
Genesis HealthCare System and Subsidiaries

**Consolidated Financial Report
with Additional Information
December 31, 2018**

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Independent Auditor's Report

To the Board of Directors
Genesis HealthCare System and Subsidiaries

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Genesis HealthCare System and Subsidiaries (the "System"), which comprise the consolidated balance sheet as of December 31, 2018 and 2017 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Genesis HealthCare Foundation, a controlled subsidiary, whose statements reflect total assets constituting 9 percent of consolidated total assets at December 31, 2018 and 2017 and total excess of expense over revenue constituting 32 percent for December 31, 2018 and total excess of revenue over expense constituting 28 percent of consolidated total excess of revenue over expense for the years ended December 31, 2018 and 2017. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Genesis HealthCare Foundation, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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. Genesis HealthCare Foundation was not audited under *Government Auditing Standards*.

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

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

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Genesis HealthCare System and Subsidiaries as of December 31, 2018 and 2017 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
Genesis HealthCare System and Subsidiaries

Emphasis of Matter

As described in Note 2 to the consolidated financial statements, on January 1, 2018, the System adopted Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers*, using the modified retrospective adoption method. On December 31, 2018, the System also adopted the provisions of ASC Topic 958, *Presentation of Financial Statements of Not-for-Profit Entities*, using the retrospective adoption method. Our opinion is not modified with respect to these matters.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements of Genesis HealthCare System and Subsidiaries. The consolidating balance sheet and consolidating statement of operations and changes in unrestricted net assets are presented for the purpose of additional analysis and are not a required part of the consolidated financial statements.

The consolidating balance sheet and consolidating statement of operations and changes in unrestricted net assets are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, based on our audits and the report of other auditors for the 2018 Genesis HealthCare Foundation financial statements, the consolidating balance sheet and consolidating statement of operations and changes in unrestricted net assets are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2019 on our consideration of Genesis HealthCare System and Subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Genesis HealthCare System and Subsidiaries' internal control over financial reporting and compliance.



March 28, 2019

Genesis HealthCare System and Subsidiaries

Consolidated Balance Sheet

December 31, 2018 and 2017

	2018	2017
Assets		
Current Assets		
Cash and cash equivalents	\$ 32,724,395	\$ 32,199,969
Accounts receivable (Note 4)	61,934,722	66,434,655
Estimated third-party payor settlements	4,795,234	-
Inventory	11,173,994	9,855,851
Other assets	11,409,184	9,320,152
Total current assets	122,037,529	117,810,627
Assets Limited as to Use (Note 7)	182,184,019	193,961,300
Property and Equipment - Net (Note 8)	306,236,381	308,339,694
Beneficial Interest in Perpetual Trusts	14,258,247	14,498,896
Other Assets		
Long-term investments	779,370	679,394
Other noncurrent assets	4,434,320	3,341,967
Total assets	\$ 629,929,866	\$ 638,631,878
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	\$ 21,205,891	\$ 17,472,082
Current portion of long-term debt (Note 9)	4,328,569	3,755,000
Estimated third-party payor settlements	-	3,389,385
Accrued liabilities and other:		
Accrued compensation	26,747,616	27,522,315
Other accrued liabilities	7,706,587	7,134,456
Total current liabilities	59,988,663	59,273,238
Long-term Debt - Net of current portion (Note 9)	284,536,006	287,941,989
Other Liabilities		
Pension and other postretirement obligations (Note 14)	35,018,739	35,430,217
Deferred revenue and other long-term liabilities	4,785,722	3,850,051
Accrued professional liability	7,994,200	6,855,707
Total liabilities	392,323,330	393,351,202
Net Assets		
Net assets without donor restrictions:		
Net assets	216,967,818	224,509,472
Noncontrolling interest (Note 15)	878,100	818,395
Net assets with donor restrictions	19,760,618	19,952,809
Total net assets	237,606,536	245,280,676
Total liabilities and net assets	\$ 629,929,866	\$ 638,631,878

Genesis HealthCare System and Subsidiaries

Consolidated Statement of Operations

Years Ended December 31, 2018 and 2017

	2018	2017
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue before provision for bad debts		\$ 458,028,353
Less provision for bad debts		<u>(15,311,728)</u>
Patient service revenue (Note 5)	\$ 465,803,474	442,716,625
Pharmacy sales and other	<u>81,246,614</u>	<u>78,036,144</u>
Total unrestricted revenue, gains, and other support	547,050,088	520,752,769
Expenses		
Salaries and wages	215,779,350	207,822,211
Employee benefits and payroll taxes	54,397,567	49,871,798
Operating supplies and expenses	80,027,558	75,276,753
Professional services and consultant fees	17,739,102	21,040,555
Purchased services	44,534,681	44,108,237
Utilities	6,889,040	6,202,889
Repairs, rentals, insurance, and other	48,163,942	40,738,756
Pharmacy cost of goods sold	39,057,454	36,066,194
Depreciation	22,907,031	22,738,970
Interest expense	<u>14,627,405</u>	<u>14,564,170</u>
Total expenses	<u>544,123,130</u>	<u>518,430,533</u>
Operating Income	2,926,958	2,322,236
Other Income (Loss)		
Investment income (Note 7)	4,812,680	6,760,831
Unrealized (losses) gains on trading securities (Note 7)	(14,232,979)	12,436,937
Pension expense	(1,927,891)	(1,616,826)
Other	<u>1,366,778</u>	<u>(2,200,390)</u>
Total other (loss) income	<u>(9,981,412)</u>	<u>15,380,552</u>
Excess of Revenue (Under) Over Expenses	(7,054,454)	17,702,788
Capital Distributions	-	(411,999)
Pension-related Changes Other than Net Periodic Cost	(1,128,061)	4,473,538
Net Assets Released from Restriction for Capital Equipment	<u>700,566</u>	<u>858,842</u>
(Decrease) Increase in Net Assets without Donor Restrictions	<u>\$ (7,481,949)</u>	<u>\$ 22,623,169</u>

Genesis HealthCare System and Subsidiaries

Consolidated Statement of Changes in Net Assets

Years Ended December 31, 2018 and 2017

	2018	2017
Net Assets without Donor Restriction		
Excess of revenue (under) over expenses	\$ (7,054,454)	\$ 17,702,788
Pension-related changes other than net periodic cost	(1,128,061)	4,473,538
Capital distributions	-	(411,999)
Net assets released from restriction for capital equipment	700,566	858,842
	<u>(7,481,949)</u>	<u>22,623,169</u>
(Decrease) increase in net assets without donor restriction		
Net Assets with Donor Restriction		
Restricted contributions	737,574	803,350
Net unrealized (loss) gain in fair value of perpetual trusts	(229,199)	1,465,996
Net assets released from restriction for capital equipment	(700,566)	(858,842)
	<u>(192,191)</u>	<u>1,410,504</u>
(Decrease) increase in net assets with donor restriction		
(Decrease) Increase in Net Assets	(7,674,140)	24,033,673
Net Assets - Beginning of year	245,280,676	221,247,003
Net Assets - End of year	<u><u>\$ 237,606,536</u></u>	<u><u>\$ 245,280,676</u></u>

Genesis HealthCare System and Subsidiaries

Consolidated Statement of Cash Flows

Years Ended December 31, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
(Decrease) increase in net assets	\$ (7,674,140)	\$ 24,033,673
Adjustments to reconcile (decrease) increase in net assets to net cash and cash equivalents from operating activities:		
Depreciation and amortization	23,050,796	22,784,603
Unrealized loss (gain) on trading securities	14,232,979	(12,436,937)
Net realized gain on investments	(1,811,239)	(4,184,604)
Pension-related changes other than net periodic cost	1,128,061	(4,473,538)
Restricted contributions	(737,574)	(803,350)
Provision for bad debts	-	15,311,728
Net unrealized loss (gain) in fair value of perpetual trusts	229,199	(1,465,996)
Changes in operating assets and liabilities that provided (used) cash and cash equivalents:		
Accounts receivable	4,499,933	(14,730,154)
Inventory and other assets	(3,231,571)	4,136,412
Estimated third-party payor settlements	(8,184,619)	8,518,090
Accounts payable	3,733,809	(5,730,104)
Accrued compensation and other	(202,568)	1,618,919
Deferred revenue	(845,961)	(885,961)
Accrued professional liability, pension, and other	178,097	(579,425)
Net cash and cash equivalents provided by operating activities	24,365,202	31,113,356
Cash Flows from Investing Activities		
Purchase of property and equipment	(21,159,048)	(15,914,527)
Proceeds from sale of property and equipment	355,330	105,159
Purchases of investments and assets limited as to use	(3,427,594)	(12,754,979)
Proceeds from sale of investments and assets limited as to use	2,694,609	10,651,680
Net cash and cash equivalents used in investing activities	(21,536,703)	(17,912,667)
Cash Flows from Financing Activities		
Principal payments on long-term debt	(3,755,000)	(3,575,000)
Proceeds from restricted contributions	737,574	803,350
Payments to revolving credit loan	(6,000,000)	(1,250,000)
Proceeds from bond issuance	6,713,353	2,306,839
Net cash and cash equivalents used in financing activities	(2,304,073)	(1,714,811)
Net Increase in Cash and Cash Equivalents	524,426	11,485,878
Cash and Cash Equivalents - Beginning of year	32,199,969	20,714,091
Cash and Cash Equivalents - End of year	\$ 32,724,395	\$ 32,199,969
Supplemental Cash Flow Information - Cash paid for interest - Net of capitalized interest	\$ 14,615,000	\$ 14,608,000

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1 - Nature of Business

Genesis HealthCare System (the "System") is a nonprofit corporation organized under the laws of the State of Ohio to provide and promote healthcare services.

