018
Series 2010 Revenue Bonds				
2010A	4.00% to 5.00%	2040	\$ 57,640,000	\$ 57,640,000
2010B	variable	2040	67,300,000	69,925,000
2010C	variable	2040	22,430,000	23,305,000
2010D	2.44%	2020	4,285,000	6,350,000
2010E	3.01%	2025	16,560,000	16,660,000
Series 2008 Revenue Bonds				
2008A	variable	2038	50,020,000	51,735,000
2008B	variable	2038	22,770,000	23,540,000
			<u>241,005,000</u>	<u>249,155,000</u>
Unamortized premium			731,169	794,962
Debt issuance costs			(1,283,271)	(1,392,718)
Current maturities			(8,360,000)	(8,150,000)
Long-term variable rate debt classified as current			<u>(156,375,000)</u>	<u>(162,520,000)</u>
			<u>\$ 75,717,898</u>	<u>\$ 77,887,244</u>

In 2010, Health Services issued \$73,000,000 aggregate principal amount of Series 2010A fixed rate revenue bonds, \$75,000,000 aggregate principal amount of Series 2010B variable rate revenue bonds, \$25,000,000 aggregate principal amount of Series 2010C variable rate revenue bonds, \$10,335,000 aggregate principal amount of Series 2010D fixed rate revenue bonds, and \$16,860,000 aggregate principal amount of Series 2010E fixed rate revenue bonds through the Delaware Health Facilities Authority (DHFA). The proceeds were used to fund various capital projects and capital expenditures.

The 2010B Bonds and 2010C Bonds bear interest at a variable rate as determined by a remarketing agent, reset on a weekly and monthly basis, respectively. At the time of the bond issuance, interest was assumed at a rate of 2.71% annually for both the 2010B Bonds and the 2010C Bonds. During 2019 and 2018, respectively, interest rates ranged from 0.90% to 2.28% and 0.76% to 1.85% for the 2010B bonds and from 1.32% to 1.85% and 0.85% to 1.72% for the 2010C Bonds.

In 2008, Health Services issued \$55,000,000 aggregate principal of Series 2008A variable rate revenue bonds and \$25,000,000 aggregate principal of Series 2008B variable rate revenue bonds through the DHFA. The proceeds were used for the repayment of a short term loan and to acquire land. The Series 2008A Bonds bear interest at a variable rate, as determined by a remarketing agent, reset on a daily basis. The Series 2008B Bonds bear interest at a variable rate, as determined by a remarketing agent, reset on a weekly basis. At the time of the bond issuance, interest was assumed at a rate of 3.50% annually for both the 2008A Bonds and the 2008B bonds. During 2019 and 2018, respectively, the rates for the Series 2008 Bonds ranged from 0.57% to 2.37% and 0.58% to 1.93%.

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Health Services is obligated to purchase any Series 2010B Bonds, Series 2010C Bonds, and Series 2008 Bonds not remarketed. The Series 2010B Bonds, Series 2010C Bonds, and Series 2008 Bonds are classified as a current liability on the June 30, 2019 and June 30, 2018 balance sheets. In the event the Series 2010B Bonds, Series 2010C Bonds, and Series 2008 Bonds are not remarketed, Health Services would use available cash and investments to meet the obligations. Assuming the remarketing of the Series 2010B Bonds, Series 2010C Bonds and Series 2008 Bonds, scheduled maturities are as follows:

2020	\$ 8,360,000
2021	8,580,000
2022	8,805,000
2023	9,050,000
2024	9,300,000
Thereafter	<u>196,910,000</u>
	<u>\$ 241,005,000</u>

11. Interest Rate Swap Agreement

In conjunction with the issuance of the Series 2008 Bonds, Health Services entered into an interest rate swap agreement for a notional amount of \$25,000,000 with a financial institution to reduce Health Services' overall interest expense. Under the interest rate swap agreement, Health Services receives payments from the financial institution in the amount of 67% of one month LIBOR. In exchange, Health Services will pay the financial institution a fixed rate. The fair value of the interest rate swap represented a liability of \$2,289,752 and \$1,012,012 at June 30, 2019 and 2018, respectively, recorded within other liabilities. The change in the fair value of the interest rate swap is recorded as a component of other nonoperating revenues, gains, and losses within the consolidated statements of operations and changes in net assets. The change in the fair value of the interest rate swap was \$1,277,740 and \$1,052,929 as of June 30, 2019 and 2018, respectively.