Effective January 1, 1997, Bethesda Care System (Bethesda Care), an Ohio nonprofit corporation, signed an affiliation agreement (the "agreement") with Good Samaritan Medical Center of the Franciscan Sisters of Christian Charity (GSMC), an Ohio nonprofit corporation, and Franciscan Sisters of Christian Charity Sponsored Ministries, Inc., a Wisconsin nonstock nonprofit corporation (FSCCM), which is the sole corporate member of GSMC. The agreement provided for the creation of Genesis HealthCare System, of which Bethesda Care and FSCCM are 50 percent comembers. The agreement provides for the integration of GSMC and Bethesda Care operations under the System and shall be a community-based healthcare delivery system operating a Catholic community hospital and healthcare system.

The System is the sole corporate member of CareServe and its subsidiaries (CareServe) and Genesis HealthCare Foundation (the "Foundation"). In addition, the System owns 100 percent of the stock of CareLife, Inc. and its wholly owned subsidiaries. The System also has a 75 percent member interest in Community Ambulance Service (CAS).

All rights, titles, and interest of Bethesda Care and GSMC and their nonprofit and for-profit subsidiaries were transferred to the System on January 1, 1997, with the exception of legal title to certain real property comprising substantially all of Bethesda Hospital and GSMC's current campuses, and cash and investments totaling approximately \$5,710,000 for each member. Bethesda Care and GSMC have entered into a 70-year lease agreement to lease the nontransferred real property to the System for a nominal amount. Related debt of Bethesda Care and GSMC was transferred to the System effective January 1, 1997.

During 2004, the System established Southeast Ohio Medical Insurance Company, Ltd. (SOMIC), a wholly owned captive insurance company incorporated in the Cayman Islands. Effective August 1, 2004, SOMIC began providing professional liability and related general liability insurance to the System and certain employed health professionals. SOMIC also provides professional liability and related general liability coverage to participating staff physicians.

During 2010, the System entered into a joint venture with an Ohio limited liability company (Alternate Solutions Healthcare Central, LLC) to form Zanesville Homecare Ventures, LLC (Genesis Homecare). The System assigned 100 percent of its membership interest to CareLife, Inc. Each member owns 50 percent of Zanesville Homecare Ventures, LLC. The operations of Genesis Homecare are accounted for using the equity method on CareLife, Inc.

During 2013, the System established Ohio Integrated Care Providers, LLC (OICP). OICP was developed to create a clinically integrated system to develop improved patient care and lower healthcare costs. As of December 31, 2018, OICP does not have any risk-based contracts to provide these services.

The System paid approximately \$1,890,000 and \$2,381,000 in 2018 and 2017, respectively, to FSCCM for management and support services.

Note 2 - Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include all the accounts of the System, including all wholly owned subsidiaries and majority-owned entities. The noncontrolling interest in majority-owned entities on the December 31, 2018 and 2017 consolidated balance sheet represents a 25 percent outside membership interest in CAS. The System consolidated the balance sheet and statement of operations and changes in net assets of CAS. All material intercompany accounts and transactions have been eliminated in consolidation.

Note 2 - Significant Accounting Policies (Continued)

Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Accounts Receivable

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges, reduced for explicit price concessions provided to third-party payors, discounts provided to qualifying individuals as part of a financial assistance policy, and implicit price concessions provided primarily to self-pay patients. Estimates for explicit price concessions are based on provider contracts, payment terms for relevant prospective payment systems, and historical experience, adjusted for economic conditions and other trends affecting the System's ability to collect outstanding amounts.

For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the System records significant implicit price concessions in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible.

Inventories

Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at the lower of cost or net realizable value, determined on a first-in, first-out basis.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheet. Investments in partnerships and limited liability companies are reported using the equity method of accounting. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenue over expenses unless the income or loss is restricted by donor or law.

The System invests much of its funds in the FSCCM pooled investment management program. The pooled investment management program primarily invests in cash and cash equivalents, marketable equity securities, corporate and government bonds, mutual funds, common collective funds, fund of funds hedge funds, real estate funds, and private equity funds. Earnings in the pooled investment program are allocated to the participants based upon each participant's weighted-average percentage of the pooled investment fund.

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

Beneficial Interest in Perpetual Trust

The Foundation is the beneficiary of certain funds held in trust by others, which represent resources neither in the possession nor under the control of the Foundation, but held in perpetuity and administered by outside trustees, with the Foundation deriving income from a portion of the assets held in such trusts. The Foundation's interest in perpetual trusts is recorded at the fair market value of the Foundation's interest in the trust and is recorded as an investment held for long-term purposes. The contribution revenue from perpetual trusts is an increase in net assets with donor restriction.

Note 2 - Significant Accounting Policies (Continued)

Cash distributions received by these perpetual trusts are reported as investment income in the accompanying consolidated statement of operations. The investment income is reported as increases in net assets with donor restriction or net assets without donor restriction based upon the existence or absence of donor-imposed restrictions.

Changes in the fair market value of the Foundation's portion of the funds held in perpetual trusts are reported in the accompanying consolidated statement of operations as a net unrealized gain or loss in net assets with donor restriction.

Assets Limited as to Use

Assets limited as to use include assets designated by the board of directors for future capital improvement, assets held by trustees under indenture agreements, funds received by donors, and assets held for professional and other liability claims. The board retains control over assets held for future capital improvements and may, at its discretion, use them for other purposes.

Property and Equipment

Property and equipment purchases are recorded at cost or at fair value if acquired by gift. Depreciation is computed principally using the straight-line method over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred. Interest was incurred on borrowed funds during construction of capital assets during 2018 and 2017, and the System has recorded capitalized interest.

Professional and Other Liability Insurance

The System accrues an estimate of the ultimate expense, including litigation and settlement expense, for incidents of potential improper professional service and other liability claims occurring during the year, as well as for those claims that have not been reported at year end.

Classification of Net Assets

Net assets of the System are classified based on the presence or absence of donor-imposed restrictions.

Earnings, gains, and losses on restricted net assets are classified as net assets without donor restrictions unless specifically restricted by the donor or by applicable state law. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are released to net assets without donor restrictions.

At December 31, 2018, net assets with donor restrictions of \$2,004,968 are subject to the passage of time and \$17,755,650 subject to expenditure for specified purpose. At December 31, 2017, net assets with donor restrictions of \$1,967,960 are subject to the passage of time and \$17,984,849 are subject to expenditure for specified purpose.

Revenue Recognition - Patient Service Revenue

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

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Performance obligations are determined based on the nature of the services provided by the System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in our hospital receiving inpatient acute care services or patients receiving services in our outpatient centers or other clinical settings. The System measures the performance obligation from admission into the hospital, or the commencement of an outpatient services or other visit, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services or other visit.

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

The System determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with the System's policy, and implicit price concessions provided to uninsured patients. The System determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The System determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the System's total operating expenses divided by gross patient service revenue. The System estimates that it provided approximately \$2,064,000 and \$1,573,000 of services to indigent patients during 2018 and 2017, respectively. The System recorded \$8,916,000 and \$9,302,000 in net distributions from the Ohio Medicaid HCAP program as revenue during 2018 and 2017, respectively, and it is estimated that approximately \$1,302,000 and \$1,100,000 of the total net distributions from the Ohio HCAP program related to HCAP and charity patients during 2018 and 2017, respectively.

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Pharmacy Sales and Other Revenue

Revenue is primarily composed of retail pharmacy sales, home infusion services, durable medical equipment sales, revenue from electronic health records incentive payments, and hospital cafeteria sales. Retail pharmacy sales, durable medical equipment sales, and hospital cafeteria sales are performance obligations that are satisfied at a point in time. The System recognizes revenue at a point in time when goods are provided to patients and customers in a retail setting and the System does not believe it is required to provide additional goods or services related to that sale. The System determines the transaction price based on standard charges for goods provided, which is collected at the time of the sale. Revenue recognized in other operating revenue for performance obligations satisfied at a point in time totaled \$72,475,995 and \$66,337,699 for December 31, 2018 and 2017, respectively. The remaining revenue recognized in other operating revenue relates to revenue from contracts with customers that is recognized over time, as well as rentals and nonexchange revenue.

Contributions

The System reports gifts of cash and other assets as restricted support 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 restriction are reclassified to net assets without donor restriction and reported in the consolidated statement of changes in net assets as net assets released from restrictions.

The System reports gifts of property and equipment as net assets without donor restriction support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as donor restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the System reports the expiration of donor restrictions when the assets are placed in service.

Excess of Revenue (Under) Over Expenses

The consolidated statement of operations includes excess of revenue over expenses. Changes in net assets without donor restriction, which are excluded from excess of revenue over expenses, consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets, permanent transfers of assets to and from affiliates for other than goods and services, capital distributions to joint venture partners, and pension-related changes other than net periodic cost.

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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Tax Status

The System and its subsidiaries are tax-exempt organizations, except for CareLife; accordingly, no tax provision is reflected in the consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System and to recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service or other applicable taxing authorities.

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

Sale Leaseback

The System has entered into sale-leaseback arrangements. Under the arrangements, the System sold property and leased it back. The leasebacks have been accounted for as operating leases. The gain on the transactions is deferred and recognized into income in proportion to rental expense over the term of the lease.

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including March 28, 2019, which is the date the consolidated financial statements were available to be issued.

Upcoming Accounting Pronouncement

In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the System's year ending December 31, 2019. The ASU permits application of the new lease guidance using one of two retrospective application methods. The System has not yet determined which application method it will use. Management expects that this new standard will significantly increase long-term assets and short- and long-term liabilities upon adoption. The effects on the results of operations are not expected to be significant.

New Accounting Pronouncements

Effective January 1, 2018, the System adopted ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using a modified retrospective method of application to all contracts existing on January 1, 2018. The core principle of the guidance in ASU No. 2014-09 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 ASU No. 2014-09 resulted in changes to the System's presentation for disclosure of revenue primarily related to uninsured or underinsured patients. Prior to the adoption of ASU No. 2014-09, a significant portion of the System's provision for doubtful accounts related to self-pay patients, as well as copays, coinsurance, and amounts and deductibles owed by patients with insurance. Under ASU No. 2014-09, the estimated uncollectable amounts due from these patients are generally considered implicit price concessions that are a direct reduction to operating revenue, with a corresponding material reduction in the amounts presented separately as provision for doubtful accounts. For the year ended December 31, 2018, the System recorded approximately \$17,165,000 of implicit price concessions as a direct reduction of patient service revenue that would have been recorded as provision for doubtful accounts prior to the adoption of ASU No. 2014-09. At December 31, 2018, the System recorded approximately \$7,647,000 as a direct reduction of accounts receivable that would have been reflected as allowance for doubtful accounts prior to the adoption of ASU No. 2014-09. The adoption of ASU No. 2014-09 also resulted in changes to the System's presentation and disclosure of customer contract assets and liabilities and the assessment of variable consideration under customer contracts, which are further discussed in Note 4.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 2 - Significant Accounting Policies (Continued)

As of December 31, 2018, the System adopted ASU No. 2016-14, *Not-for-Profit Entities*. This standard requires net assets to be classified in two categories, net assets without donor restrictions and net assets with donor restrictions, rather than the three previous classifications. In addition, the underwater portion of donor-restricted endowments is now reported as net assets with donor restrictions. This standard also requires changes in the way certain information is aggregated and reported by the System, including disclosures of quantitative and qualitative information about the liquidity and availability of resources and the presentation of expenses by both functional and natural classification. The standard also clarifies the definition of management and general and prohibits certain expenses from being allocated out of management and general. As a result of the adoption of this standard, the financial information for the year ended December 31, 2017 has been restated, as follows: management and general expenses have increased \$49,847,331, from the amounts previously reported, with a corresponding decrease in program expenses. Additionally, net assets of \$1,967,960 previously reported as temporarily restricted net assets and net assets of \$17,984,849 previously reported as permanently restricted net assets have been combined into net assets with donor restrictions.

In 2018, the System adopted ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard requires the presentation of the service cost component of net benefit cost to be in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. All other components of net benefit costs should be presented separately from the service cost component and outside of income from operations. The standard was retrospectively applied to the year ended December 31, 2017, utilizing the practical expedient that allows the System to utilize amounts previously disclosed in Note 14. As a result, approximately \$1,616,826 of expenses was reclassified from employee benefits and payroll taxes to pension expense on the consolidated statement of operations.

Note 3 - Cash in Excess of Insured Limits

The System and its subsidiaries maintain cash and investment balances at several financial institutions located in the vicinity of Zanesville, Ohio. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per institution. As of December 31, 2018 and 2017, the System holds funds at various institutions in excess of insured limits.

Note 4 - Patient Accounts Receivable

Patient accounts receivable is based on the estimated transaction price for completed contracts, which totals \$61,934,722 at December 31, 2018. Prior to the adoption of ASU No. 2014-09, patient accounts receivable at December 31, 2017 were composed of \$153,551,875 less allowances for uncollectible accounts of \$8,890,839 and allowances for contractual adjustments of \$78,226,381.

The System grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	2018	2017
Medicare and Medicare HMO	10 %	28 %
Medicaid and Medicaid HMO	7	9
Commercial insurance and other	60	48
Self-pay	23	15
Total	100 %	100 %

December 31, 2018 and 2017

Note 4 - Patient Accounts Receivable (Continued)

Under the provisions of ASU No. 2014-09, which was adopted effective January 1, 2018, amounts related to services provided to patients that have not been billed and that do not meet the conditions of unconditional right to payment at the end of the reporting period are contract assets. The System's contract assets consist primarily of services that have been provided to patients who are still receiving inpatient care in the System at the end of the reporting period. Contract assets are not considered significant for separate presentation and have been included in patient accounts receivable in the accompanying consolidated balance sheet at December 31, 2018.

The opening balance of contract assets was approximately \$3,773,000 on January 1, 2018, and the ending balance of contract assets was approximately \$3,199,000 on December 31, 2018, a decrease of \$574,000.

Note 5 - Patient Service Revenue

The System has agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors follows:

Medicare

Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and home care services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.

Medicaid

Inpatient acute care hospital services are reimbursed on a prospective basis using the All Patient Refined Diagnosis Related Group (APR-DRG) system. Outpatient acute care services are reimbursed on a prospective basis using the Enhanced Ambulatory Patient Groups (EAPG) system.

The Medicaid payment system in Ohio is a prospective one, whereby rates for the following state fiscal year beginning July 1 are based upon filed cost reports for the preceding calendar year. The continuity of this system is subject to the uncertainty of the fiscal health of the State of Ohio, which can directly impact future rates and the methodology currently in place. Any significant changes in rates, or the payment system itself, could have a material impact on the future Medicaid funding to providers.

Other Third-party Payors

The System has also entered into agreements with certain commercial carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement to the System under these agreements is discounts from established charges, prospectively determined rates per discharge, and prospectively determined daily rates.

Health Maintenance Organizations

Services rendered to HMO beneficiaries are paid at predetermined rates or at a percentage of system charges.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare and Medicaid programs that are subject to audit by fiscal intermediaries. 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.

December 31, 2018 and 2017

Note 5 - Patient Service Revenue (Continued)

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare entities have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in entities entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the System. In addition, the contracts the System has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are treated as variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The System also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2018, changes in its estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt for the year ended December 31, 2018 was not significant to the System.

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

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

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 5 - Patient Service Revenue (Continued)

The System has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected primarily by payor. The composition of net patient service revenue by primary payor for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Medicare and Medicare HMOs	\$ 180,565,529	\$ 177,729,276
Medicaid and Medicaid HMOs	61,012,262	56,726,538
Anthem	67,755,413	68,899,796
Commercial insurance and other	136,084,694	120,300,631
Self-pay	20,385,576	19,060,384
Total	<u>\$ 465,803,474</u>	<u>\$ 442,716,625</u>

Revenue from patient's deductibles and coinsurance are included in the categories presented above based on the primary payor.

The System recognizes patient service revenue over time as patients simultaneously receive and consume benefits provided as care is administered. Total patient service revenue recognized over time was \$465,803,474 and \$442,716,625 for December 31, 2018 and 2017, respectively.

Financing Component

The System has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the System's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the System does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Note 6 - Community Benefit

In support of its mission, the System provides various health-related services, at a loss, to the indigent and other residents in its service area. The following is a summary of the System's community benefit expense:

	2018	2017
Community partnership programs (unaudited)	\$ 2,767,000	\$ 2,418,000
Donations/Contributions (unaudited)	401,000	354,000
Traditional charity care	2,064,000	1,573,000
Unpaid costs for government program patients (unaudited)	34,712,000	24,696,000
Total	<u>\$ 39,944,000</u>	<u>\$ 29,041,000</u>

Community Partnership Programs

Community partnership programs include programs provided to persons with inadequate healthcare resources or for other groups within the community that need special services and support. Examples include programs related to the poor, elderly, substance abuse, child abuse, and others with specific particular healthcare needs. They also include broader populations who benefit from health community initiatives, such as health promotion, education, and health screening.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 6 - Community Benefit (Continued)

Donations/Contributions

Donations/Contributions include cash and in-kind donations that are made on behalf of the poor and needy to community agencies and to special funds for charitable activities, as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and disadvantaged.