12. Employee Benefit Plans

Pension Plans

Health Services sponsors a noncontributory defined benefit pension plan covering substantially all eligible employees hired on or before August 13, 2006. Employees hired after that date are participants in a defined contribution plan. Contributions to the pension plan are based on the minimum amount required by the Employee Retirement Income Security Act of 1974.

Retirement benefits are paid based principally on years of service and salary. Pension plan assets consist primarily of corporate bonds, notes, and U.S. government obligations. As purchases and sales of pension plan assets take place, cash may sit overnight in money market funds.

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Postretirement Benefits

Health Services provides postretirement health care benefits to eligible employees and their dependents. The following table sets forth the components of the benefit obligations, plan assets, and funding status of the plan based on actuarial valuations performed as of June 30, 2019 and June 30, 2018:

	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 848,843,908	\$ 882,968,089	\$ 74,389,592	\$ 76,834,173
Service cost	27,413,130	30,212,493	1,137,562	1,229,544
Interest cost	32,921,889	31,056,222	2,895,182	2,716,401
Actuarial loss (gain)	134,818,205	(34,578,994)	8,594,165	(3,528,723)
Retiree contributions	-	-	405,599	456,101
Benefits paid	(55,075,468)	(60,813,902)	(3,757,956)	(3,317,904)
Benefit obligation at end of year	\$ 988,921,664	\$ 848,843,908	\$ 83,664,144	\$ 74,389,592
Change in Plan assets				
Fair value of Plan assets at beginning of year	\$ 841,891,820	\$ 885,413,440	\$ -	\$ -
Actual return on Plan assets (net of expenses)	123,428,993	(14,207,718)	-	-
Employer contributions	71,200,000	31,500,000	3,352,357	2,861,803
Retiree contributions	-	-	405,599	456,101
Benefits paid	(55,075,468)	(60,813,902)	(3,757,956)	(3,317,904)
Fair value of Plan assets at end of year	\$ 981,445,345	\$ 841,891,820	\$ -	\$ -
Reconciliation of funded status to net amount recognized in the balance sheet				
Amounts recorded as accrued liabilities				
Funded status	\$ (7,476,319)	\$ (6,952,088)	\$ (83,664,144)	\$ (74,389,592)
Current liabilities	-	-	(4,673,319)	(4,020,061)
Noncurrent liabilities	(7,476,319)	(6,952,088)	(78,990,825)	(70,369,531)
Accrued liability	(7,476,319)	(6,952,088)	(83,664,144)	(74,389,592)
Amounts recorded within net assets without donor restrictions				
Net prior service (credit)	-	-	(17,029,745)	(23,026,134)
Actuarial loss	204,131,778	162,353,110	17,115,957	8,720,113
Net amount recognized at year end	\$ 196,655,459	\$ 155,401,022	\$ (83,577,932)	\$ (88,695,613)
Accumulated benefit obligation	\$ 858,378,232	\$ 734,739,342	\$ -	\$ -
	Pension Benefits		Postretirement Benefits	
	2019	2018	2019	2018
Weighted-average assumptions used to determine benefit obligations at June 30				
Discount rate	3.250 %	4.000 %	3.250 %	4.000 %
Rate of compensation increase	3.000 %	3.000 %		