Traditional Charity Care

Traditional charity care covers services provided to persons who cannot afford to pay. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. Charity care is determined based on established policies, using patient income and assets to determine payment ability.

Unpaid Costs for Government Program Patients

The System is a licensed Medicare and Medicaid provider with approximately 77 percent of its patient base qualifying for one of these two programs. At present, the reimbursement rates for both programs do not fully cover the cost of provider care to these patients. This represents the estimated shortfall created when a facility receives payments below the costs of treating Medicare and Medicaid beneficiaries.

Note 7 - Assets Limited as to Use

The detail of investments is summarized as follows:

	2018	2017
Assets limited as to use:		
By board of directors for future capital improvements	\$ 103,570,447	\$ 110,700,274
Funds held in trust for payment of debt service	27,765,198	27,681,477
Funds received from donors	36,882,454	39,040,156
Funds held for professional and other liability claims	13,965,920	16,539,393
	<u>\$ 182,184,019</u>	<u>\$ 193,961,300</u>

Investments consist of the following:

	2018	2017
Cash equivalents	\$ 28,078,105	\$ 27,786,806
Alternative investments	9,077,589	12,451,425
Marketable equity securities	6,567,999	5,028,614
Mutual funds	33,829,279	36,933,581
Real estate	1,060,600	1,060,600
Investment in FSCCM pooled investment management program	103,570,447	110,700,274
	<u>\$ 182,184,019</u>	<u>\$ 193,961,300</u>

Investment income and gains are composed of the following:

	2018	2017
Investment income	\$ 3,001,441	\$ 2,576,227
Net realized gains on sales of investments	1,811,239	4,184,604
Unrealized investment gains	(14,232,979)	12,436,937
	<u>\$ (9,420,299)</u>	<u>\$ 19,197,768</u>

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 8 - Property and Equipment

Cost of property and equipment and depreciable lives are summarized as follows:

	2018	2017	Depreciable Life - Years
Land and land improvements	\$ 23,668,214	\$ 21,743,998	10-15
Buildings and fixed equipment	258,451,466	247,678,797	7-50
Major movable and minor equipment	226,198,242	217,582,926	3-13
Construction in progress	1,621,441	4,694,319	-
Total cost	509,939,363	491,700,040	
Less accumulated depreciation	203,702,982	183,360,346	
Net property and equipment	<u>\$ 306,236,381</u>	<u>\$ 308,339,694</u>	

Note 9 - Long-term Debt

Long-term debt is as follows:

	2018	2017
Muskingum County, Ohio Hospital Facilities Revenue Bonds, Series 2013, dated May 9, 2013, due on February 15, 2048, maturing in various amounts through 2048, with interest due semiannually, interest rates ranging from 4.0 to 5.0 percent	\$ 284,270,000	\$ 288,025,000
Genesis HealthCare System revolving credit loan payable to various banks carrying an interest rate equal to LIBOR, plus an applicable margin, expiring on May 9, 2019 with principal payments due by expiration and interest payments due monthly	-	6,000,000
Perry County, Ohio Hospital Facilities Revenue Bonds, Series 2017, dated September 1, 2017, due on September 1, 2037, maturing in various amounts through 2037, with interest due monthly, interest rates initially at 65.001 percent * one-month LIBOR + 1.46 percent (2.99 percent at December 31, 2018)	9,085,660	2,306,839
Unamortized bond discount	(297,569)	(307,685)
Unamortized debt issuance costs	(4,193,516)	(4,327,165)
Long-term debt less unamortized bond discount and debt issuance costs	288,864,575	291,696,989
Less current portion	4,328,569	3,755,000
Long-term portion	<u>\$ 284,536,006</u>	<u>\$ 287,941,989</u>

In May 2013, the County of Muskingum, Ohio issued \$295,000,000 of tax-exempt bonds on behalf of the Obligated Group. The bonds were issued to finance the construction of an addition and the related renovations of one of the System's hospital campuses (Bethesda) and refinance outstanding debt.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 9 - Long-term Debt (Continued)

Also in May 2013, in conjunction with the issuance of the Series 2013 bonds, the System entered into a revolving credit facility with PNC Bank, N.A. and The Huntington National Bank. PNC Bank, N.A. holds 65 percent of the outstanding balance, and The Huntington National Bank holds the remaining 35 percent. In 2018, the agreement was terminated with The Huntington National Bank and PNC, N.A. holds 100 percent of the outstanding balance. During 2018, the maximum borrowing capacity was decreased from \$20,000,000 to \$15,000,000. The System has the ability to choose an interest rate based upon a selection of various market rates at the time the revolving credit loans are drawn upon. At December 31, 2018, there had been \$0 drawn against the revolving credit facility that expires in May 2021.

In September 2017, the County of Perry, Ohio issued \$10,000,000 of tax-exempt bonds on behalf of the Obligated Group. The bonds were issued to purchase and finance the construction of the Genesis Perry County Medical Center along with furnishing the Center. Interest-only payments are required monthly on the bonds through February 2019.

In 2018, the System paid interest of \$14,690,000, of which \$75,000 was capitalized. In 2017, the System paid interest of \$14,623,000, of which \$15,000 was capitalized.

The System formed an obligated group to accomplish common financing plans. The obligated group is governed by a master agreement and is composed of Genesis HealthCare System; CareServe; CareLife; Inc. and Subsidiaries; Ohio Integrated Care Providers; and the Genesis HealthCare Foundation (collectively, the "Obligated Group"). Each member of the Obligated Group is jointly and severally obligated with respect to substantially all of the debt for the System.

The terms of the debt require the Obligated Group to, among other things, comply with certain financial ratios, restrict additional encumbrances, maintain rates sufficient to meet debt service requirements, and maintain specified net assets.

The affiliation agreement (described in Note 1) also established a credit enhancement and line of credit agreement. In addition, the credit enhancement and line of credit agreement provide that the System could loan or provide credit support to FSCCM up to certain specified limits. Such loans cannot exceed 25 percent of the debt capacity of the System, as defined in the affiliation agreement, and interest is payable based on the Dow Jones Bond Averages, 20 Bond Taxable Index. FSCCM does not anticipate exercising the line of credit in 2019. In lieu of borrowing amounts from the System, FSCCM has the option to seek credit enhancement from the System. The System shall have the option to become a member of FSCCM's obligated group with respect to the proposed borrowing, provide a contractual guarantee with respect to the proposed borrowing, or pay to FSCCM credit enhancement payments with respect to such proposed borrowing for the difference between the credit rating obtained with and without the System as a member of the FSCCM obligated group. No loans or credit support were provided to FSCCM by the System in 2018 or 2017.

Minimum principal payments on long-term debt to maturity as of December 31, 2018 are as follows:

2019	\$	4,328,569
2020		4,609,283
2021		4,819,283
2022		5,044,283
2023		5,254,283
Thereafter		269,299,959
Less unamortized bond discount		(297,569)
Less unamortized debt issuance costs		(4,193,516)
Total	\$	<u>288,864,575</u>

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 10 - Operating Leases

The System is obligated under various operating leases. Total rent expense under these leases was approximately \$9,724,000 and \$9,541,000 for the years ended December 31, 2018 and 2017, respectively. Future lease payments include additional operating lease costs based on the sale-leaseback agreement into which the System entered during 2010.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year:

<u>Years Ending</u>	<u>Amount</u>
2019	\$ 7,335,391
2020	6,532,549
2021	6,015,634
2022	5,619,751
2023	3,849,652
Thereafter	<u>8,198,278</u>
Total	<u>\$ 37,551,255</u>

Note 11 - Professional Liability Insurance

Effective August 1, 2004, the System, through SOMIC, maintains a policy of self-insuring its professional liability risks for individual losses up to specified amounts per claim. In addition, the self-insurance plan has specified annual aggregate limits. The System carries commercial insurance coverage for incidents that would exceed coverages specified by the self-insurance program on a claims-made basis.

Because of the nature of its operations, the System is at all times subject to pending and threatened legal actions that arise in the normal course of its activities.

Malpractice and general patient liability claims for incidents that may give rise to litigation have been asserted against the System and attending physicians with insurance coverage provided by SOMIC by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. There are also known incidents that have occurred through December 31, 2018 that may result in the assertion of additional claims. There may be other claims from unreported incidents arising from services provided to patients. The reserve for medical malpractice includes amounts for claims and related legal expenses for these unreported incidents. In 2018 and 2017, the reserve was actuarially determined by combining industry data and the System's historical experience. Accrued malpractice losses have been discounted at 2.00 percent and, in management's opinion, provide an adequate reserve for loss contingencies.

The System established a trust for the purpose of setting aside assets based on actuarial funding recommendations for claims incurred prior to August 1, 2004. Under the trust agreement, the trust assets can only be used for payment of malpractice losses, related expenses, and the cost of administering the trust.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

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Note 12 - Functional Expenses

The System provides diversified healthcare services to residents in the southeastern Ohio area. Expenses related to providing these services during 2018 are as follows:

	Program Services	General and Administrative	Total
Salaries, benefits, and payroll taxes	\$ 167,484,160	\$ 102,692,758	\$ 270,176,918
Operating supplies and expenses	77,589,115	2,438,443	80,027,558
Professional services and consultant fees	16,543,008	1,196,094	17,739,102
Purchased services	32,815,682	11,718,999	44,534,681
Utilities	1,467,133	5,421,907	6,889,040
Repairs, rentals, insurance, and other	18,777,401	29,386,540	48,163,941
Pharmacy cost of goods sold	39,057,454	-	39,057,454
Depreciation	11,434,077	11,472,954	22,907,031
Interest expense	-	14,627,405	14,627,405
Total	<u>\$ 365,168,030</u>	<u>\$ 178,955,100</u>	<u>\$ 544,123,130</u>

Expenses related to providing these services during 2017 are as follows:

	Program Services	General and Administrative	Total
Salaries, benefits, and payroll taxes	\$ 160,705,652	\$ 96,988,357	\$ 257,694,009
Operating supplies and expenses	72,842,680	2,434,073	75,276,753
Professional services and consultant fees	18,486,250	2,554,305	21,040,555
Purchased services	29,355,466	14,753,201	44,108,667
Utilities	1,288,701	4,914,188	6,202,889
Repairs, rentals, insurance, and other	17,621,793	23,116,533	40,738,326
Pharmacy cost of goods sold	36,066,194	-	36,066,194
Depreciation	11,301,661	11,437,309	22,738,970
Interest expense	1,284	14,562,886	14,564,170
Total	<u>\$ 347,669,681</u>	<u>\$ 170,760,852</u>	<u>\$ 518,430,533</u>

The financial statements report certain expense categories that are attributable to more than one healthcare service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs are directly assigned and allocated between program and support based on the System's detailed general ledger account structure for 2018 and 2017.

Note 13 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the consolidated financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the System has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. The Level 2 inputs include quoted prices for similar assets in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 13 - Fair Value Measurements (Continued)

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The System's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

The System's policy is to recognize transfers between levels of the fair value hierarchy as of the beginning of the reporting period. For the years ended December 31, 2018 and 2017, there were no transfers between levels.

The following tables present information about the System's assets, held directly by the System, excluding its investment in the pooled investment program, measured at fair value on a recurring basis at December 31, 2018 and 2017 and the valuation techniques used by the System to determine those fair values.

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2018				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Valued at Net Asset Value	Balance at December 31, 2018
Assets					
Marketable equity securities:					
Growth equities	\$ 4,811,775	\$ -	\$ -	\$ -	\$ 4,811,775
Value equities	1,756,224	-	-	-	1,756,224
Real estate	-	1,060,600	-	-	1,060,600
Mutual funds:					
Index funds	5,830,626	-	-	-	5,830,626
Value funds	2,409,380	-	-	-	2,409,380
Global equity funds	2,823,252	-	-	-	2,823,252
International funds	5,051,768	-	-	-	5,051,768
Emerging markets	1,725,261	-	-	-	1,725,261
Master limited partnerships	610,381	-	-	-	610,381
Mortgages	1,665,682	-	-	-	1,665,682
Global infrastructure	374,753	-	-	-	374,753
TIPS	1,060,166	-	-	-	1,060,166
Fixed-income funds	12,278,010	-	-	-	12,278,010
Beneficial interest in perpetual trusts	-	-	14,258,247	-	14,258,247
Investments valued at net asset value	-	-	-	9,077,589	9,077,589
Total assets	\$ 40,397,278	\$ 1,060,600	\$ 14,258,247	\$ 9,077,589	\$ 64,793,714

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 13 - Fair Value Measurements (Continued)

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2017				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Valued at Net Asset Value	Balance at December 31, 2017
Assets					
Marketable equity securities:					
Growth equities	\$ 3,146,848	\$ -	\$ -	\$ -	\$ 3,146,848
Value equities	1,881,766	-	-	-	1,881,766
Real estate	-	1,060,600	-	-	1,060,600
Mutual funds:					
Index funds	5,420,911	-	-	-	5,420,911
Value funds	2,448,720	-	-	-	2,448,720
Global equity funds	3,308,446	-	-	-	3,308,446
International funds	5,012,517	-	-	-	5,012,517
Emerging markets	1,451,760	-	-	-	1,451,760
Master limited partnerships	667,983	-	-	-	667,983
Mortgages	1,237,264	-	-	-	1,237,264
Global infrastructure	421,341	-	-	-	421,341
TIPS	2,367,160	-	-	-	2,367,160
Fixed-income funds	14,597,479	-	-	-	14,597,479
Beneficial interest in perpetual trusts	-	-	14,498,896	-	14,498,896
Investments valued at net asset value	-	-	-	12,451,425	12,451,425
Total assets	\$ 41,962,195	\$ 1,060,600	\$ 14,498,896	\$ 12,451,425	\$ 69,973,116

The fair value of the Level 2 securities as of December 31, 2018 and 2017 was determined primarily on quoted prices from the System's custodian bank and administrators of the funds.

As described in Note 2, the System participates in FSCCM's pooled investment program. As of December 31, 2018 and 2017, the System has \$103,570,447 and \$110,700,274, respectively, of investments at market value in the pool. The fair value of the investments in the pooled investment program is determined based on Level 3 inputs, estimated based on the System's percentage share of ownership, based on original value of contributions. There are no restrictions on redemption from the pooled investment management program for the System.

The underlying investments in the pool program are composed of assets with valuation techniques that result in 69 percent as Level 1, 22 percent as Level 2, and the remaining amounts composed of assets valued at net asset value, which are excluded from the fair value reporting hierarchy as of December 31, 2018. At December 31, 2017, the investments in the pool program were composed of 71 percent Level 1, 8 percent Level 2, and the remaining amounts composed of assets valued at net asset value, which are excluded from the fair value hierarchy.

The details of the fair value and unfunded commitments are described at length in the financial statements of FSCCM. The System's pro rata share of unfunded commitments is approximately \$4,764,000 and \$2,729,000 at December 31, 2018 and 2017, respectively.

There were no withdrawals or deposits during both 2018 and 2017. The total allocation of pooled (losses) earnings was \$(7,129,827) and \$14,174,453 in 2018 and 2017, respectively.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 13 - Fair Value Measurements (Continued)

The following table sets forth a summary of the changes in the fair value of the System's Level 3 assets at December 31, 2018 and 2017:

	Fair Value at January 1, 2018	Net Purchases and Issuances (Sales and Settlements)	Total Realized and Unrealized Gains	Net Transfers Into (Out of) Level 3	Fair Value at December 31, 2018
Level 3 Investments - Beneficial interest in perpetual trusts	\$ 14,498,896	\$ -	\$ (240,649)	\$ -	\$ 14,258,247
	Fair Value at January 1, 2017	Net Purchases and Issuances (Sales and Settlements)	Total Realized and Unrealized Losses	Net Transfers Into (Out of) Level 3	Fair Value at December 31, 2017
Level 3 Investments - Beneficial interest in perpetual trusts	\$ 13,067,990	\$ -	\$ 1,430,906	\$ -	\$ 14,498,896

Investments in Entities that Calculate Net Asset Value per Share

The System holds shares or interests in investment companies at year end whereby the fair value of the investment held is estimated based on net asset value per share (or its equivalent) of the investment companies as a practical expedient. At year end, the fair value, unfunded commitments, and redemption rules of those investments are as follows:

Investments Held at December 31, 2018

	Fair Value	Unfunded Commitments
Private equity (1)	\$ 804,429	\$ 1,107,884
Long and short equities hedge fund (3)	6,274,060	-
Private real estate (4)	256,425	555,750
Event-driven hedge fund (5)	1,742,675	-
Total	<u>\$ 9,077,589</u>	<u>\$ 1,663,634</u>

Investments Held at December 31, 2017

	Fair Value	Unfunded Commitments
Private equity (1)	\$ 1,218,822	\$ 1,110,496
Multistrategy hedge fund (2)	2,558,486	-
Long and short equities hedge fund (3)	6,355,652	-
Private real estate (4)	327,922	555,750
Event-driven hedge fund (5)	1,990,543	-
Total	<u>\$ 12,451,425</u>	<u>\$ 1,666,246</u>

(1) Private equity funds broadly diversified across managers, investment stages, geography, industry sectors, and company size

(2) Multistrategy hedge funds with broadly diversified multiadvisor, multistrategy fund of hedge funds utilizing a proprietary portfolio construction methodology that combined a top-down strategy allocation process with comprehensive manager selection, due diligence, and risk management

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 13 - Fair Value Measurements (Continued)

(3) Long and short equities hedge funds are fund of funds with long/short focus. The managers employed by the funds are fundamentally driven, bottoms-up, research-intensive stock pickers who use very little, if any, leverage.