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	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Components of net periodic benefit cost				
Service cost	\$ 27,413,130	\$ 30,212,493	\$ 1,137,562	\$ 1,229,544
Interest cost	32,921,889	31,056,222	2,895,182	2,716,401
Expected return on plan assets	(35,789,650)	(35,862,938)	-	-
Amortization of prior service (credit)	-	-	(5,996,389)	(6,030,362)
Recognized actuarial loss	5,400,194	8,558,056	198,321	803,771
Net periodic benefit cost	<u>29,945,563</u>	<u>33,963,833</u>	<u>(1,765,324)</u>	<u>(1,280,646)</u>
Other changes in pension liability recognized in unrestricted net assets				
Net actuarial loss (gain)	47,178,862	15,491,662	8,594,165	(3,528,723)
Amortization of (gain)	(5,400,194)	(8,558,056)	(198,321)	(803,771)
Amortization of prior service credit	-	-	5,996,389	6,030,362
Total recognized in net assets without donor restrictions	<u>41,778,668</u>	<u>6,933,606</u>	<u>14,392,233</u>	<u>1,697,868</u>
Total recognized in net benefit cost and net assets without donor restrictions	<u>\$ 71,724,231</u>	<u>\$ 40,897,439</u>	<u>\$ 12,626,909</u>	<u>\$ 417,222</u>

	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Weighted-average assumptions used to determine net periodic benefit cost at beginning of fiscal year				
Discount rate	4.000 %	3.625 %	4.000 %	3.625 %
Expected return on plan assets	4.250 %	4.250 %		
Rate of compensation increase	3.000 %	3.000 %		

Health Services expects to recognize \$15,830,272 of loss amortization, no prior service cost amortization and no amortization of transition asset or obligation as components of net pension cost during the year ending June 30, 2020, and expects to recognize \$1,420,380 of loss amortization, \$(5,996,389) of prior service (credit) amortization and no amortization of transition asset or obligation as components of net postretirement benefit cost during the year ending June 30, 2020. Other components of net periodic pension cost, which are presented in other non-operating losses, revenues, and gains on the consolidated statement of operations and changes in net assets, were (\$370,453) and \$1,241,150 as of June 30, 2019 and 2018, respectively.

The expected rate of return on plan assets assumption was developed based on historical returns for the major asset classes. This review also considered both current market conditions and projected future contributions.

Health Services utilizes published long-term high quality corporate bond indices to determine the discount rate at measurement date. Where commonly available, Health Services considers indices of various durations to reflect the timing of future benefit payments.

Plan Assets

Pension plan weighted target and actual average asset allocations at June 30, 2019 and June 30, 2018 by asset category are as follows:

Asset Category	2019	2018
Fixed income	<u>100 %</u>	<u>100 %</u>
	<u>100 %</u>	<u>100 %</u>

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The investment policy incorporates a liability-driven investment approach that focuses on the funded status of the Plan and seeks to match the duration of the assets with that of the liabilities. As such, the investment portfolio allocation is comprised of 100% long duration fixed income securities. The Plan's financial condition is monitored on an ongoing basis by means of an annual funding review, an annual independent actuarial valuation, and quarterly investment portfolio reviews.

The following table represents the Plan's financial instruments as of June 30, 2019, measured at fair value on a recurring basis using the fair value hierarchy defined in Note 5:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 17,415,752	\$ -	\$ -	\$ 17,415,752
U.S. Government and agency securities	176,582,902	26,126,937	-	202,709,839
Corporate and other debt securities	-	761,315,781	-	761,315,781
Equity securities	3,973	-	-	3,973
Total assets at fair value	<u>\$ 194,002,627</u>	<u>\$ 787,442,718</u>	<u>\$ -</u>	<u>\$ 981,445,345</u>

The following table represents the Plan's financial instruments as of June 30, 2018, measured at fair value on a recurring basis using the fair value hierarchy defined in Note 5:

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 22,690,992	\$ -	\$ -	\$ 22,690,992
U.S. Government and agency securities	196,010,677	21,575,554	-	217,586,231
Corporate and other debt securities	-	601,610,020	-	601,610,020
Equity securities	4,577	-	-	4,577
Total assets at fair value	<u>\$ 218,706,246</u>	<u>\$ 623,185,574</u>	<u>\$ -</u>	<u>\$ 841,891,820</u>

Contributions

During Fiscal 2019, Health Services contributed \$71,200,000 to the pension plan in advance of the expected September, 2019 required contribution. Health Services expects to contribute approximately \$30,200,000 to the pension plan and \$4,673,318 to the postretirement benefit plan during the fiscal year ending June 30, 2020. The actual pension plan contribution may be higher or lower depending on interest rates, pension plan asset values, and legislated funding requirements.