(4) Private real estate funds that invest in private real estate broadly classified as core, value-added, and opportunistic

(5) Event-driven hedge funds are seeking stable returns and appreciation, independent of returns of the overall equity and debt markets, by using a variety of strategies but principally employing event-driven strategies.

Note 14 - Pension and Other Postretirement Benefit Plans

The System maintains a defined benefit pension plan covering substantially all its employees who have completed one year of continuous service, as defined by the plan. Benefits paid under the plan are based generally on employees' years of service and compensation levels during employment. The plan requires annual contributions that are sufficient to meet the minimum funding standards of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986.

Effective April 8, 2009, new employees are no longer eligible to participate in the defined benefit plan, but will be eligible to participate in a defined contribution plan in which substantially all employees are eligible. The contributions are based on an employer's matching contribution of an employee's contribution up to a maximum of 60 percent of an employee's 5 percent contribution to the employee plan, based on years of service. For the years ended December 31, 2018 and 2017, the amount of retirement expense for the defined contribution plan was approximately \$2,490,000 and \$1,996,000, respectively.

The defined benefit plan was amended in 2011. As a result of the amendment, contributions to the plan for participants who were 50 years old and older as of June 30, 2011 were reduced as follows based on years of service:

- Up to five years of service - Reduced from 2.25 to 2 percent.
- 5-10 years of service - Reduced from 3 to 2 percent.
- 10 years of service or greater - Reduced from 4 to 3 percent.

For participants who were under the age of 50 as of June 30, 2011, benefits were frozen, but interest would continue to accrue on the frozen balance.

Obligations and Funded Status

	Pension Benefits	
	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 105,621,214	\$ 103,582,641
Service cost	435,833	520,611
Interest cost	4,107,267	4,283,483
Actuarial loss	(5,372,288)	2,347,383
Benefits paid	(5,444,457)	(5,112,904)
Projected benefit obligation at end of year	99,347,569	105,621,214
Change in plan assets:		
Fair value of plan assets at beginning of year	71,980,442	64,130,807
Actual return on plan assets	(4,384,381)	9,465,587
Employer contributions	3,150,333	3,496,952
Benefits paid	(5,444,457)	(5,112,904)
Fair value of plan assets at end of year	65,301,937	71,980,442
Funded status at end of year	\$ (34,045,632)	\$ (33,640,772)

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Included in unrestricted net assets at December 31, 2018 and 2017 are the following amounts that have not yet been recognized in net periodic pension cost:

	Pension Benefits	
	2018	2017
Net loss	\$ 29,984,082	\$ 28,815,718
Prior service cost	-	(23,105)
Total included in net assets not yet recognized in net periodic benefit cost	<u>\$ 29,984,082</u>	<u>\$ 28,792,613</u>

The accumulated benefit obligation for all defined benefit pension plans was \$99,322,005 and \$105,591,146 at December 31, 2018 and 2017, respectively.

Components of Net Periodic Benefit Cost

	2018	2017
Service cost	\$ 435,833	\$ 520,611
Interest cost	4,107,267	4,283,483
Expected return on plan assets	(5,082,497)	(5,113,087)
Recognized prior service credit	(23,105)	(30,399)
Recognized actuarial loss	2,926,226	2,476,829
Net periodic benefit cost	<u>\$ 2,363,724</u>	<u>\$ 2,137,437</u>

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized into net periodic benefit cost over the next fiscal year is \$2,574,955.

Assumptions

Weighted-average Assumptions Used to Determine Benefit Obligations at December 31

	Pension Benefits	
	2018	2017
Discount rate	4.50 %	4.00 %
Rate of compensation increase	3.00	3.00

Weighted-average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31

	Pension Benefits	
	2018	2017
Discount rate	4.00 %	4.25 %
Increase in future compensation levels	3.00	3.00
Expected rate of return on plan assets	7.50	7.50

The overall expected rate of return on plan assets represents a weighted-average composite rate based on the historical rates of returns of the respective asset classes adjusted for anticipated market movements.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the System, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and assures timely payment of retirement benefits.

The System's overall investment strategy is to achieve a mix of approximately 55 percent equity, 25 percent of investments in fixed income, and 20 percent in alternative investments, with a wide diversification of asset types, fund strategies, and fund managers.

Equity securities primarily include investments in large-cap and mid-cap companies primarily located in the United States and international equities, along with mutual funds. Fixed-income securities include asset management investments that invest in corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries. Alternative investments include investments in fund of funds hedge funds, real estate funds, and private equity funds that follow several different strategies.

The fair values of the System's pension plan assets at December 31, 2018 and 2017 by major asset classes are as follows:

	Fair Value Measurements at December 31, 2018				Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments in Limited Partnerships Valued at Net Asset Value	
Mutual funds:					
Value funds	\$ 3,181,012	\$ -	\$ -	\$ -	\$ 3,181,012
Non-U.S. funds	8,678,994	-	-	-	8,678,994
Emerging market funds	2,919,961	-	-	-	2,919,961
S&P index funds	6,146,231	-	-	-	6,146,231
Fixed-income investments	4,525,513	-	-	-	4,525,513
Money market funds	1,846,437	-	-	-	1,846,437
Bonds and notes:					
Federal Home Loan Mortgage bonds	-	3,885,543	-	-	3,885,543
Corporate bonds	-	8,245,024	-	-	8,245,024
Common stock	6,161,732	-	-	-	6,161,732
Comingled funds	-	13,586,194	-	-	13,586,194
Investments in limited partnerships valued at net asset value:					
Equity and credit market hedge fund (1)	-	-	-	5,259,100	5,259,100
Private equity funds (2)	-	-	-	444,595	444,595
Real estate funds (3)	-	-	-	421,601	421,601
Total	\$ 33,459,880	\$ 25,716,761	\$ -	\$ 6,125,296	\$ 65,301,937

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

	Fair Value Measurements at December 31, 2017				Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments in Limited Partnerships Valued at Net Asset Value	
Mutual funds:					
Value funds	\$ 3,824,716	\$ -	\$ -	\$ -	\$ 3,824,716
Non-U.S. funds	11,357,983	-	-	-	11,357,983
Emerging market funds	3,639,951	-	-	-	3,639,951
S&P index funds	7,641,721	-	-	-	7,641,721
Fixed-income investments	4,461,143	-	-	-	4,461,143
Money market funds	1,358,375	-	-	-	1,358,375
Bonds and notes:					
Federal Home Loan Mortgage bonds	-	8,951,077	-	-	8,951,077
Corporate bonds	-	3,660,654	-	-	3,660,654
Common stock	7,010,214	-	-	-	7,010,214
Comingled funds	-	13,473,580	-	-	13,473,580
Investments in limited partnerships valued at net asset value:					
Equity and credit market hedge fund (1)	-	-	-	5,429,700	5,429,700
Private equity funds (2)	-	-	-	590,502	590,502
Real estate funds (3)	-	-	-	580,826	580,826
Total	\$ 39,294,103	\$ 26,085,311	\$ -	\$ 6,601,028	\$ 71,980,442

(1) Equity and credit market hedge fund - A fund of funds with a mix of directional and nondirectional strategies that include equity long/short, event-driven, relative-value, and global asset allocation. The managers seek equity-like returns that will capture opportunities in up markets while preserving capital in more difficult markets.

(2) Three private equity funds broadly diversified across managers, investment stages, geography, industry sectors, and company size

(3) Investment in private property funds broadly classified as core, value-added, and opportunistic

The tables above present information about the pension and postretirement benefit plan assets measured at fair value at December 31, 2018 and 2017 and the valuation techniques used by the System to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the System has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The System's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each plan asset.

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Cash Flow

Contributions

The System expects to contribute \$2,960,000 to its pension plan in 2019.

Estimated Future Benefit Payments

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

Years Ending December 31	Pension Benefits
2019	\$ 5,314,020
2020	5,543,273
2021	5,937,790
2022	6,021,826
2023	6,545,283
2024-2028	31,958,710

The System also has a life insurance plan with a projected benefit obligation of approximately \$814,000 and \$849,000 at December 31, 2018 and 2017, respectively.

Note 15 - Changes in Consolidated Unrestricted Net Assets Attributable to the System and the Noncontrolling Interest

The changes in consolidated unrestricted net assets attributable to the System and the noncontrolling interest were as follows:

	Controlling Interest	Noncontrolling Interest	Total
Balance at December 31, 2016	\$ 201,557,270	\$ 1,147,428	\$ 202,704,698
Excess of revenue over expenses	17,619,822	82,966	17,702,788
Capital distributions	-	(411,999)	(411,999)
Pension-related changes other than net periodic cost	4,473,538	-	4,473,538
Net assets released from restriction for capital equipment	858,842	-	858,842
Balance at December 31, 2017	224,509,472	818,395	225,327,867
Excess of revenue (under) over expenses	(7,114,159)	59,705	(7,054,454)
Pension-related changes other than net periodic cost	(1,128,061)	-	(1,128,061)
Net assets released from restriction for capital equipment	700,566	-	700,566
Balance at December 31, 2018	<u>\$ 216,967,818</u>	<u>\$ 878,100</u>	<u>\$ 217,845,918</u>

Genesis HealthCare System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16 - Liquidity

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

	2018	2017
Cash and cash equivalents	\$ 32,724,395	\$ 32,199,969
Accounts receivable	61,934,722	66,434,655
Estimated third-party payor settlements	4,795,234	-
Other receivables	3,791,613	3,722,428
Total	<u>\$ 103,245,964</u>	<u>\$ 102,357,052</u>

None of these financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the consolidated balance sheet date.

The System has a goal to maintain financial assets, which consist of cash and cash equivalents, on hand to meet 134 days of normal operating expenses, which are, on average, approximately \$1,489,657 and \$1,420,358 at December 31, 2018 and 2017, respectively. The System has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. The System maintains certain assets limited as to use that could be liquidated if needed for operational use.

The System has entered into a revolving credit facility with PNC Bank, N.A. The maximum borrowing capacity is \$15,000,000 (see Note 9).

The terms of the debt require the Obligated Group to, among other things, comply with certain financial ratios, restrict additional encumbrances, maintain rates sufficient to meet debt service requirements, and maintain specified net assets.

The System also realizes there could be unanticipated liquidity needs.

Note 17 - Endowments

The System's endowments consist of funds established for a variety of purposes. Its endowments include both donor-restricted endowment funds and funds designated by the board of trustees to function as endowments. 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. The System considers various factors in making a determination to appropriate or accumulate donor-restricted endowment funds. The System employs a diversified investment approach in order to minimize risk and maximize returns, utilizing both intermediate and long-term portfolios. The System's asset allocation objective for the long-term portfolio is to maximize total return while preserving capital values. The short-term portfolio is intended to preserve the principal of the fund and to meet current liquidity requirements.

The System can appropriate each year all available earnings in accordance with donor restrictions. The endowment corpus is to be maintained in perpetuity. Certain donor-restricted endowments require a portion of annual earnings to be maintained in perpetuity along with the corpus. Only amounts exceeding the amounts required to be maintained in perpetuity are expended.

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 17 - Endowments (Continued)

Endowment net asset composition by type of fund as of December 31, 2018 and 2017 is as follows:

	Endowment Net Asset Composition by Type of Fund	
	2018	2017
Endowed net assets with donor restrictions	\$ 3,497,403	\$ 2,985,953
Beneficial interest in perpetual trusts	14,258,247	14,998,896
Total endowed net assets	<u>\$ 17,755,650</u>	<u>\$ 17,984,849</u>

In addition to endowed net assets shown above, the System also maintained \$2,004,968 and \$1,973,960 for 2018 and 2017, respectively, of net assets with donor restrictions that were not endowments.

Changes in endowment net assets for the fiscal years ended December 31, 2018 and 2017 are as follows:

	Changes in Endowment Net Assets	
	2018	2017
Endowment net assets - Beginning of year	\$ 17,984,849	\$ 16,518,853
Investment (loss) income on endowments	(240,649)	1,430,906
Gifts to endowments	11,450	35,090
Endowment net assets - End of year	<u>\$ 17,755,650</u>	<u>\$ 17,984,849</u>

Return Objectives and Risk Parameters

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the System must hold in perpetuity or for a donor-specified period(s). Under this policy, as approved by the board of trustees, the endowment assets are invested in a manner that is intended to achieve a return of 4 percent net of inflation and investment expenses. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

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

Spending Policy and How the Investment Objectives Relate to Spending Policy

The board of directors determines spending annually. While no policy indicating specific percentages has been set, the governing board considers amounts of 3 to 5 percent of the fund's average fair value in the prior fiscal year for distribution. In establishing the amount of distribution, the governing board considers the long-term expected rate of return on its endowment. Accordingly, over the long term, the System expects the current spending policy to allow its endowment to grow an average of 1 percent annually. The organization does not have a policy that permits spending from underwater endowment funds. The System had no underwater endowments funds during 2018 and 2017.

Additional Information

Genesis HealthCare System and Subsidiaries

Consolidating Balance Sheet

December 31, 2018

	Genesis HealthCare System	CareServe	CareLife, Inc. and Subsidiaries	Genesis HealthCare Foundation	Obligated Eliminating Entries	Total Obligated Group	Community Ambulance Service	Southeast Ohio Medical Insurance Company, Ltd.	Eliminating Entries	Total
Assets										
Current Assets										
Cash and cash equivalents	\$ 24,849,461	\$ -	\$ 6,832,183	\$ 237,729	\$ -	\$ 31,919,373	\$ 633,657	\$ 171,365	\$ -	\$ 32,724,395
Accounts receivable	48,336,207	-	12,716,446	-	-	61,052,653	882,069	685,849	(685,849)	61,934,722
Estimated third-party payor settlements	4,795,234	-	-	-	-	4,795,234	-	-	-	4,795,234
Inventory	6,572,872	-	4,601,122	-	-	11,173,994	-	-	-	11,173,994
Other assets	22,072,123	260,480	4,171,841	2,165,793	(10,130,389)	18,539,848	1,188,127	13,390	(8,332,181)	11,409,184
Total current assets	106,625,897	260,480	28,321,592	2,403,522	(10,130,389)	127,481,102	2,703,853	870,604	(9,018,030)	122,037,529
Assets Limited as to Use	128,764,794	1,133,338	385,928	36,882,454	-	167,166,514	1,051,585	13,965,920	-	182,184,019
Property and Equipment - Net	297,878,321	-	7,335,867	171,291	-	305,385,479	850,902	-	-	306,236,381
Beneficial Interest in Perpetual Trusts	-	-	-	14,258,247	-	14,258,247	-	-	-	14,258,247
Other Assets										
Long-term investments	3,453,068	-	446,838	-	-	3,899,906	-	-	(3,120,536)	779,370
Other noncurrent assets	4,301,523	-	100,000	32,797	-	4,434,320	-	-	-	4,434,320
Total assets	<u>\$ 541,023,603</u>	<u>\$ 1,393,818</u>	<u>\$ 36,590,225</u>	<u>\$ 53,748,311</u>	<u>\$ (10,130,389)</u>	<u>\$ 622,625,568</u>	<u>\$ 4,606,340</u>	<u>\$ 14,836,524</u>	<u>\$ (12,138,566)</u>	<u>\$ 629,929,866</u>

Genesis HealthCare System and Subsidiaries

Consolidating Balance Sheet (Continued)

December 31, 2018

	Genesis HealthCare System	CareServe	CareLife, Inc. and Subsidiaries	Genesis HealthCare Foundation	Obligated Eliminating Entries	Total Obligated Group	Community Ambulance Service	Southeast Ohio Medical Insurance Company, Ltd.	Eliminating Entries	Total
Liabilities and Net Assets										
Current Liabilities										
Accounts payable	\$ 14,030,580	\$ 1	\$ 6,488,915	\$ 409,487	\$ -	\$ 20,928,983	\$ 195,193	\$ 758,164	\$ (676,449)	\$ 21,205,891
Current portion of long-term debt	4,328,569	-	-	-	-	4,328,569	-	-	-	4,328,569
Accrued liabilities and other:										
Accrued compensation	17,082,848	-	9,389,106	-	-	26,471,954	275,662	-	-	26,747,616
Other accrued liabilities	11,060,334	-	5,664,550	-	(10,130,389)	6,594,495	469,313	8,984,360	(8,341,581)	7,706,587
Total current liabilities	46,502,331	1	21,542,571	409,487	(10,130,389)	58,324,001	940,168	9,742,524	(9,018,030)	59,988,663
Long-term Debt - Net of current portion	284,536,006	-	-	-	-	284,536,006	-	-	-	284,536,006
Other Liabilities										
Pension and other postretirement obligations	35,018,739	-	-	-	-	35,018,739	-	-	-	35,018,739
Deferred revenue and other long-term liabilities	4,785,722	-	-	-	-	4,785,722	-	-	-	4,785,722
Accrued professional liability	3,020,200	-	-	-	-	3,020,200	-	4,974,000	-	7,994,200
Total liabilities	373,862,998	1	21,542,571	409,487	(10,130,389)	385,684,668	940,168	14,716,524	(9,018,030)	392,323,330
Net Assets										
Net assets without donor restrictions:										
Net assets	167,160,605	1,393,817	15,047,654	33,578,206	-	217,180,282	2,788,072	120,000	(3,120,536)	216,967,818
Noncontrolling interest	-	-	-	-	-	-	878,100	-	-	878,100
Net assets with donor restrictions	-	-	-	19,760,618	-	19,760,618	-	-	-	19,760,618
Total net assets	167,160,605	1,393,817	15,047,654	53,338,824	-	236,940,900	3,666,172	120,000	(3,120,536)	237,606,536
Total liabilities and net assets	\$ 541,023,603	\$ 1,393,818	\$ 36,590,225	\$ 53,748,311	\$ (10,130,389)	\$ 622,625,568	\$ 4,606,340	\$ 14,836,524	\$ (12,138,566)	\$ 629,929,866