Estimated Future Benefit Payments

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

	Pension Benefits	Postretirement Benefits
2020	\$ 59,073,333	\$ 4,673,318
2021	57,357,726	4,610,139
2022	59,820,278	4,763,866
2023	61,178,154	4,845,575
2024	62,671,310	4,935,604
2025 - 2029	333,597,512	25,593,126

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The annual rate of increase assumed in the per capita cost of covered health care benefits was 6.75% and 7.50% for the Pre 65 and Post 64 participants, respectively, for June 30, 2019; the rates are assumed to decrease gradually to 5% for the fiscal year 2026 and remain at that level thereafter.

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total service and interest cost	\$ 39,695	\$ (37,091)
Effect on postretirement benefit obligation	575,904	(540,531)

Defined Contribution Retirement Plan

Health Services sponsors a defined contribution retirement plan for all employees hired after August 13, 2006. Under the plan, Health Services contributes a percent of compensation quarterly based on an employee's years of vesting service. The employees vest in the employer contributions over a three-year period beginning on the employee's hire date. The expense incurred by Health Services for the year ended June 30, 2019 and June 30, 2018 was \$17,337,669 and \$15,388,540, respectively.

Deferred Compensation Plan

Health Services maintains a Tax-Deferred Annuity Plan for all employees. Under the plan, Health Services accumulates employee contributions which are transferred to and invested by various trustees. Health Services contributes 50% of the employee contributions up to a maximum of 3% of an employee's salary. Contributions for the year ended June 30, 2019 and 2018 were \$17,765,599 and \$16,494,256, respectively.

13. Self-Insurance Liabilities

Health Services maintains self-insurance programs for worker's compensation, medical professional liability, and general liability claims coverage. Risk retention for the primary medical professional and primary general liabilities are maintained through an alternative risk finance program via the Captive, which provides for indemnification to Health Services resulting from medical malpractice and general liability exposures in Delaware, Maryland, New Jersey, and Pennsylvania. The Captive's policy provides for a self-insured retention of \$3,500,000 per medical incident or occurrence and \$20,000,000 in annual aggregate. In addition, an excess umbrella liability coverage was established through full reinsurance with commercial carriers providing a total of \$60,000,000 in excess coverage.

Actuarially determined undiscounted projections for medical malpractice and worker's compensation claims at June 30, 2019 and 2018 amounted to \$55,333,073 and \$49,839,192, respectively and represent the value of claims that will be settled in the future based on anticipated payout patterns. The current portion of the accruals of \$17,506,000 and \$16,515,268 at June 30, 2019 and 2018, respectively, is recorded as a component of other accrued expenses and current liabilities on the balance sheet. Total expenses incurred for medical malpractice and worker's compensation costs were \$22,682,955 in 2019 and \$29,205,140 in 2018.

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14. Commitments and Contingencies

Operating Leases

Commitments for leases that do not meet the criteria for capitalization are classified as operating leases with rent expense charged to operations as incurred. Health Services has various leases for office facilities and equipment under cancelable and noncancelable operating leases, with initial terms in excess of one year. Total related lease expense amounted to \$10,437,241 and \$9,920,081 in 2019 and 2018, respectively.

Future minimum lease payments under noncancelable operating leases are as follows:

2020	\$	8,348,001
2021		6,605,774
2022		5,487,630
2023		4,450,515
2024		1,976,016
Thereafter		563,549

Litigation

Health Services is a defendant in several matters of litigation, all in the ordinary course of conducting business. Management believes the ultimate outcome of these matters will not have a material effect on Health Services' financial position or results of operations.

Commitments

In fiscal 2017, Health Services entered a seven-year agreement with a vendor to provide health care IT software and solutions. Payments under this commitment will total \$163,674,466. At June 30, 2019, the remaining commitment is \$107,554,426, of which \$25,121,091 will be paid in fiscal 2020.

15. Related Party Transactions

As Health Services is an affiliate of the System, Health Initiatives, CCHHCS, and Health Plans, certain administrative, professional, and technical services were provided to these affiliates totalling \$8,956,434 and \$6,136,652 for the years ended June 30, 2019 and 2018, respectively. Included within other current assets are amounts due from affiliates of \$13,926,607 and \$7,606,979 at June 30, 2019 and 2018, respectively.

Within long-term investments are funds held for the benefit of CCHHCS in the amount of \$10,909,829 and \$10,318,078 at June 30, 2019 and 2018, respectively. A corresponding amount due to CCHHCS is recorded within other liabilities at June 30, 2019 and 2018.

Health Services did not make any equity transfers to affiliated organizations during the fiscal years ended June 30, 2019 and 2018, respectively.

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16. Concentrations of Credit Risk

Health Services grants credit without collateral to its patients, most of whom are local residents and insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2019 and 2018 was as follows:

	2019	2018
Medicare	19 %	19 %
Medicaid	14	20
Commercial insurance	47	45
Self-pay and other	20	16
	<u>100 %</u>	<u>100 %</u>

17. Liquidity and Availability

As of June 30, 2019, Health Services has the following financial assets available for general expenditure within one year of the balance sheet date:

	2019
Cash and cash equivalents	\$ 102,516,275
Short-term investments	188,510,758
Patient accounts receivable, net	304,981,613
Other current assets	10,877,221
Assets limited as to use	30,023,062
Investments	1,672,829,039
	<u>\$ 2,309,737,968</u>

The above assets are available for general expenditure within one year in the normal course of operations. Health Services defines general expenditure as an operating expense. Other current assets in the table above relate to non-patient accounts receivables that Health Services expects to collect within one year. Assets limited as to use are comprised of board designated funds, which can be released by the Board and become available for general expenditure. Health Services has long-term investments that could be made available for general expenditure within the next year, if needed.

Health Services invests cash in excess of daily requirements in either money market funds, short-term investments, or long-term investments. Investment decisions are made based on anticipated liquidity needs, such that financial assets are available as general expenditures, liabilities, and other obligations come due.

As of June 30, 2019, Health Services was in compliance with financial bond covenants.

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18. Functional Expenses

Health Services provides general health care services to patients within its geographic region. Expenses related to providing these services for the year ended June 30, 2019 consisted of the following:

	Healthcare Services	General and Administrative	Total
Operating Expenses			
Salaries and employee benefits	\$ 1,031,687,080	\$ 176,183,294	\$ 1,207,870,374
Supplies and other expenses	497,806,287	111,069,383	608,875,670
Interest Expense	3,252,850	368,516	3,621,366
Depreciation	76,460,635	25,599,996	102,060,631
Total Operating Expenses	<u>\$ 1,609,206,852</u>	<u>\$ 313,221,189</u>	<u>\$ 1,922,428,041</u>

The consolidated statement of operations and changes in net assets reports 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, amortization and interest and other occupancy costs, are allocated to a function based on a square footage. IT expenses are allocated based on a percentage of services provided to each function.

For the year ended June 30, 2018, functional expenses were \$1,585,888,629 for providing health care services and \$249,076,559 for general and administrative items, totalling \$1,834,965,188.

19. Subsequent Events

Health Services has performed an evaluation of subsequent events through August 22, 2019, which is the date the consolidated financial statements were issued. There were no events that require adjustment to the audited consolidated financial statements or disclosure in the notes to the audited consolidated financial statements.