Genesis HealthCare System and Subsidiaries

Consolidating Statement of Operations and Changes in Unrestricted Net Assets

Year Ended December 31, 2018

	Genesis HealthCare System	CareServe	CareLife, Inc. and Subsidiaries	Genesis HealthCare Foundation	Obligated Eliminating Entries	Total Obligated Group	Community Ambulance Service	Southeast Ohio Medical Insurance Company, Ltd.	Eliminating Entries	Total
Patient Service Revenue										
Patient service revenue	\$ 398,673,230	\$ -	\$ 62,317,423	\$ -	\$ -	\$ 460,990,653	\$ 4,812,821	\$ -	\$ -	\$ 465,803,474
Pharmacy sales and other	20,105,925	15,845	67,077,118	1,054,855	(10,205,055)	78,048,688	1,049,630	3,355,270	(1,206,974)	81,246,614
Total patient service revenue	418,779,155	15,845	129,394,541	1,054,855	(10,205,055)	539,039,341	5,862,451	3,355,270	(1,206,974)	547,050,088
Expenses										
Salaries and wages	127,168,039	-	85,804,739	279,426	-	213,252,204	2,527,146	-	-	215,779,350
Employee benefits and payroll taxes	44,320,853	52	9,004,034	-	-	53,324,939	1,072,628	-	-	54,397,567
Operating supplies and expenses	77,228,628	-	4,075,228	12,692	(1,625,079)	79,691,469	336,089	-	-	80,027,558
Professional services and consultant fees	14,083,526	-	4,978,186	-	(1,337,610)	17,724,102	15,000	-	-	17,739,102
Purchased services	36,737,980	-	9,422,146	193,584	(1,580,295)	44,773,415	629,613	159,513	(1,027,860)	44,534,681
Utilities	5,382,459	-	1,407,809	3,419	-	6,793,687	90,194	5,159	-	6,889,040
Repairs, rentals, insurance, and other	34,289,088	-	9,675,159	363,007	-	44,327,254	646,090	3,190,598	-	48,163,942
Pharmacy cost of goods sold	-	-	44,719,260	-	(5,662,071)	39,057,189	265	-	-	39,057,454
Depreciation	21,637,382	-	1,020,808	13,438	-	22,671,628	235,403	-	-	22,907,031
Interest expense	14,627,405	-	-	-	-	14,627,405	-	-	-	14,627,405
Total expenses	375,475,360	52	170,107,369	865,566	(10,205,055)	536,243,292	5,552,428	3,355,270	(1,027,860)	544,123,130
Operating Income (Loss)	43,303,795	15,793	(40,712,828)	189,289	-	2,796,049	310,023	-	(179,114)	2,926,958
Other Income (Loss)										
Investment income	3,656,678	41,520	5,601	1,063,566	-	4,767,365	45,315	-	-	4,812,680
Unrealized losses on trading securities	(10,609,618)	(119,540)	(32,168)	(3,353,611)	-	(14,114,937)	(118,042)	-	-	(14,232,979)
Pension expense	(1,927,891)	-	-	-	-	(1,927,891)	-	-	-	(1,927,891)
Other	1,364,505	-	750	-	-	1,365,255	1,523	-	-	1,366,778
Total other loss	(7,516,326)	(78,020)	(25,817)	(2,290,045)	-	(9,910,208)	(71,204)	-	-	(9,981,412)
Excess of Revenue Over (Under) Expenses	35,787,469	(62,227)	(40,738,645)	(2,100,756)	-	(7,114,159)	238,819	-	(179,114)	(7,054,454)
Transfer (to) from Affiliate	(41,530,394)	-	43,204,005	(1,673,611)	-	-	-	-	-	-
Pension-related Changes Other than Net Periodic Cost	(1,128,061)	-	-	-	-	(1,128,061)	-	-	-	(1,128,061)
Net Assets Released from Restriction for Capital Equipment	-	-	-	700,566	-	700,566	-	-	-	700,566
(Decrease) Increase in Net Assets without Donor Restrictions	\$ (6,870,986)	\$ (62,227)	\$ 2,465,360	\$ (3,073,801)	\$ -	\$ (7,541,654)	\$ 238,819	\$ -	\$ (179,114)	\$ (7,481,949)

Report on Internal Control Over Financial
Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements
Performed in Accordance with *Government
Auditing Standards*

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditor's Report

To Management and the Board of Directors
Genesis HealthCare System and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Genesis HealthCare System and Subsidiaries (the "System"), which comprise the consolidated balance sheet as of December 31, 2018 and the related consolidated statements of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements and have issued our report thereon dated March 28, 2019. Our report includes a reference to other auditors who audited the financial statements of Genesis HealthCare Foundation, as described in our report on Genesis HealthCare System and Subsidiaries' consolidated financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of Genesis HealthCare Foundation were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Genesis HealthCare System and Subsidiaries' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the System's consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as Findings 2018-01, 2018-02, and 2018-03, that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

To Management and the Board of Directors
Genesis HealthCare System and Subsidiaries

Genesis HealthCare System and Subsidiaries' Responses to Findings

Genesis HealthCare System and Subsidiaries' responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Genesis HealthCare System and Subsidiaries' responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements, and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Plante & Moran, PLLC

March 28, 2019

Schedule of Findings and Questioned Costs

Genesis HealthCare System and Subsidiaries

Schedule of Findings and Questioned Costs

Year Ended December 31, 2018

Section II - Financial Statement Audit Findings

Reference Number	Finding
2018-01	<p>Finding Type - Significant deficiency</p> <p>Criteria - Upon completion of a capital project, the project should be transferred out of construction in progress (CIP) and into the appropriate fixed asset account to begin depreciation.</p> <p>Condition - Completed capital projects and fixed assets placed in service during the year remained in CIP after being placed in service; therefore, these capital projects were not depreciated as they should have been.</p> <p>Context - This impacted both the asset clearing account and CIP at year end.</p> <p>Cause - Lack of review of asset clearing and CIP account for project and assets that were complete and placed in service.</p> <p>Effect - Certain projects and assets that were complete were not transferred out of CIP, and depreciation expense was not recognized for these assets during 2018.</p> <p>Recommendation - The System should review CIP and asset clearing account on a regular basis to ensure that as projects are completed they are transferred to the appropriate asset category and depreciation begins.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The System agrees with the recommendation and will include review of CIP and the asset clearing account on the month-end review checklist.</p>

Reference Number	Finding
2018-02	<p>Finding Type - Significant deficiency</p> <p>Criteria - Invoices should be expensed, and the related liability should be recognized in the period in which the goods or service was received. The System should review invoices received after year end to determine the proper period to recognize the expense and related liability.</p> <p>Condition - During our testing of accounts payable invoices, Plante & Moran, PLLC (PM) identified invoices that should have been expense and accrued as of the end of the year. The System's policy failed to identify and recognize the expense and related liability in the proper period.</p> <p>Context - Based on the testing performed, three invoices were identified as being improperly excluded from the period under audit.</p> <p>Cause - The invoices were received after the System closed its accounts payable, and the invoices were not manually accrued.</p> <p>Effect - The expense and related liability were understated.</p> <p>Recommendation - The System should review invoices received after year end to determine the proper period to recognize the expense and related liability.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The System agrees with the recommendation and will review the current process in place to ensure invoices are reviewed and recognized in the proper period.</p>

Genesis HealthCare System and Subsidiaries

Schedule of Findings and Questioned Costs (Continued)

Year Ended December 31, 2018

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-03	<p>Finding Type - Significant deficiency</p> <p>Criteria - All accounts should be reviewed, reconciled, and adjusted on a timely basis.</p> <p>Condition - During our audit procedures, PM identified certain accounts that were either unreconciled or unadjusted on a timely basis.</p> <p>Context - The accounts that were unreconciled or unadjusted on a timely basis did not result in any material adjustments to the financial records.</p> <p>Cause - Turnover within the accounting department</p> <p>Effect - Certain balances were misstated by an immaterial amount. The System provided adjustments for differences that were more than trivial.</p> <p>Recommendation - The System should implement a month-end review process, which includes ensuring all account balances are reconciled and adjusted on a timely basis at the end of each period.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The System agrees with the recommendation and will review the current process in place to ensure all accounts are reconciled and adjusted on a timely basis.</p>